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Part II

## Securities and Exchange Commission

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17 CFR Parts 240, 242, and 249

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; Proposed Rule

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 240, 242, and 249

[Release No. 34-69490; File Nos. S7-02-13; S7-34-10; S7-40-11]

RIN 3235-AL25

#### 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

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rules; proposed interpretations.

**SUMMARY:** The Securities and Exchange Commission (“SEC” or “Commission”) is publishing for public comment proposed rules and interpretive guidance to address the application of the provisions of the Securities Exchange Act of 1934, as amended (“Exchange Act”), that were added by Subtitle B of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), to cross-border security-based swap activities. Our proposed rules and interpretive guidance address the application of Subtitle B of Title VII of the Dodd-Frank Act with respect to each of the major registration categories covered by Title VII relating to market intermediaries, participants, and infrastructures for security-based swaps, and certain transaction-related requirements under Title VII in connection with reporting and dissemination, clearing, and trade execution for security-based swaps. In this connection, we are re-proposing Regulation SBSR and certain rules and forms relating to the registration of security-based swap dealers and major security-based swap participants. The proposal also contains a proposed rule providing an exception from the aggregation requirement, in the context of the security-based swap dealer definition, for affiliated groups with a registered security-based swap dealer. Moreover, the proposal addresses the sharing of information and preservation of confidentiality with respect to data collected and maintained by SDRs. In addition, the Commission is proposing rules and interpretive guidance addressing the policy and procedural framework under which the Commission would consider permitting compliance with comparable regulatory requirements in a foreign jurisdiction to

substitute for compliance with requirements of the Exchange Act, and the rules and regulations thereunder, relating to security-based swaps (*i.e.*, “substituted compliance”). Finally, the Commission is setting forth our view of the scope of our authority, with respect to enforcement proceedings, under Section 929P of the Dodd-Frank Act.

**DATES:** Submit comments on or before August 21, 2013.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-02-13, and File Numbers S7-34-10 (Regulation SBSR) and/or S7-40-11 (registration of security-based swap dealers and major security-based swap participants), as applicable, on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-02-13, and File Numbers S7-34-10 (Regulation SBSR) and/or S7-40-11 (registration of security-based swap dealers and major security-based swap participants), as applicable. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments also are available for Web site viewing and printing in the Commission’s Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

#### **FOR FURTHER INFORMATION CONTACT:**

Matthew A. Daigler, Senior Special Counsel, at 202-551-5578, Wenchi Hu, Senior Special Counsel, at 202-551-6268, Richard E. Grant, Special Counsel, at 202-551-5914, or Richard Gabbert,

Special Counsel, at 202-551-7814, Office of Derivatives Policy, Division of Trading and Markets, regarding security-based swap dealers and major security-based swap participants; Jeffrey Mooney, Assistant Director, Matthew Landon, Senior Special Counsel, or Stephanie Park, Special Counsel, Office of Clearance and Settlement, Division of Trading and Markets, at 202-551-5710, regarding security-based swap clearing agencies, security-based swap data repositories, and the security-based swap clearing requirement; David Michehl, Senior Counsel, Office of Market Supervision, Division of Trading and Markets, at 202-551-5627, regarding security-based swap reporting; Leah Mesfin, Special Counsel, at 202-551-5655, or Michael P. Bradley, Special Counsel, at 202-551-5594, Office of Market Supervision, Division of Trading and Markets, regarding the trade execution requirement and swap execution facilities; Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-7010.

**SUPPLEMENTARY INFORMATION:** The Commission is proposing new rules and interpretive guidance under the Exchange Act relating to the application of Subtitle B of Title VII of the Dodd-Frank Act to cross-border activities and re-proposing Regulation SBSR and certain rules and forms relating to the registration of security-based swap dealers and major security-based swap participants.

The Commission is proposing the following rules under the Exchange Act: Rule 0-13 (Substituted Compliance Request Procedure); Rule 3a67-10 (Foreign Major Security-Based Swap Participants); Rule 3a71-3 (Cross-Border Security-Based Swap Dealing Activity); Rule 3a71-4 (Exception from Aggregation for Affiliated Groups with Registered Security-Based Swap Dealers); Rule 3a71-5 (Substituted Compliance for Foreign Security-Based Swap Dealers); Rule 3Ca-3 (Application of the Mandatory Clearing Requirement to Cross-Border Security-Based Swap Transactions); Rule 3Ch-1 (Application of the Mandatory Trade Execution Requirement to Cross-Border Security-Based Swap Transactions); Rule 3Ch-2 (Substituted Compliance for Mandatory Trade Execution); Rule 13n-4(d) (Exemption from the Indemnification Requirement); Rule 13n-12 (Exemption from Requirements Governing Security-Based Swap Data Repositories for Certain Non-U.S. Persons); Rule 18a-4(e) (Segregation Requirements for Foreign Security-Based Swap Dealers); and Rule 18a-4(f) (Segregation Requirements for Foreign Major

Security-Based Swap Participants). The Commission also is re-proposing the following rules and forms: 17 CFR 242.900–242.911 (Regulation SBSR) (RIN 3235–AK80) and 17 CFR 249.1600 (Form SBSE), 249.1600a (Form SBSE–A), and 249.1600b (Form SBSE–BD) (RIN 3235–AL05).

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## I. Background

The global nature of the security-based swap market highlights the critical importance of addressing the application of the Title VII of the Dodd-Frank Act<sup>1</sup> ("Title VII") to cross-border activities.<sup>2</sup> The Commission has received numerous inquiries and comments from market participants, foreign regulators, and other interested parties concerning how Title VII and the Commission's implementing regulations thereunder will apply to the cross-border activities of U.S. and non-U.S. market participants. To respond to these inquiries and comments, the Commission is providing our preliminary views on the application of Title VII to cross-border security-based swap activities<sup>3</sup> and non-U.S. persons

<sup>1</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

<sup>2</sup> Unless otherwise indicated, references to Title VII of the Dodd-Frank Act in this release are to Subtitle B of Title VII.

<sup>3</sup> Generally, in this release, the application of Title VII to "cross-border activities" refers to the application of Title VII to a security-based swap transaction involving (i) a U.S. person and a non-U.S. person, (ii) two non-U.S. persons where one or both are located within the United States, or (iii) two non-U.S. persons conducting a security-based swap transaction that otherwise occurs in relevant part within the United States, including by

that act in capacities regulated under the Dodd-Frank Act in the proposed rules and interpretations discussed below.

#### A. The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Act was enacted, among other reasons, to promote the financial stability of the United States by improving accountability and transparency in the financial system.<sup>4</sup> The 2008 financial crisis highlighted significant issues in the over-the-counter (“OTC”) derivatives markets, which have experienced dramatic growth in recent years<sup>5</sup> and are capable of affecting significant sectors of the U.S. economy.<sup>6</sup> Title VII of the Dodd-Frank Act provides for a comprehensive new regulatory framework for swaps and security-based swaps, including by: (i) Providing for the registration and comprehensive regulation of swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants; (ii) imposing clearing and trade execution requirements on swaps and security-based swaps, subject to certain exceptions; (iii) creating recordkeeping and real-time reporting regimes and public dissemination; and (iv) enhancing the rulemaking and enforcement authorities of the Commission and the Commodity Futures Trading Commission (“CFTC”).<sup>7</sup>

Specifically, the Dodd-Frank Act provides that the CFTC will regulate “swaps,” the Commission will regulate “security-based swaps,”<sup>8</sup> and both the

negotiating the terms of the security-based swap transaction within the United States or where performance of one or both counterparties under the security-based swap is guaranteed by a U.S. person.

<sup>4</sup> The Dodd-Frank Act was enacted “[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.” Public Law 111–203, Preamble.

<sup>5</sup> From their beginnings in the early 1980s, the notional value of these markets grew to approximately \$650 trillion globally by the end of 2011. See Bank for International Settlements, Statistical Release: OTC Derivatives Statistics at End–December 2011 (May 2012) at 1, available at: [http://www.bis.org/publ/otc\\_hy1205.pdf](http://www.bis.org/publ/otc_hy1205.pdf).

<sup>6</sup> See Section II.A.6(b), *infra*.

<sup>7</sup> See Public Law 111–203 sections 701–774.

<sup>8</sup> The definition of “security” in both the Exchange Act and the Securities Act of 1933 (“Securities Act”), 15 U.S.C. 77a *et seq.*, was amended by the Dodd-Frank Act to include security-based swaps. Public Law 111–203, Section 761(a)(2) (inserting “security-based swap” after “security future” in Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10) and Section

CFTC and the Commission (together, the “Commissions”) will regulate “mixed swaps.”<sup>9</sup> Title VII also amends the

768(a)(1) (inserting “security-based swap” after “security future” in Section 2(a)(1) of the Securities Act, 15 U.S.C. 77b(a)(1)). The revision of the Exchange Act’s definition of “security” raises, among other things, issues related to the definition of “broker” in Section 3(a)(4) of the Exchange Act, 15 U.S.C. 78c(a)(4), the definition of “dealer” in Section 3(a)(5) of the Exchange Act, 15 U.S.C. 78c(a)(5), the exchange registration requirements in Sections 5 and 6 of the Exchange Act, 15 U.S.C. 78e and 78f, respectively, and the requirement in Section 12 of the Exchange Act that securities be registered before a transaction is effected on a national securities exchange. See 15 U.S.C. 781(a). The Securities Act requires that any offer and sale of a security must either be registered under the Securities Act (see Section 5 of the Securities Act, 15 U.S.C. 77e) or made pursuant to an exemption from registration (see, e.g., Sections 3 and 4 of the Securities Act, 15 U.S.C. 77c and 77d, respectively). In addition, the Securities Act requires that any offer to sell, offer to buy or purchase or sell a security-based swap to any person who is not an eligible contract participant (“ECP”) must be registered under the Securities Act. See Section 5(e) of the Securities Act, 15 U.S.C. 77e(e). Because of the statutory language of Section 5(e), exemptions from this requirement in Sections 3 and 4 of the Securities Act are not available. This release does not address the requirements under Section 5 of the Securities Act.

The Commission adopted interim final rules that provide exemptions from certain provisions of the Securities Act, the Exchange Act, and the Trust Indenture Act of 1939 (“Trust Indenture Act”), 15 U.S.C. 77aaa *et seq.*, for those security-based swaps that prior to July 16, 2011 were “security-based swap agreements” and are defined as “securities” under the Securities Act and the Exchange Act as of July 16, 2011 due solely to the provisions of Title VII of the Dodd-Frank Act. See Exemptions for Security-Based Swaps, Securities Act Release No. 9231 (July 1, 2011), 76 FR 40605 (July 11, 2011); see also Extension of Exemptions for Security-Based Swaps, Securities Act Release No. 9383 (Jan. 29, 2013), 78 FR 7654 (Feb. 4, 2013). The Commission also issued temporary exemptions under the Exchange Act regarding certain issues raised by the inclusion of security-based swaps in the definition of “security.” See Order Extending Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With the Revision of the Definition of “Security” To Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 68864 (Feb. 7, 2013), 78 FR 10218 (Feb. 13, 2013); see also Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With the Pending Revision of the Definition of “Security” To Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 64795 (July 1, 2011) 76 FR 39927 (July 7, 2011).

<sup>9</sup> In addition, the Dodd-Frank Act adds to the Commodity Exchange Act (“CEA”) and Exchange Act definitions of the terms “swap dealer,” “security-based swap dealer,” “major swap participant,” and “major security-based swap participant,” and amends the CEA definition of the term “eligible contract participant.” These terms are defined in Sections 721 and 761 of the Dodd-Frank Act and, with respect to the term “eligible contract participant,” in Section 1a(18) of the CEA, 7 U.S.C. 1a(18), as redesignated and amended by Section 721 of the Dodd-Frank Act. Section 712(d)(1) of the Dodd-Frank Act provides that the CFTC and the Commission, in consultation with the Board of Governors of the Federal Reserve System, shall jointly further define the terms “swap,” “security-based swap,” “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-

Exchange Act to include many specific provisions governing security-based swaps that could apply to cross-border security-based swap transactions and to non-U.S. persons who act in capacities regulated under the Dodd-Frank Act.<sup>10</sup> These provisions primarily relate to Commission oversight of security-based swap dealers,<sup>11</sup> major security-based

based swap participant,” “eligible contract participant,” and “security-based swap agreement.” Further, Section 721(c) of the Dodd-Frank Act requires the CFTC to adopt a rule to further define the terms “swap,” “swap dealer,” “major swap participant,” and “eligible contract participant,” and Section 761(b)(3) of the Dodd-Frank Act permits the Commission to adopt a rule to further define the terms “security-based swap,” “security-based swap dealer,” “major security-based swap participant,” and “eligible contract participant,” with regard to security-based swaps, for the purpose of including transactions and entities that have been structured to evade Title VII or the amendments made by Title VII.

The Commission and the CFTC jointly adopted rules and interpretive guidance further defining the terms “swap,” “security-based swap,” and “security-based swap agreement,” and regulations regarding mixed swaps. See Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 67453 (July 18, 2012), 77 FR 48208 (Aug. 13, 2012) (“Product Definitions Adopting Release”). The Commission and the CFTC also jointly adopted rules further defining the terms “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant,” and “eligible contract participant.” See Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596 (May 23, 2012) (“Intermediary Definitions Adopting Release”).

<sup>10</sup> The provisions of the Exchange Act relating to security-based swaps that were enacted by Title VII also are referred to herein as “Title VII requirements” or “requirements in Title VII.”

<sup>11</sup> See Section 764(a) of the Dodd-Frank Act. The Commission, jointly with the CFTC, adopted rules further defining the term “security-based swap dealer.” See Intermediary Definitions Adopting Release, 77 FR 30596.

The Commission has proposed rules regarding the registration and substantive requirements for security-based swap dealers and major security-based swap participants. See Proposed Rules Governing Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Exchange Act Release No. 68071 (Oct. 18, 2012) 77 FR 70214 (Nov. 23, 2012) (“Capital, Margin, and Segregation Proposing Release”); Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (Oct. 12, 2011) (RIN 3235–AL05), 76 FR 65784 (Oct. 24, 2011) (“Registration Proposing Release”); Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 64766 (June 29, 2011), 76 FR 42396 (July 18, 2011) (“External Business Conduct Standards Proposing Release”); and Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 63727 (Jan. 14, 2011), 76 FR 3859 (Jan. 21, 2011) (“Trade Acknowledgment Proposing Release”). The Commission has not yet proposed rules governing the recordkeeping, reporting, and notification requirements for security-based swap

swap participants,<sup>12</sup> security-based swap data repositories (“SDRs”),<sup>13</sup> security-based swap clearing agencies,<sup>14</sup> security-based swap execution facilities (“SB SEFs”),<sup>15</sup> and mandatory security-based swap reporting and dissemination,<sup>16</sup> clearing,<sup>17</sup> and trade execution.<sup>18</sup>

### B. Overview of the Cross-Border Proposal

With limited exceptions, the Commission has not proposed specific provisions of rules or forms or provided guidance regarding the application of

dealers and major security-based swap dealers pursuant to Section 15F(f) of the Exchange Act, 15 U.S.C. 78o–10(f), as added by Section 764(a) of the Dodd-Frank Act.

<sup>12</sup> See Section 764(a) of the Dodd-Frank Act. The Commission, jointly with the CFTC, adopted rules further defining the term “major security-based swap participant.” See Intermediary Definitions Adopting Release, 77 FR 30596. In a number of releases, the Commission also has proposed rules regarding the registration and substantive requirements for major security-based swap participants. See note 11, *supra*.

<sup>13</sup> See Section 763(i) of the Dodd-Frank Act. The Commission has proposed rules regarding the registration and regulation of SDRs. See Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306 (Dec. 10, 2010), corrected at 75 FR 79320 (Dec. 20, 2010) and 76 FR 2287 (Jan. 13, 2011) (“SDR Proposing Release”).

<sup>14</sup> See Section 763(b) of the Dodd-Frank Act. The Commission adopted rules regarding the standards for risk management practices and operations of registered clearing agencies, including security-based swap clearing agencies. See Clearing Agency Standards, Exchange Act Release No. 68080 (Oct. 22, 2012), 77 FR 66220 (Nov. 2, 2012) (“Clearing Agency Standards Adopting Release”).

<sup>15</sup> See Section 763(c) of the Dodd-Frank Act. The Commission has proposed rules regarding the registration and regulation of SB SEFs. See Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 29, 2011) (“SB SEF Proposing Release”).

<sup>16</sup> See Sections 763 and 766 of the Dodd-Frank Act. The Commission has proposed rules on trade reporting, data elements, and real-time public reporting for security-based swaps. See Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 63346 (Nov. 19, 2010) (RIN 3235–AK80), 75 FR 75208 (Dec. 2, 2010) (“Regulation SBSR Proposing Release”).

<sup>17</sup> See Section 763(b) of the Dodd-Frank Act. The Commission has proposed or adopted rules relating to the end-user clearing exception and the process for submitting for review of security-based swaps for mandatory clearing. See Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b–4 and Form 19b–4 Applicable to All Self-Regulatory Organizations, Exchange Act Release No. 67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) (“Clearing Procedures Adopting Release”); End-User Exception to Mandatory Clearing of Security-Based Swaps (Corrected), Exchange Act Release No. 63556 (Dec. 15, 2010), 75 FR 79992 (Dec. 21, 2010) (“End-User Exception Proposing Release”).

<sup>18</sup> See Section 763(b) of the Dodd-Frank Act.

Title VII to cross-border activities.<sup>19</sup> Rather than addressing these issues in a piecemeal fashion through the various substantive rulemaking proposals implementing Title VII, the Commission instead is addressing the application of Title VII to cross-border activities holistically in a single proposing release.<sup>20</sup> This approach provides market participants, foreign regulators, and other interested parties with an opportunity to consider, as an integrated whole, the Commission’s proposed approach to the application of Title VII to cross-border security-based swap activities and non-U.S. persons that act in capacities regulated under the Dodd-Frank Act.<sup>21</sup>

After providing an overview of the security-based swap market, the Commission’s preliminary views on the scope of application of Title VII to cross-border security-based swap activity, and the legal and policy principles guiding the Commission’s approach to the application of Title VII to cross-border activities in Section II, we set forth our proposed approach in the subsequent sections of the release.

In Sections III and IV, we propose rules and interpretive guidance regarding the registration and regulation of security-based swap dealers and major security-based swap participants, including the treatment of foreign

<sup>19</sup> The Commission has proposed a rule addressing the application of the security-based swap trade reporting requirement to cross-border transactions and to non-U.S. persons. See Regulation SBSR Proposing Release, 75 FR 75239–40, as discussed in Section VII, *infra*. The Commission also has proposed rules imposing special requirements on “nonresident security-based swap dealers,” “nonresident major security-based swap participants,” “non-resident swap data repositories,” and “non-resident SB SEFs.” See Registration Proposing Release, 76 FR 65799–801, as discussed in Section III.E, *infra*; SDR Proposing Release, 75 FR 77310, as discussed in Section VI, *infra*; and SB SEF Proposing Release, 76 FR 11000–3, as discussed in Section VII, *infra*.

<sup>20</sup> Tables reflecting the Commission’s proposed approach as it would apply to security-based swap transactions between different types of entities are included in this release as Appendix A. Each table focuses on a specific type of security-based swap dealing entity or market participant and sets out the Title VII requirements that would apply to such person under different transaction scenarios.

<sup>21</sup> Cf. CFTC Proposed Interpretive Guidance and Policy Statement, Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 FR 41214 (July 12, 2012) (“CFTC Cross-Border Proposal”); Exemptive Order Regarding Compliance with Certain Swap Regulations, 77 FR 41110 (July 12, 2012) (“CFTC Proposed Cross-Border Exemptive Order”); Final Exemptive Order Regarding Compliance with Certain Swap Regulations, 78 FR 858 (Jan. 7, 2013) (“Final CFTC Cross-Border Exemptive Order”); Further Proposed Guidance Regarding Compliance With Certain Swap Regulations, 78 FR 909 (Jan. 7, 2013) (“CFTC Further Proposed Guidance”). In Section XIII.B below, we solicit general comment on the differences between our proposed approach and the CFTC’s proposed approach.

branches of U.S. banks and the provision of guarantees in the cross-border context. In connection with this, we are re-proposing the following rules and forms: 17 CFR 249.1600 (Form SBSE), 249.1600a (Form SBSE–A), and 249.1600b (Form SBSE–BD).<sup>22</sup>

In Sections V–VII, we propose rules and interpretive guidance regarding the registration of security-based swap clearing agencies, SDRs, and SB SEFs, as well as discuss generally under what circumstances the Commission would consider granting exemptions from registration for these infrastructures. To facilitate relevant authorities’ access to security-based swap data collected and maintained by Commission-registered SDRs, the Commission also is proposing interpretive guidance to specify how SDRs may comply with the notification requirement in the Exchange Act and specifying how the Commission proposes to determine whether a relevant authority is appropriate for purposes of receiving security-based swap data from an SDR.<sup>23</sup> In addition, the Commission is proposing a tailored exemption from the indemnification requirement in the Exchange Act.<sup>24</sup>

In Sections VIII–X, we propose rules and interpretive guidance regarding the application of Title VII to cross-border activities with respect to certain transactional requirements in connection with reporting and dissemination, clearing, and trade execution for security-based swaps. As discussed further below, these requirements apply to persons independent of their registration status. In connection with this, we are re-proposing the following rules: 17 CFR 242.900–242.911 (Regulation SBSR).<sup>25</sup>

In Section XI, we set forth a proposed policy and procedural framework under which we would consider permitting compliance with comparable regulatory requirements in a foreign jurisdiction to substitute for compliance with certain requirements of the Exchange Act, and the rules and regulations thereunder, relating to security-based swaps (*i.e.*, “substituted compliance”).<sup>26</sup> Generally speaking, the Commission is proposing a policy and procedural framework that would allow for the possibility of substituted compliance in recognition of

<sup>22</sup> See Registration Proposing Release, 76 FR 65784, as discussed in Section III.E, *infra*.

<sup>23</sup> See Section VI.C, *infra*.

<sup>24</sup> *Id.*

<sup>25</sup> See Regulation SBSR Proposing Release, 75 FR 75208, as discussed in Section VIII, *infra*.

<sup>26</sup> See Section XI, *infra*. As discussed in Section XI, in permitting substituted compliance, the Commission might use different procedural approaches depending on the different substantive requirements that are the subject of the substituted compliance determinations. See also note 27, *infra*.

the potential, in a market as global as the security-based swap market, for market participants who engage in cross-border security-based swap activity to be subject to conflicting or duplicative compliance obligations.<sup>27</sup> In addition, the Commission is proposing a rule that would set forth procedures for requesting a substituted compliance determination.

In Section XII, the Commission sets forth our view of the scope of our authority, with respect to enforcement proceedings, under Section 929P of the Dodd-Frank Act.<sup>28</sup> Section XIII sets forth a general request for comment, including request for comment on the consistency of our proposed approach with the CFTC's proposed approach to applying the provisions of the CEA that were enacted by Title VII in the cross-border context.

Finally, in Section XIV, the Commission addresses the Paperwork Reduction Act, and Section XV provides an economic analysis of the proposed approach, including a discussion of the associated costs and benefits of the proposals discussed in Sections III–XI, as well as a discussion of issues related to efficiency, competition, and capital formation.

Because this release is directly related to security-based swap data reporting and dissemination, clearing, and trade execution, as well as the regulation of various persons required to register as a result of amendments made to the Exchange Act by Title VII, we anticipate that some of the rules, forms, and interpretive guidance proposed herein, and comments received thereon, will be addressed in the adopting releases relating to the impacted substantive rules. In some areas, we may decide to address comments received on the proposals contained in this release by adopting rules in a separate rulemaking.<sup>29</sup>

<sup>27</sup> Separately, in Sections V–VII below, the Commission also discusses generally when we would consider exempting non-resident security-based swap clearing agencies and SB SEFs that are subject to comparable, comprehensive supervision and regulation in their home countries, and certain SDRs that are non-U.S. persons, from certain obligations under the Exchange Act, including the requirement to register.

<sup>28</sup> The rules, forms, and interpretive guidance proposed herein and discussed in Sections II–XI below relate solely to the applicability of the registration (and the attendant substantive regulation) and reporting and dissemination, clearing, and trade execution requirements in Title VII, and are not intended to limit or address the cross-border reach or extraterritorial application of the antifraud or other provisions of the federal securities laws.

<sup>29</sup> The Commission is not addressing in this release issues relating to compliance dates of final rules adopted pursuant to amendments made to the Exchange Act by Title VII. Compliance issues,

### C. Consultation and Coordination

As discussed more fully below, a number of market participants, foreign regulators, and other interested parties have already provided their views on the application of Title VII to cross-border activities through both written comment letters to the Commission and/or the CFTC and meetings with Commissioners and Commission staff.<sup>30</sup> The Commission has taken the commenters' views expressed thus far into consideration in developing these proposed rules, forms, and interpretive guidance.<sup>31</sup> In addition, in developing this proposal, the Commission has, in compliance with Sections 712(a)(2)<sup>32</sup> and 752(a)<sup>33</sup> of the Dodd-Frank Act, consulted and coordinated with the CFTC, the prudential regulators,<sup>34</sup> and foreign regulatory authorities.

including compliance dates, will be addressed in connection with the various Title VII final rules. See Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Release No. 67177 (June 11, 2012), 77 FR 35625 (June 14, 2012) (“Implementation Policy Statement”). See also Reopening of Comment Periods for Certain Rulemaking Releases and Policy Statement Applicable to Security-Based Swaps Proposed Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Release No. 34–69491 (May 1, 2013).

<sup>30</sup> The views expressed in comment letters and meetings are collectively referred to as the views of “commenters.” See Appendix D for a list of commenters referred to in this release and the location of their comment letters on the Commission's (or the CFTC's) Web site.

<sup>31</sup> In addition, the Commission and the CFTC held a joint public roundtable regarding the application of Title VII to cross-border activities. See Joint Public Roundtable on International Issues Relating to the Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Release No. 64939 (July 21, 2011), 76 FR 44507 (July 26, 2011).

<sup>32</sup> Section 712(a)(2) of the Dodd-Frank Act states, in part, that “the Securities and Exchange Commission shall consult and coordinate to the extent possible with the Commodity Futures Trading Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible.”

<sup>33</sup> Section 752(a) of the Dodd-Frank Act states, in part, that “[i]n order to promote effective and consistent global regulation of swaps and security-based swaps, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the prudential regulators (as that term is defined in Section 1a(39) of the Commodity Exchange Act), as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps.”

<sup>34</sup> The term “prudential regulator” is defined in Section 1a(39) of the CEA, 7 U.S.C. 1a(39), and that definition is incorporated by reference in Section 3(a)(74) of the Exchange Act, 15 U.S.C. 78c(a)(74). Pursuant to the definition, the Board of Governors of the Federal Reserve System (“Federal Reserve Board”), the Office of the Comptroller of the

Efforts to regulate the swaps market are underway not only in the United States but also abroad. In 2009, leaders of the Group of 20 (“G20”)—whose membership includes the United States, 18 other countries, and the European Union (“EU”)—called for global improvements in the functioning, transparency, and regulatory oversight of OTC derivatives markets. Specifically, the G20 leaders declared that:

[a]ll standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the [Financial Stability Board] and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk and protect against market abuse.<sup>35</sup>

In subsequent summits, the G20 leaders have reiterated their commitment to OTC derivatives regulatory reform.<sup>36</sup> The Commission has participated in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing the regulation of OTC derivatives.<sup>37</sup> Through these

Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency (collectively, the “prudential regulators”) is the “prudential regulator” of a security-based swap dealer if the entity is directly supervised by that agency.

<sup>35</sup> G20 Meeting, Pittsburgh, United States, September 25, 2009, available at: [http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh\\_summit\\_leaders\\_statement\\_250909.pdf](http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf).

<sup>36</sup> For example, on June 18–19, 2012, the leaders of the G20 convened in Los Cabos, Mexico, and reaffirmed their commitments with respect to the regulation of the OTC derivatives markets. See the G20 Leaders Declaration (June 2012), para. 39, available at: <http://www.g20.org/documents/>.

<sup>37</sup> Senior representatives of OTC derivatives market regulators from G20 jurisdictions have met on a number of occasions to discuss international coordination of OTC derivatives regulations. See, e.g., Joint Press Statement of Leaders on Operating Principles and Areas of Exploration in the Regulation of the Cross-Border OTC Derivatives Market (Dec. 4, 2012), available at: <http://www.sec.gov/news/press/2012/2012-251.htm>; Joint Statement on Regulation of OTC Derivatives Markets (May 7, 2012), available at: <http://www.sec.gov/news/press/2012/2012-85.htm>; and Joint Statement on Regulation of OTC Derivatives Markets (Dec. 9, 2011), available at: <http://www.sec.gov/news/press/2011/2011-260.htm>. See also Financial Stability Board (“FSB”), OTC Derivatives Market Reforms, Fifth Progress Report on Implementation (April 15, 2013) (“FSB Progress Report April 2013”), at 47, available at: [http://www.financialstabilityboard.org/publications/r\\_130415.pdf](http://www.financialstabilityboard.org/publications/r_130415.pdf) (noting that SEC staff has regularly consulted its counterparts in other jurisdictions to discuss and compare approaches to the application of Title VII of the Dodd-Frank Act in cross-border contexts); FSB Progress Report April 2013 at 5 and



discussions and our participation in various international task forces and working groups,<sup>38</sup> we have gathered information about foreign regulatory reform efforts and have discussed the possibility of conflicts and gaps, as well as inconsistencies and duplications, between U.S. and foreign regulatory regimes. We have taken these discussions into consideration in developing these proposed rules, forms, and interpretations.

In addition, the Commission and the CFTC have conducted staff studies to assess developments in OTC derivatives regulation abroad. As directed by Congress in Section 719(c) of the Dodd-Frank Act, on January 31, 2012, the Commission and the CFTC jointly submitted to Congress a “Joint Report on International Swap Regulation” (“Swap Report”).<sup>39</sup> The Swap Report discussed swap and security-based swap regulation and clearinghouse regulation in the Americas, Asia, and the European Union, and identified similarities and differences in jurisdictions’ approaches to areas of regulation, as well as other areas of regulation that could be harmonized. The Swap Report also identified major clearinghouses, clearing members, and regulators in each geographic area and described the major contracts (including clearing volumes and notional values), methods for clearing swaps, and the systems used for setting margin in each geographic area.<sup>40</sup>

45–46 (discussing meetings of the group of market regulators “to identify and explore ways to address issues and uncertainties in the application of rules in a cross-border context, including options to address identified conflicts, inconsistencies, and duplication.”).

<sup>38</sup> The Commission participates in the FSB’s Working Group on OTC Derivatives Regulation (“ODWG”), both on its own behalf and as the representative of the International Organization of Securities Commissions (“IOSCO”), which is co-chair of the ODWG. The Commission also serves as one of the co-chairs of the IOSCO Task Force on OTC Derivatives Regulation.

<sup>39</sup> See CFTC and SEC, Joint Report on International Swap Regulation (Jan. 31, 2012), available at: <http://www.sec.gov/news/studies/2012/sec-cftc-intlswapreg.pdf>.

<sup>40</sup> In addition, Commission and CFTC staff submitted a joint study to Congress on the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions which may be used to describe complex and standardized financial derivatives. See Joint Study on the Feasibility of Mandating Algorithmic Descriptions for Derivatives: A Study by the Staff of the Securities and Exchange Commission and the Commodity Futures Trading Commission as Required by Section 719(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Apr. 7, 2011), available at: <http://www.sec.gov/news/studies/2011/719b-study.pdf>. In preparing this report, Commission and CFTC staff coordinated extensively with international financial institutions and foreign regulators.

#### D. Substituted Compliance

As noted above, we recognize the potential, in a market as global as the security-based swap market, that market participants who engage in cross-border security-based swap activity may be subject to conflicting or duplicative compliance obligations. To address this possibility, we are proposing a “substituted compliance” framework under which we would consider permitting compliance with requirements in a foreign<sup>41</sup> regulatory system to substitute for compliance with certain requirements of the Exchange Act relating to security-based swaps, provided that the corresponding requirements in the foreign regulatory system are comparable to the relevant provisions of the Exchange Act.<sup>42</sup> The availability of substituted compliance should reduce the likelihood that market participants would be subject to potentially conflicting or duplicative sets of rules.

As discussed more fully below, the Commission would perform comparability analysis and make substituted compliance determinations with respect to four separate categories of requirements.<sup>43</sup> If, for example, a foreign regulatory system achieves comparable regulatory outcomes in three out of the four categories, then the Commission would permit substituted compliance with respect to those three categories of comparable requirements, but not for the one, non-comparable category for which comparable regulatory outcomes are not achieved. In other words, we are not proposing an “all-or-nothing” approach. In addition, in making comparability determinations within each category of requirements, the Commission is proposing to take a holistic approach; that is, we would ultimately focus on regulatory outcomes rather than a rule-by-rule comparison. Substituted compliance therefore should accept differences between regulatory regimes when those

<sup>41</sup> In this release, the term “foreign” is used interchangeably with the term “non-U.S.” See, e.g., note 372, *infra* (discussing the definition of “foreign security-based swap dealer”).

<sup>42</sup> See Section XI, *infra*.

<sup>43</sup> Specifically, the Commission is proposing to make substituted compliance determinations with respect to the following categories of requirements: (i) Requirements applicable to registered security-based swap dealers in Section 15F of the Exchange Act and the rules and regulations thereunder; (ii) requirements relating to regulatory reporting and public dissemination of security-based swaps; (iii) requirements relating to clearing for security-based swaps; and (iv) requirements relating to trade execution for security-based swaps. See Section XI, *infra*.

differences nevertheless accomplish comparable regulatory outcomes.

#### E. Conclusion

In proposing these rules, forms, and interpretations, the Commission is mindful that the security-based swap market is global in nature and developed prior to the enactment of the Dodd-Frank Act.<sup>44</sup> There are challenges involved in imposing a comprehensive regulatory regime on existing markets, particularly ones that have not been subject to the particular regulation that the Dodd-Frank Act provides. Any rules and interpretive guidance we adopt governing the application of Title VII to cross-border activities could significantly affect the global security-based swap market. As discussed further below, to the extent practicable and consistent with our statutory mandate,<sup>45</sup> the Commission has proposed these rules and interpretations with the intent to achieve the regulatory benefits intended by the Dodd-Frank Act and to facilitate a well-functioning global security-based swap market, including by taking into account the impact these proposed rules and interpretations will have on counterparty protection, transparency, systemic risk, liquidity, efficiency, and competition in the market. In addition, the Commission is mindful of the fact that the application of Title VII to cross-border activities raises issues of potential conflict or overlap with foreign regulatory regimes. Furthermore, the Commission is attentive to the fact that a number of registrants may be registered with both us and the CFTC.<sup>46</sup>

The rules and interpretations proposed today represent the Commission’s preliminary views regarding the application of Title VII to cross-border security-based swap activities and to non-U.S. persons who act in capacities regulated under the Dodd-Frank Act. We note that these proposed rules and interpretations are tailored to the unique circumstances of the security-based swap market, and as such would not necessarily be appropriate to apply to the Commission’s regulation of traditional securities markets. We also recognize that there are a number of possible alternative approaches to applying Title VII in the cross-border context. Accordingly, the Commission invites public comment regarding all aspects of

<sup>44</sup> See Section II, *infra*.

<sup>45</sup> See Section II.C, *infra* (discussing the principles guiding proposed approach to applying Title VII in the cross-border context).

<sup>46</sup> All references in this release to an entity that is “registered” indicate an entity that is registered with the Commission, unless otherwise indicated.

the proposed approach, including each proposed rule and interpretation contained herein, and potential alternative approaches. In particular, data and comment from market participants and other interested parties with respect to the likely effect of each proposed rule and interpretation regarding application of a specific Title VII requirement, and the effect of such proposed application in the aggregate, will be particularly useful to the Commission in evaluating possible modifications to the proposal and understanding the consequences of the substantive rules that have not yet been adopted under Title VII.

## II. Overview of the Security-Based Swap Market and the Legal and Policy Principles Guiding the Commission's Approach to the Application of Title VII to Cross-Border Activities

In this section, the Commission provides a general overview of the security-based swap market that informs our proposed implementation of Title VII, including a description of the various dealing structures used by U.S.-based and foreign-based entities to conduct their security-based swap businesses, and existing clearing, reporting, and trade execution practices. We also discuss the Commission's preliminary views on the scope of application of Title VII and the principles guiding our proposed approach to applying Title VII in the cross-border context.

### A. Overview of the Security-Based Swap Market

#### 1. Global Nature of the Security-Based Swap Market

The security-based swap market is a global market.<sup>47</sup> Security-based swap business currently takes place across national borders, with agreements negotiated and executed between counterparties often in different jurisdictions (and at times booked and risk-managed in still other jurisdictions).<sup>48</sup>

The global nature of the security-based swap market is evidenced by the

<sup>47</sup> See, e.g., IIB Letter at 1 (noting the "truly global nature of the OTC derivatives market"); Cleary Letter IV at 2 (noting that swaps and security-based swaps trade in a "unique global market"); Société Générale Letter II at 2 (noting the "global nature of the derivatives business"); see also Bank of International Settlements ("BIS"), Committee on the Global Financial System, No. 46, The macro financial implications of alternative configurations for access to central counterparties in OTC derivatives markets (Nov. 2011) at 1, available at: <http://www.bis.org/publ/cgfs46.pdf> (referring to the "globalized nature of the market, in which a significant proportion of OTC derivatives trading is undertaken across borders").

<sup>48</sup> See, e.g., SIFMA Letter I at 2.

data available to the Commission.<sup>49</sup> Based on market data in the Depository Trust and Clearing Corporation's Trade Information Warehouse ("DTCC-TIW"),<sup>50</sup> viewed from the perspective of the domiciles of the counterparties booking credit default swap ("CDS") transactions, approximately 49% of U.S. single-name CDS transactions in 2011 were cross-border transactions between a U.S.-domiciled<sup>51</sup> counterparty and a foreign-domiciled counterparty<sup>52</sup> and an additional 44% of such CDS transactions were between two foreign-domiciled counterparties.<sup>53</sup> Thus, approximately 7% of the U.S. single-name CDS transactions in 2011 were between two U.S.-domiciled counterparties.<sup>54</sup> These statistics indicate that cross-border transactions are the norm, not the exception, in the security-based swap market.<sup>55</sup> Accordingly, the question of how the Commission is implementing Title VII with respect to security-based swaps

<sup>49</sup> See Section XV.B, *infra* (discussing in detail the global nature of the security-based swap market).

<sup>50</sup> The information was made available to the Commission in accordance with the agreement between DTCC-TIW and the OTC Derivatives Regulatory Forum ("ODRF").

<sup>51</sup> The domicile classifications in DTCC-TIW are based on the market participants' own reporting and may not have been verified. Prior to enactment of the Dodd-Frank Act, funds and accounts did not formally report their domicile to DTCC-TIW because there was no systematic requirement to do so. After enactment of the Dodd-Frank Act, the DTCC-TIW has collected the registered office location of the account or fund. This information is self-reported on a voluntary basis. It is possible that some market participants may misclassify their domicile status because the databases in DTCC-TIW do not assign a unique legal entity identifier to each separate entity. Notwithstanding this limitation, we believe that the cross-border and foreign activity presented in the analysis by the Commission's Division of Risk, Strategy, and Financial Innovation demonstrates the nature of the CDS market. See Section XV.B.2.c, *infra*.

<sup>52</sup> DTCC-TIW classified a foreign branch or foreign subsidiary of a U.S. domiciled entity as foreign-domiciled. Therefore, CDS transactions with a foreign-domiciled counterparty include CDS transactions with a foreign branch or foreign subsidiary of a U.S.-domiciled entity as counterparty.

<sup>53</sup> Put another way, in 2011, a vast majority (approximately 93%) of U.S. single-name CDS transactions directly involved at least one foreign-domiciled counterparty. This observation is based on the data compiled by the Commission's Division of Risk, Strategy, and Financial Innovation on single-name CDS transactions with U.S. reference entities from the DTCC-TIW between January 1, 2011, and December 31, 2011. See Section XV.B.2.d, *infra*.

<sup>54</sup> *Id.*

<sup>55</sup> We note, however, that, in addition to classifying transactions between a U.S. counterparty and a foreign branch of a U.S. bank as a cross-border transaction (see note 51, *supra*), these statistics characterize as cross-border transactions those in which all or substantially all of the activity takes place in the United States and all or much of the risk of the transactions ultimately is borne by U.S. persons.

will, to a large extent, be affected by how the Commission applies Title VII to the cross-border transactions that are the majority of security-based swaps.

#### 2. Dealing Structures

Dealers use a variety of business models and legal structures to conduct security-based swap dealing business<sup>56</sup> with counterparties in jurisdictions all around the world.<sup>57</sup> Commenters have indicated that both U.S.-based and foreign-based entities use certain dealing structures for a variety of legal, tax, strategic, and business reasons that often pre-date the enactment of the Dodd-Frank Act.<sup>58</sup> Among the reasons cited for the variety of dealing structures is the desire of counterparties to reduce risk and enhance credit protection based on the particular characteristics of each entity's business.<sup>59</sup>

In this subsection, we describe certain dealing structures that U.S.-based entities and foreign-based entities in the security-based swap market might use. In each of these dealing structures, because the booking entity is the counterparty to the security-based swap transaction resulting from the dealing activity (*i.e.*, the principal) and bears the ongoing risk of performance on the transaction, we view the booking entity, and not the intermediary that acts as an agent on behalf of the booking entity to originate the transaction, as the dealing entity.<sup>60</sup>

##### (a) U.S. Bank Dealer

A U.S. bank holding company may use a U.S. subsidiary that is a banking entity to deal directly with U.S. and foreign counterparties. Such U.S. bank dealer may use a sales force in its U.S. home office to originate security-based swap transactions in the United States and use separate sales force in foreign branches to originate security-based swap transactions with counterparties in foreign local markets.<sup>61</sup> The resulting security-based swap transactions may be

<sup>56</sup> As used in this release, "security-based swap dealing," "security-based swap dealing activity," "dealing activity," and related concepts have the meaning described in the Intermediary Definitions Adopting Release, 77 FR 30596, unless otherwise indicated in this release.

<sup>57</sup> See, e.g., Cleary Letter IV at 5; Davis Polk Letter I at 2-3; IIB Letter at 7.

<sup>58</sup> See, e.g., Cleary Letter at 3.

<sup>59</sup> See, e.g., SIFMA Letter at 2.

<sup>60</sup> See Intermediary Definitions Adopting Release, 77 FR 30617 n.264 ("A sales force, however, is not a prerequisite to a person being a security-based swap dealer. For example, a person that enters into security-based swaps in a dealing capacity can fall within the dealer definition even if it uses an affiliated entity to market and/or negotiate those security-based swaps (*e.g.*, the person is a booking entity)."). See also Section III.D, *infra*.

<sup>61</sup> See Sullivan & Cromwell Letter at 2.

booked in the home office of the U.S. bank or in a foreign branch of the bank.<sup>62</sup>

(b) U.S. Non-bank Dealer

A U.S.-based holding company may use a non-bank subsidiary to conduct security-based swap dealing activity in the U.S. market and foreign local markets. The U.S. non-bank dealer may act as principal to originate and book transactions in the United States and use a sales force in the foreign local markets (e.g., salespersons employed by its foreign affiliate) as agent to originate transactions on its behalf, and then centrally book the resulting transactions in the U.S. non-bank dealer. In some situations, such as where the holding company has rated debt, but the U.S. non-bank dealer does not, the U.S. non-bank dealer's performance under security-based swaps may be supported by a parental guarantee provided by the holding company.<sup>63</sup> The guarantee would typically give counterparties to the U.S. non-bank dealer direct recourse to the holding company for obligations owed by such non-bank dealer under the security-based swaps as though the guarantor had entered into the transactions directly with the counterparties.<sup>64</sup>

(c) Foreign Subsidiary Guaranteed by a U.S. Person

A U.S.-based holding company also may conduct dealing activity in both U.S. markets and foreign markets out of a foreign subsidiary.<sup>65</sup> The foreign subsidiary may use a sales force in the United States (e.g., salespersons employed by its U.S. affiliate) to originate security-based swap transactions with counterparties in the U.S. markets, or may directly solicit, negotiate, and execute security-based swap transactions with counterparties in the U.S. markets from outside the United States, and centrally book the resulting transactions itself. The foreign subsidiary also may conduct security-

based swap dealing activity in various foreign markets using local salespersons as agent to originate and centrally book the resulting security-based swap transactions itself. In some situations, such as where the U.S.-based holding company has rated debt, but the foreign subsidiary does not, the foreign subsidiary's performance under security-based swaps may be supported by a parental guarantee provided by the holding company.<sup>66</sup> Such guarantee would typically give its counterparty direct recourse to the U.S. parent acting as guarantor for obligations owed by such foreign subsidiary under the security-based swaps. As a result, a guarantee provided by a U.S. person of another person's obligations owed under a security-based swap transaction poses the same degree of risk to the United States as the risk posed by a transaction entered into directly by such U.S. person.

In circumstances where a foreign non-bank subsidiary of a U.S. holding company has sufficient creditworthiness and does not rely on a U.S. parental guarantee to support its creditworthiness, the risk of the security-based swaps entered into by the foreign subsidiary of a U.S.-based holding company resides in the foreign subsidiary outside the United States.

(d) Foreign-Based Dealer

i. Direct Dealing

Foreign-based entities also may use a number of business models and legal structures to conduct global security-based swap dealing activity in both the U.S. and foreign markets. Like U.S. dealers, foreign dealers may deal directly with U.S. counterparties and non-U.S. counterparties without using any agents in the local market to intermediate and book the resulting transactions in the foreign entities themselves.<sup>67</sup>

ii. Intermediation in the United States

Foreign dealers also may use local personnel with knowledge of and expertise on the local markets to intermediate security-based swap transactions in each local market, for instance, using salespersons in the United States to originate security-based swaps in the U.S. market, and either book the resulting transactions in an entity based in the United States (such as a U.S. affiliate) or centrally book the

resulting transactions in a foreign central booking affiliate.<sup>68</sup>

Intermediation activity within the United States on behalf of foreign entities may occur in two principal legal structures.

First, foreign dealers that are banking entities may conduct dealing activity with U.S. counterparties out of their U.S. branches. In this structure, a foreign banking entity may originate and book transactions in its U.S. branch, or the U.S. branch may originate transactions that are booked in the foreign home office.<sup>69</sup>

Second, both bank and non-bank foreign dealers may conduct dealing activity out of their U.S. subsidiaries. The U.S. subsidiaries may act as principal to originate and book security-based swaps in the United States and enter into inter-affiliate back-to-back transactions with the foreign central booking entity (usually the foreign parent) for purposes of centralized booking and centralized risk management.<sup>70</sup> The U.S. subsidiary also may act as agent to originate security-based swaps in the United States on behalf of the foreign entity and the resulting transactions would be booked in a centralized foreign booking entity, usually the foreign parent. In some situations, such as where the foreign-based entity has rated debt, but the U.S. subsidiary does not, the U.S.-based subsidiary's performance under security-based swaps that it enters into as principal may be supported by a parental guarantee provided by the foreign-based entity.<sup>71</sup>

The transactions originated by the U.S. branch of a foreign bank or a U.S. subsidiary of a foreign bank or non-bank entity may not be limited to those with U.S. counterparties in the U.S. security-based swap market. Foreign bank or non-bank entities may utilize their U.S. branches or U.S. subsidiaries to conduct dealing activity with, for instance, non-U.S. counterparties located in various jurisdictions within the same region or same time zones, such as Canada or Latin America, and centrally book the resulting transactions in the home offices of the foreign entities themselves. For example, a Canadian counterparty might enter into a security-based swap with a non-U.S.-based dealer that solicits and negotiates the transaction out of a U.S. subsidiary

<sup>62</sup> See *id.* at 3–4.

<sup>63</sup> See Cleary Letter IV at 10 (discussing a U.S. holding company providing a guarantee of performance on the obligations of its foreign swap dealing subsidiary).

<sup>64</sup> See Intermediary Definitions Adopting Release, 77 FR 30689. See also Product Definitions Adopting Release, 77 FR 48227 (stating that the Commission would consider issues involving cross-border guarantees of security-based swaps in a separate release addressing the application of Title VII in the cross-border context).

<sup>65</sup> See, e.g., Sullivan & Cromwell Letter, at 3–4 (stating that Bank of America Corporation, Citigroup Inc. and JPMorgan Chase & Co. conduct swap activities overseas through subsidiaries of the bank holding company, Edge Corporation subsidiaries of their U.S. banks and non-U.S. branches of the bank); Cleary Letter IV at 10–11.

<sup>66</sup> See Cleary Letter IV at 10 (discussing a U.S. holding company providing a guarantee of performance on the obligations of its foreign swap dealing subsidiary).

<sup>67</sup> See Cleary Letter VI at 3, 13 (discussing direct dealing by a foreign dealer from abroad); IIB Letter at 7.

<sup>68</sup> See Cleary Letter IV at 4, 21 (discussing the use of U.S. affiliate to intermediate) and IIB Letter at 7.

<sup>69</sup> See IIB Letter at 8.

<sup>70</sup> See Cleary Letter IV at 10 (discussing inter-affiliate transactions).

<sup>71</sup> See *id.* (discussing a non-U.S. holding company providing a guarantee on the obligations of its U.S. swap dealing subsidiary).

acting as agent but books the transaction itself outside the United States.

### 3. Clearing Practices

Prior to the enactment of the Dodd-Frank Act, there was no provision in the Exchange Act or any other laws in the United States for the mandatory clearing of OTC derivatives. Although initiatives related to central clearing had been considered before 2008, the 2008 financial crisis brought a new focus on CDS as a source of systemic risk and contributed to a more general recognition that central clearing parties (“CCPs”) could play a role in helping to manage bilateral counterparty credit risk in OTC CDS.<sup>72</sup>

In November 2008, the Commission, in consultation and coordination with the Federal Reserve Board and the CFTC, took steps to help facilitate the prompt development of CCPs for OTC derivatives.<sup>73</sup> Specifically, the Commission authorized the clearing of OTC security-based swaps by permitting certain clearing agencies to clear CDS on a temporary conditional basis.<sup>74</sup> As the Commission and other regulatory agencies monitored the activities of those clearing agencies, a significant volume of interdealer OTC CDS

transactions and a smaller volume of dealer-to-non-dealer OTC CDS transactions were centrally cleared on a voluntary basis.<sup>75</sup> The level of voluntary clearing in swaps and security-based swaps has steadily increased since that time. Although the volume of interdealer CDS cleared to date is quite large,<sup>76</sup> many security-based swap transactions are still ineligible for central clearing, and many transactions in security-based swaps eligible for clearing at a CCP continue to settle bilaterally.

Voluntary clearing of security-based swaps in the United States is currently limited to CDS products. Central clearing of security-based swaps began in March 2009 for index CDS products, in December 2009 for single-name corporate CDS products, and in November 2011 for single-name sovereign CDS products. At present, there is no central clearing in the United States for security-based swaps that are not CDS products, such as those based on equity securities. The level of clearing activity appears to have steadily increased as more CDS have become eligible to be cleared.<sup>77</sup>

### 4. Reporting Practices

The OTC derivatives markets have historically been largely opaque.<sup>78</sup> With respect to CDS, for example, the Government Accountability Office found in 2009 that “comprehensive and consistent data on the overall market

have not been readily available,” that “authoritative information about the actual size of the CDS market is generally not available,” and that regulators currently are unable “to monitor activities across the market.”<sup>79</sup> The reporting of comprehensive OTC derivative transaction data to trade repositories is intended to address the lack of transparency in this market, and as such it was one of the G20 regulatory reform commitments previously discussed.<sup>80</sup>

The first trade repositories were established in the mid-2000s.<sup>81</sup> The development of trade repositories for different asset classes accelerated following the 2009 G20 commitment in this area, and as legislative and regulatory requirements began to be put in place. As of the end of the first quarter of 2013, fourteen FSB member jurisdictions had legislation in place either requiring reporting of OTC derivatives contracts or authorizing regulators to implement such regulations.<sup>82</sup> In addition, as of the date of publication of the FSB Progress Report April 2013, eighteen trade repositories were either registered or in the process of becoming registered and twelve were operational, meaning, typically, that they were at least accepting transaction reports from more than one asset class.<sup>83</sup>

Prior to the Dodd-Frank Act, global trade repositories had been established for credit, interest rate, and equity

<sup>72</sup> The President’s Working Group on Financial Markets made the central clearing of OTC derivatives a top policy objective in 2008. See Policy Objectives for the OTC Derivatives Market (Nov. 14, 2008), available at: <http://www.treasury.gov/resource-center/fin-mkts/Documents/policyobjectives.pdf>; see also Policy Statement on Financial Market Developments (Mar. 13, 2008), available at: <http://www.law.du.edu/images/uploads/presidents-working-group.pdf>; and Progress Update on March Policy Statement on Financial Market Developments (Oct. 2008), available at: <http://www.treasury.gov/resource-center/fin-mkts/Documents/q4progress%20update.pdf>.

<sup>73</sup> On November 14, 2008, the Commission executed a Memorandum of Understanding with the Board and the CFTC that established a framework for consultation and information sharing on issues related to central counterparties for the OTC derivatives market. See <http://www.sec.gov/news/press/2008/2008-269.htm>.

<sup>74</sup> The Commission authorized five entities to clear CDS. See CDS clearing by ICE Clear Europe Limited, Exchange Act Release Nos. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) and 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010); CDS clearing by Eurex Clearing AG, Exchange Act Release Nos. 60373 (July 23, 2009), 74 FR 37740 (July 29, 2009) and 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010); CDS clearing by Chicago Mercantile Exchange Inc., Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009) and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010); CDS clearing by ICE Clear Credit LLC (formerly ICE Trust US LLC), Exchange Act Release Nos. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009) and 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010); Temporary CDS clearing by LIFFE A&M and LCH.Clearnet Ltd., Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (“CDS Clearing Exemption Orders”).

<sup>75</sup> Voluntary CCP clearing grew out of a series of meetings beginning in September 2005 hosted by the Federal Reserve Bank of New York with major market participants and their domestic and international supervisors for the purpose of discussing problems in the processing of CDS, and related risk management and control issues. See <http://www.ny.frb.org/newsevents/news/markets/2005/an050915.html>. In June 2008 the attendees agreed to an agenda for improvement in the derivatives market infrastructure that included “developing a central counterparty for credit default swaps that, with a robust risk management regime, can help reduce systemic risk.” See <http://www.ny.frb.org/newsevents/news/markets/2008/ma080609.html>; see also <https://www.theice.com/marketdata/reports/ReportCenter.shtml>.

<sup>76</sup> As of April 19, 2012, ICE Clear Credit had cleared approximately \$15.6 trillion notional amount of CDS contracts based on indices of securities and approximately \$1.5 trillion notional amount of CDS contracts based on individual reference entities or securities. As of April 19, 2012, ICE Clear Europe had cleared approximately €7.2 trillion notional amount of CDS contracts based on indices of securities and approximately €1.2 trillion notional amount of CDS contracts based on individual reference entities or securities. See Clearing Agency Standards Adopting Release, 77 FR 66236 n.184 (citing <https://www.theice.com/marketdata/reports/ReportCenter.shtml>).

<sup>77</sup> See Section XV.B.2(e), *infra*.

<sup>78</sup> See FSB, Implementing OTC Derivatives Market Reforms (Oct. 25, 2010) (“FSB October 2010 Report”), at 11, available at: [http://www.financialstabilityboard.org/publications/r\\_101025.pdf](http://www.financialstabilityboard.org/publications/r_101025.pdf).

<sup>79</sup> Government Accountability Office, “Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps,” GAO-09-397T (Mar. 2009), at 2, 5, 27, available at: <http://www.gao.gov/new.items/d09397t.pdf>.

<sup>80</sup> See note 35 and accompanying text, *supra*. See also SDR Proposing Release, 75 FR 77307 (“Under the Dodd-Frank Act, SDRs are intended to play a key role in enhancing transparency in the [security-based swap] market by retaining complete records of [security-based swap] transactions, maintaining the integrity of those records, and providing effective access to those records to relevant authorities and the public in line with their respective information needs. The enhanced transparency provided by an SDR is important to help regulators and others monitor the build-up and concentration of risk exposures in the [security-based swap] market. Without an SDR, data on [security-based swap] transactions is dispersed and not readily available to regulators and others.”).

<sup>81</sup> See Committee on Payment and Settlement Systems (“CPSS”) and Technical Committee of IOSCO, Report on OTC Derivatives Data Reporting and Aggregation Requirements (Jan. 2012), at 5, available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD366.pdf> (“CPSS-IOSCO Data Report”).

<sup>82</sup> FSB Progress Report April 2013 at 19.

<sup>83</sup> *Id.* at 20–21, 63–65. Ten trade repositories were offering trade reporting on interest rate derivatives transactions; eight were offering trade reporting on commodity derivative transactions; seven were offering trade reporting on equity derivatives transactions; eight were offering trade reporting on foreign exchange derivative transactions; and seven were offering trade reporting on credit derivatives.

derivatives.<sup>84</sup> In addition, in June 2010, the OTC Derivatives Regulators' Forum ("ODRF")<sup>85</sup> developed indicative guidance for Warehouse Trust<sup>86</sup> aiming to identify data that authorities would expect to request from Warehouse Trust to carry out their mandates.<sup>87</sup>

Public availability of trade repository data varies globally and has changed significantly over time. For example, since October 2008, on a weekly basis, DTCC has published aggregated data via its Web site.<sup>88</sup> More generally, in a recent FSB survey, all trade repositories that responded stated that they provide or intend to provide, transaction data on OTC derivatives to the public. In some cases and for some products, trading information is provided on a real-time basis. Some trade repositories publicly

<sup>84</sup> Pursuant to initiatives led by the OTC Derivatives Supervisors Group ("ODSG"), in 2009 the largest OTC derivatives dealers at the global level committed to reporting all of their CDS trades to a trade repository. At that time, a trade repository for credit derivatives was already in existence and used by the industry. To promote the development of trade repositories for all interest rate and equity derivatives, in 2008 and 2009 ISDA sought proposals for the creation of central trade repositories for these asset classes. Two entities were selected to provide trade repository functions for these asset classes. See FSB October 2010 Report at 44. The ODSG originated in 2005, when the Federal Reserve Bank of New York ("New York Federal Reserve") hosted a meeting with representatives of major OTC derivatives market participants and their domestic and international supervisors, including the Commission, in order to address the emerging risks of inadequate infrastructure for the rapidly growing market in credit derivatives. The ODSG is chaired by the New York Federal Reserve.

<sup>85</sup> The ODRF, formed in January 2009, brings together representatives from central banks, prudential supervisors, and securities and market regulators to discuss issues of common interest, regarding OTC derivatives central counterparties and trade repositories. The ODRF's scope and focus include information sharing/needs and oversight co-ordination and co-operation.

<sup>86</sup> The Warehouse Trust Company LLC ("Warehouse Trust") today provides certain post-trade processing services to DTCC-TIW. DTCC-TIW provides a centralized electronic trade database for OTC credit derivatives contracts.

<sup>87</sup> See FSB October 2010 Report at 63. Building on this work, CPSS and IOSCO have published a consultation paper setting forth more comprehensive guidance regarding trade repositories more broadly. The paper provides guidance to authorities that supervise trade repositories; regulators, supervisors, resolution authorities, central banks, and other public-sector authorities (collectively, "authorities") that request OTC derivative data from trade repositories; and trade repositories. This guidance concerns the types of data to which authorities will typically require access and possible approaches to addressing potential constraints and concerns that may prevent effective access to such data. See CPSS and IOSCO, Consultative Report on Authorities' Access to Trade Repository Data (April 2013), available at: <http://iosco.org/library/pubdocs/pdf/IOSCO408.pdf?v=1>.

<sup>88</sup> See CPSS-IOSCO Data Report at 45-46.

disclose only aggregated, end-of-day information.<sup>89</sup>

#### 5. Trade Execution Practices

Unlike the markets for cash equity securities and listed options, the market for security-based swaps currently is characterized generally by bilateral negotiation directly between two counterparties in the OTC market and is largely decentralized; many instruments are individually negotiated and often customized; and many security-based swaps are not centrally cleared.<sup>90</sup> The historical one-to-one nature of trade negotiation in security-based swaps has fostered various types of trading venues and execution practices, ranging among the following:

##### Bilateral Negotiations

"Bilateral negotiation" refers to the execution practice whereby one party uses the telephone, email or other means of communication to directly contact a potential counterparty to negotiate and execute a security-based swap. In bilateral negotiation and execution, only the two parties to the transaction are aware of the terms of the negotiation and the final terms of the agreement.<sup>91</sup>

##### Single-Dealer RFQ Platforms

A single-dealer request for quote ("RFQ") platform refers to an electronic trading platform where a dealer may post indicative quotes for security-based swaps in various asset classes that the dealer is willing to trade. Only the dealer's approved customers have access to the platform. When a customer wishes to transact in a security-based swap, the customer requests an executable quote, the dealer provides one, and if the customer accepts the dealer's quote, the transaction is executed electronically. This type of platform generally provides indicative quotes on a pricing screen, but only from one dealer to its customers.<sup>92</sup>

##### Multi-Dealer RFQ Platforms

A multi-dealer RFQ electronic trading platform refers to a multi-dealer RFQ system whereby a requester can send an RFQ to solicit quotes on a certain security-based swap from multiple dealers at the same time. After the RFQ is submitted, the recipients have a prescribed amount of time in which to

respond to the RFQ with a quote. Responses to the RFQ are firm. The requestor then has the opportunity to review the responses and accept the best quote. A multi-dealer RFQ platform provides a certain amount of pricing information, depending on its characteristics.<sup>93</sup>

##### Central Limit Order Books

A central limit order book system or similar system refers to a trading system in which firm bids and offers are posted for all participants to see, with the identity of the parties withheld until a transaction occurs. Bids and offers are then matched based on price-time priority or other established parameters and trades are executed accordingly. The quotes on a limit order book system are firm. In general, a limit order book system provides greater pricing information than the three platforms described above because all participants can view bids and offers before placing their bids and offers.<sup>94</sup> Currently, limit order books for the trading of security-based swaps in the United States are utilized by inter-dealer brokers for dealer-to-dealer transactions.

##### Brokerage Trading

"Brokerage trading" refers to an execution practice used by brokers to execute security-based swaps on behalf of customers, often in larger sized transactions. In such a system, a broker receives a request from a customer (which may be a dealer) who seeks to execute a specific type of security-based swap. The broker then interacts with other customers (which may also be dealers) to fill the request and execute the transaction. This model often is used by dealers that seek to transact with other dealers through the use of an interdealer broker as an intermediary. In this model, participants may or may not be able to see bids and offers of other participants.<sup>95</sup>

These various trading venues and execution practices provide different degrees of pre-trade pricing information and different levels of access. The Commission currently does not have sufficient information with respect to the volume of security-based swap transactions executed across these different trading venues and execution practices to evaluate the individual impact of such venues and practices on

<sup>89</sup> See OTC Derivatives Market Reforms, Fourth Progress Report on Implementation (Oct. 31, 2012) at 5, available at: [http://www.financialstabilityboard.org/publications/r\\_121031a.pdf](http://www.financialstabilityboard.org/publications/r_121031a.pdf).

<sup>90</sup> See SB SEF Proposing Release, 76 FR 10951.

<sup>91</sup> See *id.*

<sup>92</sup> See *id.* at 10951.

<sup>93</sup> For example, to the extent that a RFQ platform sets limits on the number of dealers to whom a customer may send an RFQ, the customer's pre-trade transparency is restricted to that number of quotes it receives in response to its RFQ. See SB SEF Proposing Release, 76 FR 10952.

<sup>94</sup> See *id.*

<sup>95</sup> See *id.*

pricing information available in the security-based swap market.

#### 6. Broad Economic Considerations of Cross-Border Security-Based Swaps<sup>96</sup>

Our primary economic considerations for promulgating rules and interpretations regarding the application of Title VII to cross-border activities include the potential risks of security-based swaps to the U.S. financial system<sup>97</sup> that could affect financial stability, the level of transparency and counterparty protection in the security-based swap market, the costs to market participants, and the impact of such rules and interpretations on liquidity, efficiency, and competition in the market. Unlike most other securities transactions, a security-based swap gives rise to ongoing obligations between transaction counterparties during the life of the transaction. This means that each counterparty to the transaction undertakes the obligation to perform the security-based swap in accordance with its terms and bears the counterparty credit risk and market risk until the transaction is terminated.<sup>98</sup> The cross-border rules ultimately adopted by the Commission could materially impact the economic effects of the final Title VII regulatory requirements.

#### (a) Major Economic Considerations

In determining how Title VII requirements should apply to persons and transactions in the cross-border context, the Commission is aware of the potentially significant trade-offs inherent in our policy decisions. For example, it is possible that counterparties excluded from the Title VII regulatory framework would not, among other things, receive the same level of counterparty protection or impartial access to trading venues and information as those included in the Title VII regulatory framework. However, it is also possible that market participants excluded from the Title VII

regulatory framework would face lower regulatory burdens and lower compliance costs associated with their security-based swap activity. Further, it is possible that these trade-offs could alter the incentives for individuals to participate in the security-based swap market, which may impact the overall market, affecting its liquidity, as well as its efficiency and the competitive dynamics among participants. In addition, we also recognize that regulators in other jurisdictions are currently engaged in implementing their own regulatory reforms of the OTC derivatives markets and that our proposed application of Title VII to cross-border activities may affect the policy decisions of these other regulators as they seek to address potential conflicts or duplication in the regulatory requirements that apply to market participants under their authority. In proposing our rules and interpretations in this release, the Commission has considered the benefits of the Title VII regulatory framework, including counterparty protection and access to information, as well as the costs of compliance, taking into account the potential impact of the rules and interpretations on liquidity, efficiency, and competition in the security-based swap market.

Moreover, the costs and benefits of various Title VII substantive requirements may not be the same for each individual market participant, depending on the role it plays, the market function it performs, and the activity it engages in in the security-based swap market. For example, Title VII requirements for security-based swap dealers and major security-based swap participants may impose significant costs on persons falling within the definitions of security-based swap dealer and major security-based swap participant that are not borne by other market participants. The costs of these requirements may provide economic incentive for some market participants falling within the definitions of security-based swap dealer and major security-based swap participant to restructure their security-based swap business to operate wholly outside of the Title VII regulatory framework, exiting the security-based swap market in the United States and not transacting with U.S. persons. Conversely, certain Title VII requirements may promote financial stability and increase market participants' confidence in entering into security-based swap transactions.

#### (b) Global Nature and Interconnectedness of the Security-Based Swap Market

In considering the proposed approach to the application of the Title VII requirements, the Commission has been informed by the analysis of current market activity described in this release,<sup>99</sup> including the extent of cross-border trading activity in the security-based swap market.<sup>100</sup> The security-based swap transactions between U.S.- and non-U.S. domiciled market participants provide conduits of risk into the U.S. financial system, which could affect the safety and soundness of the U.S. financial system. Similarly, such transactions also provide conduits for liquidity into the U.S. financial system. As a consequence, changes to incentives or costs that result from the application of U.S. regulatory requirements may have effects on the liquidity of the global market, as well as its efficiency and competitive dynamics.

With respect to conduits of risk, one area of particular concern in the current security-based swap market is the risks that arise when a large market participant becomes financially distressed, including the potential for sequential counterparty failure. A default by one or more security-based swap dealers or major security-based swap participants could produce spillovers or contagion by reducing the willingness and/or ability of market participants to extend credit to each other, and thus could substantially reduce liquidity and valuations for particular types of financial instruments.<sup>101</sup>

The experience of American International Group, Inc. ("AIG"), a Delaware corporation based in New York, and its subsidiary, AIG Financial Products Corp. ("AIG FP"), a Delaware corporation based in Connecticut, during and after the 2008 financial crisis both illustrates spillovers and contagion arising from security-based swap transactions and demonstrates how cross-border transactions could contribute to the destabilization of the

<sup>96</sup> See Section XV, *infra* (providing more detailed commentary on the economic effects of the proposed rules, including supporting citations).

<sup>97</sup> The Commission generally understands the "U.S. financial system" to include the U.S. banking system and the U.S. financial markets, including the U.S. security-based swap market, the traditional securities markets (*e.g.*, the debt and equity markets), and the markets for other financial activities (*e.g.*, lending).

<sup>98</sup> See Intermediary Definitions Adopting Release, 77 FR 30616–17 (noting that "the completion of a purchase or sale transaction" in the secondary equity or debt markets "can be expected to terminate the mutual obligations of the parties," unlike security-based swap transactions, which often give rise to "an ongoing obligation to exchange cash flows over the life of the agreement").

<sup>99</sup> See Section II.A, *supra*, and Section XV.B.2, *infra*.

<sup>100</sup> For example, review of the DTCC–TIW single-name CDS transactions executed in 2011 reveals that approximately 49% of the U.S. single-name CDS transactions were between one U.S.-domiciled counterparty and one foreign-domiciled counterparty, and 44% of such transactions were between two foreign-domiciled counterparties. See Section II.A.1, *supra*, and Section XV.B.2(d), *infra*.

<sup>101</sup> See, *e.g.*, Markus K. Brunnermeier and Lasse Heje Pedersen, "Market Liquidity and Funding Liquidity," *Rev. Financ. Stud.* (2009); Denis Gromb and Dimitri Vayanos, "A Model of Financial Market Liquidity," *Journal of the European Economic Association* (2010).



U.S. financial system if the security-based swap market were not adequately regulated.<sup>102</sup> AIG FP sold extensive amounts of credit protection in the form of CDS in the years leading up to the crisis,<sup>103</sup> largely on the strength of AIG's AAA rating; AIG FP's obligations were guaranteed by its parent AIG.<sup>104</sup> AIG FP's CDS business reflected the global nature of the security-based swap market because, although both AIG and AIG FP were headquartered in the United States, much of AIG FP's CDS business was run out of its London office,<sup>105</sup> and AIG FP sold credit protection to counterparties both within the United States and around the world.<sup>106</sup>

As the subprime mortgage market in the United States collapsed, the ongoing obligations borne by AIG FP and, through its guarantees, its parent AIG, arising from AIG FP's CDS transactions produced losses that threatened to overwhelm both AIG FP and AIG. The Federal Reserve Bank of New York established a credit facility to prevent AIG from collapsing. These funds were later supplemented by financial support from the U.S. Treasury and the Federal Reserve, resulting in over \$180 billion in financial assistance.<sup>107</sup>

<sup>102</sup> More generally, the Lehman Brothers Holding Inc. bankruptcy offers an example of how risk can spread across affiliated entities of multinational financial institutions. See Lehman Brothers International (Europe) in Administration, Joint Administrators' Progress Report for the Period 15 September 2008 to 14 March 2009 (Apr. 14, 2009), available at: <http://www.pwc.co.uk/assets/pdf/lbie-progress-report-140409.pdf> ("The global nature of the Lehman business with highly integrated, trading and non-trading relationships across the group led to a complex series of inter-company positions being outstanding at the date of Administration. There are over 300 debtor and creditor balances between LBIE and its affiliates representing \$10.5B of receivables and \$11.0B of payables as at 15 September 2008.")

<sup>103</sup> In 2007, AIG FP's CDS portfolio reached a peak of \$527 billion. Congressional Oversight Panel, June Oversight Report, "The AIG Rescue, Its Impact on Markets, and the Government's Exit Strategy," June 2010, at 23, available at: <http://www.gpo.gov/dfs/pkg/CPRT-111JPR56698/pdf/CPRT-111JPR56698.pdf> ("AIG Report").

<sup>104</sup> See Intermediary Definitions Adopting Release, 77 FR 30689 n.1133 ("AIGFP's obligations were guaranteed by its highly-rated parent company . . . an arrangement that facilitated easy money via much lower interest rates from the public markets, but ultimately made it difficult to isolate AIGFP from its parent, with disastrous consequences") (quoting AIG Report at 20).

<sup>105</sup> See AIG Report at 18.

<sup>106</sup> See Office of the Special Inspector General for the Troubled Asset Relief Program, Factors Affecting Efforts to Limit Payments to AIG Counterparties, at 20 (Nov. 17, 2009) (listing AIG FP's CDS counterparties, including a variety of U.S. and foreign financial institutions), available at: [http://www.sigtar.gov/Audit%20Reports/Factors\\_Affecting\\_Efforts\\_to\\_Limit\\_Payments\\_to\\_AIG\\_Counterparties.pdf](http://www.sigtar.gov/Audit%20Reports/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf).

<sup>107</sup> See AIG Report at 2.

As we discuss in more detail below, security-based swap market regulators need to take into account the spillover and contagion effect of security-based swap risk to avoid overburdening the financial system. One way to mitigate the spillover effect of a firm failure is to impose capital standards that take into account the security-based swap risk the firm undertakes while allowing flexibility in how it conducts security-based swap business.<sup>108</sup> At the same time, the Commission is mindful that the application of Title VII prudential requirements such as capital and margin impose costs on market participants that could provide economic incentives to restructure or separate their security-based swap activity according to geographical or jurisdictional regions, or to engage in less security-based swap activity, which may reduce the liquidity or efficiency of the overall market.<sup>109</sup>

There are circumstances where risk generated by security-based swaps may reside in the United States while conduits of such risk (e.g., security-based swap transactions or persons engaged in security-based swap transactions) could take place or reside outside the United States or outside the scope of application of the Title VII requirements. In these instances, the Commission has considered the nature of the risk, the magnitude of the risk, and the existence of other financial regulations, such as regulation of systemically important financial institutions in Title I and Title II of the Dodd-Frank Act and banking regulations.

The Commission is mindful that the same interconnectedness in the security-based swap market that may provide conduits for risk also may mean that changes to incentives or costs caused by the application of U.S. regulatory requirements may have effects on the liquidity of the global market, as well as its efficiency and competitive dynamics. As described below in Section XV.C, there are a myriad of paths for liquidity as well as risk to move throughout the financial system in this interconnected market. In addition, differences in regulatory requirements between the United States and non-U.S. jurisdictions may also impact markets by changing the competitive dynamics currently at play in the interconnected global market. For example, as articulated in Section XV.C, some potential responses by market participants to the proposed rules and interpretations in this release may result

<sup>108</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70218.

<sup>109</sup> See *id.* at 70303-06.

in lessened competition in the security-based swap market within the United States. Among other considerations, some entities may determine that the compliance costs arising from the requirements of Title VII warrant exiting the security-based swap market in the United States and not transacting with U.S. persons. These exits could result in higher spreads and affect the ability and willingness of end users to engage in security-based swaps.

### (c) Central Clearing

Many of the bilateral counterparty credit risks associated with security-based swaps can be mitigated by central clearing. Central clearing of security-based swaps provides a mechanism for market participants to engage in security-based swap activity without having to assess the creditworthiness of each counterparty. Clearing of security-based swaps shifts the counterparty risk from individual counterparties to CCPs whose members collectively share the default risk of all members.<sup>110</sup> Central clearing also requires consistent application of mark-to-market pricing and margin requirements, which standardizes the settling of payment or collateral delivery resulting from market movements and minimizes the risk of clearing member defaults.<sup>111</sup>

However, central clearing may also pose risk to financial systems. Because a CCP necessarily concentrates a large number of otherwise bilateral contracts into a single location, a CCP could itself become systemically important.<sup>112</sup>

<sup>110</sup> See, e.g., Darrell Duffie and Haoxiang Zhu, "Does a Central Clearing Counterparty Reduce Counterparty Risk?" Stanford University, Working Paper (2010), available at: <http://www.stanford.edu/~duffie/DuffieZhu.pdf>; Nout Wellink, "Mitigating systemic risk in OTC derivatives markets," Banque de France, Financial Stability Review, No. 14—Derivatives—Financial innovation and stability (July 2010), available at: [http://www.banque-france.fr/fileadmin/user\\_upload/banque\\_de\\_france/publications/Revue\\_de\\_la\\_stabilite\\_financiere/etude15\\_rsf\\_1007.pdf](http://www.banque-france.fr/fileadmin/user_upload/banque_de_france/publications/Revue_de_la_stabilite_financiere/etude15_rsf_1007.pdf).

<sup>111</sup> See Christopher Culp, "OTC-Cleared Derivative: Benefits, Costs, and Implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act," Journal of Applied Finance No. 2 (2010), available at: <http://www.rmcsinc.com/articles/OTCCleared.pdf>.

<sup>112</sup> The Financial Stability Oversight Council ("FSOC") can designate a CCP as systemically important under Section 804 of the Dodd-Frank Act. See, e.g., Craig Pirrong, "Mutualization of Default Risk, Fungibility, and Moral Hazard: The Economics of Default Risk Sharing in Cleared and Bilateral Markets," University of Houston, Working Paper (2010), available at: [http://business.nd.edu/uploadedFiles/Academic\\_Centers/Study\\_of\\_Financial\\_Regulation/pdf\\_and\\_documents/clearing\\_moral\\_hazard\\_1.pdf](http://business.nd.edu/uploadedFiles/Academic_Centers/Study_of_Financial_Regulation/pdf_and_documents/clearing_moral_hazard_1.pdf) ("[c]learing of OTC derivatives has been touted as an essential component of reforms designed to prevent a repeat of the financial crisis. A back-to-basics analysis of the economics of clearing suggests

While a loss by any single member in excess of its margin posted with the CCP is likely to be absorbed by the CCP's risk capital structure, correlated losses among many members, such as those which occurred among many asset classes during the 2008 financial crisis, could diminish the effectiveness of the risk mutualization structure of a CCP. Its failure could create financial instability through its members if the members, as residual obligors to the default related losses are unable to absorb the resulting financial impact. Such an outcome could lead to failure among CCP member counterparties, particularly when obligations are sizable, which may be the case if the members are themselves systemically important.

Certain aspects of Title VII are intended to reduce the risk of CCP failure by promoting sound risk management practices among registered clearing agencies, while also providing open access to market participants.<sup>113</sup> Sound risk management practices are important among both domestic and foreign CCPs, given the global nature of CCP membership.<sup>114</sup> When a CCP in the United States has significant number of foreign members, the CCP and its U.S.-domiciled members would be exposed to the foreign members. Similarly, when U.S.-domiciled entities are members of foreign domiciled CCPs, U.S. exposure to a foreign institution is created that may be systemically important.

#### (d) Security-Based Swap Data Reporting

Certain Title VII requirements are designed to increase market transparency for regulators and among security-based swap market participants. Requirements of regulatory reporting are designed to provide regulators with a broad view of the market and help monitor pockets of risk that might not otherwise be observed by market participants with an incomplete view of the market. Separately, requirements of post-trade reporting of prices in real-time are intended to promote price discovery and lower the trading costs by lessening the information advantage afforded certain OTC market participants with the largest order flow. Allowing all market participants access to more information

that such claims are overstated, and that traditional OTC mechanisms may be more efficient for some instruments and some counterparties.”)

<sup>113</sup> See, e.g., Clearing Agency Standards Adopting Release, 77 FR 66220.

<sup>114</sup> Based on the analysis of the member positions at ICE Clear Credit in the United States by the staff in the Division of Risk, Strategy and Financial Innovation, approximately half of the positions at ICE Clear Credit in the United States are held by foreign-domiciled dealing entities. See Section XV.B.2(e), *infra*.

about transactions' prices and sizes should create a more level playing field and may promote the efficiency of exchange or SEF trading of security-based swaps. In particular, as in other security markets, quoted bids and offers should form and adjust according to the reporting of executed trades. At the same time, however, we recognize that increased post-trade transparency also could impact the liquidity of, and competition in, the security-based swap market.<sup>115</sup> For example, market participants may be less willing to provide liquidity for large, potentially market-moving trades if the implementation of the Title VII public dissemination requirements reveals private information about future hedging and inventory needs.

The increased transparency caused by the Title VII reporting requirements could be diminished if consistent reporting requirements are not applied to transactions across various jurisdictions and information regarding security-based swaps taking place in the global market is not shared among jurisdictions. For instance, the aggregate exposures created by a particular security-based swap or class of security-based swaps may only be partially observed if security-based swap transactions span multiple jurisdictions. As a result any single regulator may not have a complete view of the security-based swap risks and may underestimate such risks. Separately, if some regulatory regimes do not require, or provide for less informative, post-trade reporting rules, then certain transactions may gravitate to these jurisdictions so that market participants can escape reporting their transaction prices. In both instances the increased transparency contemplated by the Title VII reporting requirements may be diluted.

#### B. Scope of Title VII's Application to Cross-Border Security-Based Swap Activity

Congress has given the Commission authority in Title VII to implement a security-based swap regulatory framework. In the statutory definitions and registration requirements for market intermediaries and participants (*i.e.*, security-based swap dealers and major security-based swap participants) and security-based swap infrastructures (*i.e.*, SDRs, security-based swap clearing agencies, and SB SEFs), Congress has identified the types of security-based swap activity that triggers Title VII

<sup>115</sup> See Section XV.C, *infra* (discussing the effects of our proposed cross-border approach on competition, efficiency, and capital formation).

registration and regulatory requirements relevant to such persons or the application of Title VII transaction-level requirements.

We recognize that applying Title VII to persons and transactions that fall within the statutory definitions or requirements may subject some persons based outside the United States, or some transactions arising from activity that occurs in part inside and in part outside the United States, to the various provisions of Title VII. At the same time, however, the global nature of the security-based swap market and the characteristics of the risk associated with security-based swap activity suggest that applying Title VII only to the conduct of persons located within the United States or to security-based swap activity occurring entirely within the United States would exclude from regulation a significant proportion of security-based swap activity that occurs in part inside and in part outside the United States.<sup>116</sup> Our proposed approach is intended to strike a reasonable balance in light of the authority provided by Congress, the structure of the security-based swap market, and the transfer of risk within that market. Accordingly, among other things, our proposed approach does not impose Title VII requirements on persons whose relevant security-based swap activity occurs entirely outside the United States and thus likely does not raise the types of concerns in the U.S. financial system that would warrant application of Title VII.

Commenters have raised concerns about the application of Title VII to security-based swap activity in the cross-border context and specifically about the possibility that the Commission may apply our security-based swap regulations to “extraterritorial” conduct. In this subsection, we discuss commenters' views regarding the applicability of Title VII to cross-border security-based swap activity, explain our proposed approach to determining whether the relevant security-based swap activity takes place, in whole or in part, within the United States, and interpret what it means for a person to “transact a business in security-based swaps without the jurisdiction of the United States” as set forth in Section 30(c) of the Exchange Act (“Section 30(c)").<sup>117</sup> In subsequent sections of the release, we discuss in more detail our proposed

<sup>116</sup> See Section II.A, *supra*. We preliminarily believe that many of the circumstances of concern also would create the opportunity for evasion of the Dodd-Frank Act's regulatory regime. See, e.g., note 55B, *infra*.

<sup>117</sup> 15 U.S.C. 78dd(c).



application of Title VII to cross-border security-based swap activity.

### 1. Commenters' Views

Commenters generally expressed the view that Section 30(c) restricts the Commission's authority to apply Title VII to "extraterritorial" conduct and thus, that the Commission follow a territorial approach in applying Title VII to cross-border security-based swap activity. One commenter interpreted Section 30(c) as prescribing a strictly territorial approach to the application of Title VII, arguing that this section codifies the territorial approach that we have historically taken in our existing securities regulations.<sup>118</sup> Several commenters argued that a narrow interpretation of the "extraterritorial" reach of Title VII was consistent with both Commission precedent<sup>119</sup> and the Supreme Court's decision in *Morrison v. National Australia Bank*.<sup>120</sup>

Based on this interpretation of Section 30(c), commenters generally argued that Title VII does not give the Commission authority to regulate entities that transact a business in security-based swaps outside the United States.<sup>121</sup> Some commenters suggested that non-U.S. entities (including affiliates of U.S. persons) that conduct business entirely with counterparties outside the United States should not be required to register as swap or security-based swap dealers or comply with Title VII.<sup>122</sup> Some of these commenters also urged the

<sup>118</sup> See Cleary Letter IV at 33–36; see also SIFMA Letter I at 5, 22; Sullivan & Cromwell Letter at 6 (suggesting that Section 30(c) permits "extraterritorial" application of Title VII only to prevent "efforts to evade" statutory requirements).

<sup>119</sup> See, e.g., Sullivan & Cromwell Letter at 11 (stating that the Commission has "plainly stated that it uses a territorial approach in applying the broker-dealer requirements to international operations").

<sup>120</sup> 130 S.Ct. 2869 (2010). See, e.g., Jones Day Letter at 7–8 (suggesting that the jurisdictional limits of Dodd-Frank Act Sections 722 and 772 be interpreted narrowly in a manner consistent with the *Morrison* decision); Cleary Letter IV at 33–6 (arguing against an extraterritorial application of Title VII); SIFMA Letter I at 5–6; ISDA Letter I at 11.

<sup>121</sup> See, e.g., Jones Day Letter at 7–8; Cleary Letter IV at 33–6; Sullivan & Cromwell Letter at 10–11; SIFMA Letter I at 5–6; ISDA Letter I at 11.

<sup>122</sup> See SIFMA Letter I at 4; see also ISDA Letter I at 11 (recommending that designation as a dealer should not be triggered by transactions entered into with foreign affiliates or branches of a U.S. bank or with foreign entities whose obligations are guaranteed by a U.S. person, or by legacy positions with U.S. counterparties); Davis Polk Letter II at 5–6 (stating that a foreign entity engaged in swaps exclusively with foreign counterparties is "without the jurisdiction of the United States"). Similarly, one commenter recommended that transactions between two foreign entities should be excluded from calculations of substantial position for purposes of the major participant definition. Canadian MAVs Letter at 7–8.

Commission not to subject foreign branches and affiliates of U.S. banks to Title VII registration requirements to the extent that they transact solely with foreign persons.<sup>123</sup> Some commenters urged that, even within a single entity, only those branches, departments, or divisions that engage in business within the United States should be required to register.<sup>124</sup>

Commenters generally took the view that Section 30(c) does not permit the Commission to apply Title VII to transactions occurring outside the United States. Accordingly, commenters suggested that Section 30(c) restricts the Commission's ability to apply Title VII requirements to the foreign business of entities that are required to register with the Commission.<sup>125</sup> For example, one commenter interpreted Section 30(c) to prohibit application of Title VII to any of a person's "activity" or "business" outside the United States, even if that person otherwise transacts a business in security-based swaps within the jurisdiction of the United States.<sup>126</sup>

Similarly, some commenters suggested that Section 30(c) prohibits the application of Title VII to transactions involving the foreign affiliates of U.S. persons, on the basis that such transactions occur "without the jurisdiction of the United States" when no U.S. person is a counterparty to the trade.<sup>127</sup> One commenter explained that, because such transactions involve parties outside the United States and occur outside the United States, they are "removed from the stream of U.S. commerce."<sup>128</sup>

<sup>123</sup> See, e.g., Sullivan & Cromwell Letter at 7 (stating that a territorial interpretation of Section 30(c) prevented the Commission from imposing Title VII requirements on the U.S. banks' "Non-U.S. Operations," defined to include both foreign affiliates or subsidiaries and foreign branches of these banks).

<sup>124</sup> See, e.g., Cleary Letter IV at 12; see also *id.* at 26 (arguing that a non-U.S. branch or affiliate of a U.S. entity should not be required to register as a dealer by virtue of its transactions with a non-U.S. person counterparty); ISDA Letter I at 11 (stating that a "branch, division or office of an entity should be able to be designated as a Dealer without subjecting the whole entity to regulation").

<sup>125</sup> See Cleary Letter IV at 11; see also SIFMA Letter I at 14 (suggesting that Section 30(c) "provid[es] strong support" for not applying Title VII to transactions between a registered foreign swap dealer and non-U.S. persons); ISDA Letter I at 11 (recommending that no Title VII requirements should apply to transactions between a non-U.S. entity registered as a dealer and its non-U.S. person counterparties).

<sup>126</sup> See Cleary Letter IV at 12.

<sup>127</sup> See SIFMA Letter I at 5–6; see also ISDA Letter I at 11 (suggesting that dealer-related requirements of Title VII should not apply to business with non-U.S. person counterparties, including foreign affiliates and branches of U.S. persons).

<sup>128</sup> See Sullivan & Cromwell Letter at 9.

Commenters also generally recommended a narrower interpretation of the language in Section 30(c) permitting the application of Title VII regulations to persons transacting a business in security-based swaps without the jurisdiction of the United States to the extent that they are doing so in contravention of rules the Commission has prescribed as "necessary or appropriate to prevent the evasion of any provision of [the Exchange Act that was added by the Dodd-Frank Act]." Under this view, Section 30(c) permits "extraterritorial" application of Title VII only to entities that have themselves engaged in willful or intentional evasion.<sup>129</sup> These commenters argued that the longstanding use of foreign branches and affiliates by security-based swap market entities demonstrates that these types of business structures are not evasive and, therefore, do not fall within the exception to the limits on the applicability of Title VII as set forth in Section 30(c).<sup>130</sup>

### 2. Scope of Application of Title VII in the Cross-Border Context

#### (a) Overview and General Approach

Section 772(b) of the Dodd-Frank Act amends Section 30 of the Exchange Act to provide that "[n]o provision of [Title VII] . . . shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States," unless that business is transacted in contravention of rules prescribed to prevent evasion of Title VII.<sup>131</sup> In so amending Section 30 of the Exchange Act, Congress directly appropriated nearly identical language defining the scope of the Exchange Act's application that appears in subsection (b) of Section 30 of the Exchange Act,<sup>132</sup> indicating that Congress intended the territorial application of Title VII to entities and transactions in the security-based swap market to follow similar principles to those applicable to the

<sup>129</sup> See, e.g., *id.* at 9–10 (suggesting that "extraterritorial" application of Title VII requires an "intent to evade" Title VII).

<sup>130</sup> See Cleary Letter IV at 7.

<sup>131</sup> See Section 30(c) of the Exchange Act, 15 U.S.C. 78dd(c), added by Section 772(b) of the Dodd-Frank Act.

<sup>132</sup> Section 30(b) of the Exchange Act, 15 U.S.C. 78dd(b), provides that the Exchange Act and related rules "shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States," unless that business is transacted in contravention of rules prescribed as necessary or appropriate to prevent evasion of the Exchange Act.

securities market under the Exchange Act.<sup>133</sup>

In light of this similar language, commenters have urged us to follow a territorial approach in applying Title VII to cross-border security-based swap activity.<sup>134</sup> We preliminarily agree that a territorial approach, if properly tailored to the characteristics of the security-based swap market, should help ensure that our regulatory framework focuses on security-based swap activity that is most likely to raise the concerns that Congress intended to address in Title VII, including the effects of security-based swap activity on the financial stability of the United States, on the transparency of the U.S. financial system, and on the protection of counterparties.

We differ from commenters, however, in our understanding of what a territorial approach means in the context of a global security-based swap market. As noted above, some commenters suggested that the security-based swap activity of foreign branches and affiliates of U.S. persons with non-U.S. persons occurs outside the United States and has only an indirect connection with the United States and that, therefore, subjecting transactions resulting from that activity to Title VII would involve extraterritorial application of the statute.<sup>135</sup> Although we recognize that some of the security-based swap activity involving these foreign branches and affiliates occur outside the United States, we believe that a properly tailored territorial approach should look to both the full range of activities described in the statutory text as well as to the concerns that Congress intended Title VII to address in determining whether the relevant activity, considered in its entirety, occurs at least in part within the United States.<sup>136</sup>

As noted above, security-based swap transactions differ from most traditional securities transactions in that they give rise to an ongoing obligation between the counterparties to the trade: the counterparties bear the risks that result

from those transactions for the duration of the transactions.<sup>137</sup> The Dodd-Frank Act was enacted, in part, to address the risks to the financial stability of the United States posed by entities bearing such risks, and a territorial approach to the application of Title VII should be consistent with achieving these statutory purposes. A territorial approach to the application of Title VII that excluded from the application of Title VII any activity conducted by the foreign operations of a U.S. person where they do business only with non-U.S. counterparties located outside the United States would likely fail to achieve the financial stability goals of Title VII, as such an approach would not account for the security-based swap risks that may be borne by entities located within the United States whose foreign operations solicit, negotiate, or execute transactions outside the United States. In addition, it is not clear that a different territorial approach that focused solely on the location of the entity bearing the risk (and disregarded whether certain relevant activity, including execution of the transaction, occurred within the United States) would adequately address the Dodd-Frank Act's concern with promoting transparency in the U.S. financial system and protecting counterparties, concerns that are likely to be raised by the solicitation, negotiation, or execution within the United States, even if the risk arising from those security-based swaps transactions is borne by entities outside the United States. For example, some transactions characterized by commenters as occurring outside the United States, even with non-U.S. persons, are entered into by persons located within the United States and would appear to raise the same types of risk concerns as transactions occurring wholly within the United States.

Similarly, the Commission preliminarily believes that a territorial approach should be informed by the text of the statutory provision that imposes the registration or other regulatory requirement.<sup>138</sup> Some commenters suggested, for instance, that a territorial approach would necessarily exclude certain foreign operations of U.S. persons from registration as security-based swap dealers so long as they did not enter into security-based swap transactions with counterparties located

within the United States.<sup>139</sup> However, in this instance, these commenters did not show how their suggested approach relates to the statutory definition of security-based swap dealer or to the rules and interpretation adopted by the Commission and the CFTC to further define "security-based swap dealer" in the Intermediary Definitions Adopting Release, including our discussion of conduct that is indicative of dealing activity.<sup>140</sup> In our preliminary view, we should identify the activity that the statutory provision regulates before reaching a determination of whether relevant activity is occurring within the United States.<sup>141</sup> Only after we identify the activity that the statutory provision regulates would we then be able to determine whether the conduct at issue involves activity that the statutory provision regulates and whether this conduct occurs within the United States. To the extent that conduct involving activity that the statutory provision regulates occurs within the United States, application of Title VII to that conduct would be consistent with a territorial approach.

#### (b) Territorial Approach to Application of Title VII Security-Based Swap Dealer Registration Requirements

We discuss our application of this approach with respect to each of the major Title VII registration categories and requirements in connection with reporting, public dissemination, clearing, and trade execution for security-based swaps in further detail in the sections below,<sup>142</sup> but for sake of illustration, we provide a brief overview of our territorial approach as it applies to the security-based swap dealer definition.

Section 3(a)(71) of the Exchange Act<sup>143</sup> defines security-based swap dealer as a person that engages in any of the following types of activity:

- (i) Holding oneself out as a dealer in security-based swaps,
- (ii) making a market in security-based swaps,
- (iii) regularly entering into security-based swaps with counterparties as an ordinary course of business for one's own account,
- (iv) engaging in any activity causing oneself to be commonly known in the

<sup>133</sup> See, e.g., *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 846 (1986) (holding that "when Congress revisits a statute giving rise to a longstanding administrative interpretation without pertinent change, the 'congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress'").

<sup>134</sup> See, e.g., Cleary Letter IV at 33–37.

<sup>135</sup> See, e.g., Cleary Letter IV at 35; ISDA Letter I at 11; SIFMA Letter I at 5–6; Sullivan & Cromwell Letter at 11–13.

<sup>136</sup> See *Morrison*, 130 S. Ct. at 2884 (looking to the "focus" of the relevant statutory provision in determining whether the statute was being applied to domestic conduct).

<sup>137</sup> See Section II.A, *infra*.

<sup>138</sup> See *Morrison*, 130 S. Ct. at 2884 (performing a textual analysis of Section 10(b) of the Exchange Act to determine what conduct was relevant in determining whether the statute was being applied to domestic conduct).

<sup>139</sup> See, e.g., Sullivan & Cromwell Letter at 11.

<sup>140</sup> See note 135, *supra*; see also Intermediary Definitions Adopting Release, 77 FR 30616–19.

<sup>141</sup> See *Morrison*, 130 S. Ct. at 2884.

<sup>142</sup> See Sections III–VII, *infra* (discussing each major registration category), and Sections VIII–IX.A, *infra* (discussing certain requirements in connection with reporting and dissemination, clearing, and trade execution for security-based swaps).

<sup>143</sup> 15 U.S.C. 78c(a)(71).

trade as a dealer in security-based swaps.<sup>144</sup>

We have further interpreted this definition by jointly adopting interpretive guidance with the CFTC that identifies the types of activity that is relevant in determining whether a person is a security-based swap dealer.<sup>145</sup> In this interpretive guidance, we have identified indicia of security-based swap dealing activity to include the following activities:

- Providing liquidity to market professionals or other persons in connection with security-based swaps,
- seeking to profit by providing liquidity in connection with security-based swaps,
- providing advice in connection with security-based swaps or structuring security-based swaps,
- having a regular clientele and actively soliciting clients,
- using inter-dealer brokers, and
- acting as a market maker on an organized security-based swap exchange or trading system.<sup>146</sup>

As the foregoing list of relevant activities illustrates, both the statutory text and our interpretation of that text include within the security-based swap dealer definition a range of activities. The broad scope of activities listed above identifies various characteristics of dealing activity. Given the risks associated with dealing activity that the dealer definition and associated regulatory framework in Title VII are intended to address, we preliminarily believe that a territorial approach consistent with these statutory purposes should consider whether the entity performs any of these indicia of dealing activity within the United States (even if some of these indicia also arise in activity conducted outside the United States). This type of analysis appears to us more consistent with the statutory text and with the Supreme Court's approach to statutory analysis in its decision in *Morrison* than an approach that excludes from jurisdiction certain foreign operations of U.S. persons transacting with foreign counterparties. We also believe that our proposed approach would better help ensure that our regulatory framework achieves the various purposes of security-based swap dealer regulation under Title VII, while avoiding application of security-based swap dealer registration to persons whose dealing activity is unlikely to raise the types of dealer-specific risks

that Title VII dealer registration was intended to address because it occurs entirely outside the United States.<sup>147</sup>

Under our proposed territorial approach to the security-based swap dealer definition, as explained further below, we would require persons resident or organized in the United States, or with their principal place of business in the United States, to count all of their dealing transactions toward their *de minimis* threshold, including transactions that arise from dealing activity that occurs in part outside the United States (for example, because it is negotiated and executed through that person's foreign branch or office).<sup>148</sup>

An interpretation of Section 30(c) that advances the view that security-based swap activity conducted by a U.S. person through a foreign branch constitutes activity "without the jurisdiction of the United States" or that a transaction arising from such activity constitutes "transacting a business in security-based swaps without the jurisdiction of the United States" for purposes of Section 30(c) may not fully account for the statutory definition of "security-based swap dealer," the purposes of Title VII, or the global nature of the security-based swap market. It does not account for the entire range of activities performed by entities active in the security-based swap market, including security-based swap dealers, and the relevance of such activities to the statutory definitions and requirements, given the purposes of Title VII, and it would leave unaddressed significant levels of activity that poses precisely the sorts of

risks that Title VII was intended to address.

In our preliminary view, to the extent that a U.S. person engages in dealing activity through a foreign operation that is part of the U.S. legal person (such as a foreign branch or office), relevant activity for purposes of the security-based swap dealer definition occurs, at least in part, within the United States because we believe it is the U.S. entity as a whole, and not just the foreign branch or office, that is holding itself out as a dealer and making a market in security-based swaps. Moreover, it is necessarily the U.S. person as a whole that is seeking to profit by providing liquidity and engaging in market-making in security-based swaps, and it is the financial resources of the entire entity that enable it to provide liquidity and engage in market-making in connection with security-based swaps. Its dealing counterparties will look to the entire U.S. person, and not just the foreign branch or office, for performance on the transaction. The entire U.S. person assumes, and stands behind, the obligations arising from the resulting agreement. For these reasons, to the extent that a dealer resides or is organized, or has its principal place of business, within the United States, we believe that it cannot hold itself out as a security-based swap dealer, even through a foreign branch, as anything other than a single person, given that it generally could not operate as a dealer absent the financial and other resources of the entire U.S. person. Its dealing activity with all of its counterparties, including dealing activity conducted through its foreign branch or office, is best characterized as occurring, at least in part, within the United States and should therefore be counted toward the entity's *de minimis* threshold.

More generally, we preliminarily believe that transactions that create ongoing obligations that are borne by a U.S. person are properly described as directly occurring within the United States, particularly given Title VII's focus on, among other things, addressing risks to the financial stability of the United States.<sup>149</sup> Indeed, the history of AIG FP confirms that such transactions of U.S. persons can pose risks to the U.S. financial system even if they are conducted through foreign operations. The nature of such risks, and their role in the financial crisis and in the enactment of Title VII, suggest that the statutory framework established

<sup>144</sup> Section 3(a)(71)(A) of the Exchange Act, 15 U.S.C. 78c(a)(71)(A).

<sup>145</sup> See Intermediary Definitions Adopting Release, 77 FR 30617-18.

<sup>146</sup> *Id.*

<sup>147</sup> Under our proposed approach to the application of the *de minimis* threshold in the cross-border context, non-U.S. persons that engage in dealing activity with U.S. persons or otherwise within the United States at levels below the *de minimis* threshold generally would also not be required to register as security-based swap dealers. Such entities are engaged in dealing activity within the United States, and their dealing activity within the United States may raise certain concerns addressed by Title VII. However, we preliminarily believe that, to the extent that this dealing activity remains at levels below the *de minimis* threshold, they should be treated similarly to a U.S. person that engages in dealing activity at levels below the *de minimis* threshold. See Section III.B.4, *infra*. Like U.S. entities engaged in dealing activity, they may be required to register under the aggregation requirements the Commission and the CFTC adopted in the Intermediary Definitions Adopting Release, 77 FR 30631; 17 CFR 240.3a71-2(a)(1). Under the aggregation requirements we propose below, even entities with security-based swap dealing activity at levels below the *de minimis* threshold may be required to register if the total security-based swap dealing activity of affiliates under common control (excluding the activity of any registered affiliates that have independent operations) exceeds the *de minimis* threshold. See Section III.B.8, *infra*.

<sup>148</sup> See Section III.B.4, *infra*.

<sup>149</sup> As we discuss below, such activity would include providing guarantees for a foreign entity's security-based swap transactions. See Section II.B.2(d), *infra*.

by Congress and the objectives of Title VII may require a broader analysis than excluding transactions involving U.S. persons from the application of Title VII solely because they are conducted through operations outside the United States, while others by the same U.S. persons occur within the United States.<sup>150</sup>

However, we preliminarily believe that non-U.S. persons engaged in dealing activity would be required to count toward their *de minimis* thresholds only transactions arising from their dealing activity with U.S. persons<sup>151</sup> or dealing activity otherwise conducted within the United States. In addition, to the extent that a non-U.S. person engages in security-based swap dealing activity within the United States, we preliminarily believe that such dealing activity should be counted toward the non-U.S. person's *de minimis* threshold regardless of whether its counterparties are U.S. persons.<sup>152</sup> This view is consistent with the fact that such security-based swap activity raises the types of concerns that the Dodd-Frank Act was intended to address.

We preliminarily believe that a non-U.S. person not engaged in any security-based swap activity within the United States (or engaged only at levels below the *de minimis* threshold) is unlikely to pose the types of concerns within the U.S. financial system that Title VII dealer regulation was intended to address.<sup>153</sup> Thus, under our proposed approach, a non-U.S. person that engages in dealing activity entirely outside the United States (*i.e.*, does not enter into transactions with a U.S. person or otherwise conduct any part of its dealing activity within the United States) would not be required to register as a security-based swap dealer.<sup>154</sup>

<sup>150</sup> However, for reasons explained below, the Commission is not proposing to subject the foreign operations of U.S. persons to certain of the requirements in Title VII. *See, e.g.*, Sections III.B.7, III.B.9, VIII.C, IX.C.3(a), and X.B.3(a), *infra*.

<sup>151</sup> However, for reasons explained below, the Commission is not proposing to require non-U.S. persons to include transactions with the foreign branches of U.S. banks in their *de minimis* calculations. *See* Section III.B.7, *infra*.

<sup>152</sup> *See* Intermediary Definitions Adopting Release, 77 FR 30617–18.

<sup>153</sup> Proposed Rule 3a71–3(b) under the Exchange Act, as discussed in Section III.B.4, *infra*. Of course, the transactions of an entity engaged in security-based swap dealing activity within the United States at levels below the *de minimis* threshold or in security-based swap activity within the United States that is not dealing activity may be subject to other Title VII requirements, as discussed below, or other provisions of the federal securities laws.

<sup>154</sup> This proposed approach to the application of Title VII security-based swap dealer registration requirements is not intended to limit or address the cross-border reach or extraterritorial application of the antifraud or other provisions of the federal securities laws.

#### (c) Application of Other Title VII Requirements to Registered Entities

We are proposing to apply the Title VII requirements associated with registration (including, among others, capital and margin requirements and external business conduct requirements<sup>155</sup>) to the activities of registered entities to the extent we have determined that doing so advances the purposes of Title VII.<sup>156</sup> Although some commenters suggested that a territorial approach would prohibit the Commission from applying Title VII to the foreign security-based swap activities of even registered entities, such an interpretation of the application of Title VII to registered entities is difficult to reconcile with the statutory language describing the requirements applicable to registered security-based swap dealers, with the text of Section 30(c),<sup>157</sup> or with the purposes of Title VII and the nature of risks in the security-based swap market as described above. We have long taken the view that an entity that has registered with the Commission subjects itself to the entire regulatory system governing such registered entities.<sup>158</sup>

<sup>155</sup> *See* Section 15F of the Exchange Act, 15 U.S.C. 78o–10.

<sup>156</sup> *See, e.g.*, Sections III.C.3 and 4, *infra* (discussing requirements applicable to security-based swap dealers).

<sup>157</sup> Section 30(c) prohibits the application of the Exchange Act only with respect to those persons that “transact[] a business in security-based swaps without the jurisdiction of the United States.” Because only security-based swap entities that transact a business in security-based swaps within the United States would be required to register under the approach proposed in this release, registered entities are not persons that “transact[] a business in security-based swaps without the jurisdiction of the United States.”

<sup>158</sup> *See* Registration Requirements for Foreign Broker-Dealers, Exchange Act Release No. 27017 (July 11, 1989), 54 FR 30013, 30016–17 (July 18, 1989) (“Rule 15a–6 Adopting Release”) (noting that a foreign registrant is subject to the regulatory system applicable to such entities); Revision of Form BD, Exchange Act Release No. 25285 (Jan. 22, 1988) (“It is the Commission’s view that a broker-dealer submits to the Commission’s jurisdiction when it registers with the Commission.”); *In re International Paper and Power Co.*, 4 SEC 873, 876 (1939) (registration with the Commission makes registrant “subject to the complete jurisdiction of the Commission”). *See also* Exemption of Certain Foreign Brokers or Dealers, Exchange Act Release No. 58047 (June 27, 2008), 73 FR 39182 (July 8, 2008) (“Proposed Amendments to Rule 15a–6”), at 39182 (describing registration requirements as applying to the entire foreign entity); *In re Ira William Scott*, 53 SEC 862, 866 (1998) (holding that investment adviser that registers with the Commission has “submitted himself to [the Commission’s] jurisdiction pursuant to the Advisers Act”). *Cf. In re United Corp.*, 232 F.2d 601, 606 (1956) (stating that, upon registration as a holding company, an entity comes within “the jurisdiction of the Commission and [is] subject to all requirements applicable to a registered holding company”).

#### (d) Application of Title VII Regulatory Requirements to Transactions of Foreign Entities Receiving Guarantees From U.S. Persons

We also are proposing to apply certain Title VII transaction-level requirements (*e.g.*, mandatory clearing, reporting and dissemination, and mandatory trade execution of security-based swaps) to certain transactions involving one or more non-U.S. persons whose performance under the security-based swaps is guaranteed by a U.S. person. We discuss the statutory basis for applying specific Title VII requirements to such transactions in the relevant substantive discussions below.<sup>159</sup> In this subsection, we briefly explain why we believe that a territorial approach that is consistent with the purposes and text of the Dodd-Frank Act supports the application of Title VII to such transactions.

In a security-based swap transaction between two non-U.S. persons where the performance of at least one side of the transaction is guaranteed by a U.S. person, the guarantee gives the guaranteed entity’s counterparty direct recourse to the U.S. person for performance of obligations owed by the guaranteed entity under the security-based swap,<sup>160</sup> and the U.S. guarantor exposes itself to the security-based swap risk as if it were a direct counterparty to the security-based swap through the security-based swap activity engaged in by the guaranteed entity. As a result, the guarantee creates risk to the U.S. financial system and counterparties (including U.S. guarantors) to the same degree as if the transaction were entered into directly by a U.S. person. In addition, in many cases, the counterparty would not enter into the transaction (or would not do so on the same terms) with the guaranteed entity, and the guaranteed entity would not be able to engage in any security-based swaps, absent the presence of the guarantee. Given that the guarantee is

<sup>159</sup> *See* Sections VIII–XI, *infra*.

<sup>160</sup> In discussing the application of the major participant tests to guaranteed positions in the Intermediary Definitions Adopting Release, the Commission and the CFTC noted that an entity’s security-based swap positions are attributed to a parent, other affiliate, or guarantor for purposes of the major participant analysis to the extent that the counterparties to those positions have recourse to that parent, other affiliate, or guarantor in connection with the position. Positions are not attributed in the absence of recourse. *See* Intermediary Definitions Adopting Release, 77 FR 30689. As a result, the term “guarantee” as used in this release refers to a contractual agreement pursuant to which one party to a security-based swap transaction has recourse to its counterparty’s parent, other affiliate, or guarantor with respect to the counterparty’s obligations owed under the transaction.

provided by a U.S. person and poses risks to the U.S. financial system, and considering the reliance by both the guaranteed entity and its counterpart on the creditworthiness of the guarantor in the course of engaging in security-based swap transactions and for the duration of the security-based swap, we preliminarily believe that a transaction entered into by a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person is within the United States by virtue of the involvement of the U.S. guarantor in the security-based swap. Therefore, we preliminarily believe that subjecting such transactions to Title VII is consistent with our territorial approach.

(e) Regulations Necessary or Appropriate to Prevent Evasion of Title VII

As noted above, several commenters expressed the view that Section 30(c) of the Exchange Act restricts the Commission's authority to apply amendments made to the Exchange Act by Title VII to "extraterritorial" conduct. Section 30(c) provides the Commission with the express authority to prescribe rules and regulations for persons that transact a business in security-based swaps without the jurisdiction of the United States to the extent the Commission determines that doing so is necessary or appropriate to prevent evasion. Some commenters have expressed the view that this authority extends to "extraterritorial" activity only when such activity is intended to evade Title VII or to conceal a domestic violation of Title VII, suggesting that Section 30(c) prohibits application of Title VII to transactions by foreign affiliates or operations established for a legitimate business purpose, as the existence of such a purpose is evidence that the conduct is not intended to be evasive.<sup>161</sup>

While recognizing the concerns expressed by commenters, the Commission preliminarily believes that Section 30(c) does not require the Commission to find actual evasion in order to invoke our authority to reach activity "without the jurisdiction of the United States." Section 30(c) also does not require that every particular application of Title VII to security-based swap activity "without the jurisdiction of the United States" address *only* business that is transacted in a way that evades Title VII. Section 30(c) authorizes the Commission to apply Title VII to persons transacting a business "without the jurisdiction of the

United States" if they violate rules that the Commission has prescribed as "necessary or appropriate to prevent the evasion of any provision" of Title VII. The focus of this provision is not whether such rules impose Title VII requirements only on entities engaged in evasive activity but whether the rules are generally "necessary or appropriate" to prevent evasion of Title VII. In other words, Section 30(c) permits the Commission to impose prophylactic rules intended to prevent possible evasion, even if they affect both evasive and non-evasive conduct. Thus, under our preliminary proposed interpretation of Section 30(c), the statute permits us to prescribe such rules to conduct without the jurisdiction of the United States, even if those rules would also apply to a market participant that has been transacting business through a pre-existing market structure such as a foreign branch or guaranteed foreign affiliate established for valid business purposes, provided the proposed rule or interpretation is designed to prevent possible evasive conduct.<sup>162</sup>

*C. Principles Guiding Proposed Approach to Applying Title VII in the Cross-Border Context*

In considering how to apply Title VII in the cross-border context, the Commission has been mindful of the global nature of the security-based swap market and the types of risks created by security-based swap activity to the U.S. financial system and market participants, as well as the needs of a well-functioning security-based swap market.<sup>163</sup> We also have been guided by the purpose of the Dodd-Frank Act<sup>164</sup> and the applicable requirements of the Exchange Act, including the following:

- *Risk to the U.S. Financial System*—The Dodd-Frank Act was intended to promote, among other things, the financial stability of the United States by limiting/mitigating risks to the financial system.<sup>165</sup>
- *Transparency*—The Dodd-Frank Act was intended to promote

<sup>162</sup> We preliminarily believe that the proposed rules or interpretations set forth in this release are not being applied to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of Section 30(c). See Section II.B.2(a), *supra*. However, as noted below, the Commission also preliminarily believes that the proposed rules or interpretations are necessary or appropriate to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act and prophylactically will help ensure that the particular purposes of the Dodd-Frank Act addressed by the rule or interpretation are not undermined. See, e.g., note 558, *infra*.

<sup>163</sup> See Sections II.A.1–II.A.3, *supra*.

<sup>164</sup> See note 4, *supra*.

<sup>165</sup> See *id.*

transparency in the U.S. financial system.<sup>166</sup>

- *Counterparty Protection*—The Dodd-Frank Act adds provisions to the Exchange Act relating to counterparty protection, particularly with respect to "special entities."<sup>167</sup>

- *Economic Impacts*—The Exchange Act requires the Commission to consider the impact of our rulemakings on efficiency, competition, and capital formation.<sup>168</sup>

- *Harmonization with Other U.S. Regulators*—In connection with implementation of Title VII, the Dodd-Frank Act requires the Commission to consult and coordinate with the CFTC and prudential regulators to ensure "regulatory consistency and comparability, to the extent possible."<sup>169</sup>

- *Consistent International Standards*—To promote effective and consistent global regulation of swaps and security-based swaps, the Dodd-Frank Act requires the Commission and the CFTC to consult and coordinate with foreign regulatory authorities on the "establishment of consistent international standards" with respect to the regulation of swaps and security-based swaps.<sup>170</sup> In this regard, the Commission recognizes that regulators in other jurisdictions are currently engaged in implementing their own regulatory reforms of the OTC derivatives markets and that our proposed application of Title VII to cross-border activities may affect the policy decisions of these other regulators as they seek to address potential conflicts or duplication in the regulatory requirements that apply to

<sup>166</sup> See *id.*

<sup>167</sup> See Section 15F(h) of the Exchange Act, as added by Section 764(a) of the Dodd-Frank Act, in particular.

<sup>168</sup> Specifically, Section 3(f) of the Exchange Act provides: "Whenever pursuant to this title the Commission is engaged in rulemaking, . . . required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." Section 23(a)(2) of the Exchange Act also provides: "The Commission . . . in making rules and regulations pursuant to any provisions of this title, shall consider among other matters the impact any such rule or regulation would have on competition. The Commission . . . shall not adopt any such rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]."

<sup>169</sup> See Section 712(a)(2) of the Dodd-Frank Act.

<sup>170</sup> See Section 752(a) of the Dodd-Frank Act. In this regard, some commenters have encouraged the Commission to consider international comity when applying Title VII in the cross-border context. See note 225, *infra*.

<sup>161</sup> See, e.g., Cleary Letter IV at 5–6, 7, 18; Sullivan & Cromwell Letter at 6–7.

market participants under their authority.<sup>171</sup>

- *Anti-Evasion*—The Dodd-Frank Act amends the Exchange Act to provide the Commission with authority to prescribe rules and regulations as necessary or appropriate to prevent the evasion of any provision of the Exchange Act that was added by the Dodd-Frank Act.<sup>172</sup>

At times these principles reinforce one another; at other times they compete with each other. For instance, attempts to regulate risk posed to the United States may, depending on what is proposed, make it more costly for U.S.-based firms to conduct security-based swap business, particularly in foreign markets, compared to foreign firms, or could make foreign firms less willing to deal with U.S. persons. On the other hand, attempts to provide U.S. persons greater access to foreign security-based swap markets may, depending on what is proposed, fail to appropriately address the risk posed to the United States from transactions conducted outside the United States or create opportunities for market participants to evade the application of Title VII, particularly until such time as global initiatives to regulate the derivatives markets are fully enacted and implemented.

Balancing these sometimes competing principles is complicated by the fact that Title VII imposes a new regulatory regime on a marketplace that already exists as a functioning, global market. Title VII establishes reforms that will have implications for entities that compete internationally in the global security-based swap market. As we have formulated our proposal, we have generally sought, in accordance with the statutory factors described above, to avoid creating opportunities for regulatory arbitrage or evasion or the potential for duplicative or conflicting regulations. We also have considered the needs for a well-functioning security-based swap market and for avoiding disruption that may reduce liquidity, competition, efficiency, transparency, or stability in the security-based swap market.

#### D. Conclusion

Consistent with the principles and requirements outlined above, we are proposing to structure our

<sup>171</sup> For example, subjecting non-U.S. persons to Title VII may prompt a foreign jurisdiction to respond by subjecting U.S. persons to the foreign jurisdiction's regulatory regime. However, substituted compliance of the type proposed in this release or other mechanisms may address potential conflicts or duplication arising from overlapping regulatory requirements.

<sup>172</sup> See Section 30(c) of the Exchange Act, 15 U.S.C. 78dd(c), as discussed in Section II.B, *supra*.

implementation of Title VII around an approach that focuses on identifying market participants whose presence or activity within the United States or activity involving market participants within the United States may give rise to the types of risk to the U.S. financial system and counterparties that Title VII seeks to address, as described more fully below in the subsequent sections of the release.

#### Request for Comment

The Commission requests comment on all aspects of the discussion and analysis above, including the following:

- Is our understanding of the global nature of the security-based swap market accurate? If not, why not? Please elaborate.
- Is our understanding of the dealing structures used by U.S. and non-U.S. persons accurate? If not, why not? Are there other dealing structures used by market participants? If so, please elaborate.
- Is our understanding of clearing, reporting, and trade execution practices accurate? If not, why not? Please elaborate.
- As discussed above in Section II.B.1, some commenters recommend a narrower approach to the cross-border application of Title VII than this proposal sets forth. We request further comment on these and any other potential alternative approaches to determining the extent to which Title VII should be applied to cross-border transactions, non-U.S. persons, and registered entities.

### III. Security-Based Swap Dealers

#### A. Introduction

Among the market participants subject to regulation under Title VII as a result of their security-based swap activities are security-based swap dealers.<sup>173</sup> As discussed above, a “security-based swap dealer” generally is defined as any person that (i) Holds itself out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in security-based swaps.<sup>174</sup> The Commission, jointly with the CFTC,

<sup>173</sup> See Section 764(a) of the Dodd-Frank Act, codified as Section 15F of the Exchange Act, 15 U.S.C. 78o–10. See also Section IV, *infra* (discussing major security-based swap participants).

<sup>174</sup> See Section 3(a)(71) of the Exchange Act, 15 U.S.C. 78c(a)(71), as added by Section 761(a) of the Dodd-Frank Act; see also Section II.B.2(b), *supra*.

issued final rules and interpretive guidance to further define the term security-based swap dealer,<sup>175</sup> including rules implementing the *de minimis* exception.<sup>176</sup> As part of these final rules and interpretive guidance, the Commission stated that the relevant statutory provisions suggest that, rather than focusing solely on the risk these entities pose to the financial markets, we should interpret the “security-based swap dealer definition in a way that identifies those persons for which regulation is warranted either: (i) [D]ue to the nature of their interactions with counterparties; or (ii) to promote market stability and transparency, in light of the role those persons occupy within the security-based swap markets.”<sup>177</sup> Security-based swap dealers are subject to a comprehensive regulatory regime under Title VII. The statutory provisions added to the Exchange Act by Title VII are intended to provide for financial responsibility associated with security-based swap dealers’ activities (e.g., the ability to satisfy obligations and the protection of counterparties’ funds and assets), and other counterparty protections, as well as market stability and transparency.<sup>178</sup>

By its terms, application of the security-based swap dealer definition set forth in Section 3(a)(71) of the Exchange Act<sup>179</sup> does not depend on whether a security-based swap dealer or its counterparty is a U.S. person.<sup>180</sup> Rather, the security-based swap dealer definition encompasses persons engaged in security-based swap dealing activities without regard to the geographic location or legal residence of either the dealing person or such person’s counterparties. The Commission did not provide guidance on the application of the security-based swap dealer definition to non-U.S. persons or to U.S. persons that conduct dealing activities

<sup>175</sup> See Intermediary Definitions Adopting Release, 77 FR 30596; 17 CFR 240.3a71–1.

<sup>176</sup> Section 3(a)(71)(D) of the Exchange Act, 15 U.S.C. 78c(a)(71)(D), provides that “[t]he Commission shall exempt from designation as a security-based swap dealer an entity that engages in a de minimis quantity of security-based swap dealing in connection with transactions with or on behalf of its customers. The Commission shall promulgate regulations to establish factors with respect to the making of this determination to exempt.” This provision is implemented in Rule 3a71–2 under the Exchange Act (17 CFR 240.3a71–2), as discussed in the Intermediary Definitions Adopting Release, 77 FR 30626–43.

<sup>177</sup> Intermediary Definitions Adopting Release, 77 FR 30617.

<sup>178</sup> See Intermediary Definitions Adopting Release, 77 FR 30608; see also Section III.C.1, *infra* (discussing substantive requirements applicable to security-based swap dealers).

<sup>179</sup> 15 U.S.C. 78c(a)(71).

<sup>180</sup> See Section 3(a)(71) of the Exchange Act, 15 U.S.C. 78c(a)(71); 17 CFR 240.3a71–1.

in the cross-border context in either our proposed or final rules.<sup>181</sup> As discussed above<sup>182</sup> and as further discussed below, market participants, foreign regulators, and other interested parties have raised concerns regarding, among other things, the application of Title VII to non-U.S. persons that engage in security-based swap dealing activity and U.S. persons who conduct dealing activities “outside the United States.”<sup>183</sup>

The rules and interpretations described below represent the Commission’s proposed approach to applying the security-based swap dealer definition to non-U.S. persons and to U.S. persons who conduct dealing activities in the cross-border context in light of the principles discussed above.<sup>184</sup> Our proposal reflects a particular balancing of these principles, informed by, among other things, the particular nature of the security-based swap market,<sup>185</sup> the structure of security-based swap dealing activity,<sup>186</sup> and our experience in applying the federal securities laws in the cross-border context in the past.<sup>187</sup> We recognize that other approaches are possible to achieve the goals of the Dodd-Frank Act, in whole or in part. Accordingly, we invite comment regarding all aspects of the proposal described below, and each proposed rule and interpretation contained therein, including potential alternative approaches. Data and comment from market participants and other interested parties regarding the likely effect of each proposed rule and interpretation and potential alternative approaches will be particularly useful to the Commission in evaluating possible modifications to the proposal.

## B. Registration Requirement

### 1. Introduction

In the Intermediary Definitions Adopting Release, which was adopted jointly with the CFTC, the Commission set forth a *de minimis* threshold of security-based swap dealing that takes into account the notional amount of security-based swap positions

connected with a person’s security-based swap dealing activity over the prior 12 months.<sup>188</sup> When a person engages in security-based swap dealing in connection with transactions above that threshold, such person meets the definition of a security-based swap dealer under Section 3(a)(71) of the Exchange Act,<sup>189</sup> and the rules and regulations thereunder,<sup>190</sup> and is required to register as a security-based swap dealer with the Commission pursuant to Section 15F(a)(1) of the Exchange Act.<sup>191</sup>

The *de minimis* exception in Section 3(a)(71) of the Exchange Act is silent on its application to the cross-border security-based swap dealing activity of U.S. persons and non-U.S. persons, and the Commission did not address this issue in the Intermediary Definitions Adopting Release.<sup>192</sup> Without additional Commission guidance, it would be unclear how persons would be required to calculate the notional amount of their security-based swaps for purposes of the *de minimis* exception based on their global book of security-based swap dealing activity. In addition, as discussed below, commenters have

<sup>188</sup> See Intermediary Definitions Adopting Release, 77 FR 30626–43. The *de minimis* threshold was adopted by the Commission in the Intermediary Definitions Adopting Release to implement a statutory exclusion from the security-based swap dealer definition found in Section 3(a)(71)(D) of the Exchange Act. See note 176, *supra*. The *de minimis* threshold is defined in terms of a notional amount of security-based swap positions connected with dealing activity in which a person engages over the course of the immediately preceding 12 months. An entity engaged in security-based swap dealing activity in connection with security-based swap transactions with or on behalf of its customers below the *de minimis* threshold amount is exempt from designation as a security-based swap dealer. See Intermediary Definitions Adopting Release, 77 FR 30626.

<sup>189</sup> 15 U.S.C. 78c(3)(a)(71).

<sup>190</sup> 17 CFR 240.3a71–1 and 240.3a71–2.

<sup>191</sup> Section 15F(a)(1) of the Exchange Act provides that “[i]t shall be unlawful for any person to act as a security-based swap dealer unless the person is registered as a security-based swap dealer with the Commission.” 15 U.S.C. 78o–10(a)(1). A person that engages in security-based swap dealing activity in connection with transactions with or on behalf of customers in excess of the *de minimis* threshold falls within the security-based swap dealer definition, and such person must register as a security-based swap dealer pursuant to Section 15F(a)(1). By contrast, persons that fall within the statutory definitions of a broker and dealer in Sections 3(a)(4) and (5) of the Exchange Act, 15 U.S.C. 78c(a)(4) and (a)(5), are required to register with the Commission only if they make use of the “mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security. . . .” Section 15(a)(1) of the Exchange Act, 15 U.S.C. 78o(a)(1).

<sup>192</sup> See Intermediary Definitions Adopting Release, 77 FR 30628 n.407 (indicating that the Commission and the CFTC intended to address the application of the Title VII dealer regime to non-U.S. persons in separate releases).

raised questions regarding how the *de minimis* threshold should be applied in the cross-border context, expressing concern that, among other things, if a non-U.S. person were required to register as a security-based swap dealer with the Commission because its security-based swap dealing activity exceeded the *de minimis* threshold, it might be subject to duplicative and potentially conflicting requirements by the Commission and a foreign jurisdiction.<sup>193</sup>

Under the Commission’s proposal, as described more fully in the following subsections of this release, a non-U.S. person<sup>194</sup> would be required to register as a security-based swap dealer with the Commission pursuant to Section 15F(a)(1) of the Exchange Act<sup>195</sup> if the notional amount of security-based swap positions connected with its security-based swap dealing activity<sup>196</sup> with U.S. persons (other than with foreign branches of U.S. banks)<sup>197</sup> or otherwise conducted within the United States<sup>198</sup> exceeds the *de minimis* threshold in the security-based swap dealer definition.<sup>199</sup> Thus, a non-U.S. person with a global security-based swap dealing business, but whose positions connected with its security-based swap dealing activity with U.S. persons (other than with foreign branches of U.S. banks) or otherwise conducted within the United States fall below the *de minimis* threshold, would not be required to register with the Commission as a security-based swap dealer.<sup>200</sup> A U.S. person, by contrast, would be required to count all of its security-based swap transactions (including transactions conducted

<sup>193</sup> See Section III.B.2, *infra*.

<sup>194</sup> Proposed Rule 3a71–3(a)(7) under the Exchange Act (defining “U.S. person”), as discussed in Section III.B.5, *infra*.

<sup>195</sup> 15 U.S.C. 78o–10(a)(1).

<sup>196</sup> See note 188, *supra*.

<sup>197</sup> Proposed Rule 3a71–3(a)(1) under the Exchange Act (defining “foreign branch”), as discussed in Section III.B.7, *infra*.

<sup>198</sup> Proposed Rule 3a71–3(a)(5) under the Exchange Act (defining “transaction conducted within the United States”), as discussed in Section III.B.6, *infra*. This provision would capture dealing activity undertaken by non-U.S. persons that are physically located within the United States, such as through a U.S. branch of a foreign bank, or through an agent, such as non-U.S. person’s U.S. subsidiary or an unaffiliated third party acting on the non-U.S. person’s behalf. As discussed elsewhere in the release, foreign security-based swap dealers utilize these organizational models as part of their global security-based swap dealing businesses. See Section II.A.2, *supra* (discussing dealing structures), and Section III.D, *infra* (discussing intermediation).

<sup>199</sup> Proposed Rule 3a71–3(b)(1)(ii) under the Exchange Act.

<sup>200</sup> *But see* Section III.B.9, *infra* (discussing the aggregation of affiliate positions).

<sup>181</sup> See Intermediary Definitions Adopting Release, 77 FR 30596; Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant,” Exchange Act Release No. 63452 (Dec. 7, 2010), 75 FR 80174 (Dec. 21, 2010) (“Intermediary Definitions Proposing Release”).

<sup>182</sup> See Section II.B, *supra*.

<sup>183</sup> See Section III.B.3, *infra*.

<sup>184</sup> See Section II.C, *supra*.

<sup>185</sup> See Section II.A, *supra*.

<sup>186</sup> See Section II.A.2, *supra*.

<sup>187</sup> See Section III.B.2, *infra*.



through a foreign branch),<sup>201</sup> conducted in a dealing capacity, toward the *de minimis* threshold to determine whether it would be required to register as a security-based swap dealer with the Commission pursuant to Section 15F(a)(1) of the Exchange Act.<sup>202</sup>

As further discussed below, however, we are not proposing to require a non-U.S. person engaged in security-based swap dealing activity to count a transaction with a non-U.S. person conducted outside the United States toward its *de minimis* threshold, even if its performance (or the performance of its counterparty) on the security-based swap is guaranteed by a U.S. person.<sup>203</sup> In addition, in conformity with the position that the Commissions took in the Intermediary Definitions Adopting Release,<sup>204</sup> we are not proposing to require cross-border security-based swap transactions between majority-owned affiliates to be considered when determining whether a person is a security-based swap dealer.<sup>205</sup>

In the following subsections, we first briefly discuss the Commission's approach to the registration of foreign brokers and dealers, as background, and the views of commenters on the application of Title VII to cross-border activities, particularly as such views relate to security-based swap dealing activity. Then we propose a rule regarding the application of the *de minimis* exception to cross-border security-based swap dealing activity.<sup>206</sup> In order to give further definition to this proposed rule, we are proposing rules defining a number of relevant terms, including "U.S. person"<sup>207</sup> and

<sup>201</sup> Proposed Rule 3a71-3(a)(4) under the Exchange Act (defining "transaction conducted through a foreign branch"), as discussed in Section III.C.4, *infra*.

<sup>202</sup> Proposed Rule 3a71-3(b)(1)(i) under the Exchange Act.

<sup>203</sup> See Section III.B.8, *infra*. However, such U.S. guarantor may become a major security-based swap participant by virtue of the guarantee it extends on the performance of the obligations under the transaction. See Section IV.C.2, *infra*. In addition, a security-based swap entered into by a non-U.S. person whose performance under such security-based swap is guaranteed by a U.S. person would be required to be reported and, in certain cases, publicly disseminated, under re-proposed Regulation SBSR. See Section VIII.C, *infra*. Such security-based swap also may be subject to the clearing and trade execution requirements in Title VII. See Sections IX and X, *infra*.

<sup>204</sup> See Intermediary Definitions Adopting Release, 77 FR 30624-25.

<sup>205</sup> See Section III.B.8, *infra*.

<sup>206</sup> Proposed Rule 3a71-3(b) under the Exchange Act, as discussed in Section III.B.4, *infra*.

<sup>207</sup> Proposed Rule 3a71-3(a)(7) under the Exchange Act, as discussed in Section III.B.5, *infra*. The proposed definition of U.S. person is used not only in the proposed rule regarding the application of the *de minimis* threshold in the cross-border context, but also in proposed rules discussed in subsequent sections of the release.

"transaction conducted within the United States."<sup>208</sup> We also are proposing a rule excluding from a non-U.S. person's *de minimis* calculation security-based swap transactions entered into, in a dealing capacity, with a foreign branch of a U.S. bank.<sup>209</sup> In addition, we are proposing a rule providing an exception from the aggregation requirement, in the context of the security-based swap dealer definition, for affiliated groups with a registered security-based swap dealer.<sup>210</sup> Finally, we are proposing interpretive guidance regarding and requesting comment on the treatment of inter-affiliate and guaranteed transactions in the cross-border context for purposes of the *de minimis* threshold.<sup>211</sup>

## 2. Background Discussion Regarding the Registration of Foreign Brokers and Dealers

Under the Commission's traditional approach to the registration of brokers and dealers under the Exchange Act, registration and other requirements generally are triggered by a broker or dealer physically operating in the United States, even if such activities are directed only to non-U.S. persons outside the United States.<sup>212</sup> The Commission's territorial approach also generally requires broker-dealer registration by foreign brokers or dealers that, from outside the United States,

<sup>208</sup> Proposed Rule 3a71-3(a)(5) under the Exchange Act, as discussed in Section III.B.6, *infra*. Like the proposed definition of U.S. person, the definition of "transaction conducted within the United States" is used not only in the proposed rule regarding the application of the *de minimis* threshold in the cross-border context, but also in proposed rules discussed in subsequent sections of the release. In general, under the Commission's proposal, transactions conducted within the United States, as defined in the proposed rule, would trigger certain transaction-level requirements in Title VII. See Sections VIII-X, *infra*.

<sup>209</sup> Proposed Rule 3a71-3(b)(1)(ii) under the Exchange Act; see also proposed Rule 3a71-3(a)(1) under the Exchange Act (defining "foreign branch"), as discussed in Section III.B.7, *infra*.

<sup>210</sup> Proposed Rule 3a71-4 under the Exchange Act, as discussed in Section III.B.8, *infra*.

<sup>211</sup> See Section III.B.8, *infra*.

<sup>212</sup> See Rule 15a-6 Adopting Release, 54 FR 30016-17 ("As a policy matter, the Commission now uses a territorial approach in applying the broker-dealer registration requirements to the international operations of broker-dealers. Under this approach, all broker-dealers physically operating within the United States that effect, induce, or attempt to induce any securities transactions would be required to register as broker-dealers with the Commission, even if these activities were directed only to foreign investors outside the United States."); see also Proposed Amendments to Rule 15a-6, 73 FR 39182 ("Under this [territorial] approach, broker-dealers located outside the United States that induce or attempt to induce securities transactions with persons in the United States are required to register with the Commission, unless an exemption applies").

induce or attempt to induce securities transactions by persons within the United States.<sup>213</sup> By contrast, the Commission has not required foreign entities to register as broker-dealers if they conduct their "sales activities" entirely outside the United States.<sup>214</sup>

In addition to our territorial approach to registration of broker-dealers under the Exchange Act, the Commission traditionally has taken an "entity" approach to the application of regulation to registered broker-dealers.<sup>215</sup> Pursuant to this approach, we have not limited the application of the Exchange Act, and rules and regulations thereunder, solely to the transactions of such entities that result in the registration requirement. Instead, we have taken the position that a registered broker-dealer is generally subject to registration and consequent substantive requirements with respect to all of its securities activity, including the activity of its branches and offices, regardless of whether the activity occurs in the United States or with U.S. persons.<sup>216</sup> For instance, under this approach, if a foreign broker-dealer is required to register with the Commission as a result of conducting securities activity through a branch in the United States, the registration requirements and the regulatory system governing U.S. broker-dealers, including capital, margin, and recordkeeping requirements, would apply to the entire foreign broker-dealer entity, including its head office, not just the U.S. branch.<sup>217</sup> By contrast, the Commission

<sup>213</sup> See Rule 15a-6 Adopting Release, 54 FR 30016 ("[E]ven if section 30(b) [of the Exchange Act] were read to incorporate a territorial approach, the Commission does not believe that section 30(b) would exempt from broker-dealer registration the activities suggested by the commenters. In particular, directed selling efforts to U.S. investors in the United States hardly could be considered activities not traversing the U.S. territorial limits. A broker-dealer operating outside the physical boundaries of the United States, but using the U.S. mails, wires, or telephone lines to trade securities with U.S. persons located in this country, would not be, in the words of section 30(b), 'transact[ing] a business in securities without the jurisdiction of the United States.'")

<sup>214</sup> See Rule 15a-6 Adopting Release, 54 FR 30016 (citing Exchange Act Release No. 25801, 53 FR 23646 n.9, and accompanying text).

<sup>215</sup> See Rule 15a-6 Adopting Release, 54 FR 30017 ("Also, the Commission uses an entity approach with respect to registered broker-dealers"); see also Proposed Amendments to Rule 15a-6, 73 FR 39182 ("Because this territorial approach applies on an entity level, not a branch level, if a foreign broker-dealer establishes a branch in the United States, broker-dealer registration requirements would extend to the entire foreign broker-dealer entity.")

<sup>216</sup> As noted above, this is consistent with the approach we have taken in other contexts under the federal securities laws. See note 158, *supra*.

<sup>217</sup> See Rule 15a-6 Adopting Release, 54 FR 30017.



traditionally has not extended our regulatory oversight of broker-dealers to the activities of their corporate parents, subsidiaries, or other affiliates.<sup>218</sup>

The Commission's approach to registration and regulation of foreign broker-dealers thus extends Commission oversight to the global activities of non-U.S.-based securities market intermediaries that are registered broker-dealers because of their securities activities with U.S. persons or that physically operate within the United States.<sup>219</sup> In recognition of the internationalization of securities markets, however, the Commission has used available exemptive authority to tailor rules and regulations to the specific circumstances of foreign markets and market participants. For example, we used our exemptive authority under Section 15(a)(2) of the Exchange Act to adopt Rule 15a-6 under the Exchange Act ("Rule 15a-6"),<sup>220</sup> which provides limited exemptions from registration to foreign brokers or dealers engaging in securities transactions, or offering to engage in securities transactions, within the United States or with U.S. persons, subject to certain conditions.<sup>221</sup>

### 3. Comment Summary

#### (a) Market Participants

As noted above, various commenters expressed concerns about the "extraterritorial" application of Title VII, and many of these commenters expressed particular concerns about the possible extraterritorial application of security-based swap dealer regulation and registration requirements.<sup>222</sup> In addition to concerns described above regarding the application of Title VII to

<sup>218</sup> See *id.* ("If the foreign broker-dealer establishes an affiliate in the United States, however, only the affiliate must be registered as a broker-dealer; the foreign broker-dealer parent would not be required to register."); see also Proposed Amendments to Rule 15a-6, 73 FR 39182. As discussed in Section III.B.89, *infra*, this is consistent with the approach that the Commission is proposing to take in the context of security-based swap dealer registration.

<sup>219</sup> See Rule 15a-6 Adopting Release, 54 FR 30017.

<sup>220</sup> 17 CFR 240.15a-6.

<sup>221</sup> See Rule 15a-6 Adopting Release, 54 FR 30013. As discussed below, some commenters have suggested that the Commission use an approach that would be modeled after the approach the Commission has applied to foreign broker-dealers in Rule 15a-6 to address issues related to cross-border security-based swap transactions and foreign security-based swap dealers.

<sup>222</sup> See *e.g.*, ACP/AMF Letter, BaFin Letter, Cleary Letter IV, Davis Polk Letter I, Davis Polk Letter II, IIB Letter, ISDA Letter I, Japanese Banks Letter, JFSA Letter I, Newedge Letter, Rabobank Letter, Société Générale Letter I, SIFMA Letter, Société Générale Letter II, Sullivan & Cromwell Letter, and TCX Letter.

cross-border security-based swap activity,<sup>223</sup> commenters noted that the derivatives industry functions in a global market and that new regulations pose the potential to disrupt this market if they do not take into account the nature of the industry and the appropriate extraterritorial reach of the regulations.<sup>224</sup> A consistent theme in many of these comment letters was the importance of taking into account the principles of international comity in limiting the extraterritorial reach of the proposed rules, including entering into coordination agreements with our foreign regulatory counterparts on the jurisdictional reach of U.S. and foreign derivatives rules.<sup>225</sup>

For example, a number of commenters recommended that the Commission take a territorial approach in determining when a person engaging in security-based swap dealing activity would be required to register with the Commission as a security-based swap dealer, generally recommending registration of an entity for its security-based swaps dealing activity from within the United States or with regard to its dealings with U.S. counterparties.<sup>226</sup> Several commenters

<sup>223</sup> See Section II.B, *supra*.

<sup>224</sup> See Section II.B, *supra*; see also ISDA Letter I at 17 (urging that the new regulations be implemented so as to not distort the current global derivatives market that functions "within a relatively level international playing field," and noting that to address concerns related to competition and conflicts between various regulators and regulations "[i]t is imperative that U.S. and non-U.S. regulators must coordinate requirements to avoid unintended impediments to, and fragmentation of, the derivatives markets").

<sup>225</sup> See, *e.g.*, Davis Polk Letter II at 12 (recommending that in implementing Title VII regulations, "the Commissions and the Federal Reserve should also give effect to the general jurisdictional limits specified in Sections 722 and 772 of the Dodd-Frank Act in a manner that is consistent with the principle of international comity evident in the statute and general legal principles governing statutory construction pertaining to extraterritorial and international matters"); Société Générale Letter I at 8, 11 (recommending U.S. and foreign counterparts to work toward a memorandum of understanding on the jurisdictional reach of U.S. and EU derivatives rules and warning that without cooperation between the U.S. and foreign regulators the result could be "regulatory retaliation" whereby "the [s]waps market could devolve into regulatory chaos, thereby increasing systemic risk"); Newedge Letter at 10-12 (expressing concern that requiring foreign firms to register as swaps dealers or major swap participants in the U.S. "could result in foreign regulators taking retaliatory action against U.S. firms engaging in swap activities with non-U.S. persons domiciled within their physical borders" and that any regulation of foreign firms not physically present in the United States that are already subject to foreign regulations is unnecessary and would violate principles of international comity).

<sup>226</sup> See, *e.g.*, Sullivan & Cromwell Letter at 11 ("The SEC has, in the past, plainly stated that it uses a territorial approach in applying broker-dealer

further suggested that a non-U.S. person's *de minimis* amount of swap activities with U.S. persons should not trigger security-based swap dealer registration.<sup>227</sup> Some commenters expressed the view that the Commission's cross-border framework should seek to avoid imposing duplicative regulation and unnecessary cost on entities that are already regulated in a foreign jurisdiction.<sup>228</sup> Some commenters have suggested that the Commission use an approach that would be modeled after the approach the Commission has applied to foreign broker-dealers in Rule 15a-6 to address issues related to cross-border security-

registration requirements to international operations. Only those broker-dealers who induce, or attempt to induce, securities transactions with persons in the United States would be required to register."); MFA Letter II at 15-16 (commenting that the proposed security-based swap dealer and major security-based swap participant rules do not appear to encompass trading outside of the U.S. between non-U.S. entities or non-U.S. affiliates of U.S. entities, and adding that the rules also should not capture the non-U.S. affiliates of U.S. investment managers that advise offshore funds, or non-U.S.-domiciled funds that have U.S. investment managers but trade in swaps referencing non-U.S. securities or on a non-U.S. market, considering that foreign regulators will have jurisdiction over the non-U.S. activities of U.S. entities); IIB Letter at 9 (urging the Commission to adopt an interpretation that a "reference to a U.S. underlier or reference entity in a swap conducted outside the U.S. [is not] a sufficient connection to the U.S. to subject either counterparty to U.S. Swap Dealer registration requirements"); Newedge Letter at 2 (suggesting that foreign entities engaging in swaps transactions "with US persons should not be required to register as swaps dealers or major swaps participants in the US to the extent they are not physically located in the US and are subject to a comparable regulatory regime").

<sup>227</sup> See, *e.g.*, Sullivan & Cromwell Letter at 2, 8 (acknowledging that a foreign entity's swaps transactions with U.S. persons in excess of the *de minimis* amount, "if otherwise covered by the definitions, [should] be required to register" as a swaps entity, but suggesting that swaps activities with U.S. persons within "any *de minimis* amount authorized by the final rules and in transactions with their U.S. affiliates for purposes of risk management" should not trigger swaps entity registration); TCX Letter at 6 ("We are concerned that, should TCX become subject to swap dealer registration notwithstanding the arguments presented above, the *de minimis* exception as proposed in the [Intermediary Definitions Proposing Release] has been drafted too narrowly to be of any practical use to TCXIM or to any other similarly-situated offshore entity with limited US swaps business. In particular, we urge the Commission to clarify that an offshore entity's swaps with US counterparties, excluding non-US subsidiaries of US entities, must be counted when determining if the *de minimis* exemption is available.");

<sup>228</sup> See, *e.g.*, IIB Letter at 7 (suggesting that the "Commissions should establish a framework for cross-border swap activities that preserves and leverages the strengths of existing market practices and home country supervision and regulation" and "avoid a framework that is duplicative, inefficient (for supervisors and market participants) and would result in unrealistic extraterritorial supervisory responsibilities for the Commissions and potential fragmentation of the derivatives markets").

based swap transactions and foreign security-based swap dealers.<sup>229</sup>

For purposes of analyzing the appropriate definition of U.S. person in the security-based swap dealer context, several commenters suggested that the Commission look to rules adopted under the Securities Act and adopt a definition of U.S. person based on Regulation S under the Securities Act ("Regulation S").<sup>230</sup> Some commenters stated the view that under Regulation S, only affiliates or branches located within the United States would be considered U.S. persons.<sup>231</sup> Some commenters argued that a foreign affiliate of a U.S. person and non-U.S. branches of a U.S. bank should be treated as non-U.S. persons and, depending on their dealing activity, not be required to register as security-based swap dealers because such entities may not have direct and significant connection with, or effect on, U.S. commerce.<sup>232</sup> One commenter further argued that a non-U.S. affiliate of a U.S. person, in its insolvency, is subject to separate resolution from its parent, and thus should be treated as a non-U.S. entity.<sup>233</sup>

<sup>229</sup> See, e.g., Davis Polk Letter I at 11 n.17 ("This model is similar to the mode of operation permitted by Rule 15a-6 under the Securities Exchange Act of 1934, pursuant to which foreign broker-dealers interface with U.S. customers under arrangements with affiliated or non-affiliated broker-dealers without themselves registering as broker-dealers in the U.S."); Cleary Letter IV at 22 ("Accordingly, as one alternative, we suggest that the Commissions adopt an approach that is modeled on the Commissions' existing regimes, permitting non-U.S. swap dealers to transact with U.S. persons without registering in the U.S. if those transactions are intermediated by a U.S.-registered swap dealer. This would be consistent with the approach adopted by the SEC under Rule 15a-6 and prior interpretative precedents with respect to non-U.S. securities dealers.").

<sup>230</sup> See 17 CFR 230.901(k). See, e.g., Cleary Letter IV at 2, 6-9; Davis Polk Letter I at note 6.

<sup>231</sup> See, e.g., Cleary Letter IV at 7 (stating that "Regulation S does not include as a 'U.S. person' the non-U.S. branch or affiliate of a U.S. or non-U.S. person; only affiliates or branches located in the U.S. are covered"); SIFMA Letter at 5 (stating that "It is noteworthy that the Regulation S definition of U.S. person does not include non-U.S. affiliates of U.S. persons or non-U.S. branches of a U.S. bank . . .").

<sup>232</sup> See, e.g., Sullivan & Cromwell Letter at 2-3, 6-9 (arguing against the extraterritorial application to foreign affiliates of a U.S. person, stating that when a foreign entity's "counterparty to a transaction is a non-U.S. affiliate of a U.S. person," the transactions are "removed from the U.S. stream of commerce. As a result, there is no 'direct' effect on U.S. commerce and it is highly unlikely that the transactions would have any significant effect on U.S. commerce"); ISDA Letter I at 11 (stating that "Non-U.S. entities (including non-U.S. affiliates and branches of U.S. banks) should not be required to register as Dealers where they are conducting business with non-U.S. counterparties.").

<sup>233</sup> See Cleary Letter IV at 7 ("The non-U.S. affiliate of a U.S. person is, in its own insolvency or that of its parent, typically subject to separate resolution from its parent and other affiliates").

Several commenters stated that a foreign branch or office of a U.S. person also should be treated as a non-U.S. person, despite the fact that, as a few commenters acknowledged, foreign branches of U.S. banks are not separate legal entities from their U.S. head office and typically are not separately capitalized, although in some cases they may be subject to certain local capital or reserve maintenance requirements.<sup>234</sup> Several commenters suggested that broker-dealer registration, not security-based swap dealer registration, may be more appropriate for a U.S. branch, agency, or affiliate that acts as an agent of a non-U.S. person for security-based swaps transactions.<sup>235</sup>

Several commenters acknowledged concerns that persons may seek to book transactions through non-U.S. branches or subsidiaries in an effort to evade the requirements of Title VII.<sup>236</sup> These

<sup>234</sup> See, e.g., Cleary Letter IV at 7 (arguing that "[a]lthough bank branches are not usually separately capitalized," they should not be considered U.S. persons because their operations are subject to separate local licensing, examination, and books and records requirements); SIFMA Letter I at 15 n.37 ("We acknowledge that Title VII capital requirements cannot be applied at the branch-level and, therefore, must be applied at the bank level."); Sullivan & Cromwell Letter at 16 (remarking that "foreign branches have long been allowed to engage in a wider range of activities than are their U.S. head offices and have benefitted from the presumption against applying U.S. law extraterritorially" despite the fact that "foreign branches of U.S. banks are not corporate entities separate and apart from their bank parents").

<sup>235</sup> See, e.g., IIB Letter at 10 (suggesting that a U.S.-based person who acts as an agent for a non-U.S. person in soliciting or negotiating security-based swap transactions with counterparties located outside of the U.S. should register as a broker-dealer); Rabobank Letter at 3 (recommending that U.S. affiliates who help to arrange swaps transactions with U.S. persons should "register as futures commissions merchants or introducing brokers, broker-dealers, or swap dealers depending upon their respective roles in soliciting transactions, receiving customer margin, performing delegated compliance functions, effecting transactions as an agent on exchanges and swap execution facilities and in OTC markets, or clearing customer transactions"); cf. Newedge Letter at 1-2 (asserting that broker-dealers and foreign entities subject to comparable regulations who "engage principally in customer [security-based] swap facilitation activities" should not be subject to security-based swap dealer and major security-based swaps participant registration requirements because they already are "subject to stringent rules relating to capital, risk, margin and other requirements by virtue of their registration status"; and alternatively, suggesting that registrants who "execute swaps solely in response to customer orders and that hedge each such transactions individually . . . should be exempt since, among other things, their trading poses little or no risk to themselves, their customers or the markets generally.").

<sup>236</sup> See, e.g., Sullivan & Cromwell Letter at 10 ("We understand the concerns that the Commission may have that persons would seek to book transactions through non-U.S. branches or subsidiaries in order to evade the requirements of the CEA or Exchange Act.").

commenters, however, urged that the Commissions not seek to address the potential for evasion through an overbroad definition of a security-based swap dealer, noting that there are legitimate business reasons for conducting security-based swap transactions with non-U.S. persons through non-U.S. operations.<sup>237</sup>

#### (b) Foreign Regulators

Foreign regulators have reached out to the Commission through correspondence and bilateral and multilateral discussions to better understand the approach being considered by the Commission, to express concern about the potential impact of potential approaches on their markets, and to seek regulatory coordination.<sup>238</sup> One of the principal concerns of foreign regulators is that the Commission would require foreign entities to register with the Commission and subject them to regulatory requirements that are duplicative of, or potentially conflict with, the requirements imposed by their home country or host country.<sup>239</sup> In their view, the Commission's application of Title VII requirements to foreign entities in jurisdictions that commit to developing or have developed similar OTC derivatives regulations would fail to acknowledge, under general principles of international comity, the effectiveness, suitability, and scope of foreign regulatory regimes and place undue regulatory burdens on foreign

<sup>237</sup> See, e.g., Sullivan & Cromwell Letter at 9-10 (expressing understanding for the Commissions' evasion concerns, but noting that U.S. companies have legitimate business reasons for establishing their non-U.S. operations, including requirements in some foreign jurisdictions that only local banks and local branches of foreign banks may engage in swap activities); Cleary Letter IV at 5-7 (noting legitimate business reasons for establishing non-U.S. operations abroad, and stating that the Commissions "should not adopt an extraterritorial regulatory framework premised on the assumption that activities conducted outside the U.S. will be undertaken for the purpose of evasion").

<sup>238</sup> See, e.g., BaFIN Letter at 1-2 ("Close cooperation of our respective authorities, accompanied by a Memorandum of Understanding, might help to establish an adequate regulatory environment for the swap activities of US and German entities and to provide the confidence that the respective national legislation is adequately recognized and complied with.").

<sup>239</sup> See, e.g., JFSA Letter I at 1-2 (requesting that Japanese financial institutions be exempted from "Swap Dealer" and "Major Swap Participant" registration under the Dodd-Frank Act); BaFIN Letter at 1 ("The obligations for foreign banks should be proportionate and take into account equivalent requirements in their home jurisdiction."). See also ECB Letter at 2 (expressing concern about the "possible inconsistency between US and EU legislation with respect to differing rules on exempting public international institutions . . . from the clearing and reporting obligation.").

entities that conduct security-based swap business with U.S. persons.<sup>240</sup>

Such concerns from foreign regulators include comments that U.S. regulators should not ask financial institutions domiciled in their jurisdictions to register as security-based swap dealers because this would create undesirable redundancies for those financial institutions that are already regulated in the foreign jurisdiction.<sup>241</sup> Certain foreign regulators also argued that the Commission should not regulate foreign subsidiaries of U.S. security-based swap dealers because these entities would already be regulated by a foreign regulator.<sup>242</sup> Some foreign regulators expressed the expectation that the Commission would limit the registration of foreign banks as security-based swap dealers to operations conducting activities with U.S. counterparties or clients and would not apply the registration and regulation requirements to foreign banks as a whole.<sup>243</sup>

#### 4. Application of the *De Minimis* Exception to Cross-Border Security-Based Swap Dealing Activity

The Commission recognizes the concerns raised by commenters regarding the potential for imposing inconsistent or conflicting requirements on security-based swap dealers with global operations, as well as their desire that the Commission take into account the principles of international comity when applying Title VII to cross-border dealing activity. After considering the goals of the Dodd-Frank Act and the scope of the provisions of Title VII covering security-based swap dealers, in light of the global nature of the security-based swap market, the various structures of dealing operations, and the views of commenters, the Commission is proposing an approach to the application of the Title VII registration

requirement to cross-border security-based swap dealing activity that focuses on whether dealing conduct occurs with U.S. persons or otherwise occurs within the United States.

Specifically, as explained below, the Commission is proposing to require a non-U.S. person engaged in security-based swap dealing activity to register with the Commission as a security-based swap dealer pursuant to Section 15F(a)(1) of the Exchange Act<sup>244</sup> if the notional amount of security-based swap transactions connected with its dealing activity with U.S. persons (other than with foreign branches of U.S. banks)<sup>245</sup> or otherwise conducted within the United States<sup>246</sup> exceeds the *de minimis* threshold in the security-based swap dealer definition.<sup>247</sup> A U.S. person engaged in security-based swap dealing activity would be required to count all security-based swap transactions connected with its dealing activity toward the *de minimis* threshold, including transactions conducted through a foreign branch.<sup>248</sup>

##### (a) Meaning of the Term “Person” in the Security-Based Swap Dealer Definition

As a preliminary matter, we note that, as the Commission discussed in the Intermediary Definitions Adopting Release, the term “person” as used in the security-based swap dealer definition should be interpreted to refer to a particular legal person.<sup>249</sup> Accordingly, a trading desk, department, office, branch, or other discrete business unit that is not a separately organized legal person would not be viewed as a security-based swap dealer (regardless of where located); rather, the legal person of which it is a part would be the security-based swap dealer.<sup>250</sup> Similarly, the term “person”

<sup>244</sup> 15 U.S.C. 78o–10(a)(1).

<sup>245</sup> Proposed Rule 3a71–3(a)(7) under the Exchange Act (defining “U.S. person”), as discussed in Section III.B.5, *infra*; proposed Rule 3a71–3(a)(1) under the Exchange Act (defining “foreign branch”), as discussed in Section III.B.7, *infra*.

<sup>246</sup> Proposed Rule 3a71–3(a)(5) under the Exchange Act (defining “transaction conducted within the United States”), as discussed in Section III.B.6, *infra*.

<sup>247</sup> Proposed Rule 3a71–3(b) under the Exchange Act; *see also* 17 CFR 240.3a71–2.

<sup>248</sup> *See id.*

<sup>249</sup> *See* Intermediary Definitions Adopting Release, 77 FR 30624. Section 3(a)(9) of the Exchange Act defines “person” as “a natural person, company, government, or political subdivision, agency, or instrumentality of a government.” 15 U.S.C. 78c(a)(9); *see also* proposed Rule 3a71–3(a)(7) under the Exchange Act (defining “U.S. person”), as discussed in Section III.B.5, *infra*.

<sup>250</sup> This approach is consistent with the Commission’s discussion in the Intermediary Definitions Adopting Release regarding the entity-

in the Commission’s rules implementing the *de minimis* exception should be interpreted to refer to a particular legal person.<sup>251</sup>

Thus, the security-based swap dealer definition would apply to the particular legal person performing the dealing activity, even if that person’s dealing activity is limited to a trading desk or discrete business unit.<sup>252</sup> The presumption is that a person who falls within the security-based swap dealer definition is a dealer with regard to all of its security-based swap activities.<sup>253</sup> As a result, a legal person with a branch, agency, or office that is engaged in dealing activity in connection with transactions above the *de minimis* threshold would be required to register as a security-based swap dealer, even if the legal person’s dealing activity were limited to such branch, agency, or office. By contrast, each affiliate of a security-based swap dealer would need to separately consider whether it falls within the *de minimis* exception if that affiliate engages in security-based swap dealing activity.<sup>254</sup>

##### (b) Proposed Rule

We are proposing a rule identifying the types of security-based swap transactions that should be included in

level designation of security-based swap dealers. 77 FR 30624. It also generally is consistent with the Commission’s traditional entity approach to the registration of broker-dealers, as discussed in Section III.B.2, *supra*.

<sup>251</sup> *See* 17 CFR 240.3a71–2; proposed Rule 3a71–3(b) under the Exchange Act.

<sup>252</sup> Within an affiliated group of companies, only those legal persons that engage in dealing activities will be designated as dealers; that designation will not be imputed to other non-dealer affiliates or to the group as a whole. A single affiliate group may have multiple swap or security-based swap dealers. *See* Intermediary Definitions Adopting Release, 77 FR 30624–25. *But see* Section III.B.8, *infra* (discussing aggregation).

<sup>253</sup> The definition of security-based swap dealer provides that a person may be designated as a security-based swap dealer for a single type or class or category of security-based swaps or activity, and not others. *See* Section 3(a)(71)(B) of the Exchange Act, 15 U.S.C. 78c(71)(B); 17 CFR 240.3a71–1(c) (“A person that is a security-based swap dealer in general shall be deemed to be a security-based swap dealer with respect to each security-based swap it enters into, regardless of the type, class, or category of the security-based swap or the person’s activities in connection with the security-based swap, unless the Commission limits the person’s designation as a security-based swap dealer to specified types, classes, or categories of security-based swaps or specified activities of the person in connection with security-based swaps.”). *See* note 588, *infra*.

Although the Commission is not proposing to designate non-U.S. persons as security-based swap dealers in a limited capacity, the Commission’s proposed approach would limit the application of certain transaction-level requirements to the “U.S. Business” of foreign security-based swap dealers. *See* Section III.C.4, *infra*.

<sup>254</sup> *See* Section III.B.8, *infra* (discussing inter-affiliate transactions), and Section III.B.8, *infra* (discussing aggregation).

<sup>240</sup> *See* Asian-Pacific Regulators Letter at 4.

<sup>241</sup> *See, e.g.*, JFSA Letter I at 1 (“If these institutions were also to be regulated under US DFA framework, this will create an undesirable and redundant effect on these Japanese institutions.”).

<sup>242</sup> *See, e.g.*, ACP/AMF Letter at 1–32 (“[W]e strongly support . . . a mutual recognition regime built around an adequate and balanced symmetrical system taking into account the home and the host country regulatory regimes. Thus . . . we expect that [the registration of non-resident entities] will be limited to activities in relation with US counterparties and/or clients and will not involve similar obligations to the financial organizations as a whole. The obligations for non-resident entities should indeed be proportionate and take into [account] equivalent requirements in their home jurisdiction.”).

<sup>243</sup> *See, e.g.*, BaFIN Letter at 1 (“Without questioning the registration of foreign banks, I suppose that such registration will be limited to activities in relation with US counterparties and/or clients and will not involve similar obligations to foreign banks as a whole”).

a person's calculation of the notional amount of security-based swap transactions connected with dealing activity for purposes of determining whether the *de minimis* exception excludes that dealer from the security-based swap dealer definition.<sup>255</sup> The proposed rule confirms that all of a U.S. person's security-based swap transactions conducted in a dealing capacity would count toward its *de minimis* threshold, wherever those transactions are solicited, negotiated, executed, or booked.<sup>256</sup> Although we recognize that some commenters have suggested that the Commission should not require U.S. persons to include positions connected with dealing activity conducted through foreign branches in calculating the amount of their dealing activity,<sup>257</sup> we are not proposing to adopt this approach. The security-based swap dealing activity of a foreign branch is activity of the U.S. legal person regardless of the role played by the foreign branch or the location of the security-based swap dealing activity. We believe that any dealing activity undertaken by a U.S. person occurs at least in part within the United States and therefore warrants application of Title VII, regardless of where particular dealing activity in connection with the transactions is conducted.<sup>258</sup> The security-based swap dealing activity of a U.S. person creates risk to the U.S. person and to the U.S. financial system, because the risk of such transactions ultimately is borne by the U.S. person, even if the transactions in connection with that dealing activity are conducted in part outside the United

<sup>255</sup> Proposed Rule 3a71-3(b) under the Exchange Act. Appendix B to this release contains a table that identifies whether a potential security-based swap dealer would be required to count a transaction with a specific type of counterparty toward its *de minimis* threshold. The table in Appendix B is only a summary of the rules and interpretations proposed in this release that is provided for ease of reference; it does not supersede, and should be read in conjunction with, the proposed rules and interpretations.

<sup>256</sup> Proposed Rule 3a71-3(b)(1)(i) under the Exchange Act. As noted above, as used in this release, "security-based swap dealing," "security-based swap dealing activity," "dealing activity," and related concepts have the meanings described in the Intermediary Definitions Adopting Release, 77 FR 30596, unless otherwise indicated in this release. Such dealing activity is normally carried out through interactions with counterparties or potential counterparties, which includes solicitation, negotiation, or execution of a security-based swap.

<sup>257</sup> See, e.g., Sullivan and Cromwell Letter, at 9-11.

<sup>258</sup> See notes 231 and 234, *supra*. As noted in Section II.A.3 above, the security-based swap transactions of U.S. persons, wherever entered into, give rise to ongoing obligations that may affect the financial stability of the United States and thus present the type of risk that Title VII was intended to address.

States, and because the U.S. person is part of the U.S. financial system.<sup>259</sup> To achieve the purposes of Title VII, including the reduction of systemic risk, we preliminarily believe that U.S. persons that engage in security-based swap dealing activity through foreign branches should be subject to the regulatory framework for dealers established by Congress in Title VII, even if they deal exclusively with non-U.S. persons.

By contrast, a non-U.S. person would be required to consider only the security-based swap transactions connected with its dealing activity with U.S. persons (other than foreign branches of U.S. banks)<sup>260</sup> or otherwise conducted within the United States<sup>261</sup> for purposes of the *de minimis* exception.<sup>262</sup> Under this proposed approach, a non-U.S. person would be required to calculate its security-based swap position for purposes of the *de minimis* threshold by adding together the notional amount of transactions connected with dealing activity with U.S. persons (other than foreign branches of U.S. banks)<sup>263</sup> or otherwise conducted within the United States.<sup>264</sup>

<sup>259</sup> These risk concerns may be greater for uncleared security-based swap than for cleared security-based swaps where the U.S. person would not retain the credit risk of its counterparty; however, cleared security-based swaps still represent an importation of risk into the U.S. financial system when entered into by U.S. persons because in the context of cleared security-based swaps, the U.S. persons would be exposed to the credit, financial, and operational risks of the clearing agency.

<sup>260</sup> Proposed Rule 3a71-3(a)(7) under the Exchange Act (defining "U.S. person"), as discussed in Section III.B.5; proposed Rule 3a71-3(a)(1) under the Exchange Act (defining "foreign branch"), as discussed in Section III.B.7, *infra*.

<sup>261</sup> Proposed Rule 3a71-3(a)(5) under the Exchange Act (defining "transaction conducted within the United States"), as discussed in Section III.B.6, *infra*. Proposed Rule 3a71-3(a)(9) under the Exchange Act defines "United States" as "the United States of America, its territories and possessions, any States of the United States, and the District of Columbia." The proposed definition of "United States" is consistent with the definition of that term in other contexts in the federal securities laws. See, e.g., 17 CFR 230.902(l); 17 CFR 240.15a-6(b)(6).

<sup>262</sup> Proposed Rule 3a71-3(b)(1)(ii) under the Exchange Act.

<sup>263</sup> See Section III.B.7, *infra* (discussing the exception from the *de minimis* threshold for transactions by foreign dealers with foreign branches of U.S. banks).

<sup>264</sup> Proposed Rule 3a71-3(b)(1)(ii) under the Exchange Act. For purposes of the *de minimis* threshold, the U.S. person-status of a non-U.S. person's counterparty would be relevant only at the time of a transaction that arises out of the non-U.S. person's dealing activity. Any change in a counterparty's U.S. person status after the transaction is executed would not affect that transaction's treatment for purposes of the *de minimis* exception, though it would affect the treatment of any subsequent dealing transactions with that counterparty. See also Product Definitions

As a result, a foreign entity with a global security-based swap dealing business, but whose transactions connected with its dealing activity with U.S. persons (other than foreign branches of U.S. banks) or otherwise conducted within the United States fall under the *de minimis* threshold, would not fall within the security-based swap dealer definition and, therefore, would not be required to register as a security-based swap dealer.<sup>265</sup>

This approach to the *de minimis* exception for non-U.S. persons engaged in cross-border dealing activity preliminarily appears to us to focus appropriately on a non-U.S. person's security-based swap dealing activity in the United States. In addition, this proposed approach, when combined with our broader approach to the registration and regulation of foreign security-based swap dealers, appears to us to appropriately focus our oversight on those non-U.S. persons engaged in security-based swap dealing activities that most directly impact the U.S. security-based swap market and U.S. financial system and that, therefore, warrant the application of the provisions of Title VII covering security-based swap dealers.<sup>266</sup>

Adopting Release, 77 FR 48286 ("If the material terms of a Title VII instrument are amended or modified during its life based on an exercise of discretion and not through predetermined criteria or a predetermined self-executing formula, the Commissions view the amended or modified Title VII instrument as a new Title VII instrument").

<sup>265</sup> See 17 CFR 240.3a71-2(a). The Commission notes that, to the extent that a non-U.S. person does not conduct dealing activity within the United States or with U.S. persons (or to the extent that the volume of positions connected with such dealing activity does not exceed the *de minimis* threshold discussed below), it would not be required to register with the Commission as a security-based swap dealer under Section 15F(a)(1) of the Exchange Act regardless of the volume of non-dealing security-based swap transactions it has within the United States or with U.S. persons. See Intermediary Definitions Adopting Release, 77 FR 30631. Such an entity still would be subject to the major security-based swap participant thresholds with respect to its non-dealing security-based swap transactions. However, once a non-U.S. person's transactions with U.S. persons (other than foreign branches of U.S. banks) or otherwise conducted within the United States involve dealing activity that exceeds the *de minimis* threshold, that person would be required to register as a security-based swap dealer and would be subject to the statutory requirements applicable to security-based swap dealers for all of its security-based swap transactions. See Intermediary Definitions Adopting Release, 77 FR 30645.

<sup>266</sup> The Commission understands that entities such as foreign central banks, international financial institutions, multilateral development banks, and sovereign wealth funds ("SWFs") (together, "foreign public sector financial institutions" or "FPSFIs") rarely enter into security-based swap transactions in a dealing capacity. As such, we believe that the proposed approach outlined in this release would sufficiently address the dealer registration concerns of these entities.

The Commission is not proposing, as some commenters have suggested, an approach modeled on Rule 15a-6(a)(3), which would permit non-U.S. persons to conduct security-based swap dealing activity with U.S. persons without registering with the Commission if such dealing activity were intermediated by a registered security-based swap dealer.<sup>267</sup> The Commission preliminarily believes that such an approach would not address the risk to the U.S. financial system by dealing activity of non-U.S. persons within the United States or with U.S. persons. As a dealer, the non-U.S. person would be the party to the security-based swap transaction and, therefore, the party that bears the financial risk of such transaction and whose financial integrity is of primary concern to the Commission. This concern is heightened by the fact, noted above, that, unlike most other securities transactions, security-based swap transactions give rise to ongoing obligations between the transaction counterparties.<sup>268</sup> Under the alternative suggested, the important financial responsibility requirements that Title VII imposes on security-based swap dealers would not apply to the non-U.S. person with respect to that transaction. Instead, the intermediating registered security-based swap dealer would be subject to the financial responsibility rules with respect to the transaction, but since it would not be a party to, and would not bear the financial risk of, the security-based swap transaction, it would not bear the ongoing financial risk of such transaction. As a result, the financial responsibility requirements imposed on the intermediating dealer would not address the dealing risk posed by the non-U.S. person in this context.<sup>269</sup>

#### Request for Comment

The Commission requests comment on all aspects of the proposed rule

The Commission is soliciting comment on whether our proposal sufficiently addresses the concerns of FPSFIs and whether our understanding of the security-based swap activity of such entities is accurate. See also Section III.B.5(b)iv, *infra* (discussing international organizations).

<sup>267</sup> See note 229, *supra*.

<sup>268</sup> See Section II.A.3, *supra*.

<sup>269</sup> The Commission also is not proposing a dealer-to-dealer exception modeled on Rule 15a-6(a)(4)(i) (providing that a foreign broker or dealer shall be exempt from the registration requirements of Section 15(a)(1) or 15B(a)(1) of the Exchange Act to the extent that the foreign broker or dealer effects transactions in securities with or for, or induces or attempts to induce the purchase or sale of any security by "[a] registered broker or dealer, whether the registered broker or dealer is acting as principal for its own account or as agent for others, or a bank acting in a broker or dealer capacity as permitted by U.S. law").

regarding the application of the *de minimis* exception to U.S. persons and non-U.S. persons, including the following:

- Should the proposed rule limit the *de minimis* test to the notional amount of a U.S. person's positions connected with its dealing activity involving transactions with other U.S. persons or otherwise conducted within the United States? For example, should the proposed rule be altered to provide that U.S. banks would not include the notional amount of transactions connected with the dealing activity of their foreign branches in the *de minimis* calculation, rather than counting these transactions against the *de minimis* threshold as required under the proposed approach? Why or why not?

- Should the proposed rule require non-U.S. persons to count transactions with the foreign branches of U.S. banks towards their *de minimis* calculations? Why or why not?

- Should the proposed rule follow an approach modeled on Rule 15a-6(a)(3), which would permit non-U.S. persons to conduct security-based swap dealing activity within the United States without registering with the Commission if those transactions were intermediated by a registered U.S. security-based swap dealer? If so, what compliance obligations, if any, should the unregistered non-U.S. person be subject to? What obligations should the U.S. security-based swap dealer be subject to with respect to such intermediated transactions, particularly with respect to capital, margin, and segregation requirements? How would this approach deal with risk concerns, especially with any security-based swaps not subject to clearing?

- Should the proposed rule follow an approach modeled on Rule 15a-6(a)(4)(i), which would permit non-U.S. persons to conduct security-based swap dealing activity within the United States without registering with the Commission if those transactions were with a registered U.S. security-based swap dealer? If so, what conditions, if any, should the Commission impose on such an exception?

- Should non-U.S. persons acting in a dealing capacity be required to count transactions entered into with registered security-based swap dealers toward their *de minimis* threshold? Why or why not? If non-U.S. persons are not required to count security-based swap transactions, conducted in a dealing capacity, with registered security-based swap dealers, should U.S. persons be required to count security-based swap transactions, conducted in a dealing capacity, with registered security-based

swap dealers? If not, why not? If so, why?

- The CFTC has proposed an interpretation that would require a non-U.S. person to consider the aggregate notional value of its swap dealing transactions (or any swap dealing transactions of its affiliates under common control) where the non-U.S. person's obligations are guaranteed by a U.S. person.<sup>270</sup> Should the proposed rule require a non-U.S. person whose security-based swap transactions are guaranteed by a U.S. person to count all of its security-based swap dealing transactions that are guaranteed by a U.S. person toward the *de minimis* threshold, even if they are not entered into with U.S. persons or otherwise conducted within the United States?

- Should the proposed rule require counting against the *de minimis* threshold the notional amount of a non-U.S. person's transactions entered into in its dealing capacity within the United States or with a U.S. person? Should a non-U.S. person be required instead to aggregate the total worldwide notional amount of its security-based swap transactions entered into in a dealing capacity, regardless of the geographic location of the dealing activity or the counterparty's status as a U.S. person if it engages in any dealing transactions with U.S. persons? Why or why not?

- What circumstances, if any, would justify requiring a non-U.S. person to register with the Commission if its dealing activity arising from its transactions with non-U.S. persons outside the United States would exceed the *de minimis* threshold if it had been conducted within the United States or with U.S. persons but the non-U.S. person enters into transactions within the United States or with U.S. persons solely in a non-dealing capacity?

- What circumstances would justify following a different territorial approach that would treat transactions connected with the dealing activity conducted by a U.S. person through its foreign locations with non-U.S. persons as outside the United States and not required to be counted against such U.S. person's *de minimis* threshold?

- Does the Commission's proposed approach adequately address the concerns of FPSFIs? Is our understanding of the security-based swap activity of FPSFIs accurate? If not, please explain.

- What would be the market impact of the proposed approach to apply the *de minimis* exception in the cross-border context? How would the proposed application of the *de minimis*

<sup>270</sup> See CFTC Cross-Border Proposal, 77 FR 41221.

exception to U.S. persons and non-U.S. persons affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the *de minimis* exception? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## 5. Proposed Definition of "U.S. Person"

### Introduction

The proposed rule defining "U.S. person" would identify a person's status as a U.S. person for purposes of applying the calculation for the *de minimis* exception in the cross-border context.<sup>271</sup> The proposed definition of U.S. person generally follows an approach to defining U.S. person similar to that used by the Commission in other contexts.<sup>272</sup> Specifically, the proposed rule would define U.S. person to mean any of the following:

- Any natural person resident in the United States;
- Any partnership, corporation, trust, or other legal person organized or incorporated under the laws of the United States<sup>273</sup> or having its principal

<sup>271</sup> Proposed Rule 3a71-3(a)(7) under the Exchange Act. The definition of "U.S. person" also is used in other proposed rules and interpretive guidance discussed below. See Sections IV-XI, *infra*.

<sup>272</sup> See, e.g., Regulation S Adopting Release, 55 FR 18308 ("The Regulation adopted today is based on a territorial approach to Section 5 of the Securities Act."). Although the proposed rule generally follows the same approach as Regulation S, the Commission preliminarily believes that it is necessary to depart from Regulation S in certain respects. See Section III.B.10, *infra* (comparing the proposed definition of "U.S." person with the definition of "U.S. person" in Regulation S). Notably, neither the Exchange Act nor Rule 15a-6 contains a definition of U.S. person.

The proposed definition of U.S. person is similar to the definition of U.S. person that the CFTC staff provided its October 12, 2012 no-action letter. See Time-Limited No-Action Relief: Swaps Only With Certain Persons to be Included in Calculation of Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant (Oct. 12, 2012), available at: <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-22.pdf>; see also Final CFTC Cross-Border Exemptive Order, 78 FR 862 (indicating that for purposes of its temporary conditional relief the CFTC is taking a similar approach to the U.S. person definition as that set forth in the October 12, 2012 no-action letter).

<sup>273</sup> Proposed Rule 3a71-3(a)(9) under the Exchange Act defines "United States" as "the United States of America, its territories and

place of business in the United States; or

- Any account (whether discretionary or non-discretionary) of a U.S. person.<sup>274</sup>

The proposed rule also would provide that the term "U.S. person" would not include the following international organizations: The International Monetary Fund ("IMF"), 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.<sup>275</sup>

We preliminarily believe that the proposed definition of U.S. person would achieve three objectives necessary to effective application of Title VII in the cross-border context. First, it would identify those types of individuals or entities that, by virtue of their location within the United States or their legal or other relationship with the United States, are likely to impact the U.S. market even if they transact with security-based swap dealers that are not U.S. persons.<sup>276</sup> Second, it would identify those types of individuals or entities that, by virtue of their location within the United States or their legal or other relationship with the United States, are part of the U.S. security-based swap market and should receive the protections of Title VII. Third, it would permit us to identify dealing entities that most likely would be active in the U.S. security-based swap market and whose dealing activity most likely would pose a risk to the U.S. financial system by virtue of their counterparties' resident or domicile status.

Because of the nature of the risks posed by security-based swaps, which are borne by the entire corporate entity even if the transaction is entered into by a specific trading desk, office, or branch of such entity, consistent with the Commission's approach to the meaning of "person" in the security-based swap dealer definition, as discussed above,

possessions, any States of the United States, and the District of Columbia."

<sup>274</sup> Proposed Rule 3a71-3(a)(7)(i) under the Exchange Act.

<sup>275</sup> Proposed Rule 3a71-3(a)(7)(ii) under the Exchange Act.

<sup>276</sup> As noted in Section II.A.3 above, the security-based swap transactions of U.S. persons give rise to ongoing liability that is borne by a person located within the United States and thus are likely to pose the types of financial stability risks to U.S. financial system that Title VII was intended to address. The security-based swap activity of U.S. persons occurs, at least in part, within the United States.

we are proposing to define the term "U.S. person" to include the entire entity, including its branches and offices that may be located in a foreign jurisdiction.<sup>277</sup> Thus, under this approach, the term "U.S. person" would be interpreted to include any foreign trading desk, office, or branch of an entity that is organized under U.S. law or whose principal place of business is located in the United States.<sup>278</sup>

### (b) Discussion

#### i. Natural Persons

Under the proposed rule, any natural person resident in the United States would be a U.S. person, regardless of that individual's citizenship status.<sup>279</sup> Individuals resident abroad, on the other hand, would not be treated as U.S. persons, even if they possess U.S. citizenship.<sup>280</sup> We preliminarily believe that natural persons residing within the United States who engage in security-based swap transactions may raise the types of concerns intended to be addressed by Title VII, including those related to transparency and customer protection.<sup>281</sup> We also note that this approach is generally consistent with the approach we have taken in prior rulemakings relating to the cross-border application of certain similar regulatory requirements.<sup>282</sup> Moreover, any risk to such person arising from its security-based swap activity may manifest itself most directly within the United States, where a significant portion of its commercial and legal relationships exist because that is where its residency is (unlike a U.S. citizen resident abroad).

#### ii. Corporations, Organizations, Trusts, and Other Legal Persons

Under the proposed rule, any partnership, corporation, trust, or other legal person organized or incorporated under the laws of the United States<sup>283</sup> or having as its principal place of business in the United States would be a U.S. person.<sup>284</sup> We have previously looked to an entity's place of

<sup>277</sup> See Section III.B.4(a), *supra*.

<sup>278</sup> *Id.*

<sup>279</sup> Proposed Rule 3a71-3(a)(7)(i)(A) under the Exchange Act.

<sup>280</sup> This proposed approach to treating natural persons as U.S. persons based on residency, rather than citizenship, differs from the proposed approach to legal entities, such as partnerships and corporations, discussed below.

<sup>281</sup> See note 4, *supra*.

<sup>282</sup> See Rule 15a-6 Adopting Release, 54 FR 30017 (providing that foreign broker-dealers soliciting U.S. investors abroad generally would not be subject to registration requirements with the Commission).

<sup>283</sup> Proposed Rule 3a71-3(a)(9) under the Exchange Act (defining "United States").

<sup>284</sup> Proposed Rule 3a71-3(a)(7)(i)(B) under the Exchange Act.

organization or incorporation to determine whether it is a U.S. person in adopting rules under the federal securities laws,<sup>285</sup> and we preliminarily believe that it is also appropriate to do so in the context of Title VII. We preliminarily believe that the decision of a corporation, trustee, or other entity to organize under the laws of the United States indicates a degree of involvement in the U.S. economy or legal system that warrants ensuring that its security-based swap activity is subject to the requirements of Title VII.<sup>286</sup>

Similarly, we believe that the proposed definition should ensure that Title VII applies to entities that are organized or incorporated in a jurisdiction outside the United States if they have their principal place of business in the United States.<sup>287</sup> Any risk to such entities arising from their security-based swap activity is likely to manifest itself most directly within the United States, where a significant portion of their commercial and legal relationships would be likely to exist. Moreover, focusing exclusively on whether an entity is organized or incorporated in the United States could encourage some entities that are currently organized or incorporated in the United States to incorporate in a non-U.S. jurisdiction to avoid the costs of complying with Title VII while maintaining their principal place of business—and thus in all likelihood, the risks arising from their security-based swap transactions—within the United States. To prevent this possibility, we are proposing to define “U.S. person” to include entities that are organized or incorporated abroad but have their principal place of business within the United States.<sup>288</sup>

<sup>285</sup> See Regulation S Adopting Release, 55 FR 18316.

<sup>286</sup> Under this prong of the proposed rule, “special entities,” as defined in Section 15F(h)(2)(C) of the Exchange Act, would be U.S. persons because they are legal persons organized under the laws of the United States. Section 15F(h)(2)(C) of the Exchange Act defines the term “special entity” as “(i) a Federal agency; (ii) a State, State agency, city, county, municipality, or other political subdivision of a State; (iii) any employee benefit plan, as defined in Section 3 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002; (iv) any governmental plan, as defined in Section 3 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002; or (v) any endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986.” 15 U.S.C. 78o–10(h)(2)(C).

<sup>287</sup> For example, a business may be incorporated under the laws of a foreign jurisdiction but nonetheless have its business operations, including its home office, in the United States.

<sup>288</sup> As discussed in Section III.B.6 below, the Commission also is proposing to require non-U.S. persons that conduct security-based swap transactions within the United States, in a dealing

An entity’s status as a U.S. person under the proposed rule would be determined at the legal entity-level and thus apply to the entire legal entity, including any foreign operations that are part of the U.S. legal entity.<sup>289</sup> Consistent with this entity-level approach, a foreign branch, agency, or office of a U.S. person would be treated as a U.S. person under the proposed definition.<sup>290</sup> As the Commission noted in proposing Regulation SBSR, “[b]ecause a branch or office has no separate legal existence under corporate law, the branch or office would be an integral part of the U.S. person itself.”<sup>291</sup> In other words, because a branch or office is merely an extension of the head office, not a separately incorporated or organized legal entity, we preliminarily believe that it lacks the legal independence to be considered a non-U.S. person for purposes of Title VII if its head office is a U.S. person. We preliminarily believe a wholesale exclusion from the requirements of Title VII for a foreign branch, agency, or office of a U.S. person is not warranted with respect to its security-based swap transactions because the legal obligations and economic risks associated with the transactions directly affect a U.S. person, of which the branch, agency, or office is merely a part.

Under the proposed definition, the status of an entity as a U.S. person would have no bearing on whether separately incorporated or organized legal entities in its affiliated corporate group are U.S. persons. Accordingly, a foreign subsidiary of a U.S. person

capacity, to count such transactions toward their *de minimis* threshold. In addition, the Commission is proposing to subject security-based swap transactions that are conducted within the United States to certain transaction-level requirements in Title VII in connection with reporting and dissemination, clearing, and trade execution. See Sections VIII–X, *infra*.

<sup>289</sup> In principle, Regulation S looks to the location of the branch rather than the jurisdiction in which the entity is organized or incorporated in determining whether the branch is a U.S. person. See 17 CFR 230.902(k)(1)(v) and (2)(v). Thus, under Regulation S, the foreign branch of a U.S. bank is not treated as a U.S. person while the U.S. branch of a foreign bank is treated as a U.S. person. Under subsection (a)(7)(ii) of proposed Rule 3a71–3 under the Exchange Act, the foreign branch of a U.S. bank would be treated as part of a U.S. person. See Section III.B.10, *infra* (discussing the proposed definition of “U.S. person” with the definition of “U.S. person” in Regulation S).

<sup>290</sup> Proposed Rule 3a71–3(a)(7) under the Exchange Act.

<sup>291</sup> See Regulation SBSR Proposing Release, 75 FR 75240 (“The Commission intends for this proposed definition [of U.S. person] to include branches and offices of U.S. persons”). The Commission is re-proposing Regulation SBSR in this release, including its definition of U.S. person. See Section VIII, *infra*.

would not be a U.S. person by virtue of its relationship with its U.S. parent. Similarly, a foreign entity with a U.S. subsidiary would not be a U.S. person simply by virtue of its relationship with its U.S. subsidiary.<sup>292</sup> The Commission preliminarily believes that it is appropriate to treat each affiliate separately because of the distinct legal status of each of the affiliates.<sup>293</sup>

### iii. Accounts of U.S. Persons

Consistent with the proposed definition’s focus on the location of the person bearing the actual risk arising from the security-based swap transaction, the proposed definition of U.S. person would include any accounts (whether discretionary or not) of U.S. persons.<sup>294</sup> Such accounts would be U.S. persons regardless of whether the entity at which the account is held or maintained is a U.S. person. Conversely, accounts of non-U.S. persons would not be U.S. persons solely because they are held by a U.S. financial institution or other entity that is itself a U.S. person.<sup>295</sup> In our view, the purposes of Title VII require that its provisions apply to the person that actually bears the risks arising from the security-based swap transaction.<sup>296</sup> For this reason, we preliminarily believe that the status of accounts, wherever located, should turn on whether any owner of the account is itself a U.S. person,<sup>297</sup> and not on the status of the fiduciary or other person managing the account, the discretionary or non-discretionary nature of the

<sup>292</sup> See Section III.B.8, *infra*.

<sup>293</sup> But see Section III.B.8, *infra* (discussing the aggregation of affiliate positions for purposes of the *de minimis* calculation).

<sup>294</sup> Proposed Rule 3a71–3(a)(7)(i)(C) under the Exchange Act.

<sup>295</sup> An account of a non-U.S. person and, therefore, not a “U.S. person” under proposed Rule 3a71–3(a)(7) under the Exchange Act, may nevertheless engage in “transactions conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5) under the Exchange Act. For example, if a non-U.S. person executes a security-based swap from an office located in the United States that security-based swap would be a “transaction conducted within the United States” even though neither party would be a “U.S. person.” Similarly, if a non-U.S. person solicits a counterparty within the United States to enter into a security-based swap transaction, that transaction would be a “transaction conducted within the United States,” regardless of whether both counterparties were non-U.S. persons. See Section III.B.6, *infra*.

<sup>296</sup> The same approach would apply to an account of a partnership, corporation, trust, or other legal person (e.g., a fund or a special-purpose investment vehicle) to enter into a security-based swap. If the partnership, corporation, trust, or other legal person were a U.S. person, the account would be a U.S. person.

<sup>297</sup> For purposes of this definition, the term “account” includes both discretionary accounts and non-discretionary accounts. See proposed Rule 3a71–3(a)(7)(i)(C) under the Exchange Act.



account, or the status of the entity at which the account is held or maintained.<sup>298</sup> Thus any account of a U.S. person would be a U.S. person for purposes of Title VII.

#### iv. International Organizations

In addition to identifying the persons that fall within the U.S. person definition, the proposed rule also provides a list of specific international organizations that do not fall within such definition.<sup>299</sup> This list includes “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.”<sup>300</sup> Although these organizations may have headquarters in the United States, the Commission preliminarily believes that most of their membership and financial activity are outside the United States. Thus, based on the nature of these entities as international organizations the Commission is proposing not to treat them as U.S. persons for purposes of Title VII.<sup>301</sup>

#### (c) Conclusion

In short, by following a territorial approach, the Commission preliminarily believes that the proposed definition of U.S. person describes the types of individuals and entities residing, organized, or conducting business within the United States, and the types of accounts that should be designated as U.S. persons for purposes of the proposed rule regarding application of

<sup>298</sup> This proposed approach is consistent with the treatment of managed accounts in the context of the major security-based swap participant definition, whereby the swap or security-based swap positions in client accounts managed by asset managers or investment advisers are not attributed to such entities for purposes of the major participant definitions, but rather are attributed to the beneficial owners of such positions based on where the risk associated with those positions ultimately lies. See *Intermediary Definitions Adopting Release*, 77 FR 30690.

<sup>299</sup> Proposed Rule 3a71–3(a)(7)(ii) under the Exchange Act.

<sup>300</sup> *Id.*

<sup>301</sup> Regulation S also specifies that these international organizations are not considered U.S. persons, but Regulation S also considers affiliates of such organizations to be non-U.S. persons. See 17 CFR 230.902(k)(2)(vi). The Commission is soliciting comment on whether affiliates of such organizations should be treated as non-U.S. persons under proposed Rule 3a71–3(a)(7) under the Exchange Act. Currently, under the proposed rule, an affiliate of one of these international organizations would have to separately consider its U.S. person-status.

the *de minimis* exception to security-based swap dealers.<sup>302</sup>

#### Request for Comment

The Commission requests comment on all aspects of the proposed definition of “U.S. person,” including the following:

- Does the proposed definition of “U.S. person” appropriately address the concerns of security-based swap dealer regulation under Title VII?

- Does the proposed definition appropriately identify all individuals or entities that should be designated as U.S. persons? Is the proposed definition too narrow or too broad? Why? Do the proposed criteria for determining whether an entity is a U.S. person effectively describe the types of counterparties that are relevant to identifying the transactions a security-based swap dealer must count when calculating its *de minimis* threshold for purposes of determining whether it is required to register as a security-based swap dealer and comply with the requirements of Title VII? Does the proposed definition appropriately identify the types of entities that should be entitled to the protections afforded to counterparties of security-based swap dealers under Title VII?

- Does the proposed definition appropriately treat natural persons residing in the United States as U.S. persons? Should certain categories of persons residing in the United States be excluded from the definition of U.S. person? Should certain categories of persons (such as U.S. citizens or permanent residents) residing abroad be included in the definition of U.S. person? Please explain why excluding or including particular categories of natural persons would be consistent with and further the objectives of dealer regulation under Title VII.

- Is the proposed approach to the U.S. person status of natural persons based on residency, rather than citizenship, appropriate? In particular, is the proposed approach to natural persons, which differs from the proposed approach to legal entities, such as partnerships and corporations, appropriate in light of the fact that, as the Commission understands, natural persons rarely enter into security-based swaps?

- Does incorporation or organization under the laws of the United States appropriately define the types of entities (both for-profit and non-profit) that should be treated as U.S. persons under

Title VII? Is it appropriate to define an entity as a U.S. person if it has its principal place of business in the United States, even if it is incorporated or organized under the laws of a foreign jurisdiction? Why or why not?

- Does the proposed rule adequately address the risk of evasion or avoidance of Title VII requirements? Are there entities incorporated or organized under foreign law that should be defined as a U.S. person under the proposed rule that are not currently so defined? For example, should an entity incorporated or organized under foreign law but whose security-based swap transactions are guaranteed by a U.S. person be defined as a U.S. person? Why or why not? Should a foreign entity that conducts security-based swap dealing activity predominantly with U.S. persons or within the United States be defined as a U.S. person? If so, why?

- Is it appropriate to determine the U.S. person status of a corporation or organization on an entity-wide basis? Why or why not? Should foreign branches, offices, or agencies of U.S. persons be U.S. persons? Why or why not? What distinguishes transactions mediated or entered into by a foreign branch of a U.S. bank from transactions entered into by the head office of such U.S. bank for purposes of Title VII regulation?

- What, if any, competitive concerns would be raised by defining foreign branches, offices, or agencies of U.S. persons as non-U.S. persons? Please explain the mechanism of any competitive effects. For example, would particular business structures become unworkable under this approach and what would be the relevant impact? If so, please explain possible alternatives and their relative competitiveness.

- Should the proposed rule include within the definition of U.S. person foreign affiliates of U.S. persons? Should other factors be taken into account in determining the status of such affiliated entities, such as, for example, whether performance on the security-based swap obligations of the foreign entity is guaranteed by a U.S. affiliate? Should a foreign entity with performance on its security-based swap obligations guaranteed by a U.S. affiliate, where such foreign entity’s security-based swap dealing activity is conducted predominantly or exclusively with non-U.S. persons, be included within the definition of U.S. person? Why or why not?

- Should a foreign branch of a U.S. parent, including a foreign branch of a U.S. bank, be included in the definition of “U.S. person” for all purposes under Title VII? Why or why not?

<sup>302</sup> As discussed below, the proposed definition is used in other proposed rules and interpretive guidance in the release. See Sections IV–XI, *infra*.



- Should a majority-owned subsidiary of a U.S. parent, regardless of whether the subsidiary has financial guarantees from the U.S. parent, be included in the definition of “U.S. person” for purposes of Title VII? Why or why not?

- Should an account of one U.S. person and one or more non-U.S. persons be treated as a U.S. person? Should the Commission instead establish a *de minimis* threshold amount or otherwise allow some U.S. person ownership without triggering U.S. person status for the account? If so, how?

- The CFTC has proposed a definition of U.S. person that would include a legal entity that is directly or indirectly majority-owned by one or more U.S. persons and in which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity (other than a limited liability company or limited liability partnership where partners have limited liability).<sup>303</sup> Should the Commission adopt a similar approach? If so, why? How should majority ownership be determined? Is majority ownership the appropriate test? If not, should some other percentage test be used (e.g., 25% or some other measure of control)? Are there operational or other difficulties in implementing such an approach?

- Should entities, whatever their place of domicile, that guarantee the performance of U.S. person counterparties to security-based swaps themselves be deemed U.S. persons? Why or why not? How would treating such indirect counterparties to security-based swaps as U.S. persons affect the application of Title VII rules?

- Is the proposed definition’s focus on the status of the person bearing the actual risk in the transaction (e.g., looking at the status of the account owner rather than the person with authority to direct the investment decisions) appropriate in determining whether the person is a U.S. person?

- The CFTC has proposed a definition of U.S. person that would include any pension plan for the employees, officers or principals of a legal entity with its principal place of business inside the United States. Should the Commission adopt a similar approach? If so, what categories of entities would or would not be U.S. persons when compared to the Commission’s proposed approach? How is including or excluding such entities, as applicable, from the definition of U.S. person consistent with

and in furtherance of the objectives of Title VII?

- Does the proposed rule appropriately address the treatment of certain international organizations with respect to the definition of U.S. person? Should any or all of the organizations specifically identified in the proposed rule be treated as U.S. persons? If so, why? Are there other similarly situated international organizations that should also be explicitly excluded from the U.S. person definition? Should the affiliates of international organizations be treated as non-U.S. persons, even if organized under U.S. law? If so, why? If not, why not?

- Should the proposed definition expressly exclude from the definition of U.S. person any other entity or category of entities? If so, which ones and why?

- The CFTC has proposed a definition of U.S. person that would include any commodity pool, pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership is held, directly or indirectly, by a U.S. person. Should the Commission adopt a similar definition that includes any investment fund, commodity pool, pooled account, or collective investment vehicle of which a majority ownership is held by one or more U.S. persons, even if such entity is not incorporated or organized under the laws of the United States, or does not have its principal place of business in the United States? If so, why and how should majority ownership be determined? Is majority ownership the appropriate test? If not, should some other percentage test be used (e.g., 25% or some other measure of control)? Are there operational or other difficulties in implementing such an approach?

- The CFTC has proposed a definition of U.S. person that would include any commodity pool, pooled account, or collective investment vehicle the operator of which would be required to register as a commodity pool operator under the CEA.<sup>304</sup> Should the Commission adopt a similar definition that includes any investment fund, commodity pool, pooled account, or collective investment vehicle the operator of which would be required to register as a commodity pool operator under the CEA or an investment adviser under the Investment Advisers Act of 1940 (“Investment Advisers Act”)? If so, why?

- Should the definition of U.S. person specifically address the status of estates, which is specifically addressed in

Regulation S?<sup>305</sup> If so, please explain the types of security-based swap transaction such entities typically engage in and describe any problems created by the proposed definition of U.S. person relative to the goals of Title VII.

- The CFTC has proposed a definition of U.S. person that would include any estate or trust, the income of which is subject to U.S. income tax regardless of source. Should the Commission adopt a similar approach? If so, why?

- Should the Commission define the term “principal place of business” for purposes of the proposed definition of “U.S. person”? If so, should the Commission define “principal place of business” as the location of the personnel who direct, control, or coordinate the security-based swap activities of the entity?<sup>306</sup> If no, how should the Commission define it?

#### 6. Proposed Definition of “Transaction Conducted Within the United States”

We are proposing a definition of “transaction conducted within the United States” to identify security-based swap transactions that involve activities in the United States that the Commission preliminarily believes would warrant requiring a non-U.S. person to count such transactions toward its *de minimis* threshold in the security-based swap dealer definition.<sup>307</sup> Under the proposed rule, “transaction conducted within the United States” would be defined to mean any “security-based swap transaction that is solicited, negotiated, executed, or booked within the United States, by or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty

<sup>305</sup> See Section III.B.10, *infra* (discussing the definition of “U.S. person” in Regulation S).

<sup>306</sup> This focus would be generally consistent with the focus of the definition of “principal office and place of business” in the Investment Advisers Act, where it is defined as “the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.” 17 CFR 275.222–1(b).

<sup>307</sup> Proposed Rule 3a71–3(a)(5) under the Exchange Act. The proposed definition of “transaction conducted within the United States” also is used in other places in the release in the context of our proposed application of Title VII requirements in the cross-border context. See Sections VIII–X, *infra*. The proposed definition of “transaction conducted within the United States,” and related discussion in this release, is not intended to apply outside of the scope of the proposals set forth in this release, unless otherwise indicated. Accordingly, it thus does not affect other rights or obligations of parties under the Exchange Act or the federal securities laws generally.

<sup>303</sup> See CFTC Further Proposed Guidance, 78 FR 912.

<sup>304</sup> See CFTC Cross-Border Proposal, 77 FR 41218.

to the transaction.”<sup>308</sup> It would not, however, include a transaction conducted through a foreign branch of a U.S. bank, for reasons discussed below.<sup>309</sup>

As noted above, dealing activity is normally carried out through interactions with counterparties or potential counterparties that include solicitation, negotiation, execution, or booking of a security-based swap.<sup>310</sup> Engaging in any of these activities within the United States, as part of dealing activity, would involve a level of involvement in a security-based swap transaction that the Commission believes should require such transaction to count toward a potential security-based swap dealer’s *de minimis* threshold. The proposed rule, therefore, is designed to identify for market participants the key aspects of a security-based swap transaction that the Commission believes should trigger security-based swap dealer registration requirements.

By contrast, we are not proposing to include either submitting a transaction for clearing in the United States or reporting a transaction to an SDR in the United States as activity that would cause a transaction to be conducted within the United States under the proposed rule, nor are we proposing to treat activities related to collateral management (e.g., exchange of margin payments) that may occur in the United States or involve U.S. banks or custodians as activity conducted within the United States for these purposes. We recognize that submission of a transaction for clearing to a CCP located in the United States poses risk to the U.S. financial system, and collateral management plays a vital role in an entity’s financial responsibility program and risk management. However, we preliminarily believe that none of these

<sup>308</sup> Proposed Rule 3a71–3(a)(5)(i) under the Exchange Act. The use of the term “counterparty” in the proposed rule is intended to refer to the direct counterparty to the security-based swap transaction, not a party that provides a guarantee on the performance of the direct counterparty to the transaction. See Section VIII.A, *infra* (distinguishing between direct and indirect counterparties).

<sup>309</sup> Proposed Rule 3a71–3(a)(4)(ii) under the Exchange Act. See proposed Rule 3a71–3(a)(4) under the Exchange Act (defining “transaction conducted through a foreign branch”), as discussed in Section III.B.7, *infra*.

<sup>310</sup> See Section II.B.2(b), *supra*. More generally, solicitation, negotiation, execution, and booking are activities that represent key stages in a potential or completed security-based swap transaction. As discussed below, transactions conducted within the United States, regardless of whether in a dealing or non-dealing capacity, would generally be subject to requirements relating to reporting and dissemination, clearing, and trade execution. See Sections VIII–X, *infra*.

activities, by themselves, involves activities conducted between a potential dealer and its counterparty that may be characterized as dealing activity, although clearing and collateral management services may be offered in conjunction with dealing activity.

Under the rule adopted by the Commission, jointly with the CFTC, a potential security-based swap dealer is required to consider the security-based swap positions “connected with” the dealing activity in which the potential dealer—or any other entity controlling, controlled by or under common control with the potential dealer—engages over the course of the immediately preceding 12 months (or following the effective date of final rules implementing Section 3(a)(68) of the Exchange Act, 15 U.S.C. 78c(a)(68), if that period is less than 12 months).<sup>311</sup> By incorporating the definition of a “transaction conducted within the United States” into the proposed rule applying the *de minimis* exception in the cross-border context,<sup>312</sup> the Commission is proposing that non-U.S. persons engaged in cross-border dealing activity include in their *de minimis* calculations any security-based swap transaction that is connected with<sup>313</sup> an entity’s dealing activity with another non-U.S. person if a U.S. branch or office of either counterparty, or an associated person<sup>314</sup> of either counterparty—including any affiliate and any associated person of any affiliate, or a third party agent, located within the United States—is directly involved in the transaction. Thus, a non-U.S. person engaged in security-based swap dealing activity would be required to count toward its *de minimis* threshold any dealing transaction entered into with another non-U.S. person that was conducted in the United States, whether the transaction falls within the “conducted within the United States” definition through such non-U.S. person’s own activity (or that of an agent within the United States), or that of its non-U.S. person counterparty (or such counterparty’s agent).<sup>315</sup> Similarly, if any transaction connected with a non-U.S. person’s dealing

<sup>311</sup> See 17 CFR 240.3a71–2(a)(1).

<sup>312</sup> See proposed Rule 3a71–3(b) under the Exchange Act.

<sup>313</sup> The *de minimis* exception threshold is computed based on the notional amount of an entity’s security-based swap positions, connected with its dealing activity, not transactions that are merely solicited. See Intermediary Definitions Adopting Release, 77 FR 30630.

<sup>314</sup> See Section 3(a)(70) of the Exchange Act, 15 U.S.C. 78c(a)(70) (defining “person associated with a security-based swap dealer or major security-based swap participant”); see also note 472, *infra*.

<sup>315</sup> See Proposed Rule 3a71–3(b)(1)(ii) under the Exchange Act.

activity is executed within the United States, the non-U.S. person would be required to count that transaction toward its *de minimis* threshold.<sup>316</sup>

We recognize that many of a non-U.S. person’s transactions conducted within the United States that arise out of its dealing activity may also be transactions with U.S. persons, and thus would already be counted for purposes of the *de minimis* threshold. However, requiring non-U.S. persons to include in their *de minimis* calculations only transactions with U.S. person counterparties would enable such persons to engage in significant amounts of security-based swap dealing activity within the United States without Commission oversight as a security-based swap dealer, so long as the dealing activity were limited to non-U.S. persons.<sup>317</sup> This would be the case if the potential dealer operated out of a branch, office, or affiliate, or utilized a third-party agent acting on its behalf within the United States, or merely directed its dealing activity to non-U.S. persons that themselves operate out of the United States, either through branches, office, or affiliates, or by utilizing third party agents.<sup>318</sup> The Commission preliminarily does not believe that this would be consistent with the purposes of the Dodd-Frank Act, which is intended, in part, to promote accountability and transparency in the U.S. security-based swap market.<sup>319</sup>

First, we preliminarily believe that when a non-U.S. person engages in dealing activity with another non-U.S. person from within the United States either through an agent, branch, or office, or otherwise engages in security-based swap dealing activity within the United States (such as by soliciting persons within the United States from outside the United States), the solicitation, negotiation, or execution activity that occurs within the United States constitutes dealing activity that is described by the security-based swap dealer definition.<sup>320</sup> This is the case even where such transaction is

<sup>316</sup> See *id.*

<sup>317</sup> Depending on the nature of the activity and the person located in the United States engaging in the activity, such person may need to register with the Commission as a broker-dealer under Section 15(a)(1) of the Exchange Act, 15 U.S.C. 78o(a)(1).

<sup>318</sup> The Commission is not distinguishing, for purposes of the proposed rule, whether a potential dealer or its counterparty is operating out of a branch, an office, an affiliate, or utilizes a third-party agent to act on its behalf. We are, however, soliciting comment on whether there is a basis for drawing distinctions in this area and look forward to receiving commenters’ views.

<sup>319</sup> See note 97, *supra*.

<sup>320</sup> See Section II.B.2(b), *supra*.

ultimately booked by the two non-U.S. entities outside the United States. Second, most market participants, including non-U.S. persons, entering into a security-based swap transaction with a security-based swap dealer, particularly through personnel located in the United States, could reasonably expect to be entitled to the customer protections of Title VII because of Title VII's role in setting the standards for the U.S. security-based swap market and the market participant's decision to engage in a transaction within that market.<sup>321</sup> Given the Commission's responsibility in Title VII to regulate the U.S. security-based swap market, as well as reasonable market expectations and the risk of creating confusion among market participants,<sup>322</sup> we preliminarily do not believe that it is appropriate to diverge from our traditional approach to the regulation of broker-dealers by establishing a regulatory regime for the security-based swap market that would allow non-U.S. persons to engage in unregulated dealing activity within the United States, either when it acts through U.S. branches, office, or agents or it solicits, negotiates, or executes transactions with non-U.S. persons that themselves are operating out of the United States.

Moreover, suppose non-U.S. persons were not required to register when engaging in security-based swap dealing activity within the United States with other non-U.S. persons. Non-U.S. persons seeking to negotiate security-based swap transactions using personnel in the United States may choose to enter into security-based swap

transactions with such unregistered non-U.S. persons rather than with a U.S. person to avoid the application of Title VII. In this way, customers may choose to forego the protections of Title VII in order to achieve potential cost savings. This could limit the access of U.S. persons engaged in dealing activity within the United States to non-U.S. persons, as well as more generally limiting the ability of U.S. persons to access liquidity in the security-based swap market. Accordingly, the Commission is proposing that a non-U.S. person would be required to count its security-based swap transactions conducted within the United States (as well as its transactions with U.S. persons) that arise out of its dealing activity to determine whether the notional amount of its dealing transactions exceeds the *de minimis* threshold. This would have the effect of subjecting both non-U.S. persons engaged in dealing activity within the United States and U.S. persons engaged in dealing activity within the United States to the same set of rules, thus providing their counterparties the same set of protections.

Finally, although the proposed rule reflects the importance of ensuring that neither non-U.S. person counterparty is engaged in the relevant activities within the United States for purposes of this definition, we also recognize the operational difficulties that could arise in investigating the activities of a counterparty to ensure compliance with the rule. As a result, we are preliminarily proposing to allow parties 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."<sup>323</sup> A party may rely on such a representation by its counterparty unless the party knows that the representation is not accurate.<sup>324</sup> The Commission

preliminarily believes that this would address whatever operational difficulties parties may have in determining whether or not their counterparty is conducting a transaction within the United States.

#### Request for Comment

The Commission requests comment on all aspects of the proposed rule regarding registration by non-U.S. persons who engage in dealing activity within the United States, including the following:

- Should non-U.S. persons be required to register by virtue of engaging in security-based swap dealing activity within the United States, even if none of this dealing activity is directed to, or otherwise involves, U.S. persons? Why or why not?

- Does the proposed approach appropriately impose the dealer registration requirement on non-U.S. persons based on their dealing activities conducted within the United States? Should a non-U.S. person be required to register as a security-based swap dealer if it enters into, or offers to enter into, security-based swap transactions that are transactions conducted within the United States if such non-U.S. person's dealing activity is limited to its foreign business? What about if the non-U.S. person engages in non-U.S. dealing activity, but also enters into transactions with U.S. persons in a non-dealing capacity?

- What, if any, market-transparency or counterparty-protection issues would be likely to arise if non-U.S. persons were not required to register if they engaged in dealing activity solely with non-U.S. persons from within the United States?

- What, if any, competition issues would be likely to arise if non-U.S. persons were not required to register if they engaged in dealing activity solely with non-U.S. persons from within the United States?

- Is the proposed approach toward determining whether dealing activity is conducted within the United States appropriate? Does the proposed rule identify appropriate factors in determining whether a transaction has been conducted within the United States? If not, what factors should be modified, removed, or added?

- Is the proposed identification of activities appropriate in the context of determining whether a security-based swap is a transaction conducted within

<sup>321</sup> The Commission previously has noted the role that the location of the dealer plays in setting expectations regarding the legal protections available in transactions with that dealer. See Rule 15a-6 Adopting Release, 54 FR 30017 (noting that a U.S. citizen residing abroad who seeks out transactions with foreign broker-dealers would not generally expect U.S. securities laws to apply to the transaction); Regulation S Adopting Release, 55 FR 18310 (noting the expectation that a buyer outside the United States who purchases securities offered outside the United States is aware that "the transaction is not subject to registration under the Securities Act"). See also Cleary Letter IV at 17 ("As both Commissions have consistently recognized in the past, the non-U.S. counterparty in . . . transactions [with a non-U.S. branch or affiliate of a U.S. person] conducted abroad have no expectation of protection under U.S. law"); Davis Polk Letter II at 20 ("Finally, the non-U.S. counterparty would not reasonably expect the swap [with a foreign bank swap dealer] to be subject to Title VII's requirements").

<sup>322</sup> See Rui Albuquerque and Neng Wang, "Agency Conflicts, Investment and Asset Pricing," *Journal of Finance*, Vol. 63, No. 1 (2008) (discussing the effect of customer protection on prices) and Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, "Investor Protection and Corporate Valuation," *Journal of Finance*, Vol. 57, No. 3 (2002) (discussing the effect of customer protection on prices).

<sup>323</sup> Proposed Rule 3a71-3(a)(5)(iii) under the Exchange Act.

<sup>324</sup> *Id.* Cf. Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Advisers Act Release No. 3222 (June 22, 2011), 76 FR 39646, 39676 (July 6, 2011) ("if an adviser reasonably believes that an investor is not 'in the United States,' the adviser may treat the investor as not being 'in the United States'"). We are proposing to use a knowledge standard rather than a reasonable belief standard with respect to transactions conducted within the United States between non-U.S. person counterparties due to the fact that this definition applies to both counterparties to a transaction, thus each counterparty has an incentive to ensure the accuracy of its representation. In addition, the proposed "actual knowledge" standard and related discussion in this release are not intended to apply

outside the scope of the proposals set forth in this release. Accordingly, it does not affect the standard for reliance on representations with respect to other rights or obligations of persons under the Exchange Act or the federal securities law generally.

the United States? If not, which activities should the Commission consider as key evidence of a transaction that is conducted within the United States?

- Is direct participation by a branch, agency, office, or associated person, including any affiliate and any associated person of an affiliate, within the United States an appropriate element for identifying whether a security-based swap transaction is a transaction conducted within the United States? Are there functions routinely performed by these entities that should not trigger a registration requirement, even if performed within the United States?

- Is the direct participation of a third-party agent an appropriate element for identifying whether a security-based swap transaction is a transaction conducted within the United States? If not, why not?

- From an operational perspective, what, if any, changes to policies and procedures would be required to identify transactions conducted within the United States under the proposed approach? What changes would be required, for example, to monitor circumstances that would prevent a party from relying on representations?

- Does the proposed rule appropriately identify the range of security-based swap activities (*i.e.*, solicitation, negotiation, execution, and booking) that should be considered in determining whether dealing activity is conducted within the United States? If not, what activities should be excluded or included? Why?

- Should a transaction entered into by a non-U.S. person in its capacity as a dealer be treated as dealing activity conducted within the United States if it is executed on an SB SEF, submitted to an SDR, or cleared by a security-based swap clearing agency physically located within the United States, even if no other activity related to the transaction were conducted within the United States?

- Should the Commission allow parties to rely on representations from their counterparties regarding compliance with the definition of “transaction conducted within the United States”? Are there alternatives to relying on representations to ensure compliance? Should parties be required to exercise reasonable standards of care and due diligence?

- Is the standard used for the proposed ability to rely on a representation appropriate? Should another standard of knowledge be used? If so, what standard would be more appropriate for this purpose?

- The CFTC has proposed an interpretation that does not consider whether swap dealing activity is conducted inside or outside the United States when determining whether the *de minimis* threshold is met.<sup>325</sup> Should the Commission adopt this approach? If yes, please address the effect of both approaches on customer protection, market transparency, competition, and capital formation in the U.S. security-based swap market.

- What would be the market impact of the proposed approach to determining whether dealing activity occurred within the United States? How would the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

#### 7. Proposed Treatment of Transactions With Foreign Branches of U.S. Banks

As noted above, under the proposed rule, a non-U.S. person would not be required to count toward the *de minimis* threshold in the security-based swap dealer definition its transactions with the foreign branch of a U.S. bank.<sup>326</sup> For purposes of this proposed approach, and as described more fully below,

<sup>325</sup> See CFTC Cross-Border Proposal, 77 FR 41219–20.

<sup>326</sup> Proposed Rule 3a71–3(b)(1)(ii) under the Exchange Act. Section 716 of the Dodd-Frank Act (commonly known as the “Push-Out Rule”) prohibits the provision of certain types of “Federal assistance” to certain swap and security-based swap dealers and major swap and security-based swap participants referred to as “swaps entities,” subject to certain exceptions. In addition, Section 619 of the Dodd-Frank Act (commonly referred to as the “Volcker Rule”) adds a new Section 13 to the Bank Holding Company Act of 1956 (“BHC Act”) (to be codified at 12 U.S.C. 1851) that generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (“covered fund”), subject to certain exemptions. See Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, Exchange Act Release No. 66057 (Oct. 12, 2011), 76 FR 68846 (Nov. 7, 2011). Both the Push-Out Rule and the Volcker Rule will potentially limit the ability of U.S. banks to conduct security-based swap activity.

“foreign branch” would be defined as any branch of a U.S. bank if:

- The branch is located outside the United States;

- The branch operates for valid business reasons; and

- The branch is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located.<sup>327</sup>

We preliminarily believe that these factors are appropriate for determining which entities fall within the definition of a foreign branch for purposes of this proposed approach due to their focus on the physical location of the branch and the nature of the branch’s business and regulation in a foreign jurisdiction. Requiring the branch to be located outside the United States is consistent with the goal of the proposed rule, which is to identify security-based swap activity that is not conducted within the United States. Requiring the branch to be operated for valid business purposes and to be engaged in the business of banking and subject to substantive banking regulation in a foreign jurisdiction is intended to help ensure that U.S. banks are not able to take advantage of the proposed rule by setting up offshore operations to evade the application of Title VII.

In order for a transaction to be a “transaction conducted through a foreign branch,” and therefore excluded from a non-U.S. person’s *de minimis* threshold calculation,<sup>328</sup> the foreign branch must be the named counterparty to the transaction<sup>329</sup> 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.<sup>330</sup> To the extent that the transaction is conducted within the

<sup>327</sup> Proposed Rule 3a–71–3(a)(1) under the Exchange Act. We are not proposing to include “agencies” within the definition of “foreign branch” as such term is used in connection with our treatment of transactions with foreign branches of U.S. banks. We recognize that Regulation S groups agencies and branches together in defining the term U.S. person. See 17 CFR 230.902(k)(1)(v), (2)(v). However, as discussed in Section III.B.10 below, although certain aspects of Regulation S may be useful in the context of security-based swaps, Title VII and Regulation S are tailored to serve different objectives. In particular, the common treatment of agencies and branches under Regulation S does not compel us to similarly group agencies and branches for purposes of our treatment of transactions with foreign branches of U.S. banks given the fact that the term “agency” does not have any operative meaning with respect to the foreign operations of U.S. banks.

<sup>328</sup> Proposed Rules 3a71–3(b)(1)(ii) and (2)(ii) under the Exchange Act.

<sup>329</sup> Proposed Rule 3a71–3(a)(4)(i)(A) under the Exchange Act.

<sup>330</sup> Proposed Rule 3a71–3(a)(4)(i)(B) under the Exchange Act.

United States, as described in the immediately preceding section (whether on behalf of the U.S. bank to which the branch belongs or of the foreign counterparty), the non-U.S. person would be required to count such transaction arising out of its dealing activity toward its *de minimis* threshold for purposes of determining whether it is required to register as a security-based swap dealer.<sup>331</sup>

We believe that counting transactions with a foreign branch toward the *de minimis* threshold would be consistent with the view that a foreign branch of a U.S. bank is part of a U.S. person within the proposed definition.<sup>332</sup> We also recognize that such transactions pose risk to the U.S. financial system. At the same time, however, we believe that imposing registration requirements on non-U.S. persons solely by virtue of their transactions with foreign branches of U.S. banks could limit the access of U.S. banks to non-U.S. counterparties when they conduct their foreign security-based swap dealing activity through foreign branches because non-U.S. persons may not be willing to enter into transactions with them in order to avoid being required to register as a security-based swap dealer.<sup>333</sup> We have preliminarily concluded that not requiring such transactions to be counted toward the foreign counterparty's *de minimis* threshold for purposes of the security-based swap dealer registration requirement would minimize this disparate treatment while ensuring that transactions involving foreign branches of U.S. banks remain subject to certain Title VII requirements (as described below).<sup>334</sup>

<sup>331</sup> See Section III.B.6, *supra*.

<sup>332</sup> See Section III.B.5, *supra*.

<sup>333</sup> See, e.g., Sullivan and Cromwell Letter at 14 (“The jurisdictional scope of the swaps entity definitions is critical to the ability of U.S. banking organizations to maintain their competitive position in foreign marketplaces. Imposing the regulatory regime of Title VII on their Non-U.S. Operations would place them at a disadvantage to their foreign bank competitors because the Non-U.S. Operations would be subject to an additional regulatory regime which their foreign competitors would not.”); Cleary IV at 7 (“Subjecting such non-U.S. branches and affiliates to U.S. requirements could effectively preclude them from, or significantly increase the cost of, managing their risk in the local financial markets, since local financial institutions may be required to comply with Dodd-Frank to provide those services”).

<sup>334</sup> See Section III.C, *infra*. Provided the transaction is not a transaction conducted within the United States under proposed Rule 3a71-3(a)(5) under the Exchange Act, the Commission also is not proposing to require non-U.S. persons to count transactions with a non-U.S. person toward their *de minimis* threshold even if the non-U.S. person's performance on the security-based swap is guaranteed by a U.S. person. See Section III.B.9, *infra*.

Finally, although the proposed rule reflects the importance of ensuring that neither counterparty is operating from within the United States for purposes of conducting a transaction through a foreign branch, we also recognize the operational difficulties that could arise in investigating the activities of a counterparty to ensure compliance with the rule. As a result, we are proposing to allow parties to rely on a representation received from a counterparty indicating that “no person within the United States is directly involved in soliciting, negotiating, executing, or booking” a given transaction on behalf of the counterparty.<sup>335</sup> A party may rely on such a representation by its counterparty unless the party knows that the representation is not accurate. The Commission preliminarily believes that this would address whatever operational difficulties parties may have in determining whether or not their counterparty is conducting a transaction conducted through a foreign branch.

#### Request for Comment

The Commission requests comment on all aspects of the proposed treatment of transactions with foreign branches of U.S. persons for purposes of the *de minimis* exception, including the following:

- Would the proposed approach reduce the effectiveness of customer protections or any other provisions of Title VII? If so, how should these concerns be balanced against the competitiveness concerns identified as part of the rationale behind the proposed approach?

- Does the proposed approach appropriately address the potential for disparate competitive impacts related to the application of the *de minimis* exception to dealers operating out of foreign branches? If not, how might the Commission more effectively address these concerns?

- Does the proposed approach provide an advantage to U.S. banks engaging in security-based swap dealing activity through foreign branches? Are there competitiveness concerns raised by this approach for entities (either banks or nonbanks) that do not utilize the branch model? Are there competitiveness concerns for non-U.S. persons, including non-U.S. persons whose performance under security-based swaps is guaranteed by a U.S. person? If so, what are they?

- Should the Commission allow parties to rely on representations from

their counterparties regarding compliance with the definition of “transaction conducted through a foreign branch”? Should the Commission separately allow parties to rely on representations from their counterparties regarding status under the “foreign branch” definition?

- Is the standard used for the proposed ability to rely on a representation appropriate? Should another standard of knowledge be used? If so, what standard would be more appropriate for this purpose?

- Should the definition of a “foreign branch” be broadened to include “agencies” of U.S. banks in addition to branches? If so, what rationale justifies the inclusion of agencies? In particular, what are the similarities (or differences) in the legal status and regulatory treatment of the foreign branches and foreign agencies of U.S. banks that would warrant similar treatment? How do foreign agencies of U.S. banks differ from foreign offices of U.S. persons that are not banks?

- How might the proposed approach to the foreign branches of U.S. banks be impacted by the Volcker Rule and the Push-Out Rule? How might security-based swap dealers alter their business practices in response to the Volcker Rule and the Push-Out Rule? Should the proposed approach to the foreign branches of U.S. banks be altered to account for these changes to business practice?

- What would be the market impact of the proposed treatment of transactions with foreign branches of U.S. banks? How would the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

#### 8. Proposed Rule Regarding Aggregation of Affiliate Positions

One key issue related to our proposed approach to the *de minimis* exception, both in the cross-border context and domestically, is the aggregation of transactions connected with the dealing activity of an affiliate. In the Intermediary Definitions Adopting Release, the Commission and the CFTC

<sup>335</sup> Proposed Rule 3a71-3(a)(4)(ii) under the Exchange Act; see also Section III.B.6, *supra*.

jointly stated that the notional thresholds in the *de minimis* exception encompass swap and security-based swap dealing positions entered into by an affiliate controlling, controlled by, or under common control with the person at issue.<sup>336</sup> The Commission and the CFTC further noted that for these purposes, control would be interpreted to mean the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.<sup>337</sup> This aggregation of affiliate positions was deemed necessary to prevent persons from avoiding dealer regulation by dividing up dealing activity in excess of the notional thresholds among multiple affiliates.<sup>338</sup>

The Commission is proposing a rule that would describe how this aggregation requirement would apply to U.S. persons and non-U.S. persons engaged in cross-border security-based swap dealing activity, as well as to U.S. persons engaged in purely domestic transactions.<sup>339</sup> As set forth in the Intermediary Definitions Adopting Release, the affiliate aggregation principle requires that a person aggregate the entire security-based swap dealing activity of any of its affiliates, without distinguishing whether the dealing positions are entered into by U.S. person affiliates or non-U.S. person affiliates, and without distinguishing whether the dealing positions are entered into with U.S. persons or non-U.S. persons.<sup>340</sup> The proposed rule takes an approach that generally is consistent with the affiliate aggregation interpretive guidance jointly adopted by the Commission and the CFTC to require a person to aggregate all of the security-based swap dealing positions entered into by its U.S. person affiliates,<sup>341</sup> except that it excludes from such aggregation the positions of an affiliate that is a registered security-based swap dealer, under certain

conditions.<sup>342</sup> The proposed rule also provides that such aggregation must include any security-based swap transactions of such person's non-U.S. person affiliates that would be required to be counted by such affiliates toward their respective *de minimis* thresholds in accordance with the proposed approach described above (*i.e.*, a non-U.S. person affiliate would be required to calculate its security-based swap transactions connected with dealing activity conducted with U.S. persons (other than foreign branches of U.S. banks) or otherwise conducted within the United States).<sup>343</sup>

The proposed rule similarly provides that the affiliate aggregation principle also would apply to non-U.S. persons that engage in transactions in a dealing capacity with U.S. persons (other than foreign branches of U.S. banks) or otherwise within the United States. In determining whether its dealing activity exceeds the *de minimis* threshold, a non-U.S. person must aggregate the amount of its own transactions connected with its dealing activity with U.S. persons (other than foreign branches) or otherwise conducted within the United States with the amount of any security-based swap transactions connected with the dealing activity conducted by its affiliates, whether U.S. persons or non-U.S. persons, that such affiliates would be required to count toward their respective *de minimis* thresholds in accordance with the proposed approach described above<sup>344</sup> (other than the transactions of affiliates that are registered security-based swap dealers).<sup>345</sup> Transactions of affiliates that are themselves non-U.S. persons with other non-U.S. persons (or foreign branches of U.S. banks) outside the United States would not need to be aggregated for purposes of the *de minimis* exception.<sup>346</sup>

Thus, the Commission's proposal would require aggregation of the amount of dealing transactions of all affiliates, both U.S. persons and non-U.S. persons, other than registered security-based

swap dealers. We believe that the Commission's proposed approach implements the *de minimis* exception in a manner that is consistent with the Dodd-Frank Act's focus on the U.S. security-based swap market.<sup>347</sup> The proposed approach reflects the fact that all of a U.S. affiliate's security-based swap dealing transactions impact the U.S. financial system, regardless of whether such entity's counterparties are located in the United States or abroad. The same is not true of non-U.S. affiliates, however, because the security-based swap transactions entered into by a non-U.S. affiliate with other non-U.S. persons outside the United States would not impact the U.S. financial system to the same extent as transactions with U.S. persons. Thus, because the statutory focus is on the U.S. security-based swap market, we preliminarily believe it is appropriate to distinguish between U.S. and non-U.S. affiliates based on the disparate impact of their security-based swap dealing transactions on the U.S. financial system when determining which dealing transactions should be aggregated for purposes of the *de minimis* threshold. This further suggests that we should aggregate the dealing positions of both U.S. and non-U.S. person affiliates that are not already registered security-based swap dealers, in accordance with the rule and guidance described in the following paragraph regarding aggregation of the positions of registered dealers, with the goal of capturing all dealing transactions that warrant imposing dealer registration and regulation<sup>348</sup> and minimizing the opportunity<sup>349</sup> for a person to evasively engage in large amounts of dealing activity.<sup>349</sup> As a result, where the aggregate security-based swap dealing activity of an affiliated group, calculated as described above, exceeds the *de minimis* threshold, then each affiliate within such group that engages in the security-based swap dealing activity included in such aggregation calculation would be required to register with the Commission as a security-based swap dealer, subject to the exception described below.

The Commission also is proposing a rule to address the affiliate aggregation of dealing positions for purposes of the *de minimis* threshold where one or more affiliates within a corporate group are registered with the Commission as

<sup>336</sup> See Intermediary Definitions Adopting Release, 77 FR 30631; 17 CFR 240.3a71-2(a)(1).

<sup>337</sup> See Intermediary Definitions Adopting Release, 77 FR 30631 n.437.

<sup>338</sup> See Intermediary Definitions Adopting Release, 77 FR 30631.

<sup>339</sup> Proposed Rule 3a71-4 under the Exchange Act.

<sup>340</sup> See Intermediary Definitions Adopting Release, 77 FR 30631 n.438 (explaining that the Commission intended to address the application of the aggregation principle to non-U.S. persons in a separate release); 17 CFR 240.3a71-2(a)(1).

<sup>341</sup> Proposed Rule 3a71-3(b)(2)(i) under the Exchange Act. The proposed rule also clarifies that only a person directly engaged in dealing activity that is required to be counted toward such person's *de minimis* threshold would be required to aggregate the dealing activity of its affiliates.

<sup>342</sup> Proposed Rule 3a71-4 under the Exchange Act.

<sup>343</sup> See Section III.B.4(b), *supra*; see also proposed Rule 3a71-3(b)(2)(ii) under the Exchange Act.

<sup>344</sup> See Section III.B.4(b), *supra*. A U.S. person affiliate would be required to calculate all of its security-based swap transactions connected with its dealing activity and a non-U.S. person affiliate would be required to calculate its security-based swap transactions connected with its dealing activity with U.S. persons (other than foreign branches of U.S. banks) or otherwise conducted within the United States.

<sup>345</sup> Proposed Rules 3a71-3(b)(2)(i) and (ii) and proposed Rule 3a71-4 under the Exchange Act.

<sup>346</sup> *Id.*

<sup>347</sup> See Subtitle B of Title VII of the Dodd-Frank Act.

<sup>348</sup> See note 4, *supra*.

<sup>349</sup> See Intermediary Definitions Adopting Release, 77 FR 30631.

security-based swap dealers.<sup>350</sup> Under the proposed approach, a person calculating the amount of its security-based swap positions for purposes of the *de minimis* threshold would not need to include in such calculation the security-based swap transactions of an affiliate controlling, controlled by, or under common control with the person if such affiliate is registered with the Commission as a security-based swap dealer.<sup>351</sup> The application of this proposed rule would be limited to circumstances where a person's security-based swap activities are operationally independent from those of its registered security-based swap dealer affiliate. For purposes of this proposed rule, the security-based swap activities of two affiliates would be considered operationally independent if the two affiliated persons maintained separate sales and trading functions, operations (including separate back offices), and risk management with respect to any security-based swap dealing activity conducted by either affiliate that is required to be counted against their respective *de minimis* thresholds. If any of these functions were jointly administered by the two affiliates, or were managed at a central location within the affiliates' corporate group (e.g., at the entity serving as the central booking entity) with respect to any security-based swap dealing activity conducted by either affiliate that is required to be counted against their respective *de minimis* thresholds, then an unregistered person would not be able to exclude the security-based swap dealing activities of its registered security-based swap dealer affiliate under the proposed rule.

Absent the proposed exclusion of the dealing positions of a registered security-based swap dealer affiliate in the proposed rule, any affiliate of a registered security-based swap dealer that engaged in security-based swap dealing activity with U.S. persons or within the United States would be required to aggregate the dealing positions of the registered security-based swap dealer with its own dealing positions for purposes of the *de minimis* threshold. Given that a registered security-based swap dealer would presumably conduct relevant security-based swap dealing positions in excess of the *de minimis* threshold over the course of the immediately preceding 12 months, all persons affiliated with a registered security-based swap dealer that engaged in any level of security-

based swap dealing activity that is required to be counted against the *de minimis* threshold would necessarily be required to register with the Commission as security-based swap dealers because of the affiliate aggregation principle. We preliminarily do not believe that this outcome would be consistent with the statutory purpose of the *de minimis* exception, because it would prevent all affiliates of a registered dealer from taking advantage of the exception, even those engaged in a minimal amount of dealing activity relevant to Title VII dealer registration and regulation. We also do not believe that this scenario raises the concerns about evasion that underlie the *de minimis* affiliate aggregation rule jointly adopted by the Commission and the CFTC in the Intermediary Definitions Adopting Release, given that this proposed rule would apply only where a corporate group already included a registered dealer subject to Commission oversight, and the dealing positions of all commonly controlled unregistered affiliates in the corporate group would still be aggregated for purposes of the *de minimis* threshold.<sup>352</sup> For these reasons, we believe that it is appropriate not to include the security-based swap dealing positions of registered security-based swap dealers in the *de minimis* calculations of their commonly controlled affiliates provided that their security-based swap dealing activities that are relevant to the *de minimis* calculation are operationally independent of the registered security-based swap dealer affiliates.

#### Request for Comment

The Commission requests comment on all aspects of the proposed rule regarding the aggregation of affiliate positions, including the following:

- Should the Commission permit affiliated persons to exclude the security-based swap dealing positions of affiliated registered security-based swap dealers from their *de minimis* calculations, as proposed? Why or why not?
- Would permitting affiliated entities to exclude the security-based swap dealing positions of registered security-based swap dealers from their *de minimis* calculations undermine any of the Title VII protections associated with security-based swap dealer registration and regulation? If so, please explain. Should the Commission further explain what "operationally independent" means? If so, what should the Commission consider?

- Should the Commission permit affiliated entities to exclude the security-based swap dealing positions of operationally independent affiliates from their *de minimis* calculations, even if such affiliates are not registered security-based swap dealers?

- The CFTC has adopted temporary conditional relief that would permit a non-U.S. person to exclude from its *de minimis* calculation the security-based swap dealing positions of an affiliated non-U.S. person that is registered as a swap dealer and not guaranteed by a U.S. person with respect to its swap obligations.<sup>353</sup> Should the Commission adopt a similar interpretation to permit a non-U.S. person (but not a U.S. person) to exclude the dealing positions of its affiliated registered non-U.S. security-based swap dealer (but not the dealing positions of its affiliated registered U.S. security-based swap dealer)? Should the Commission condition such exclusion on the affiliated registered security-based swap dealer not being guaranteed by a U.S. person? If so, please describe the likely economic effects of providing different exclusions from the affiliate aggregation principle for U.S. and non-U.S. security-based swap dealers and how the Commission should best address them.

- The CFTC has also proposed an interpretation that would permit non-U.S. persons engaged in dealing activity with U.S. persons to aggregate the notional amounts of security-based swap dealing transactions by their non-U.S. affiliates separately from any dealing activity performed by their U.S. affiliates.<sup>354</sup> Should the Commission adopt a similar approach? If so, please explain how this approach is consistent with the *de minimis* threshold and the rationale provided for the affiliate aggregation principle in the Intermediaries Definitions Adopting Release. In addition, please describe the likely economic effects of providing an effectively higher *de minimis* threshold for corporate groups that engage in dealing activity with U.S. persons or within the United States through affiliates located in the United States and in foreign jurisdictions.

- What would be the market impact of the proposed approach to aggregation of affiliate positions? How would the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United

<sup>353</sup> See Final CFTC Cross-Border Exemptive Order, 78 FR 868.

<sup>354</sup> See CFTC Cross-Border Proposal, 77 FR 41219–20; see also Final CFTC Cross-Border Exemptive Order, 78 FR 867–68 (providing temporary conditional relief from the CFTC's *de minimis* aggregation requirements).

<sup>350</sup> Proposed Rule 3a71–4 under the Exchange Act.

<sup>351</sup> *Id.*

<sup>352</sup> See Intermediary Definitions Adopting Release, 77 FR 30631.



States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

#### 9. Treatment of Inter-Affiliate and Guaranteed Transactions

Consistent with the approach taken in the Intermediary Definitions Adopting Release, the Commission is proposing that cross-border security-based swap transactions between majority-owned affiliates would not need to be considered when determining whether a person is a security-based swap dealer.<sup>355</sup> Thus, a non-U.S. person engaged in dealing activity outside the United States would not be required to register as a security-based swap dealer simply by virtue of entering into security-based swap transactions with its majority-owned U.S. affiliate, even if such inter-affiliate security-based swaps were back-to-back transactions (*i.e.*, the foreign subsidiary was acting as a “conduit” for the U.S. person). Similarly, a U.S. person would not be required to register as a security-based swap dealer as a result of back-to-back transactions with a non-U.S. person subsidiary that acts as a conduit for such U.S. person.<sup>356</sup> Instead, as proposed, there must be an independent basis for requiring a person to register as a security-based swap dealer that is unrelated to its inter-affiliate transactions.<sup>357</sup>

<sup>355</sup> See 17 CFR 240.3a71–1(d), as discussed in the Intermediary Definitions Adopting Release, 77 FR 30624–25. For the purposes of this rule, which was adopted in the Intermediary Definitions Adopting Release, counterparties are considered majority-owned affiliates if one party directly or indirectly owns a majority interest in the other, or if a third party directly or indirectly owns a majority interest in both, based on the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution or the contribution of a majority of the capital of a partnership. See 17 CFR 240.3a71–1(d)(2).

<sup>356</sup> This approach differs from the treatment of conduit entities in the CFTC Cross-Border Proposal. Under the CFTC Cross-Border Proposal, a U.S. entity may be required to register as a swap dealer as a result of its inter-affiliate swap transactions with an affiliated foreign dealer if the foreign dealer is acting as a conduit by transferring swaps to the U.S. entity through back-to-back transactions. See CFTC Cross-Border Proposal, 77 FR 41222.

<sup>357</sup> Proposed Rule 3a71–4 under the Exchange Act.

Furthermore, the Commission is proposing not to require a non-U.S. person that receives a guarantee from a U.S. person of its performance on security-based swaps with non-U.S. persons outside the United States to count its dealing transactions with those non-U.S. persons toward the *de minimis* threshold as a U.S. person would be required to do.<sup>358</sup> We believe that the primary risk related to these transactions is the risk posed to the United States via the guarantee from a U.S. person, not the dealing activity occurring between two non-U.S. persons outside the United States. As a result, we do not believe that the risk posed by the existence of the U.S. guarantee would be better addressed through requiring non-U.S. persons receiving such guarantees to register with the Commission as security-based swap dealers. One way that the accumulation of risk resulting from security-based swap positions is addressed in Title VII is through the major security-based swap participant registration category. We preliminarily believe that the risk associated with guarantees by U.S. persons of the performance on security-based swap obligations of non-U.S. persons may be best addressed through the application of principles of attribution in the major security-based swap participant definition described in the Intermediary Definitions Adopting Release.<sup>359</sup> We preliminarily believe that use of the major security-based swap participant definition to address the risks posed to the United States as a result of guarantees by U.S. persons effectively deals with the specific regulatory concerns posed by the risks these guarantees present to the U.S. financial system and is consistent with the regulatory framework set forth in the Dodd-Frank Act.<sup>360</sup>

The Commission also is proposing not to require a foreign dealer to count security-based swap transactions with non-U.S. persons that receive guarantees from U.S. persons toward the *de minimis* threshold. The Commission notes that, in many respects, the risk created for U.S. persons and the U.S.

<sup>358</sup> This approach differs from the treatment of guaranteed entities in the CFTC Cross-Border Proposal. Under the CFTC Cross-Border Proposal, a non-U.S. person that receives a guarantee from a U.S. person would be required to count all of its swap dealing transactions against the *de minimis* threshold. See CFTC Cross-Border Proposal, 77 FR 41221.

<sup>359</sup> See Intermediary Definitions Adopting Release, 77 FR 30688–89; Section V.C.2(a), *infra*.

<sup>360</sup> See, e.g., Section IV, *infra*; see also Bank Holding Company Act of 1956 (12 U.S.C. 1841, *et seq.*); Title I of the Dodd-Frank Act (concerning regulation of certain nonbank financial companies and bank holding companies that pose a threat to the financial stability of the United States).

financial system in these transactions is the same as the risk posed if the U.S. person who provides the guarantee had entered into transactions directly with non-U.S. persons. The U.S. guarantor would be held responsible to settle those obligations, thus maintaining similar liability as though the U.S. person had entered into security-based swap transactions directly with a non-U.S. person. The Commission preliminarily believes that the risk posed to the U.S. markets by non-U.S. persons engaged in dealing activity with non-U.S. persons outside the United States whose performance under security-based swaps is guaranteed by a U.S. person can be best addressed through the major security-based swap participant definition and requirements applicable to major security-based swap participants, as the risks to the United States appear to arise only from the resulting positions and not the dealing activity as such.

Finally, as discussed below, the Commission is proposing to subject a security-based swap transaction between two non-U.S. persons where at least one of the persons receives a guarantee on the performance of its obligations from a U.S. person to the regulatory reporting requirement (but not, in some cases, to real-time public reporting).<sup>361</sup> If the proposed approach is adopted, the Commission would gain an understanding of market developments in this area as a result of the proposed *de minimis* exception.

#### Request for Comment

The Commission requests comment on all aspects of the proposed treatment of inter-affiliate and guaranteed transactions, including the following:

- Should the Commission revise our proposed approach to inter-affiliate transactions to require those transactions to be considered when determining whether a person is a security-based swap dealer? If so, why?
- If the Commission determines not to exclude inter-affiliate transactions from security-based swap dealing activity in the cross-border context, how could such a decision be reconciled with the exclusion for inter-affiliate transactions provided in the Intermediary Definitions Adopting Release? Should the Commission and the CFTC jointly reconsider the approach to inter-affiliate transactions provided in the Intermediary Definitions Adopting Release?

<sup>361</sup> See Section VIII, *infra*. Under proposed Regulation SBSR, inter-affiliate transactions would be subject to reporting and dissemination requirements. See *id.*



• Should the Commission require the registration of non-U.S. dealers that receive guarantees on the performance of their security-based swap obligations from U.S. persons based on their transactions with non-U.S. persons as well as U.S. persons? Why or why not? Should the U.S. guarantor be viewed as engaging indirectly in dealing activity through its affiliate and, therefore, required to register as a security-based swap dealer if the security-based swap transactions in connection with its dealing activity exceed the *de minimis* threshold? Should there be a concern that the U.S. guarantor is using the non-US affiliate to evade the requirements of Title VII?

• Does the proposed approach to guarantees effectively address concerns related to the risk posed to the U.S. financial system resulting from guarantees by U.S. persons of security-based swap dealing activity by non-U.S. persons?

• Are there competitiveness concerns related to the proposed approach to guarantees with regard to U.S. entities that engage in non-U.S. security-based swap dealing activity through business models that do not rely on guarantees of non-U.S. persons, such as those that operate through foreign branches?

• The CFTC has proposed an interpretation that would subject an entity that operates a “central booking system” where swaps are booked into a single legal entity, to any applicable swap dealer registration requirement as if it had entered into such swaps directly, irrespective of whether such entity is a U.S. person or whether the booking entity is a counterparty to the swap or enters into the swap indirectly through a back-to-back swap or other arrangement with its affiliate or subsidiary.<sup>362</sup> Should the Commission adopt a similar approach? If so, please describe how such a decision could be reconciled with the exclusion for inter-affiliate transactions provided in the Intermediary Definitions Adopting Release.

• What would be the market impact of the proposed approach to inter-affiliate and guaranteed transactions? How would the application of the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more

general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

#### 10. Comparison With Definition of “U.S. Person” in Regulation S

In proposing an entity-based approach to the definition of a U.S. person, we have declined to follow the suggestions by some commenters that we adopt the definition of “U.S. person” used in Regulation S, which among other things expressly excludes from the definition of “U.S. person” agencies or branches of U.S. persons located outside the United States.<sup>363</sup> Although we recognize that the Regulation S definition of U.S. person has the advantage of familiarity for many market participants, Regulation S addresses specific policy concerns that are different from those addressed by Title VII.<sup>364</sup> Specifically, the definition of U.S. person in Regulation S was adopted in the context of providing an “issuer safe harbor” from the registration requirements of Section 5 of the Securities Act, which was intended “to ensure that the [unregistered] securities offered [abroad] come to rest offshore.”<sup>365</sup> In that context, providing a safe harbor based in part on the location of the person, branch, or office making the investment decision is consistent with the goals of that regulatory framework, which

include protecting the integrity of the registration requirements applicable to securities publicly offered in the United States under the Securities Act. The Regulation S definition of “U.S. person” reflects this policy judgment.

We preliminarily believe that the definition of U.S. person in Title VII should encompass, for example, not only a person that has its place of residence or legal organization within the United States, but also its principal place of business within the United States, as the security-based swap activities of such entities are likely to manifest themselves most directly within the United States, where the majority of their commercial, legal, and financial relationships would be likely to exist because that is where their business principally occurs.<sup>366</sup>

Similarly, we preliminarily believe that the definition of U.S. person in Title VII should include accounts of a U.S. person, regardless of whether the account is a discretionary account or is held by a dealer or other person that is not resident in the United States, because the U.S. person bears the direct risk of transactions in the account, regardless of where the investment decision is made.<sup>367</sup> Moreover, we are proposing that an entity’s U.S.-person status would apply to the entity as a whole, since the risks related to the concerns of Title VII are borne by the entire entity and not just by the specific business unit (or branch or office) engaged in security-based swap activity.<sup>368</sup> With its exclusions for certain foreign branches and agencies of U.S. persons from the definition of “U.S. person,” Regulation S would not address the entity-wide nature of the risks that Title VII seeks to address.<sup>369</sup>

The Commission preliminarily believes that adopting the definition of “U.S. person” in Regulation S without significant modifications would not achieve the goals of Title VII. As discussed above, we are instead proposing a definition of U.S. person that focuses primarily on the location of the person bearing the direct risk of the transaction. Regulation S, with its focus on the person making the investment decision (rather than the person actually

<sup>363</sup> See, e.g., Cleary Letter IV at 2 (“The Agencies should adopt a consistent definition of ‘U.S. person’ based on SEC Regulation S for purposes of analyzing whether a transaction involving one or more such persons may be subject to the provisions of Dodd-Frank.”); Davis Polk I at 6 n.6 (“We propose that the term ‘U.S. counterparty’ be defined in the same way as the term ‘U.S. person’ in Rule 902(k) of the SEC’s Regulation S under the Securities Act, 17 CFR 230.902(k). This established definition is familiar to countless financial market professionals. Following the ‘U.S. person’ definition in Regulation S, rather than creating an entirely new definition, would avoid confusion and also provide consistency of application and legal certainty for a financial institution that offers a security and a swap to the same customer, which is common.”); SIFMA Letter I at 5 (“To determine whether a party to a swap is a ‘U.S. person,’ the Commissions should rely on the existing definition of that term contained in Rule 902(k) of the SEC’s Regulation S. This established, workable definition is familiar to regulators and market participants alike, and would provide legal certainty. It is noteworthy that the Regulation S definition of U.S. person does not include non-U.S. affiliates of U.S. persons or non-U.S. branches of a U.S. bank and generally excludes collective investment vehicles established outside the United States with U.S. investors.”) (footnotes omitted); see also Section III.B.5(c), *supra*.

<sup>364</sup> See 17 CFR 230.901(k); see also Regulation S Adopting Release, 55 FR 18306.

<sup>365</sup> Regulation S Adopting Release, 55 FR 18307.

<sup>366</sup> See proposed Rule 3a71-3(a)(7)(i)(B) under the Exchange Act; Section III.B.5(b)ii, *supra*.

<sup>367</sup> See proposed Rule 3a71-3(a)(7)(i)(C) under the Exchange Act; Section III.B.5(b)iii, *supra*.

<sup>368</sup> See Section III.B.5(a), *supra*.

<sup>369</sup> Under Regulation S, the foreign branch of a U.S. bank is not treated as a U.S. person while the U.S. branch of a foreign bank is treated as a U.S. person. By contrast, under proposed Rule 3a71-3(a)(7)(i)(B) under the Exchange Act, the foreign branch of a U.S. bank would be treated as part of a U.S. person while the U.S. branch of a foreign bank would be treated as a non-U.S. person.

<sup>362</sup> See CFTC Cross-Border Proposal, 77 FR 41221-22.

bearing the risk), would not necessarily capture the entity that actually bears the risks arising from security-based swap transactions that Title VII seeks to address.<sup>370</sup>

In light of the specific objectives of Title VII, the Commission preliminarily believes that a definition of U.S. person specifically tailored to the regulatory objectives it is meant to serve, as described above, is appropriate.<sup>371</sup>

#### Request for Comment

The Commission requests comment on all aspects of the proposed definition of U.S. person, including the following:

- Should the Commission adopt the definition of U.S. person in Regulation S? If so, how should the Commission reconcile the objectives of Title VII with the objectives that Regulation S is meant to serve?

- Should the Commission include all U.S. citizens in the definition of U.S. person, regardless of a person's residence or domicile?

- Should the Commission include within the definition of U.S. person entities and accounts where the discretion to enter into security-based swaps resides with a U.S. person? To what extent would this approach produce a result that differs from the current approach reflected in the proposed rule and the definitions of "security-based swap dealer" and "major security-based swap participant"?

<sup>370</sup> Rather than creating a U.S. person definition specifically tailored to Title VII, the Commission could have proposed a modified version of Regulation S. However, significantly modifying the definition of "U.S. person" in Regulation S to accommodate the objectives of Title VII would largely eliminate the benefits associated with adopting a consistent and well-established regulatory standard.

<sup>371</sup> See Section III.B.3(b)(4), *infra*. The Commission notes that it took a different approach to the definition of U.S. person and activity in the United States in connection with the Commission's exemption from registration for foreign private advisers. See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Advisers Act Release No 3222, 76 FR 39646 (July 6, 2011) (the "Foreign Private Adviser Exemption"). The Foreign Private Adviser Exemption defines certain terms in the statutory definition of "foreign private adviser" (added by Section 402 of the Dodd-Frank Act and codified at section 202(a)(30) of the Investment Advisers Act) by incorporating the definition of a "U.S. person" and "United States" under Regulation S. As discussed in this subsection, the Commission preliminarily believes that it would be inappropriate to follow the approach in Regulation S in its entirety with respect to the cross-border regulation of security-based swaps, although it may be appropriate in the context of the Foreign Private Adviser Exemption given the similar policy objectives with Regulation S.

### C. Regulation of Security-Based Swap Dealers in Title VII

#### I. Introduction

To help address the potential effects of registration, and attendant regulatory requirements, on foreign security-based swap dealers<sup>372</sup> with global security-based swap businesses and U.S. security-based swap dealers<sup>373</sup> that engage in security-based swap dealing activity through foreign branches that also may be subject to registration or regulation in foreign jurisdictions, the Commission is proposing not to apply the external business conduct standards and segregation requirements in Title VII to the Foreign Business<sup>374</sup> of such registered foreign security-based swap dealers and registered U.S. security-based swap dealers that engage in dealing activity through foreign branches with non-U.S. persons and foreign branches of U.S. banks.<sup>375</sup> In addition, while we are not proposing a rule to limit the application of entity-level requirements in Title VII to foreign security-based swap dealers, we are proposing to establish a policy and procedural framework under which the Commission would permit substituted compliance in some circumstances by registered foreign security-based swap dealers with certain Title VII requirements specifically applicable to security-based swap dealers.<sup>376</sup>

<sup>372</sup> Proposed Rule 3a71-3(a)(8) under the Exchange Act defines "U.S. security-based swap dealer" as a security-based swap dealer, as defined in Section 3(a)(71) of the Exchange Act, 15 U.S.C. 78c(a)(71), and the rules and regulations thereunder, that is a U.S. person, as defined in proposed Rule 3a71-3(a)(7) under the Exchange Act. Proposed Rule 3a71-3(a)(3) under the Exchange Act defines "foreign security-based swap dealer" as a security-based swap dealer, as defined in Section 3(a)(71) of the Exchange Act, and the rules and regulations thereunder, that is not a U.S. security-based swap dealer.

<sup>373</sup> See note 372, *supra*.

<sup>374</sup> As discussed below, proposed Rule 3a71-3(a)(2) under the Exchange Act defines "Foreign Business" as meaning the security-based swap transactions of foreign security-based swap dealers and U.S. security-based swap dealers "other than the U.S. Business of such entities." "U.S. Business" is defined in proposed Rule 3a71-3(a)(6) under the Exchange Act, with respect to a foreign security-based swap dealer, as (i) any transaction entered into, or offered to be entered into, by or on behalf of such foreign security-based swap dealer, with a U.S. person (other than with a foreign branch); or (ii) any transaction conducted within the United States; and, with respect to a U.S. security-based swap dealer, as any transaction by or on behalf of such U.S. security-based swap dealer, wherever entered into or offered to be entered into, other than a transaction conducted through a foreign branch, as defined in proposed Rule 3a71-3(a)(4), with a non-U.S. person or another foreign branch. See Section III.C.4, *infra*.

<sup>375</sup> Proposed Rule 3a71-3(b) under the Exchange Act.

<sup>376</sup> Proposed Rule 3a71-5 under the Exchange Act, as discussed in Section XI, *infra*.

In the following sections, we discuss the views of commenters, describe the transaction-level and entity-level requirements specifically applicable to security-based swap dealers in Title VII, and discuss the proposed application of transaction-level and entity-level requirements to registered security-based swap dealers in the cross-border context.

#### 2. Comment Summary

Various foreign dealers expressed their views about the application of the Dodd-Frank Act requirements to their derivatives businesses. A number of them expressed concern that if the Commission applies security-based swap dealer regulations, not only to entities conducting business from within the United States, but also to foreign-domiciled entities, it could effectively prevent foreign dealers from, among other things, managing their global security-based swap business out of a centralized booking entity (*i.e.*, the entity that acts as principal—the named counterparty—to a security-based swap transaction), which they maintain has many advantages for foreign dealers and their clients, including more efficient counterparty netting, greater transparency, greater financial counterparty financial strength, and operational efficiencies.<sup>377</sup> One commenter cautioned that if the regulations lead foreign dealers to create "fragmented booking structures" to avoid duplicative and conflicting regulatory regimes, it could harm U.S. consumers through increased transaction costs with foreign dealers.<sup>378</sup>

Many commenters suggested that to preserve a registration framework that would allow foreign dealers to continue to book their global security-based swap business out of a central non-U.S. entity, the Commission should use our limited designation authority under the Dodd-Frank Act's swap dealer definition to designate and regulate only specific activities and particular branches or agencies of foreign banks that transact

<sup>377</sup> See, e.g., Société Générale Letter I at 3 ("Overall, the advantages of carrying out Swap transactions in and with a foreign bank with a consolidated booking structure help control risk significantly. . . . We believe it would be sensible for the Commissions to craft regulations that do not discourage foreign banks such as SG from registering as Swap Dealers."); Davis Polk Letter I at 2, 5 ("We believe operating and managing a global swaps business out of a single booking entity presents many advantages from the perspective of foreign banks, customers and supervisors.");

<sup>378</sup> See ISDA Letter I at 10 (warning that "U.S. counterparties will . . . face increased costs and decreased liquidity if U.S. regulation forces non-U.S. SDs to create fragmented booking structures to avoid duplicative and conflicting regulatory regimes").

with U.S. customers, without subjecting the whole entity or its other branches to regulation.<sup>379</sup>

In addition, various commenters suggested a variety of operational models through which foreign dealers could operate in the U.S. security-based swap market, generally premising the proposed registration and regulatory regime on the notion that home country supervision should apply to entity-level regulations (*e.g.*, capital, risk management, and conflicts of interest), while Title VII transaction-level regulations should apply only to security-based swaps involving a U.S. counterparty.<sup>380</sup> A number of commenters emphasized that transaction-level requirements should not apply to security-based swaps entered into between foreign counterparties.<sup>381</sup> Other commenters remarked that if the Commission regulates both the U.S.-facing business (*i.e.*, transactions with U.S. persons) and the foreign-facing business (*i.e.*, transactions with non-U.S. persons) of U.S. security-based swap dealers, but only the U.S.-facing business of foreign security-based swap dealers, then U.S. firms would be at a competitive disadvantage vis-à-vis their foreign counterparts with respect to

transactions with foreign counterparties.<sup>382</sup>

Several commenters further expressed concern that a requirement for foreign persons to register with the Commission as security-based swap dealers could be particularly problematic in the case of capital requirements, where foreign security-based swap dealers already would be subject to their home country's prudential requirements. These commenters favored deferring to foreign regulators the regulation and supervision of entity-level requirements when a foreign security-based swap dealer is subject to comprehensive and comparable home country regulation.<sup>383</sup> One commenter recommended a comparability standard whereby the Federal Reserve and the Commission determine comparability even when a home country regulator does not require margin for non-cleared security-based swaps, if the home country's capital regime takes into account functionally equivalent capital charges.<sup>384</sup> Several commenters recommended that, for monitoring purposes, U.S. regulators could rely on information-sharing arrangements with home regulators regarding foreign swap transactions and activities.<sup>385</sup> A few commenters argued that U.S. regulators should not have examination authority over foreign swap transactions and activities located outside the United States, and suggested that the Commissions obtain any necessary information about U.S. swap transactions and activities from U.S.

affiliates of the foreign security-based swap dealer.<sup>386</sup>

### 3. Title VII Requirements Applicable to Security-Based Swap Dealers

Certain Title VII requirements specifically applicable to security-based swap dealers apply at a transaction level, that is, to security-based swap transactions with specific counterparties. Examples of transaction-level requirements in Title VII principally include requirements relating to external business conduct standards such as the requirement that a security-based swap dealer or major security-based swap participant verify that any counterparty meets the eligibility standards for an eligible contract participant<sup>387</sup> and requirements relating to segregation of assets held as collateral in security-based swap transactions.<sup>388</sup> Other requirements apply to security-based swap dealers at an entity level, that is, to the dealing entity as a whole. Examples of entity-level requirements include, among others, requirements relating to capital,<sup>389</sup> risk management procedures,<sup>390</sup> recordkeeping and reporting,<sup>391</sup> supervision,<sup>392</sup> and designation of a chief compliance officer.<sup>393</sup> Some requirements can be considered both entity-level and transaction-level requirements. For instance, the margin requirement in Section 15F(e) of the Exchange Act can be considered both an entity-level requirement because margin affects the financial soundness of an entity and a transaction-level requirement because margin calculation is based on particular transactions (*i.e.*, an entity

<sup>379</sup> See, *e.g.*, IIB Letter at 11 (pointing out that Section 3(a)(71) of the Exchange Act, as amended by the Dodd-Frank Act, provides for limited designation as a security-based swap dealer "for a single type or single class . . . of activities, and not for other types, classes, of . . . activities," and recommending that the Commissions designate as a Swap Dealer only the particular U.S. or non-U.S. branch or agency of the foreign bank involved in the execution of swaps with U.S. customers"); Rabobank Letter at 2 (recommending that to preserve "the benefits of the centralized booking model, a non-U.S. branch of a foreign bank should register as a swap dealer solely with respect to its swap dealing activities with U.S. persons. Under this scenario, Title VII's transaction-level rules would apply only to the non-U.S. branch's swap dealing activities with U.S. persons and would not apply to its other activities or to the swap activities of other parts of the foreign bank").

<sup>380</sup> See, *e.g.*, Davis Polk Letter II at 4–20 (asserting that subjecting foreign entities to transaction-level requirements on foreign transactions would likely lead to a competitive disadvantage, because other foreign "banking organizations that are not so burdened by such dual and potentially conflicting requirements would be able to provide a wider range of services . . . , which may cause customers to migrate away from" those foreign operations, which would limit their ability to manage, transfer, and reduce systemic risk).

<sup>381</sup> See, *e.g.*, Sullivan & Cromwell Letter at 14–15 (asserting that subjecting foreign entities to transaction-level requirements on foreign transactions would likely lead to a competitive disadvantage, because other foreign "banking organizations that are not so burdened by such dual and potentially conflicting requirements would be able to provide a wider range of services . . . , which may cause customers to migrate away from" those foreign operations, which would limit their ability to manage, transfer, and reduce systemic risk).

<sup>382</sup> See, *e.g.*, SIFMA Letter I at 11 (remarking that "U.S. swap dealers also may be at a competitive disadvantage relative to non-U.S. entities if U.S. swap dealers must comply with U.S. rules when dealing with a non-U.S. counterparty in a jurisdiction that does not have similar rules, for example, if the foreign rules do not mandate margin requirements for non-cleared swaps").

<sup>383</sup> See, *e.g.*, Financial Services Roundtable Letter at 25 (suggesting that the Commissions should defer to foreign prudential regulators with regard to entity-level requirements such as capital and margin, when they are deemed consistent with U.S. standards); Davis Polk Letter I at 3–4 (emphasizing the importance of relying on home country regulation for entity-level rules such as capital, margin, conflicts of interest, risk management, and limited recordkeeping requirements).

<sup>384</sup> See Davis Polk Letter II at 13–15 (recommending a comparability standard that "focuses on the similarities in regulatory objectives as opposed to identity of technical rules," whereby the Federal Reserve, as the prudential regulator, could determine comparability even when a home country regulator does not require margin for non-cleared swaps, if "the capital regime in such home country is determined to take account appropriately of unmarginated or undermarginated swaps by imposing additional capital charges").

<sup>385</sup> See, *e.g.*, Davis Polk Letter I at 9 (stating that "[w]here information is required from the foreign bank swap dealer, U.S. regulators should seek to rely upon regulatory examinations by home country regulators, and information sharing arrangements").

<sup>386</sup> See, *e.g.*, Société Générale Letter I at 12 (recommending that a foreign dealer based outside the U.S. with no U.S. nexus "should be 'ring-fenced' and outside the scope of the Commissions' examination and regulatory authority," but allowing for a limited examination of a foreign bank's U.S. facing business concerning its clearing, trade execution, and capital rules, through its U.S. domiciled agent who "would facilitate this examination by making all necessary information available directly to the Commissions").

<sup>387</sup> See, *e.g.*, Section 15F(h)(3)(A) of the Exchange Act, 15 U.S.C. 78o–10(h)(3)(A). See generally Section 15F(h) (discussing external business conduct standards). However, requirements under Section 15F(h)(1), which address fraud, supervision and adherence to position limits, apply at the entity level.

<sup>388</sup> See Section 3E of the Exchange Act, 15 U.S.C. 78c–5.

<sup>389</sup> See Section 15F(e) of the Exchange Act, 15 U.S.C. 78o–10(e).

<sup>390</sup> See Section 15F(j)(2) of the Exchange Act, 15 U.S.C. 78o–10(j)(2).

<sup>391</sup> See Section 15F(k) of the Exchange Act, 15 U.S.C. 78o–10(k).

<sup>392</sup> See Section 15F(h)(1)(B) of the Exchange Act, 15 U.S.C. 78o–10(h)(1)(B).

<sup>393</sup> See Section 15F(k) of the Exchange Act, 15 U.S.C. 78o–10(k).

calculates margin based on the market value of specific transactions or on a portfolio basis).<sup>394</sup>

Below, we describe in more detail various transaction-level and entity-level requirements in Title VII applicable to security-based swap dealers.<sup>395</sup>

#### (a) Transaction-Level Requirements

In general, transaction-level requirements primarily focus on protecting counterparties by requiring security-based swap dealers to, among other things, provide certain disclosures to counterparties, adhere to certain standards of business conduct, and segregate customer funds, securities, and other assets. The following briefly describes the most significant transaction-level requirements applicable to security-based swap dealers in Title VII.

##### i. External Business Conduct Standards

Section 15F(h) of the Exchange Act requires the Commission to adopt rules specifying external business conduct standards for security-based swap dealers in their dealings with counterparties,<sup>396</sup> including counterparties that are “special entities.”<sup>397</sup> Congress granted the Commission broad authority to promulgate business conduct requirements, as the Commission determines to be appropriate in the public interest, for the protection of

<sup>394</sup> See Section 15F(e) of the Exchange Act, 15 U.S.C. 78o–10(e). To take another example, the requirement that security-based swap dealers implement conflict-of-interest systems and procedures relating to security-based swaps in Section 15F(j)(5) of the Exchange Act, 15 U.S.C. 78o–10(j)(5), is transactional in the sense that potential conflicts of interest relate to particular security-based swap transactions. At the same time, however, it also is an entity-level requirement because implementing such systems and procedures would require, among other things, a security-based swap dealer to establish structural and institutional safeguards to wall off the activities of persons within the firm relating to research or analysis of the price or market for any security-based swap. See External Business Conduct Standards Proposing Release, 76 FR 42420.

<sup>395</sup> For purposes of this discussion, we are addressing only requirements applicable to security-based swap dealers in Sections 3E and 15F of the Exchange Act, 15 U.S.C. 78c–5 and 78o–10, and the rules and regulations thereunder. Title VII requirements relating to regulatory reporting and public dissemination, clearing, and trade execution are discussed in Sections VIII–X below.

<sup>396</sup> Section 15F(h)(6) of the Exchange Act, 15 U.S.C. 78o–10(h)(6), directs the Commission to prescribe rules governing external business conduct standards for security-based swap dealers. Section 15F(h) of the Exchange Act, 15 U.S.C. 78o–10(h), also generally authorizes and requires the Commission to adopt rules for major security-based swap participants. See Section IV, *infra*.

<sup>397</sup> Section 15F(h)(2)(C) of the Exchange Act, 15 U.S.C. 78o–10(h)(2)(C). See note 286, *supra*.

investors or otherwise in furtherance of the purposes of the Exchange Act.<sup>398</sup>

These standards, as described in Section 15F(h)(3) of the Exchange Act, must require security-based swap dealers to: (i) Verify that a counterparty meets the eligibility standards for an ECP; (ii) disclose to the counterparty material information about the security-based swap, including material risks and characteristics of the security-based swap, and material incentives and conflicts of interest of the security-based swap dealer in connection with the security-based swap; and (iii) provide the counterparty with information concerning the daily mark for the security-based swap. Section 15F(h)(3) also directs the Commission to establish a duty for security-based swap dealers to communicate information in a fair and balanced manner based on principles of fair dealing and good faith.

In addition, Section 15F(h)(4) of the Exchange Act requires that a security-based swap dealer that “acts as an advisor to a special entity” must act in the “best interests” of the special entity and undertake “reasonable efforts to obtain such information as is necessary to make a reasonable determination” that a recommended security-based swap is in the best interests of the special entity.<sup>399</sup> Section 15F(h)(5) requires that security-based swap dealers that enter into, or offer to enter into, security-based swaps with a special entity comply with any duty established by the Commission that requires a security-based swap dealer to have a “reasonable basis” for believing that a special entity has an “independent representative” that meets certain criteria and undertakes a duty to act in the “best interests” of the special entity.

The Commission has proposed Rules 15Fh–1 through 15Fh–6 under the Exchange Act to implement the business conduct requirements described above.<sup>400</sup> In addition to external business conduct standards expressly addressed by Title VII, the Commission

<sup>398</sup> See Section 15F(h)(3)(D) of the Exchange Act, 15 U.S.C. 78o–10(h)(3)(D) (“[b]usiness conduct requirements adopted by the Commission shall establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act”). See also Section 15F(h)(1)(D) of the Exchange Act (requiring that security-based swap dealers to comply as well with “such business conduct standards . . . as may be prescribed by the Commission by rule or regulation that relate to . . . such other matters as the Commission determines to be appropriate”).

<sup>399</sup> See External Business Conduct Standards Proposing Release, 76 FR 42423–25.

<sup>400</sup> See External Business Conduct Standards Proposing Release, 76 FR 42396.

has proposed certain other business conduct requirements for security-based swap dealers that the Commission preliminarily believed would further the principles that underlie the Dodd-Frank Act. These rules would, among other things, impose certain “know your counterparty” and suitability obligations on security-based swap dealers, as well as restrict security-based swap dealers from engaging in certain “pay to play” activities.<sup>401</sup>

##### ii. Segregation of Assets

Segregation requirements are designed to identify and protect customer property held by a security-based swap dealer as collateral in order to facilitate the prompt return of the property to customers or counterparties in a liquidation proceeding of such security-based swap dealer.<sup>402</sup> Segregation not only protects counterparties who are customers of a security-based swap dealer but also facilitates orderly liquidation of a security-based swap dealer and minimizes the disruption to and impact on the U.S. security-based swap market and the U.S. financial system overall caused by insolvency and liquidation of a security-based swap dealer.

Section 3E of the Exchange Act provides the Commission with rulemaking authority to prescribe segregation requirements for securities-based swap dealers that receive assets from, for, or on behalf of a counterparty to margin, guarantee, or secure a security-based swap transaction.<sup>403</sup> Section 3E(c) provides the Commission with rulemaking authority to prescribe how any margin received by a security-based swap dealer with respect to cleared security-based swap transactions may be maintained, accounted for, treated and dealt with by the security-based swap dealer.<sup>404</sup> In addition, Section 3E(g) extended the customer protections of the U.S. Bankruptcy Code to counterparties of a security-based swap dealer with respect to cleared security-based swaps, and with respect to non-cleared security-based swaps, if there is a customer protection requirement under Section 15(c)(3) or a segregation requirement

<sup>401</sup> See External Business Conduct Standards Proposing Release, 76 FR 42399–400; proposed Rules 15Fh–3(e) (“know your counterparty”), 15Fh–3(f) (“suitability”), and 15Fh–6 (“pay to play”) under the Exchange Act.

<sup>402</sup> Proposed Rule 18a–4 under the Exchange Act, as discussed in Section I.I.C. of the Capital, Margin, and Segregation Proposing Release, 77 FR 70274.

<sup>403</sup> See Section 3E of the Exchange Act, 15 U.S.C. 78c–5.

<sup>404</sup> See Section 3E(c)(2) of the Exchange Act, 15 U.S.C. 78c–5(c)(2).

prescribed by the Commission.<sup>405</sup> The Commission has proposed Rule 18a–4 under the Exchange Act to establish segregation requirements for security-based swap dealers with respect to both cleared and non-cleared security-based swap transactions.<sup>406</sup> The provisions of proposed Rule 18a–4 were modeled on the broker-dealer customer protection rule and take into account the characteristics of security-based swaps.<sup>407</sup>

#### (b) Entity-Level Requirements

Entity-level requirements in Title VII primarily address concerns relating to the security-based swap dealer as a whole, with a particular focus on safety and soundness of the entity to reduce systemic risk in the U.S. financial system.<sup>408</sup> The most significant entity-level requirements, as discussed below, are capital and margin requirements. Certain other entity-level requirements relate to the capital and margin requirements because, at their core, they relate to how the firm identifies and manages its risk exposure arising from its activities (e.g., risk management requirements). Given their functions, these entity-level requirements would be applied under our proposal on a firm-wide basis to address risks to the security-based swap dealer as a whole.

##### i. Capital

The Commission is required to establish minimum requirements relating to capital for security-based swap dealers for which there is not a prudential regulator (“nonbank security-based swap dealers”).<sup>409</sup> The prudential regulators are required to establish requirements relating to capital for bank security-based swap dealers.<sup>410</sup> Some

<sup>405</sup> See Section 3E(g) of the Exchange Act, 15 U.S.C. 78c–5(g); Capital, Margin, and Segregation Proposing Release, 77 FR 70275.

<sup>406</sup> Proposed Rule 18a–4 under the Exchange Act, as discussed in the Capital, Margin, and Segregation Proposing Release, 77 FR 70274–88.

<sup>407</sup> 17 CFR 240.15c3–3. See Capital, Margin, and Segregation Proposing Release, 77 FR 70276.

<sup>408</sup> For example, Section 15F(e)(3) of the Exchange Act provides that the requirements relating to capital and margin imposed by the Commission pursuant to Section 15F(e)(2) shall help ensure the safety and soundness of the security-based swap dealer and be appropriate for the risk associated with the non-cleared security-based swaps held as a security-based swap dealer in order “[t]o offset the greater risk to the security-based swap dealer . . . and the financial system arising from the use of security-based swaps that are not cleared.”

<sup>409</sup> See Section 15F(e)(1)(B) of the Exchange Act, 15 U.S.C. 78o–10(e)(1)(B); note 34, *supra* (discussing the term “prudential regulator”).

<sup>410</sup> See Section 15F(e)(1)(A) of the Exchange Act, 15 U.S.C. 78o–10(e)(1)(A); see also Prudential Regulators Proposed Rule, Margin and Capital Requirements for Covered Swap Entities, 76 FR

security-based swap dealers may also be registered as swap dealers with the CFTC. The CFTC is required to establish capital requirements for nonbank swap dealers.<sup>411</sup> The prudential regulators are required to establish capital requirements for bank swap dealers.<sup>412</sup>

The objective of the Commission’s proposed capital rule for security-based swap dealers is the same as the Commission’s capital rule for broker-dealers; specifically, to ensure that the entity maintains at all times sufficient liquid assets to (i) promptly satisfy its liabilities—the claims of customers, creditors, and other security-based swap dealers, and (ii) provide a cushion of liquid assets in excess of liabilities to cover potential market, credit, and other risks.<sup>413</sup>

As noted above, the Commission’s proposed capital rules focus on the liquid assets of a nonbank security-based swap dealer available to satisfy its liabilities or cover its risks in a liquidation scenario. This focus on liquid assets would distinguish the Commission’s capital rules applicable to security-based swap dealers from those applicable to banks, which generally include a more permissive list of assets that may be taken into account for purposes of capital calculations.<sup>414</sup> The difference in approach between the capital rules applicable to nonbank dealers and bank dealers is supported by certain operational, policy, and legal differences between nonbank security-based swap dealers and bank security-based swap dealers.<sup>415</sup> Notably, existing capital standards for banks and broker-

27564 (May 11, 2011) (“Prudential Regulator Margin and Capital Proposal”).

<sup>411</sup> See Section 4s(e)(1)(B) of the CEA, 7 U.S.C. 6s(e)(1)(B), as added by Section 731 of the Dodd-Frank Act; see also CFTC Proposed Rule, Capital Requirements of Swap Dealers and Major Swap Participants, 76 FR 27802 (May 12, 2011) (“CFTC Capital Proposal”).

<sup>412</sup> See Section 4s(e)(1)(A) of the CEA, 7 U.S.C. 6s(e)(1)(A); see also Prudential Regulator Margin and Capital Proposal, 76 FR 27564.

<sup>413</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70218 (“[T]he capital and other financial responsibility requirements for broker-dealers generally provide a reasonable template for crafting the corresponding requirements for nonbank [security-based swap dealers]. For example, among other considerations, the objectives of capital standards for both types of entities are similar.”).

<sup>414</sup> See, e.g., Basel Committee on Banking Supervision (“BCBS”), Basel III: International framework for liquidity risk measurement, standards and monitoring for banks (Dec. 2010) (“Basel III”), available at: <http://www.bis.org/publ/bcbs188.pdf>.

<sup>415</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70218. In this release, the Commission discussed the operational, policy, and legal differences between banks and nonbank entities for distinguishing the Commission’s capital rules from those applicable to bank security-based swap dealers.

dealers reflect, in part, differences in their funding models and access to certain types of financial support, and we expect that those same differences also will exist between bank security-based swap dealers and nonbank security-based swap dealers. For example, banks obtain funding through customer deposits and can generally obtain liquidity through the Federal Reserve’s discount window to meet their obligations,<sup>416</sup> whereas broker-dealers and nonbank security-based swap dealers cannot.<sup>417</sup> Thus all of a nonbank entity’s counterparty obligations must be met through the nonbank entity’s own liquid assets. For these reasons, the Commission’s proposed capital standard for nonbank security-based swap dealers is a net liquid assets test modeled on the broker-dealer capital standard in Rule 15c3–1 under the Exchange Act.<sup>418</sup>

##### ii. Margin

Margin may be viewed as an entity-level requirement given its effect on the financial soundness of an entity, as well as a transaction-level requirement due to the fact that margin is calculated based on particular transactions and positions. Although margin is calculated based on individual transactions, the cumulative effect of collecting margin from counterparties is to protect an entity from the default of its counterparties. Given the emphasis placed on the financial soundness of security-based swap dealers in Title VII,<sup>419</sup> we believe that margin should be treated as an entity-level requirement for purposes of implementing Title VII in the cross-border context.

We recognize that this approach differs from the approach to margin

<sup>416</sup> Depository institutions that maintain transaction accounts or non-personal time deposits subject to reserve requirements are eligible to borrow funds from the Federal Reserve’s discount window, such as commercial banks, thrift institutions, and U.S. branches and agencies of foreign banks. See Regulation D, 12 CFR part 204.

<sup>417</sup> Under the segregation requirements in Rule 15c3–3 under the Exchange Act and proposed Rule 18a–4 under the Exchange Act, broker-dealers and security-based swap dealers are not permitted to rehypothecate customer assets to finance their business activity. Thus, they cannot use customer assets as a source of funding, whereas banks are in the business of investing customer deposits (subject to banking regulations).

<sup>418</sup> *Id.*

<sup>419</sup> See, e.g., Section 15F(e)(3)(A)(i) of the Exchange Act, 15 U.S.C. 78o–10(e)(3)(A)(i) (stating that Title VII’s capital and margin requirements are intended to “help ensure the safety and soundness of the security-based swap dealer or major security-based swap participant”). In setting capital and margin requirements for security-based swap dealers and major security-based swap participants, the Commission’s goal is to help ensure the safety and soundness of these entities because of their connection to the U.S. financial system.

proposed by the CFTC in its cross-border guidance, which focused on the transaction-by-transaction nature of margin and thus treated it as a transaction-level requirement.<sup>420</sup> However, we preliminarily believe that treating margin as an entity-level requirement is consistent with the role margin plays as part of an integrated program of financial responsibility requirements, along with the capital standards and segregation requirements, that are intended to enhance the financial integrity of security-based swap dealers.<sup>421</sup> The margin requirements proposed by the Commission are intended to work in tandem with the capital requirements to strengthen the financial system by reducing the potential for default to an acceptable level and limiting the amount of leverage that can be employed by security-based swap dealers and other market participants.<sup>422</sup> For example, the capital requirements proposed by the Commission take into account whether a security-based swap is cleared or non-cleared, the amount of margin collateral imposed by registered clearing agencies with respect to cleared security-based swaps, and the circumstances where non-cleared security-based swaps are excepted from the margin collection requirements imposed by the Commission, and would impose a capital charge in certain cases for uncollateralized or insufficiently collateralized exposures arising from cleared or non-cleared security-based swaps in order to account for the counterparty default risk that is not adequately addressed by margin collateral.<sup>423</sup> We preliminarily do not believe that margin would effectively fulfill its purpose as part of a comprehensive financial responsibility program for non-bank security-based swap dealers if the Commission were to treat margin solely as a transaction-level requirement.

The division of regulatory responsibilities related to margin requirements in Title VII mirrors that of the capital requirements discussed above. As with capital, the Commission is required to establish minimum requirements relating to initial and variation margin on all security-based swaps that are not cleared by a registered clearing agency for nonbank

security-based swap dealers.<sup>424</sup> The prudential regulators are required to establish requirements relating to margin for bank security-based swap dealers.<sup>425</sup> Security-based swap dealers that are also registered as swap dealers with the CFTC also would be subject to CFTC requirements for nonbank swap dealers with respect to initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization.<sup>426</sup>

The objective of the margin requirements for security-based swap dealers is to offset the greater risk to the security-based swap dealer and the financial system arising from the use of security-based swaps that are not cleared.<sup>427</sup> Margin serves as a buffer in the event a counterparty fails to meet an obligation to the security-based swap dealer and the security-based swap dealer must liquidate the assets posted by the counterparty to satisfy the obligation.<sup>428</sup> More generally, under Title VII, the Commission is specifically required to set both capital and margin requirements for nonbank security-based swap dealers that (i) help ensure the safety and soundness of the nonbank security-based swap dealer and (ii) are appropriate for the risk associated with the non-cleared swaps held as a security-based swap dealer.<sup>429</sup>

Pursuant to Section 15F(e) of the Exchange Act, the Commission has proposed Rule 18a-3 to establish margin requirements for nonbank security-based swap dealers with respect to non-cleared security-based swaps.<sup>430</sup>

<sup>424</sup> See Sections 15F(e)(1)(B) and (2)(B) of the Exchange Act, 15 U.S.C. 78o-10(e)(1)(B) and (2)(B).

<sup>425</sup> See Section 15F(e)(1)(A) of the Exchange Act, 15 U.S.C. 78o-10(e)(1)(A); see also Prudential Regulator Margin and Capital Proposal, 76 FR 27564.

<sup>426</sup> See Section 4s(e)(1)(B) of the CEA, 7 U.S.C. 6s(e)(1)(B), as added by Section 731 of the Dodd-Frank Act; see also CFTC Proposed Rule, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 FR 23732 (Apr. 28, 2011) ("CFTC Margin Proposal"). The CFTC also has adopted segregation requirements for cleared swaps and proposed segregation requirements for non-cleared swaps. See Protection of Cleared Swaps Customer Contracts and Collateral; Conforming Amendments to the Commodity Broker Bankruptcy Provisions, 77 FR 6336 (Feb. 7, 2012) ("CFTC Segregation for Cleared Swaps Final Release"); Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 75 FR 75432 (Dec. 3, 2010) ("CFTC Segregation for Uncleared Swaps Proposing Release").

<sup>427</sup> See Section 15F(e)(3)(A) of the Exchange Act, 15 U.S.C. 78o-10(e)(3)(A).

<sup>428</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70259.

<sup>429</sup> See Sections 15F(e)(3)(A)(i) and (ii) of the Exchange Act, 15 U.S.C. 78o-10(e)(3)(A)(i) and (ii).

<sup>430</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70257-74.

Proposed Rule 18a-3 is based on the margin rules applicable to broker-dealers.<sup>431</sup> The goal of modeling proposed Rule 18a-3 on the broker-dealer margin rules is to promote consistency with existing rules and to facilitate the portfolio margining of security-based swaps with other types of securities.<sup>432</sup> Proposed Rule 18a-3 is intended to form part of an integrated program of financial responsibility requirements, along with the proposed capital and segregation standards.<sup>433</sup>

The Commission preliminarily believes that it is necessary to treat margin as an entity-level requirement applicable to all of a dealer's security-based swap transactions in order to effectively address the Dodd-Frank Act requirements for setting margin. We preliminarily believe that treating margin solely as a transaction-level requirement, and applying margin requirements differently to a security-based swap dealer's U.S. Business and Foreign Business,<sup>434</sup> would not adequately further the goals of using margin to ensure the safety and soundness of security-based swap dealers because it could result in security-based swap dealers with global businesses collecting significantly less collateral than would otherwise be required to the extent that they are not required by local law to collect margin from their counterparties. Further, separately applying margin in this way would force those counterparties entering into transactions that constitute the U.S. Business of a dealer to bear a greater burden in ensuring the safety and soundness of such dealer than counterparties that are part of the dealer's Foreign Business.<sup>435</sup> We thus preliminarily believe that it is

<sup>431</sup> See *id.* at 70259. Broker-dealers are subject to margin requirements in Regulation T promulgated by the Federal Reserve (12 CFR 220.1-220.132), in rules promulgated by the self-regulatory organizations ("SROs") (see, e.g., Rules 4210-4240 of the Financial Industry Regulatory Authority ("FINRA")), and with respect to security futures, in rules jointly promulgated by the Commission and the CFTC (17 CFR 242.400-242.406).

<sup>432</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70259.

<sup>433</sup> *Id.*

<sup>434</sup> See proposed Rule 3a71-3(a)(2) under the Exchange Act (defining "Foreign Business").

<sup>435</sup> Although we do not believe that it is appropriate to distinguish between the geographic locations of counterparties when applying the margin requirement, we recognize that it may be appropriate, in certain circumstances, to distinguish between types of counterparties in applying margin based on such factors as the risk they pose to dealers and the policy goal of promoting liquidity in dealers. See Capital, Margin, and Segregation Proposing Release, 77 FR 70265-68 (proposing to exclude both transactions with commercial end users and those with other dealers from certain margin requirements applicable to security-based swap dealers).

<sup>420</sup> See CFTC Cross-Border Proposal, 77 FR 41226.

<sup>421</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70303 and 70259.

<sup>422</sup> See *id.* at 70304.

<sup>423</sup> See *id.* at 70245-46.

appropriate to treat margin as an entity-level requirement applicable to the security-based swap transactions of registered security-based swap dealers regardless of the location of their counterparties. As noted below, the Commission is soliciting comment on this approach.

### iii. Risk Management

Registered security-based swap dealers are required to establish robust and professional risk management systems adequate for managing their day-to-day business.<sup>436</sup> The Commission has proposed that nonbank security-based swap dealers would be required to comply with existing Rule 15c3-4 under the Exchange Act.<sup>437</sup> This rule, originally adopted for OTC derivative dealers, requires firms subject to its provisions to establish, document, and maintain a comprehensive system of internal risk management controls to assist in managing the risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks.<sup>438</sup> These various risks arise from both the U.S. Business and Foreign Business of a global security-based swap dealer. A risk management system limited in scope to cover only one type of business, or limited to certain security-based swap transactions, would not effectively control the risks undertaken by a security-based swap dealer because the risks stemming from business outside the scope of such risk management system could still negatively impact the dealer. As a result, we preliminarily believe that it is necessary to treat risk management requirements as entity-level requirements in order to place risk controls over the entire security-based swap business, thus effectively addressing the Dodd-Frank Act requirements for managing risk within security-based swap dealers.

Rule 15c3-4 identifies a number of qualitative factors that would need to be a part of the risk management controls of a nonbank security-based swap dealer. For example, a nonbank security-based swap dealer would need to have a risk control unit that reports directly to senior management and is

independent from business trading units, and it would be required to separate duties between personnel responsible for entering into a transaction and those responsible for recording the transaction in the books and records of the firm.<sup>439</sup> In addition, the Commission is authorized to adopt rules governing documentation standards of security-based swap dealers for timely and accurate confirmation, processing, netting, documentation, and valuation of security-based swaps.<sup>440</sup> Pursuant to this authority, the Commission has proposed rules regarding trade acknowledgement and verification related to security-based swap transactions.<sup>441</sup>

### iv. Recordkeeping and Reporting

Registered nonbank security-based swap dealers are required to keep books and records in such form and manner and for such period as may be prescribed by the Commission by rule or regulation; registered bank security-based swap dealers are required to keep books and records of all activities related to their "business as a security-based swap dealer" in such form and manner and for such period as may be prescribed by the Commission.<sup>442</sup> Registered security-based swap dealers also are required to make such reports as are required by the Commission regarding the transactions and positions, and financial condition of the registrant.<sup>443</sup>

In addition, security-based swap dealers are required to maintain daily trading records of the security-based swaps they enter into.<sup>444</sup> Security-based swap dealers also are required to disclose to the Commission and the prudential regulators information concerning: (i) Terms and conditions of their security-based swaps; (ii) security-based swap trading operations, mechanisms, and practices; (iii) financial integrity protections relating to security-based swaps; and (iv) other information relevant to their trading in security-based swaps.<sup>445</sup>

<sup>439</sup> See 17 CFR 240.15c3-4(c), as discussed in the Capital, Margin, and Segregation Proposing Release, 77 FR 70250.

<sup>440</sup> See Section 15F(i) of the Exchange Act, 15 U.S.C. 78o-10(i).

<sup>441</sup> See Trade Acknowledgement Proposing Release, 76 FR 3859.

<sup>442</sup> See Sections 15F(f)(1)(B)(i) and (ii) of the Exchange Act, 15 U.S.C. 78o-10(f)(1)(B)(i) and (ii).

<sup>443</sup> See Section 15F(f)(1)(A) of the Exchange Act, 15 U.S.C. 78o-10(f)(1)(A).

<sup>444</sup> See Section 15F(g) of the Exchange Act, 15 U.S.C. 78o-10(g).

<sup>445</sup> See Section 15F(j)(3) of the Exchange Act, 15 U.S.C. 78o-10(j)(3).

Each of these types of records is an important part of the Commission's oversight of our registrants because it provides the Commission with vital information regarding such entities. If the Commission's information were limited in scope to cover only one type of business, or limited to only certain security-based swap activities, the Commission would not be able to effectively regulate our registered security-based swap dealers because it would not have a full picture of the business of such registrants. As a result, we preliminarily believe that it is necessary to treat recordkeeping and reporting as entity-level requirements in order to provide the Commission with the information necessary to regulate registered security-based swap dealers and thus effectively address the Dodd-Frank Act requirements for maintaining books and records.

The Commission has not yet proposed rules regarding the recordkeeping and reporting requirements under Section 15F of the Exchange Act and solicits comment regarding the application of recordkeeping and reporting requirements in the cross-border context.

### v. Internal System and Controls

Security-based swap dealers are required to establish and enforce systems and procedures to obtain any information that is necessary to perform any of the functions that are required under Section 15F(j) of the Exchange Act<sup>446</sup> and to provide this information to the Commission, or the responsible prudential regulator, upon request.<sup>447</sup> The Commission has proposed a rule that would require a registered security-based swap dealer to establish policies and procedures that are reasonably designed to comply with its responsibilities under Section 15F(j) of the Exchange Act.<sup>448</sup>

Many of the functions required under Section 15F(j) of the Exchange Act are

<sup>446</sup> 15 U.S.C. 78o-10(j). These functions include monitoring of applicable position limits under Section 15F(j)(1) of the Exchange Act, 15 U.S.C. 78o-10(j)(1); establishment of risk management procedures under Section 15F(j)(2) of the Exchange Act, 15 U.S.C. 78o-10(j)(2); disclosure of general information to the Commission and prudential regulators under Section 15F(j)(3) of the Exchange Act, 15 U.S.C. 78o-10(j)(3); establishment of policies and procedures to avoid conflicts of interest under Section 15F(j)(5) of the Exchange Act, 15 U.S.C. 78o-10(j)(5); and avoidance of any actions that result in an unreasonable restraint of trade or place any material anticompetitive burden on trading or clearing under Section 15F(j)(6) of the Exchange Act, 15 U.S.C. 78o-10(j)(6).

<sup>447</sup> See Section 15F(j)(4) of the Exchange Act, 15 U.S.C. 78o-10(j)(4).

<sup>448</sup> See proposed Rule 15Fh-3(h)(2)(iv) under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42420.

<sup>436</sup> See Section 15F(j)(2) of the Exchange Act, 15 U.S.C. 78o-10(j)(2).

<sup>437</sup> See proposed new paragraph (a)(10)(ii) of Rule 15c3-1 under the Exchange Act (17 CFR 240.15c3-1); paragraph (g) of proposed new Rule 18a-1 under the Exchange Act. See also 17 CFR 240.15c3-4; Capital, Margin, and Segregation Proposing Release, 77 FR 70250-51. The Commission has not proposed rules relating to risk management for bank security-based swap dealers.

<sup>438</sup> See OTC Derivatives Dealers, Exchange Act Release No. 40594 (Oct. 23, 1998), 63 FR 59362 (Nov. 3, 1998).



entity-level in nature (*e.g.*, risk management procedures<sup>449</sup> and conflicts of interest<sup>450</sup>). As a result, we preliminarily believe that the requirement to establish and enforce systems and procedures to obtain any information that is necessary to perform these functions cannot be effectively implemented unless it also is treated as an entity-level requirement, or else it would not cover the full scope of the requirements under Section 15F(j) of the Exchange Act to which it applies.

#### vi. Diligent Supervision

The Commission is authorized under the Dodd-Frank Act to adopt rules requiring diligent supervision of the business of security-based swap dealers.<sup>451</sup> The Commission has proposed a rule that would establish supervisory obligations and that would incorporate principles from Section 15(b) of the Exchange Act and existing SRO rules.<sup>452</sup> Among other things, under proposed Rule 15Fh-3(h), a security-based swap dealer would be required to establish, maintain, and enforce a system to supervise, and would be required to supervise diligently, its business and its associated persons, with a view to preventing violations of applicable federal securities laws, and the rules and regulations thereunder, relating to its business as a security-based swap dealer.<sup>453</sup> The rule proposed by the Commission also would establish certain minimum requirements relating to the supervisory systems that are prescriptive in nature, that is, they would impose specific obligations on security-based swap dealers.<sup>454</sup>

As previously noted, the purpose of diligent supervision requirements is to prevent violations of applicable federal securities laws, and the rules and regulations thereunder, relating to an entity's business as a security-based swap dealer. An entity's business as a security-based swap dealer is not limited to either its Foreign Business or its U.S. Business, but rather is comprised of its entire global security-based swap dealing activity. As a result,

we preliminarily believe that it is necessary to treat diligent supervision as an entity-level requirement applicable to all of a dealer's security-based swap transactions in order to effectively address the Dodd-Frank Act requirements for diligent supervision. We believe that treating diligent supervision solely as a transaction-level requirement, and applying supervisory requirements differently to a security-based swap dealer's U.S. Business and Foreign Business, would not further the Dodd-Frank Act goal of establishing effective supervisory systems for security-based swap dealers.

#### vii. Conflicts of Interest

Section 15F(j)(5) of the Exchange Act requires security-based swap dealers to implement conflict-of-interest systems and procedures. Such policies and procedures must establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any security-based swap, or acting in the role of providing clearing activities, or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision, and contravene the core principles of open access and the business conduct standards addressed in Title VII.<sup>455</sup> The Commission has proposed a rule that would require a security-based swap dealer to establish policies and procedures that are reasonably designed to comply with its responsibilities under Section 15F(j)(5).<sup>456</sup>

The Commission preliminarily believes that it is necessary to treat conflicts of interest as an entity-level requirement applicable to all of a dealer's security-based swap transactions in order to effectively address the Dodd-Frank Act requirements for setting systems and procedures to prevent conflicts of interest from biasing the judgment or supervision of security-based swap dealers. We believe that treating conflicts of interest solely as a transaction-level requirement, and applying the required structural and institutional safeguards differently to a

security-based swap dealer's U.S. Business and Foreign Business, would not further the goals of preventing conflicts of interest from influencing the security-based swap dealing activities of registered security-based swap dealers because such safeguards would only be in place for a portion of a security-based swap dealer's activities.

#### viii. Chief Compliance Officer

Registered security-based swap dealers are required to designate a chief compliance officer who reports directly to the board of directors or to the senior officer of the security-based swap dealer.<sup>457</sup> The chief compliance officer's responsibilities include reviewing and ensuring compliance of the security-based swap dealer with applicable requirements in the Exchange Act and the rules and regulations thereunder, resolution of conflicts of interest, administration of business conduct policies and procedures, and establishment of procedures for the remediation of noncompliance issues.<sup>458</sup> The chief compliance officer also is required to prepare and sign a report that contains a description of the security-based swap dealer's compliance with applicable requirements in the Exchange Act, and the rules and regulations thereunder, and each of the security-based swap dealer's policies and procedures.<sup>459</sup> The Commission has proposed a rule to implement these statutory requirements relating to the designation and functions of a chief compliance officer.<sup>460</sup>

As noted above, part of the chief compliance officer's responsibilities, under the proposed rule, include establishing, maintaining, and reviewing policies and procedures reasonably designed to ensure compliance with applicable requirements in the Exchange Act and the rules and regulations thereunder.<sup>461</sup> Many of Title VII requirements, such as those applicable to security-based swap dealers that are described in this section, apply at the entity level. As a result, we preliminarily believe that it is necessary to treat the chief compliance officer as an entity-level requirement applicable to all of a dealer's security-

<sup>449</sup> See Section III.C.3(b)iii, *supra*.

<sup>450</sup> See Section III.C.3(b)vii, *infra*.

<sup>451</sup> See Section 15F(h)(1)(B) of the Exchange Act, 15 U.S.C. 78o-10(h)(1)(B).

<sup>452</sup> Proposed Rule 15Fh-3(h) under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42419-21.

<sup>453</sup> Proposed Rule 15Fh-3(h)(1) under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42419-21.

<sup>454</sup> Proposed Rule 15Fh-3(h)(2) under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42419-21.

<sup>455</sup> See Section 15F(j)(5) of the Exchange Act, 15 U.S.C. 78o-10(j)(5), as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42420.

<sup>456</sup> Proposed Rule 15Fh-3(h)(2)(iv) under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42420.

<sup>457</sup> See Section 15F(k) of the Exchange Act, 15 U.S.C. 78o-10(k).

<sup>458</sup> See Section 15F(k)(2) of the Exchange Act, 15 U.S.C. 78o-10(k)(2).

<sup>459</sup> See Section 15F(k)(3) of the Exchange Act, 15 U.S.C. 78o-10(k)(3).

<sup>460</sup> Proposed Rule 15Fk-1 under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42435-38.

<sup>461</sup> See Proposed Rule 15Fk-1(b)(2) under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42435-36.

based swap business in order to effectively address the Dodd-Frank Act requirements for the chief compliance officer. We believe that treating the chief compliance officer solely as a transaction-level requirement, and applying the chief compliance officer requirements differently to a security-based swap dealer's U.S. Business and Foreign Business, would be unworkable given the chief compliance officer's oversight responsibilities over entity-level requirements and thus would not further the goals of establishing the chief compliance officer role for security-based swap dealers.

#### ix. Inspection and Examination

Registered bank and nonbank security-based swap dealers are obligated to keep their books and records required pursuant to Commission rules and regulations open to inspection and examination by any representative of the Commission.<sup>462</sup> The Commission has proposed a rule that would require, among other things, "nonresident security-based swap dealers" that are required to register with the Commission to appoint and identify to the Commission an agent in the United States (other than the Commission or a Commission member, official, or employee) for service of process.<sup>463</sup> In addition, the proposed rule would require that a nonresident security-based swap dealer certify that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission.<sup>464</sup> The proposed rule also would require that the nonresident security-based swap dealer provide the Commission with an opinion of counsel concurring that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to

onsite inspection and examination by the Commission.<sup>465</sup>

In proposing this rule, the Commission stated that it preliminarily believed that the nonresident security-based swap certification and supporting opinion of counsel were important to confirm that each registered nonresident security-based swap dealer has taken the necessary steps to be in the position to provide the Commission with prompt access to its books and records and to be subject to inspection and examination by the Commission.<sup>466</sup> To effectively fulfill our regulatory oversight responsibilities with respect to nonresident security-based swap dealers registered with it, the Commission stated that it must have access to those entities' records and the ability to examine them. The Commission recognized, however, that certain foreign jurisdictions may have laws that complicate the ability of financial institutions, such as nonresident security-based swap dealers located in their jurisdictions, to share and/or transfer certain information including personal financial data of individuals that the financial institutions come to possess from third persons (*e.g.*, personal data relating to the identity of market participants or their customers).<sup>467</sup> The Commission further stated that the required certification and opinion of counsel regarding the nonresident security-based swap dealer's ability to provide prompt access to books and records and to be subject to inspection and examination would allow the Commission to better evaluate a nonresident security-based swap dealer's ability to meet the requirements of registration and ongoing supervision.<sup>468</sup>

The Commission's inspection and examination authority is vital to our oversight of registered security-based swap dealers. If the Commission's inspection and examination were limited in scope to cover only one type of business, or limited to only certain security-based swap activities, the Commission would not be able to effectively regulate our registered security-based swap dealers because it would not have a full picture of the business of such registrants. As a result, we preliminarily believe that it is necessary to treat inspection and examination requirements as entity-level in order to provide the

Commission with the information and access necessary to regulate registered security-based swap dealers.

#### x. Licensing Requirements and Statutory Disqualification

The Commission has not proposed any licensing requirements for associated persons of registered security-based swap dealers, that are specifically related to their security-based swap dealing activities. However, the Commission has proposed a rule that would require security-based swap dealers (and major security-based swap participants) to certify that no person associated with such entities who effects or is involved in effecting security-based swaps on their behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act.<sup>469</sup> This proposed rule relates to paragraph (b)(6) of Section 15F of the Exchange Act,<sup>470</sup> which generally prohibits security-based swap dealers (and major security-based swap participants) from permitting any of their associated persons<sup>471</sup> who are subject to a "statutory disqualification" to effect or be involved in effecting<sup>472</sup> security-based swaps on behalf of such entities if the security-based swap dealer (or major security-based swap participant) knew, or in the exercise of

<sup>469</sup> 15 U.S.C. 78c(a)(39). See proposed Rule 15Fb6-1 under the Exchange Act, as discussed in the Registration Proposing Release, 76 FR 65795.

<sup>470</sup> 15 U.S.C. 78o-10(b)(6).

<sup>471</sup> Section 3(a)(70) of the Exchange Act, 15 U.S.C. 78c(a)(70), generally defines the term "person associated with" a security-based swap dealer or major security-based swap participant ("SBS Entity") to include: (i) any partner, officer, director, or branch manager of an SBS Entity (or any person occupying a similar status or performing similar functions); (ii) any person directly or indirectly controlling, controlled by, or under common control with an SBS Entity; or (iii) any employee of an SBS Entity. However, it generally excludes persons whose functions are solely clerical or ministerial.

<sup>472</sup> As stated in the Registration Proposing Release, "[t]he Commission believes that associated persons 'involved in effecting' security-based swaps would include, but not be limited to, persons involved in drafting and negotiating master agreements and confirmations, persons recommending security-based swap transactions to counterparties, persons on a trading desk actively involved in effecting security-based swap transactions, persons pricing security-based swap positions and managing collateral for the [security-based swap dealer or major security-based swap participant], and persons assuring that the [security-based swap dealer's or major security-based swap participant's] security-based swap business operates in compliance with applicable regulations. In short, the term would encompass persons engaged in functions necessary to facilitate the [security-based swap dealer's or major security-based swap participant's] security-based swap business." Registration Proposing Release, 76 FR 65795 n. 56.

<sup>462</sup> See Section 15F(f)(1)(C) of the Exchange Act, 15 U.S.C. 78o-10(f)(1)(C). Registered bank security-based swap dealers are only required to keep the books and records associated with the activities related to their security-based swap dealing business, as prescribed by the Commission, and to make these books and records available for inspection by any representative of the Commission. See *id.*

<sup>463</sup> Proposed Rule 15Fb2-4 under the Exchange Act, as discussed in the Registration Proposing Release, 76 FR 65799. For a description of the term "nonresident security-based swap dealer" as defined in proposed Rule 15Fb2-4(a) under the Exchange Act, including how that definition differs from the definition of the term "foreign security-based swap dealer" as proposed in this release, see note 579 above.

<sup>464</sup> Proposed Rule 15Fb2-4 under the Exchange Act, as discussed in the Registration Proposing Release, 76 FR 65800.

<sup>465</sup> Proposed Rule 15Fb2-4 under the Exchange Act, as discussed in the Registration Proposing Release, 76 FR 65799-801.

<sup>466</sup> See Registration Proposing Release, 76 FR 65800.

<sup>467</sup> *Id.*

<sup>468</sup> *Id.*

reasonable care should have known, of the statutory disqualification.<sup>473</sup>

The Commission preliminarily believes that it is necessary to treat requirements related to licensing and statutory disqualification as entity-level requirements applicable to all of a dealer's security-based swap business in order to effectively address the Exchange Act's statutory disqualification provision. We believe that treating licensing requirements and statutory disqualification solely as transaction-level requirements, and applying the statutory disqualification differently to a security-based swap dealer's U.S. Business and Foreign Business, would not further the goals of preventing statutorily disqualified persons from effecting security-based swaps on behalf of registered security-based swap dealers because such disqualifications would only be in place for a portion of a security-based swap dealer's activities.

#### 4. Application of Certain Transaction-Level Requirements<sup>474</sup>

##### (a) Proposed Rule

The Commission is proposing a rule that would provide that a registered foreign security-based swap dealer and a foreign branch of a registered U.S. security-based swap dealer, with respect to their Foreign Business, shall not be subject to the requirements relating to external business conduct standards described in Section 15F(h) of the Exchange Act,<sup>475</sup> and the rules and regulations thereunder, other than the rules and regulations prescribed by the Commission pursuant to Section 15F(h)(1)(B).<sup>476</sup>

The proposed rule would define "Foreign Business" as security-based swap transactions entered into, or offered to be entered into, by or on behalf of a foreign security-based swap dealer or a U.S. security-based swap dealer that do not include its U.S. Business.<sup>477</sup> The proposed rule would define "U.S. Business" as:

- With respect to a foreign security-based swap dealer, (i) any transaction entered into, or offered to be entered into, by or on behalf of such foreign security-based swap dealer, with a U.S. person (other than with a foreign branch), or (ii) any transaction conducted within the United States;<sup>478</sup> and
- With respect to a U.S. security-based swap dealer, any transaction by or on behalf of such U.S. security-based swap dealer, wherever entered into or offered to be entered into, other than a transaction conducted through a foreign branch with a non-U.S. person or another foreign branch.<sup>479</sup>

Whether the activity occurred within the United States or with a U.S. person for purposes of identifying whether security-based swap transactions are part of a U.S. Business or Foreign Business would turn on the same factors used to determine whether a foreign security-based swap dealer is engaging in dealing activity within the United States or with U.S. persons, as discussed above.<sup>480</sup> The proposed rule provides that a U.S. security-based swap dealer would be considered to have conducted a security-based swap transaction through a foreign branch if:

- The foreign branch is the counterparty to such security-based swap transaction; and
- No person within the United States is directly involved in soliciting, negotiating, or executing the security-based swap transaction on behalf of the foreign branch or its counterparty.<sup>481</sup> As discussed above,<sup>482</sup> the proposed rule would define "foreign branch" as any branch of a U.S. bank if:
  - The branch is located outside the United States;
  - The branch operates for valid business reasons; and
  - The branch is engaged in the business of banking and is subject to

substantive banking regulation in the jurisdiction where located.<sup>483</sup>

All other requirements in Section 15F of the Exchange Act, and the rules and regulations thereunder, would apply to both U.S. and foreign security-based swap dealers registered with the Commission, although the Commission is proposing to establish a policy and procedural framework under which it would consider permitting substituted compliance for foreign security-based swap dealers (but not for U.S. security-based swap dealers that conduct dealing activity through foreign branches) under certain circumstances, as discussed below.<sup>484</sup>

The Commission also is proposing a rule that would provide that a foreign security-based swap dealer would not be required to comply with the segregation requirements set forth in Section 3E of the Exchange Act, and the rules and regulations thereunder, with respect to security-based transactions with non-U.S. person counterparties in certain circumstances.<sup>485</sup> Specifically, the Commission is proposing a rule that would provide the following:

- With respect to non-cleared security-based swap transactions:
  - A registered foreign security-based swap dealer that is a registered broker-dealer would be subject to the requirements relating to segregation of assets held as collateral set forth in Section 3E of the Exchange Act, and rules and regulations thereunder, with respect to assets collected from, for, or on behalf of any counterparty to margin a non-cleared security-based swap transaction.
  - a registered foreign security-based swap dealer that is not a registered broker-dealer would be subject to the requirements relating to segregation of assets held as collateral set forth in Section 3E of the Exchange Act, and Rules 18a-4(a)-(d), solely with respect to assets collected from, for, or on behalf of a counterparty that is a U.S. person to margin a non-cleared security-based swap transaction. The special account maintained by a registered foreign security-based swap dealer that is not a registered broker-dealer in accordance with proposed Rule 18a-4(c) would be required to be designated for the exclusive benefit of U.S. person security-based swap customers.<sup>486</sup>
    - With respect to cleared security-based swap transactions:

<sup>473</sup> See Registration Proposing Release, 76 FR 65795.

<sup>474</sup> For purposes of this discussion, we are addressing only requirements applicable to security-based swap dealers in Sections 3E and 15F of the Exchange Act, 15 U.S.C. 78c-5 and 78o-10, and the rules and regulations thereunder. Title VII requirements relating to reporting and dissemination, clearing, and trade execution are discussed in Sections VIII-X, *infra*.

<sup>475</sup> 15 U.S.C. 78o-10(h).

<sup>476</sup> Proposed Rule 3a71-3(c) under the Exchange Act. The approach under the proposed rule does not affect applicability of the general antifraud provisions of the federal securities laws to the activity of a foreign security-based swap dealer. See Section XII, *infra*.

<sup>477</sup> Proposed Rule 3a71-3(a)(2) under the Exchange Act.

<sup>478</sup> Proposed Rule 3a71-3(a)(6) under the Exchange Act. A person that meets the security-based swap dealer definition is a dealer with regard to all of its security-based swap activities, not just its dealing activities. See Intermediary Definitions Adopting Release, 77 FR 30645. Accordingly, a foreign security-based swap dealer's U.S. Business would not be limited only to transactions arising from its dealing activity, but rather would include all types of security-based swap activity.

<sup>479</sup> Proposed Rule 3a71-3(a)(6) under the Exchange Act.

<sup>480</sup> See Section III.B.6, *supra* (discussing the proposed definition of "transaction conducted within the United States").

<sup>481</sup> Proposed Rule 3a71-3(a)(4) under the Exchange Act. See also proposed Rule 3a71-3(a)(5)(ii) under the Exchange Act (providing that the definition of "transaction conducted within the United States" shall not include a transaction conducted through a foreign branch).

<sup>482</sup> See Section III.B.7, *supra*.

<sup>483</sup> Proposed Rule 3a71-3(a)(1) under the Exchange Act.

<sup>484</sup> See Section XI.C, *infra*.

<sup>485</sup> Proposed Rule 18a-4(e) under the Exchange Act.

<sup>486</sup> Proposed Rule 18a-4(e)(1) under the Exchange Act.

○ A registered foreign security-based swap dealer that is not a foreign bank with a branch or agency in the United States and is a registered broker-dealer shall be subject to the requirements relating to segregation of assets held as collateral set forth in Section 3E of the Exchange Act, and rules and regulations thereunder, with respect to assets collected from, for, or on behalf of any counterparty to margin a cleared security-based swap transaction.

○ a registered foreign security-based swap dealer that is not a foreign bank with a branch or agency in the United States and that is not a registered broker-dealer shall be subject to the requirements relating to segregation of assets held as collateral set forth in Section 3E of the Exchange Act, and Rules 18a–4(a)–(d), only if such registered foreign security-based swap dealer accepts any assets from, for, or on behalf of a counterparty that is a U.S. person to margin, guarantee, or secure a cleared security-based swap transaction.<sup>487</sup>

○ a registered foreign security-based swap dealer that is a foreign bank with a branch or agency in the United States would be subject to the requirements relating to segregation of assets held as collateral set forth in Section 3E of the Exchange Act, and Rules 18a–4(a)–(d),<sup>488</sup> solely with respect to assets collected from a counterparty that is a U.S. person to margin a cleared security-based swap transaction. The special account maintained by a registered foreign security-based swap dealer that is a foreign bank with a branch or agency in the United States in accordance with proposed Rule 18a–4(c) would be required to be designated for the exclusive benefit of U.S. person security-based swap customers.<sup>489</sup>

In addition, a registered foreign security-based swap dealer would be required to disclose to its counterparty the potential treatment of the assets segregated by such registered foreign security-based swap dealer pursuant to Section 3E of the Exchange Act, and rules and regulations thereunder, in insolvency proceedings under the U.S. bankruptcy law and applicable foreign insolvency laws.<sup>490</sup>

<sup>487</sup> Proposed Rule 18a–4(e)(2)(ii) under the Exchange Act.

<sup>488</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70274–88 (proposing Rules 18a–4(a)–(d) under the Exchange Act).

<sup>489</sup> Proposed Rule 18a–4(e)(2)(i) under the Exchange Act.

<sup>490</sup> Proposed Rule 18a–4(e)(3) under the Exchange Act.

## (b) Discussion

### i. External Business Conduct Standards

#### a. Foreign Security-Based Swap Dealers

The Commission preliminarily believes it is appropriate not to impose on foreign security-based swap dealers the external business conduct standards in Section 15F(h) (other than rules and requirements prescribed by the Commission pursuant to Section 15F(h)(1)(B)) of the Exchange Act, and the rules and regulations thereunder, described in the proposed rule,<sup>491</sup> with respect to their Foreign Business, because these requirements relate primarily to customer protection. The Dodd-Frank Act's counterparty protection mandate focuses on the United States and the U.S. markets.<sup>492</sup> In addition, we preliminarily believe that foreign counterparties typically would not expect to receive the customer protections of Title VII when dealing with a foreign security-based swap dealer outside the United States. At the same time, our proposed approach would preserve customer protections for U.S. counterparties that would expect to benefit from the protection afforded to them by Title VII of the Dodd-Frank Act.

Therefore, the Commission preliminarily believes that requiring foreign security-based swap dealers to comply with the external business conduct standards requirement with respect to their security-based swap transactions conducted outside the United States with non-U.S. persons (or with foreign branches of U.S. banks) would not advance this statutory purpose. Although this approach represents a departure from the entity approach the Commission has traditionally taken in the regulation of foreign broker-dealers, as discussed above, whereby the Commission applies our regulations to the entire global business of a registered broker-dealer, we preliminarily believe this departure is appropriate in the context of a global security-based swap market in order to create a regulatory framework that provides effective protections for counterparties that are U.S. persons while recognizing the role of foreign regulators in non-U.S. markets.

The Commission also preliminarily believes that this approach addresses many of the concerns raised by commenters, including foreign regulators, concerning the potential application of Title VII to transactions between registered foreign security-

<sup>491</sup> Proposed Rule 3a71–3(c) under the Exchange Act.

<sup>492</sup> See note 4, *supra*.

based swap dealers and non-U.S. counterparties. In addition, this approach is consistent with the reasonable expectations of U.S. person counterparties, who would expect to receive the protection of external business conduct standards and conflicts of interest requirements when dealing with a foreign security-based swap dealer within the United States.<sup>493</sup>

The Commission's proposed approach to external business conduct standards would not except foreign security-based swap dealers from the rules and requirements prescribed by the Commission pursuant to Section 15F(h)(1)(B) of the Exchange Act with respect to their Foreign Business.<sup>494</sup> Section 15F(h)(1)(B) requires security-based swap dealers to conform with such business conduct standards relating to diligent supervision as the Commission shall prescribe.<sup>495</sup> The Commission preliminarily believes that it is not appropriate to except foreign security-based swap dealers from compliance with such requirements. Because registered foreign security-based swap dealers would be subject to a number of obligations under the federal securities laws with respect to their security-based swap business, the Commission preliminarily believes that having systems in place reasonably designed to ensure diligent supervision would be an important aspect of their compliance with the federal securities laws. However, as discussed below, the Commission is proposing to permit substituted compliance with the diligent supervision requirement in Section 15F(h)(1)(B), and the rules and regulations thereunder, by foreign security-based swap dealers.<sup>496</sup> The Commission preliminarily believes that foreign security-based swap dealers subject to regulation in a foreign jurisdiction are very likely to be subject to diligent supervision requirements and to the extent that such requirements are comparable to Commission requirements, we would consider permitting substituted compliance, as discussed below.<sup>497</sup>

The Commission is proposing to except foreign security-based swap dealers from complying with the rules and regulations that the Commission may prescribe pursuant to Section 15F(h)(1)(A) or (C) of the Exchange

<sup>493</sup> See note 321, *supra*.

<sup>494</sup> Proposed Rule 3a71–3(c) under the Exchange Act.

<sup>495</sup> 15 U.S.C. 78o–10(h)(1)(B). See Section III.C.3(b)vi, *supra* (discussing the diligent supervision requirements).

<sup>496</sup> See Section XI.C, *infra*.

<sup>497</sup> See *id*.

Act.<sup>498</sup> Section 15F(h)(1)(A) requires security-based swap dealers to conform with such business conduct standards relating to fraud, manipulation, and other abusive practices involving security-based swaps (including security-based swaps that are offered but not entered into) as prescribed by the Commission. Section 15F(h)(1)(C) requires security-based swap dealers to adhere to rules and regulations prescribed by the Commission with respect to applicable position limits. The Commission has not engaged in rulemaking pursuant to these provisions.<sup>499</sup> If the Commission does propose rules pursuant to these provisions in the future, the Commission would consider, at that time, whether it would be appropriate to subject foreign security-based swap dealers to such requirements with respect to their Foreign Business.

#### b. U.S. Security-Based Swap Dealers

The Commission preliminarily believes it is appropriate not to subject U.S. security-based swap dealers to the external business conduct standards in Section 15F(h) (other than Section 15F(h)(1)(B)) of the Exchange Act, and the rules and regulations thereunder, as specified in the proposed rule, with respect to security-based swap transactions conducted through their foreign branches outside the United States with non-U.S. counterparties, because such requirements relate primarily to customer protection requirements. The Dodd-Frank Act generally is concerned with the protection of U.S. markets and participants in those markets.<sup>500</sup> Therefore, we preliminarily believe that subjecting U.S. security-based swap dealers to the Title VII customer protection requirements with respect to their security-based swap transactions conducted through their foreign branches outside the United States (even though the transactions may pose risk to the U.S. financial system) with non-U.S. persons would produce little

or no benefit to U.S. market participants. Although this approach would represent a departure from the entity approach the Commission has traditionally taken in the regulation of broker-dealers, whereby the Commission applies our regulations to the entire global business of a registered broker-dealer, we preliminarily believe it is appropriate in the context of a global security-based swap market in order to develop a national regulatory framework that provides effective protections for counterparties who are U.S. persons while recognizing the role of foreign regulators in non-U.S. markets.

The Commission also preliminarily believes that this approach would help address the potential application of duplicative and conflicting regulatory requirements to security-based swap transactions between the foreign branches of registered U.S. bank security-based swap dealers and non-U.S. counterparties. In addition, the Commission preliminarily believes this approach is consistent with the reasonable expectations of foreign counterparties, who would not necessarily expect to receive the protections of Title VII when dealing with a foreign branch of a U.S. bank outside the United States, even if it is registered as a security-based swap dealer with the Commission.<sup>501</sup>

The purpose of the proposed provision defining when a security-based swap transaction would be considered to have been conducted through a foreign branch is intended to prevent U.S. security-based swap dealers from using the proposed rule to evade the application of Title VII.<sup>502</sup> Requiring that the foreign branch be the named counterparty to the security-based swap transaction and that no person within the United States be directly involved in soliciting, negotiating, or executing the security-based swap transaction on behalf of the foreign branch or its counterparty is intended to help ensure that the security-based swap transaction occurs outside the United States, even though the Commission recognizes that the risk of the transaction would ultimately be borne by the U.S. security-based swap dealer, of which the foreign branch is merely a part.<sup>503</sup> The U.S. security-based swap dealer would still be subject

to the entity-level requirements described above intended to address the risk the transactions pose to the U.S. financial system.

#### ii. Segregation Requirements

The segregation requirements set forth in Section 3E of the Exchange Act, and rules and regulations thereunder, are closely tied to U.S. bankruptcy laws.<sup>504</sup> Subchapter III of Chapter 7, Title 11 of the United States Code (the “stockbroker liquidation provisions”)<sup>505</sup> provides special protections for “customers” of stockbrokers. Among other protections, “customers” share ratably with other customers ahead of virtually all other creditors in the “customer property” held by the failed stockbroker.<sup>506</sup> The Dodd-Frank Act contains provisions designed to ensure that cash and securities held by a security-based swap dealer relating to security-based swaps will be deemed customer property under the stockbroker liquidation provisions.<sup>507</sup> In particular, Section 3E(g) of the Exchange Act<sup>508</sup> provides, among other things, that a security-based swap shall be considered to be a “security” as such term is used in section 101(53A)(B)<sup>509</sup> and the stockbroker liquidation provisions. Section 3E(g) also provides that an account that holds a security-based swap shall be considered to be a “securities account” as that term is defined in the stockbroker liquidation provisions.<sup>510</sup> In addition, Section 3E(g) provides that the terms “purchase” and “sale” as defined in Sections 3(a)(13) and (14) of the Exchange Act, respectively, shall be applied to the terms “purchase” and “sale” as used in the stockbroker liquidation

<sup>504</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70274–78 (discussing the customer protection treatment provided by proposed Rules 18a–4(a)–(d) in the stockbroker liquidation provisions in the U.S. Bankruptcy Code).

<sup>505</sup> See 11 U.S.C. 741–53.

<sup>506</sup> See 11 U.S.C. 752.

<sup>507</sup> See Public Law 111–203 section 763(d), adding Section 3E(g) to the Exchange Act, 15 U.S.C. 78c–5(g).

<sup>508</sup> See 15 U.S.C. 78c–5(g).

<sup>509</sup> See 11 U.S.C. 101(53A)(B). Section 101(53A) of the U.S. Bankruptcy Code defines a “stockbroker” to mean a person—(A) with respect to which there is a customer, as defined in section 741, subchapter III of chapter 7, title 11, United States Code (the definition section of the stockbroker liquidation provisions); and (B) that is engaged in the business of effecting transactions in securities—(i) for the account of others; or (ii) with members of the general public, from or for such person’s own account. See 11 U.S.C. 101(53A).

<sup>510</sup> See 15 U.S.C. 78c–5(g) and 11 U.S.C. 741. There is not a definition of “securities account” in 11 U.S.C. 741. The term “securities account” is used in 11 U.S.C. 741(2) and (4) in defining the terms “customer” and “customer property.”

<sup>498</sup> 15 U.S.C. 78o–10(h)(1)(A) and (C).

<sup>499</sup> Although the Commission has not proposed rules under Section 15F(h)(1)(A) of the Exchange Act, the Commission has proposed new Rule 9j–1 under the Exchange Act, which is intended to prevent fraud, manipulation, and deception in connection with the offer, purchase, or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-based swap, or the avoidance of such exercise or performance. See Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps, Exchange Act Release No. 63236 (Nov. 3, 2010), 75 FR 68560 (Nov. 8, 2010). The Commission’s view of its antifraud enforcement authority in the cross-border context is described in further detail in Section XI below.

<sup>500</sup> See note 4, *supra*.

<sup>501</sup> See note 321, *supra*. The proposed definition of foreign branch is the same as discussed above. See proposed Rule 3a71–3(a)(1) under the Exchange Act, as discussed in Section III.B.7, *supra*.

<sup>502</sup> Proposed Rule 3a71–3(a)(4) under the Exchange Act.

<sup>503</sup> Proposed Rule 3a71–3(a)(4)(i) under the Exchange Act.

provisions.<sup>511</sup> Finally, Section 3E(g) provides that the term “customer” as defined in the stockbroker liquidation provisions excludes any person to the extent the person has a claim based on a non-cleared security-based swap transaction except to the extent of any margin delivered to or by the customer with respect to which there is a customer protection requirement under Section 15(c)(3) of the Exchange Act or a segregation requirement.<sup>512</sup>

The provisions of Section 3E(g) of the Exchange Act apply the customer protection elements of the stockbroker liquidation provisions to cleared security-based swaps, including related collateral, and, if subject to customer protection requirements under Section 15(c)(3) of the Exchange Act or a segregation requirement prescribed by the Commission, to collateral delivered as margin for non-cleared security-based swaps.<sup>513</sup> The Commission has proposed Rule 18a-4(a)-(d) to establish segregation requirements for security-based swap dealers with respect to cleared and non-cleared security-based swaps pursuant to Section 3E of the Exchange Act and pursuant to Section 15(c)(3) of the Exchange Act<sup>514</sup> with respect to security-based swap dealers that are broker-dealers.<sup>515</sup>

Specifically, proposed Rule 18a-4(b) requires a security-based swap dealer to promptly obtain and thereafter maintain physical possession or control of all excess securities collateral carried for the accounts of security-based swap customers. Such possession or control requirement is designed to ensure the securities held for the accounts of

security-based swap customers are under the control of the security-based swap dealer and, therefore, readily available to be returned to security-based swap customers. Proposed Rule 18a-4(c) requires a security-based swap dealer to maintain a special account for the exclusive benefit of security-based swap customers and have on deposit in that account at all times an amount of cash or qualified securities determined by computing the net amount of credits owed to customers.<sup>516</sup> The objective of the possession or control and special account requirements in proposed Rule 18a-4 is to facilitate the prompt return of “customer property” to security-based swap customers either before or during a liquidation proceeding if the firm fails. In the event of a failure of the security-based swap dealer, customers would share the “customer property” ratably with other customers and ahead of virtually all other creditors.<sup>517</sup> In addition, with respect to non-cleared security-based swaps, proposed Rule 18a-4(d) requires a security-based swap dealer to provide the notice required under Section 3E(f)(1)(A) of the Exchange Act<sup>518</sup> to a counterparty in writing prior to the execution of the first non-cleared security-based swap transaction with such counterparty. If a counterparty to a non-cleared security-based swap elects to segregate funds or other property with a third-party custodian pursuant to Section 3E(f) of the Exchange Act or elects not to require the omnibus segregation of funds or other property pursuant to proposed Rule 18a-4(c), the security-based swap dealer must obtain an agreement from such counterparty to subordinate all claims against the security-based swap dealer to the claims of security-based swap customers of such security-based swap dealer.<sup>519</sup>

As proposed in the Capital, Margin and Segregation Proposing Release, the segregation requirements in proposed Rule 18a-4(a)-(d) do not distinguish between U.S. security-based swap dealers and foreign security-based swap dealers or between U.S. person and non-U.S. person security-based swap counterparties, and do not address application of the segregation requirements in the cross-border context. The Commission preliminarily believes that the Dodd-Frank Act’s mandate to promote financial stability, improve accountability, and protect counterparties focuses territorially on the United States and the U.S. security-based swap market<sup>520</sup> and, therefore, is not proposing any changes with respect to U.S. security-based swap dealers to the segregation requirements already proposed.<sup>521</sup> The Commission’s proposed approach to application of segregation requirements to foreign security-based swap dealers intends to protect U.S. person counterparties and minimize the impact of a failed security-based swap dealer on the U.S. financial system generally and the U.S. security-based swap market in particular.

#### a. Foreign Security-Based Swap Dealers

As stated above, Section 3E(g) extends the customer protection provided by the stockbroker liquidation provisions of the U.S. Bankruptcy Code to cleared security-based swaps and non-cleared security-based swaps in different ways. In addition, a foreign security-based swap dealer may not be subject to the stockbroker liquidation provisions if it is a foreign bank with a branch or agency in the United States.<sup>522</sup> Such foreign security-based swap dealer’s insolvency and liquidation would be subject to banking regulations.<sup>523</sup> On the

unconditional subordination agreement from the counterparty that waives segregation altogether. See proposed Rule 18a-4(d)(2)(ii) under the Exchange Act.

<sup>520</sup> See note 4, *supra*.

<sup>521</sup> See proposed Rules 18a-4(a)-(d) under the Exchange Act and Section 3E of the Exchange Act, 15 U.S.C. 78c-5. See also the Capital, Margin, and Segregation Proposing Release, 77 FR 70278-88.

<sup>522</sup> See Section 109(b) of the U.S. Bankruptcy Code, 11 U.S.C. 109(b) (providing that a person may be a debtor under chapter 7 of the U.S. Bankruptcy Code only if such person is not, among other things, a bank or similar institution which is an insured bank as defined in Section 3(h) of the Federal Deposit Insurance Act, or a foreign bank that has a branch or agency (as defined in Section 1(b) of the International Banking Act of 1978) in the United States).

<sup>523</sup> See 12 U.S.C. 1821-25. Whereas insured deposit institutions would be resolved under the Federal Deposit Insurance Act, uninsured U.S. branches of foreign banks would be resolved under either relevant state statutes, in the case of uninsured state branches, or the International

<sup>511</sup> See also 15 U.S.C. 78c-5(g) and 11 U.S.C. 741-753. Section 3(a)(13) of the Exchange Act, as amended by Section 761(a) of the Dodd-Frank Act, defines the term “purchase” to mean, in the case of security-based swaps, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require. See 15 U.S.C. 3(a)(13). Section 3(a)(14) of the Exchange Act, as amended by Section 761(a) of the Dodd-Frank Act, defines the term “sale” to mean, in the case of security-based swaps, the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require. See 15 U.S.C. 3(a)(14).

<sup>512</sup> See 15 U.S.C. 78c-5(g) and 11 U.S.C. 741(2).

<sup>513</sup> See 15 U.S.C. 78c-5(g) and 11 U.S.C. 741-53.

<sup>514</sup> 15 U.S.C. 780(c)(3).

<sup>515</sup> See proposed Rules 18a-4(a)-(d) under the Exchange Act and Section 3E of the Exchange Act, 15 U.S.C. 78c-5. See also the Capital, Margin, and Segregation Proposing Release, 77 FR 70278-88, for detailed descriptions and discussions of the proposed segregation requirements for security-based swaps in proposed Rules 18a-4(a), (b), and (c) under the Exchange Act and special provisions for non-cleared security-based swaps in proposed Rule 18a-4(d) under the Exchange Act.

<sup>516</sup> See proposed Rule 18a-4(c) and the related discussion in the Capital, Margin, and Segregation Proposing Release, 77 FR 70277.

<sup>517</sup> See the stockbroker liquidation provisions in the U.S. Bankruptcy Code, 11 U.S.C. 741-53.

<sup>518</sup> 15 U.S.C. 78c-5(f)(1)(A).

<sup>519</sup> See proposed Rules 18a-4(d)(1) and (d)(2)(i) and (ii) under the Exchange Act, as discussed in the Capital, Margin, and Segregation Proposing Release, 77 FR 70287-88. If a non-cleared security-based swap counterparty elects to segregate funds or other property with a third-party custodian, the subordination agreement would be conditioned on the counterparty’s funds and other property segregated at a third-party custodian not being included in the bankruptcy estate of the security-based swap dealer. If the election is not effective in keeping the counterparty’s assets bankruptcy remote, then the counterparty should be treated as a security-based swap customer with a pro rata priority claim to customer property. See proposed Rule 18a-4(d)(2)(i) under the Exchange Act. If a non-cleared security-based swap counterparty elects not to segregate any assets at all, the security-based swap dealer would need to obtain an

other hand, if a foreign security-based swap dealer is not a foreign bank with a branch or agency in the United States, it may be subject to the stockbroker liquidation provisions<sup>524</sup> in a stockbroker liquidation proceeding in a U.S. bankruptcy court. Moreover, if a foreign security-based swap dealer is a registered broker-dealer, it is a member of the Securities Investor Protection Corporation (“SIPC”)<sup>525</sup> and is subject to segregation requirements under Section 15(c)(3) of the Exchange Act,<sup>526</sup> and rules and regulations thereunder.<sup>527</sup> Such a foreign security-based swap dealer would be subject to the liquidation proceeding under the Securities Investor Protection Act of 1970 (the “SIPA”).<sup>528</sup> Therefore, we propose an approach that would apply the segregation requirements to a foreign security-based swap dealer depending on whether it holds assets to secure cleared security-based swap transactions or non-cleared security-based swap transactions and whether such foreign security-based swap dealer is a registered broker-dealer, a foreign bank with a branch or agency in the United States, or neither of the above.<sup>529</sup>

Banking Act, in the case of uninsured federal branches.

<sup>524</sup> See note 522, *supra*.

<sup>525</sup> We recognize that a very limited number of registered foreign broker-dealers who do not conduct securities business in the United States and do not hold U.S. person customers’ funds are not members of SIPC.

<sup>526</sup> 15 U.S.C. 78o(c)(3).

<sup>527</sup> See Rule 15c3-3 under the Exchange Act, 17 CFR 240.15c3-3.

<sup>528</sup> See 15 U.S.C. 78aaa *et seq.*

<sup>529</sup> We preliminarily believe that the proposed approach with respect to the segregation requirements set forth in Section 3E of the Exchange Act, and rules and regulations thereunder, is not being applied to persons who are “transact[ing] a business in security-based swaps without the jurisdiction of the United States,” within the meaning of Section 30(c). See Section II.B.2(a), *supra*. However, the Commission also preliminarily believes that the proposed approach with respect to the segregation requirements is necessary or appropriate to help prevent the evasion of the particular provisions of the Exchange Act that were added by the Dodd-Frank Act that are being implemented by the proposed approach and prophylactically will help ensure that the purposes of those provisions of the Dodd-Frank Act are not undermined. See Section II.B.2(e), *supra*; see also Section II.B.2(c), *supra*.

For example, if the segregation requirements do not apply to the entire business of a registered foreign security-based swap dealer that is a registered broker-dealer, or do not apply to assets received from non-U.S. person customers to secure cleared security-based swaps by a registered foreign security-based swap dealer that is not a registered broker-dealer (and is not a foreign bank with a branch or agency in the United States) if such foreign security-based swap dealer also receives assets from a U.S. person customer to secure clear security-based swaps, then U.S. security-based swap dealers would have an incentive to evade the full application of the segregation requirements by moving their operations outside the United States.

We recognize that a foreign security-based swap dealer may not be subject to the stockbroker liquidation provisions and its insolvency or liquidation proceeding in the United States may be administered under SIPA or banking regulations concurrently with other potential insolvency proceedings outside the United States under applicable foreign insolvency laws. Therefore, the effectiveness of the segregation requirements with respect to a foreign security-based swap dealer in practice may depend on many factors, including the type and objectives of the insolvency or liquidation proceeding and how the U.S. Bankruptcy Code, SIPA, banking regulations and applicable foreign insolvency laws are interpreted by the U.S. bankruptcy court, SIPC, Federal Deposit Insurance Corporation and relevant foreign authorities.

#### b. Non-Cleared Security-Based Swaps

##### i. Foreign Security-Based Swap Dealer That Is a Registered Broker-Dealer

With respect to non-cleared security-based swaps, the Commission proposes to apply segregation requirements differently to foreign security-based swap dealers depending on whether they also are registered broker-dealers. Specifically, the Commission proposes to require a foreign security-based swap dealer that is a registered broker-dealer to segregate margin received from all counterparties to secure non-cleared security-based swap transactions, in accordance with Section 3E of the Exchange Act, and rules and regulations thereunder.<sup>530</sup>

If a foreign security-based swap dealer is a registered broker-dealer, it already would: (i) be subject to the customer protection requirements under Section

In this event, these security-based swap dealers could use the assets collected from the non-U.S. person counterparties for their own business purposes, and the assets segregated (*i.e.*, assets posted by U.S. person customers) could be insufficient to satisfy the combined priority claims of both U.S. person and non-U.S. person customers, potentially resulting in losses to U.S. person customers in contravention of the purposes of the customer protection framework established by the Dodd-Frank Act. See discussions of application of the segregation requirements to a foreign security-based swap dealer that is a registered broker-dealer with respect to non-cleared security-based swaps in Section III.C.4(b)ii.b.i, application of the segregation requirements to a foreign security-based swap dealer that is a registered broker-dealer with respect to cleared security-based swaps in Section III.C.4(b)ii.c.i, and application of the segregation requirements to a foreign security-based swap dealer that is not a registered broker-dealer and is not a foreign bank with a branch or agency in the United States in Section III.C.4(b)ii.c.ii above.

<sup>530</sup> See proposed Rule 18a-4(e)(1)(i) under the Exchange Act.

15(c)(3) of the Exchange Act,<sup>531</sup> and rules and regulations thereunder, including Rule 15c3-3 if it carries customer securities and cash; (ii) be required to maintain possession or control of customer securities and maintain cash or qualified securities in a special reserve account if it carries customer securities and cash; and (iii) if it is a member of SIPC, be liquidated in a formal proceeding under the SIPA.<sup>532</sup> Rule 15c3-3 under Section 15(c)(3) of the Exchange Act provides customer protection and defines “customer” broadly to include any person from whom or on whose behalf a broker or dealer has received or acquired or holds funds or securities for the account of that person.<sup>533</sup> Therefore, if a foreign security-based swap dealer that is a registered broker-dealer receives collateral from a non-cleared security-based swap counterparty, such counterparty would be a “customer” and is afforded customer protection with respect to such collateral under Rule 15c3-3. As stated above, Section 3E(g) extends “customer” status to non-cleared security-based swap counterparties to the extent of any margin delivered to or by the counterparties with respect to which there is a customer protection requirement under Section 15(c)(3).<sup>534</sup> Therefore, non-cleared security-based swap counterparties of a foreign security-based swap dealer that is a registered broker-dealer are “customers” within the meaning of the stockbroker liquidation provisions.<sup>535</sup>

As such, if the Commission does not require a foreign security-based swap dealer that is a registered broker-dealer to segregate all counterparties’ assets posted to secure non-cleared security-based swaps, in a SIPA liquidation

<sup>531</sup> 15 U.S.C. 78o(c)(3).

<sup>532</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70276-77 (discussing the broker-dealer segregation rule—Rule 15c3-3 under the Exchange Act, 17 CFR 240.15c3-3).

<sup>533</sup> See Rule 15c3-3(a)(1) under the Exchange Act, 17 CFR 240.15c3-3(a)(1).

<sup>534</sup> See Section 3E(g) of the Exchange Act, 15 U.S.C. 78c-5(g) (“The term ‘customer’, as defined in section 741 of title 11, United States Code, excludes any person, to the extent that such person has a claim based on any . . . non-cleared security-based swap except to the extent of any margin delivered to or by the customer with respect to which there is a customer protection requirement under section 15(c)(3) or a segregation requirement.”).

<sup>535</sup> A non-cleared security-based swap counterparty may waive its pro rata priority claim on customer property with other customers by executing a conditional subordination agreement pursuant to proposed Rule 18a-4(d)(i) under the Exchange Act to affirmatively elect individual segregation, or by executing an unconditional subordination agreement pursuant to proposed Rule 18a-4(d)(ii) under the Exchange Act to affirmatively waive segregation altogether.



proceeding of such foreign security-based swap dealer and broker-dealer,<sup>536</sup> the pool of assets segregated pursuant to Rule 15c3-3 and proposed Rule 18a-4 may be insufficient to satisfy the combined claims of all customers, resulting in losses to all customers. Therefore, the Commission proposes to subject a foreign security-based swap dealer that is a registered broker-dealer to the segregation requirements set forth in Section 3E of the Exchange Act, and rules and regulations thereunder, relating to assets received from all counterparties held as collateral to secure non-cleared security-based swap transactions.

ii. Non-Cleared Security-Based Swaps—Foreign Security-Based Swap Dealer That is Not a Registered Broker-Dealer

If a foreign security-based swap dealer is not a registered broker-dealer, its non-cleared security-based swap counterparties would be “customers” under the stockbroker liquidation provisions only to the extent that there is a segregation requirement prescribed by the Commission.<sup>537</sup> The Commission proposes to subject such foreign security-based swap dealer to the segregation requirements set forth in Section 3E of the Exchange Act, and rules and regulations thereunder, solely with respect to non-cleared security-based swaps with U.S. person counterparties.<sup>538</sup> This approach would provide U.S. person counterparties “customer” status under the stockbroker liquidation provisions and their assets would be segregated for their exclusive benefit. Non-U.S. person counterparties would not be “customers” and would not have “customer” status with respect to the segregated assets. As stated above, the Commission preliminarily believes that the objective of the Dodd-Frank Act is to protect U.S. counterparties and to minimize disruption to the U.S. financial system caused by a security-based swap dealer’s failure. Therefore, the Commission preliminarily believes that the proposed approach would achieve the benefit intended by the segregation requirements set forth in Section 3E of the Exchange Act, and rules and regulations thereunder.

The Commission recognizes that a foreign security-based swap dealer that

is not a broker-dealer but is a foreign bank with a branch or agency (as defined in Section 1(b) of the International Banking Act of 1978)<sup>539</sup> in the United States may not be eligible to be liquidated pursuant to the stockbroker liquidation provisions.<sup>540</sup> Such foreign security-based swap dealer’s insolvency proceeding in the United States would be administered under banking regulations.<sup>541</sup> Nevertheless, the Commission preliminarily believes that imposing segregation requirements on such foreign security-based swap dealer when it receives collateral from U.S. person counterparties would reduce the likelihood of U.S. person counterparties incurring losses by helping identify U.S. customers’ assets in an insolvency proceeding of such foreign security-based swap dealer in the United States and would potentially minimize disruption to the U.S. security-based swap market, thereby producing potential benefits to the U.S. financial system and U.S. counterparties that are consistent with the objectives of the Dodd-Frank Act.

c. Cleared Security-Based Swaps

In applying the segregation requirements to a foreign security-based swap dealer with respect to cleared security-based swap transactions, the Commission also proposes to distinguish among: (1) a foreign security-based swap dealer that is a registered broker-dealer; (2) a foreign security-based swap dealer that is not a registered broker-dealer and is not a foreign bank with a branch or agency in the United States; and (3) a foreign security-based swap dealer that is a foreign bank with a branch or agency in the United States. In the following paragraphs, we will discuss how we propose to apply the segregation requirements to foreign security-based swap dealers in each of these categories with respect to assets held by them as collateral to secure cleared security-based swaps.

<sup>539</sup> See Sections 1(b)(1), (3), and (7) of the International Banking Act of 1978, 12 U.S.C. 3101(b)(1), (3) and (7), for definitions of “agency,” “branch,” and “foreign bank.”

<sup>540</sup> See Section 109(b)(3)(B) of the U.S. Bankruptcy Code, 11 U.S.C. 109(b)(3)(B).

<sup>541</sup> See 12 U.S.C. 1821–25. Whereas insured deposit institutions would be resolved under the Federal Deposit Insurance Act, uninsured U.S. branches of foreign banks would be resolved under either relevant state statutes, in the case of uninsured state branches, or the International Banking Act, in the case of uninsured federal branches.

i. Foreign Security-Based Swap Dealer That Is a Registered Broker-Dealer

The proposed rule would apply segregation requirements to a foreign security-based swap dealer that is a registered broker-dealer with respect to assets received from all counterparties to secure cleared security-based swaps.<sup>542</sup> As stated above, Section 3E(g) of the Exchange Act extends customer protection under the stockbroker liquidation provisions to all cleared security-based swap counterparties and to all non-cleared security-based swap counterparties, with respect to which there is a customer protection requirement under Section 15(c)(3) of the Exchange Act.<sup>543</sup> Therefore, all security-based swap counterparties of a foreign security-based swap dealer that is a registered broker-dealer are customers under the stockbroker liquidation provisions.<sup>544</sup> In the absence of a Commission requirement that a foreign security-based swap dealer that is a registered broker-dealer segregate all cleared security-based swap counterparties’ collateral, if such an entity were liquidated pursuant to SIPA, the amount of assets segregated could be less than the combined priority claims of all security-based swap customers, potentially resulting in losses to customers. Therefore, the Commission proposes to subject a foreign security-based swap dealer who is a registered broker-dealer to segregation requirements set forth in Section 3E of the Exchange Act, and rules and regulations thereunder, with respect to assets received from all counterparties to secure cleared security-based swaps.

ii. Foreign Security-Based Swap Dealer That Is Not a Registered Broker-Dealer and Is Not a Foreign Bank With Branch or Agency in the United States

If a foreign security-based swap dealer is not a registered broker-dealer and is not a foreign bank that has a branch or agency (as defined in Section 1(b) of the International Banking Act of 1978) in the United States, such foreign security-based swap dealer may be eligible to be

<sup>542</sup> Proposed Rule 18a-4(e)(2)(i) under the Exchange Act.

<sup>543</sup> See Section III.C.4(b)ii.b, *supra*.

<sup>544</sup> A non-cleared security-based swap counterparty would be a customer of a foreign security-based swap dealer that is a registered broker-dealer and have a pro rata priority claim to customer property under the stockbroker liquidation provisions unless it affirmatively waives segregation altogether by executing an unconditional subordination agreement pursuant to proposed Rule 18a-4(d)(ii) under the Exchange Act, or elects individual segregation pursuant to Section 3E(f) of the Exchange Act by executing a conditional subordination agreement pursuant to proposed Rule 18a-4(d)(i) under the Exchange Act.

<sup>536</sup> In very limited circumstances where a foreign security-based swap dealer that is a registered broker-dealer is not a SIPC member, it would potentially be liquidated pursuant to the stockbroker liquidation provisions in a U.S. bankruptcy court.

<sup>537</sup> See Section 3E(g) of the Exchange Act, 15 U.S.C. 78c-5(g).

<sup>538</sup> See proposed Rule 18a-4(e)(1)(ii) under the Exchange Act.

a debtor under Chapter 7 of the U.S. Bankruptcy Code and may therefore be subject to the stockbroker liquidation provisions in the U.S. Bankruptcy Code.<sup>545</sup> As stated above, Section 3E(g) of the Exchange Act provides “customer” status to all counterparties to cleared security-based swaps, making no distinction between U.S. customers or counterparties and non-U.S. person customers or counterparties.<sup>546</sup> Therefore, in the case where such foreign security-based swap dealer receives any assets from, for, or on behalf of a U.S. person customer to margin, guarantee, or secure security-based swaps, if the Commission were to apply the segregation requirements only to assets posted by U.S. person customers but not to assets posted by non-U.S. person customers, in a stockbroker liquidation proceeding of such foreign security-based swap dealer, the assets segregated (*i.e.*, assets posted by U.S. person customers) could be insufficient to satisfy the combined priority claims of both U.S. person and non-U.S. person customers, potentially resulting in losses to U.S. person customers. As stated above, the Commission preliminarily believes that Section 3E intends to provide customer protection to U.S. person counterparties and apply segregation requirements in a way that would protect the U.S. financial system and counterparties in the United States. Therefore, the Commission proposes to apply segregation requirements described in Section 3E of the Exchange Act, and the rules and regulations thereunder, to a foreign security-based swap dealer that is not a registered broker-dealer and is not a foreign bank with a branch or agency in the United States with respect to assets received from both U.S. person counterparties and non-U.S. person counterparties if such foreign security-based swap dealer receives collateral from U.S. person counterparties to secure security-based swaps.<sup>547</sup>

### iii. Foreign Security-Based Swap Dealer That is Not a Registered Broker-Dealer and is a Foreign Bank With Branch or Agency in the United States

Finally, if a foreign security-based swap dealer is not a registered broker-dealer and is a foreign bank that has a branch or agency in the United States, it is not eligible to be a debtor under Chapter 7 and will therefore not be subject to the stockbroker liquidation

provisions of the U.S. Bankruptcy Code<sup>548</sup> and its insolvency proceeding in the United States would be administered under banking regulations.<sup>549</sup> Consistent with the objective of protecting U.S. person counterparties, the Commission is proposing that such foreign security-based swap dealer shall be subject to the segregation requirements set forth in Section 3E of the Exchange Act, and the rules and regulations thereunder, with respect to any assets received from, for or on behalf of a counterparty who is a U.S. person to margin, guarantee, or secure a cleared security-based swap, but shall not be required to segregate assets received from, for or on behalf of all other counterparties to margin, guarantee, or secure a cleared security-based swap.<sup>550</sup> The special account maintained by the foreign security-based swap dealer shall be designated for the exclusive benefit of U.S. person security-based swap customers. The Commission preliminarily believes that imposing segregation requirements on such foreign security-based swap dealer when it receives collateral from U.S. person counterparties would reduce the likelihood of U.S. person counterparties incurring losses by helping identify U.S. customers’ assets in an insolvency proceeding of such foreign security-based swap dealer in the United States and would potentially minimize disruption to the U.S. security-based swap market, thereby producing potential benefits to the U.S. financial system and U.S. counterparties that are consistent with the objectives of the Dodd-Frank Act. For the same reason, the Commission preliminarily does not believe that extending segregation requirements and customer protection to such foreign security-based swap dealer’s transactions with non-U.S. persons would advance the purposes of the Dodd-Frank Act.

### d. Disclosure

In addition to the proposed rules described above relating to application of the segregation requirements to foreign security-based swap dealers, the Commission also is proposing to require foreign security-based swap dealers to

make certain disclosures.<sup>551</sup> Since the treatment of the special account under Sections 3E(b) and (g) or individually segregated assets pursuant to Section 3E(f) of the Exchange Act in insolvency proceedings of a foreign security-based swap dealer may vary depending on the status of the foreign security-based swap dealer and the insolvency proceedings such foreign security-based swap dealer is subject to, the Commission proposes to require a foreign security-based swap dealer to disclose to each counterparty that is a U.S. person, prior to accepting any assets from, for, or on behalf of such counterparty to margin, guarantee, or secure a security-based swap, the potential treatment of the assets segregated by such foreign security-based swap dealer pursuant to Section 3E of the Exchange Act, and the rules and regulations thereunder, in insolvency proceedings relating to such foreign security-based swap dealer under U.S. bankruptcy law and applicable foreign insolvency laws. Pursuant to this proposed rule, the Commission intends to require that a foreign security-based swap dealer disclose whether it is subject to the segregation requirement set forth in Section 3E of the Exchange Act, and the rules and regulations thereunder, with respect to the assets collected from the U.S. person counterparty who will receive the disclosure, whether the foreign security-based swap dealer could be subject to the stockbroker liquidation provisions in the U.S. Bankruptcy Code, whether the segregated assets could be afforded customer property treatment under the U.S. bankruptcy law, and any other relevant considerations that may affect the treatment of the assets segregated under Section 3E of the Exchange Act in insolvency proceedings of a foreign security-based swap dealer.<sup>552</sup> Since the proposed rule regarding application of the segregation requirements in the cross-border context is designed to advance the goals of protecting U.S. person counterparties, the Commission believes that such disclosure would enhance U.S. person counterparty protection and the objectives that segregation requirements intend to achieve in the context of cross-border security-based swap dealing.

### Request for Comment

The Commission requests comment on all aspects of the proposed rule regarding the application of transaction-

<sup>545</sup> See Section 109(b) of the U.S. Bankruptcy Code, 11 U.S.C. 109(b).

<sup>546</sup> See 15 U.S.C. 78c-5(g) and 11 U.S.C. 741(2).

<sup>547</sup> Proposed Rule 18a-4(e)(2)(ii) under the Exchange Act.

<sup>548</sup> See Section 109(b) of the U.S. Bankruptcy Code, 11 U.S.C. 109(b).

<sup>549</sup> See 12 U.S.C. 1821-25. Whereas insured deposit institutions would be resolved under the Federal Deposit Insurance Act, uninsured U.S. branches of foreign banks would be resolved under either relevant state statutes, in the case of uninsured state branches, or the International Banking Act, in the case of uninsured federal branches.

<sup>550</sup> Proposed Rule 18a-4(e)(2)(iii) under the Exchange Act.

<sup>551</sup> Proposed Rule 18a-4(e)(3) under the Exchange Act.

<sup>552</sup> Proposed Rule 18a-4(e)(3) under the Exchange Act.

level requirements relating to customer protection and segregation, including the following:

- What, if any, are the likely competitive effects, within the U.S. security-based swap market and among U.S. security-based swap dealers, of the proposed approach for foreign security-based swap dealers? Please describe the specific nature of any such effects.
- Should a foreign security-based swap dealer automatically be eligible for the proposed approach by virtue of being a nonresident entity?

Alternatively, should the Commission consider other factors, such as the share of the foreign security-based swap dealer's business that constitutes U.S. Business, in determining how to apply transaction-level requirements?

- From an operational perspective, what types of internal controls would be necessary to identify Foreign Business and U.S. Business and ensure that the foreign security-based swap dealer complies with the external business conduct standards with respect to its U.S. Business? Should U.S. Business be generally defined with reference to the type of activity that, if performed in a dealing capacity, triggers the registration requirement?

- Does the proposed approach appropriately classify entity-level and transaction-level requirements? Does it appropriately identify those transaction-level requirements that relate to the operation of the security-based swap dealer on an entity level? If not, please identify those requirements that should be classified differently and how doing so is consistent with the goals of Title VII.

- To what extent would foreign security-based swap dealers in various jurisdictions be prohibited from complying, under local law, with the Commission's requirements to provide the Commission with prompt access to their books and records and to submit to onsite inspection and examination by the Commission? If there are limitations, what are they, and under what circumstances would they arise? Are there other entity-level requirements that foreign security-based swap dealers would not be permitted to comply with under local law? If so, what are they?

- Should the external business conduct rules apply in transactions between a registered non-U.S. security-based swap dealer and foreign branches of a U.S. bank?

- Should the external business conduct rules apply in transactions between a registered non-U.S. security-based swap dealer and non-U.S. persons with U.S. guarantees in transactions outside the United States?

- Does the proposed application of the business conduct standards in the cross-border context appropriately implement the business conduct standards as described in Section 15F(h) of the Exchange Act?

- As described above, the Commission does not, at this time, propose to apply the business conduct standards in Section 15F(h) of the Exchange Act, and the rules and regulations thereunder (other than the rules and regulations relating to diligent supervision prescribed by the Commission pursuant to Section 15F(h)(1)(B)), to the Foreign Business of registered security-based swap dealers. Should such standards apply to the Foreign Business of registered security-based swap dealers? Would such application of business conduct standards further the goals of Title VII of the Dodd-Frank Act?

- Should the Commission apply rules and regulations pursuant to Section 15F(h)(1)(A) of the Exchange Act relating to fraud, manipulation, and other abusive practices involving security-based swaps (including security-based swaps that are offered but not entered into) to the Foreign Business of registered foreign security-based swap dealers?

- Should the Commission apply rules and regulations pursuant to Section 15F(h)(1)(C) of the Exchange Act relating to position limits to the Foreign Business of foreign security-based swap dealers?

- Should the proposed rule relating to conflicts of interest set forth in Section 15F(j)(5) of the Exchange Act apply to both the U.S. Business and Foreign Business of security-based swap dealers?

- Does the proposed approach appropriately treat the rules and regulations prescribed by the Commission relating to diligent supervision pursuant to Section 15F(h)(1)(B) as entity-level requirements applicable to both the U.S. Business and the Foreign Business of foreign security-based swap dealers? Why or why not?

- Is it appropriate that the proposed rule does not apply future rules and regulations that the Commission may prescribe pursuant to Section 15F(h)(1)(A) of the Exchange Act relating to fraud, manipulation, and other abusive practices involving security-based swaps (including security-based swaps that are offered but not entered into) to the Foreign Business of foreign security-based swap dealers? Why or why not?

- Is it appropriate that the proposed rule does not apply future rules and regulations that the Commission may

prescribe pursuant to Section 15F(h)(1)(C) of the Exchange Act relating to position limits to the Foreign Business of foreign security-based swap dealers? Why or why not?

- Does the proposed approach appropriately treat the requirements relating to conflicts of interest set forth in Section 15F(j)(5) of the Exchange Act as entity-level requirements applicable to both the U.S. Business and Foreign Business of foreign security-based swap dealers? If not, please identify any requirements that should not be applied to a foreign security-based swap dealer and explain how such an approach would be consistent with the goals of Title VII. Please identify what the costs or operational challenges would be, if any, for a registered security-based swap dealer to establish conflict-of-interest systems and procedures that would apply to its U.S. Business but not its Foreign Business.

- Does the proposed approach appropriately implement the requirements relating to segregation of assets held as collateral in Section 3E of the Exchange Act, and rules and regulations thereunder, in light of various statuses of foreign security-based swap dealers?

- Should the Commission apply segregation requirements to a foreign security-based swap dealer that is not subject to the stockbroker liquidation provisions in the U.S. Bankruptcy Code? If not, what are the reasons for not applying segregation requirements? If the segregation requirements do not apply, how would the objective of customer protection be achieved?

- Should the Commission adopt the disclosure requirement with respect to foreign security-based swap dealers? Why or why not? Is the proposed disclosure requirement feasible? What would the difficulties be in complying with the proposed disclosure requirement?

- The CFTC has proposed an interpretation that would effectively treat a non-U.S. person whose obligations are guaranteed by a U.S. person as a U.S. person for purposes of determining whether a swap between it and a non-U.S. swap dealer or major swap participant would be subject to transaction-level requirements as interpreted by the CFTC to include, without limitation, margin and segregation requirements, reporting, clearing, and trade execution.<sup>553</sup> Should the Commission adopt a similar approach? What would be the effects on efficiency, competition and capital

<sup>553</sup> See CFTC Cross-Border Proposal, 77 FR 41228–29.

formation in the event that there are overlapping or duplicative requirements across multiple jurisdictions?

- In addition, the CFTC has proposed an interpretation that includes a description of a “conduit affiliate” that includes: (1) a non-U.S. person that is majority-owned, directly or indirectly, by a U.S. person where (2) the non-U.S. person regularly enters into swaps with one or more U.S. affiliates or subsidiaries of the U.S. person, and (3) the financial statements of the non-U.S. person are included in the consolidated financial statements of the U.S. person.<sup>554</sup> Conduit affiliates would be subject to transaction-level requirements as if they were U.S. persons. Should the Commission consider a similar approach?

- The CFTC’s proposed interpretation would subject foreign branches of U.S.-based bank swap dealers and major swap participants to the CFTC’s entity-level requirements and transaction-level requirements (other than external business conduct standards for swaps with non-U.S. persons), provided that foreign branches would be eligible for a limited exception in emerging markets where foreign regulations are not comparable.<sup>555</sup> Should the Commission consider a similar approach? If so, please explain how such an approach would be consistent with the goals of Title VII.

- What would be the market impact of the proposed approach to application of the transaction-level requirements relating to customer protection and segregation? How would the proposed application of transaction-level requirements affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the transaction-level requirements? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## 5. Application of Entity-Level Rules

### (a) Introduction

As noted above, by their very nature, entity-level requirements apply to the operation of a security-based swap dealer as a whole. The Commission recognizes that the capital, margin, and

other entity-level requirements that it adopts could have a substantial impact on international commerce and the relative competitive position of intermediaries operating in various, or multiple, jurisdictions. In particular, if these requirements are substantially more or less stringent than corresponding requirements, if any, that apply to intermediaries operating in security-based swap markets outside the United States, depending on how the rules are written, these differences could impact the ability of firms based in the United States to participate in non-U.S. markets, access to U.S. markets by foreign-based firms, and how and whether international firms make use of global “booking entities” to centralize risks related to security-based swaps, among other possible impacts. These issues have been the focus of numerous comments to the Commission and other regulators, as discussed above, as well as Congressional inquiries and other public dialogue.

### (b) Proposed Approach

The Commission is not proposing to provide specific relief for foreign security-based swap dealers from Title VII entity-level requirements, although, as discussed in Section XI below, under a Commission substituted compliance determination, a foreign security-based swap dealer would be able to satisfy relevant Title VII entity-level requirements by substituting compliance with corresponding requirements under a foreign regulatory system.<sup>556</sup> The Commission preliminarily believes that entity-level requirements are core requirements of the Commission’s responsibility to ensure the safety and soundness of registered security-based swap dealers.<sup>557</sup> The Commission preliminarily believes that it would not be consistent with this mandate to provide a blanket exclusion to foreign security-based swap dealers from entity-level requirements applicable to such entities.<sup>558</sup>

<sup>556</sup> See Section XI, *infra*.

<sup>557</sup> See note 419, *supra*.

<sup>558</sup> We preliminarily believe that the proposed approach with respect to entity-level requirements is not being applied to persons who are “transact[ing] a business in security-based swaps without the jurisdiction of the United States,” within the meaning of Section 30(c) of the Exchange Act. See Section II.B.2(a), *supra*. However, the Commission also preliminarily believes that the proposed approach with respect to entity-level requirements is necessary or appropriate to help prevent the evasion of the particular provisions of the Exchange Act that were added by the Dodd-Frank Act that are being implemented by the proposed approach and prophylactically will help ensure that the purposes of those provisions of the

For example, capital requirements play an essential role in ensuring the safety and soundness of security-based swap dealers. As discussed above, the Commission’s proposed capital rules for nonbank security-based swap dealers are modeled on the net liquid assets test found in the capital requirements applicable to broker-dealers.<sup>559</sup> We believe that this capital standard is necessary to ensure the safety and soundness of nonbank security-based swap dealers, and thus we are not proposing to exclude foreign nonbank security-based swap dealers from our capital rules. In addition, we believe that the capital, margin, and other entity-level requirements proposed and adopted by the Commission work together to provide a comprehensive regulatory scheme that is vital for ensuring the safety and soundness of registered security-based swap dealers, and that the benefits of Title VII’s entity-level requirements are equally important to both foreign and U.S. dealers registered with the Commission. As a result, we are not proposing to provide specific relief from individual entity-level requirements for foreign dealers.

We do, however, recognize the concerns raised by commenters regarding the application of entity-level requirements to foreign security-based swap dealers.<sup>560</sup> We preliminarily believe that these concerns are largely addressed through the Commission’s overall proposed approach to substituted compliance in the context of Title VII, which is discussed in detail in Section XI below. In general, the Commission is proposing a framework under which it may permit a registered foreign security-based swap dealer (or class thereof) to satisfy the capital, margin, and other requirements in Section 15F of the Exchange Act, and the rules and regulations thereunder, by

Dodd-Frank Act are not undermined. See Section II.B.2(e), *supra*; see also Section II.B.2(c), *supra*.

For example, if entity-level requirements do not apply to the entire business of a registered foreign security-based swap dealer, then U.S. security-based swap dealers would have an incentive to evade the full application of the entity-level requirements by moving their operations outside the United States. In this event, assuming the scope of the security-based swap dealers dealing activity remained unchanged, the risk presented by the entity to its U.S. counterparties and the U.S. financial system would remain unchanged. If, for instance, Title VII margin requirements did not apply to the entire entity, these entities could accumulate risk through their non-U.S. dealing activity and transmit that risk to U.S. counterparties in contravention of the purposes of the financial responsibility framework established by the Dodd-Frank Act. See Section III.C.3(b)ii, *supra*.

<sup>559</sup> See Section III.C.3(b)i, *supra*.

<sup>560</sup> See, e.g., Davis Polk Letter II at 4–20; Sullivan & Cromwell Letter at 14–15.

<sup>554</sup> See *id.* at 41229.

<sup>555</sup> See *id.* at 41230–31.

complying with the corresponding requirements established by its foreign financial regulatory authority,<sup>561</sup> subject to certain conditions.<sup>562</sup> We preliminarily believe that providing foreign security-based swap dealers with the possibility of substituted compliance in this way will help address concerns related to competitiveness and overlapping regulations related to entity-level requirements, while still ensuring that registered foreign security-based swap dealers are subject to appropriate regulatory oversight.

#### Request for Comment

The Commission requests comment on all aspects of the proposed interpretive guidance regarding the proposed provision of substituted compliance for certain requirements in Section 15F of the Exchange Act for foreign security-based swap dealers, including the following:

- What types of conflicts might a foreign security-based swap dealer face if subjected to capital requirements in more than one jurisdiction? In what situations would compliance with more than one capital requirement be difficult or impossible?

- Should the Commission provide specific relief to foreign security-based swap dealers with respect to entity-level requirements? If so, please indicate the specific relief that should be provided and the rationale for providing such relief.

- Would the provision of relief from entity-level requirements undermine the Commission's efforts to set capital requirements to ensure the safety and soundness of security-based swap

dealers, as required by Section 15F(e)(2)(C) of the Exchange Act? Why or why not?

- Should the Commission treat margin as an entity-level requirement or a transaction-level requirement? If only a transaction-level requirement, why?

- Should the Commission consider providing relief for foreign security-based swap dealers from the statutory disqualification requirement in Section 15F(b)(6) of the Exchange Act with respect to their transactions with non-U.S. persons? For example, should the Commission permit associated persons of a foreign security-based swap dealer that are subject to a statutory disqualification to conduct security-based swap activity with non-U.S. persons outside the United States? If so, why?

- The CFTC has proposed an interpretation that categorizes certain entity-level requirements and transaction-level requirements differently when compared to the Commission's proposed approach.<sup>563</sup> For example, the CFTC has proposed classifying margin requirements applicable to uncleared swaps as a transaction-level requirement, where the Commission has proposed categorizing margin as an entity-level requirement. Should the Commission adopt portions of the CFTC's approach to categorization? If so, which requirements should be re-categorized and why?

- What would be the market impact of the proposed approach to applying entity-level requirements to registered foreign security-based swap dealers? How would the proposed application of the entity-level requirements affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the entity-level requirements? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

#### D. Intermediation

##### 1. Introduction

Security-based swap dealers currently use a variety of business models and legal structures to do business with

customers in jurisdictions around the world. For instance, many security-based swap dealers with global businesses use local personnel to provide security-based swap services to customers in a particular jurisdiction while booking transactions originated from multiple jurisdictions in a single entity (*i.e.*, a centralized booking model). Some security-based swap dealers also use unique organizational structures to provide local customers with access to market or product specialists in other jurisdictions. As discussed below, commenters have indicated that, in the U.S. market, these scenarios are particularly prevalent in the case of foreign security-based swap dealers seeking access to U.S. customers or providing non-U.S. customers with expertise from employees located in the United States.<sup>564</sup>

In the following discussion, we briefly describe comments received regarding various intermediation models.

Throughout this release we use the term "intermediation" generally to refer to origination activity (*e.g.*, solicitation and negotiation of transactions) in connection with a security-based swap transaction.

#### 2. Comment Summary

Commenters stated that foreign security-based swap dealers use different types of business models to service U.S. customers and provide their global customer base with specialized information, while at the same time reducing both customer costs and entity risks through centralized netting and risk management of their global security-based swap businesses.<sup>565</sup> In

<sup>564</sup> See, *e.g.*, IIB Letter at 15 ("Perhaps more commonly, a foreign bank may transact in swaps as a dealer with U.S. customers through a separate U.S. branch, agency, or affiliate that intermediates the transactions as agent for the foreign bank. This is often because, to facilitate strong relationships with U.S. customers, the personnel who solicit and negotiate with U.S. customers and commit a foreign bank to swaps are located in the U.S.").

<sup>565</sup> See, *e.g.*, IIB Letter at 6 ("Globally, there are a number of paradigms under which swap activity is conducted. To achieve the benefits of reduced risk and increased liquidity and efficiency associated with netting and margining on a portfolio basis, foreign banks (like their U.S. domestic counterparts) typically seek to transact with swap counterparties globally, to the extent feasible, through a single, highly creditworthy entity. In many cases, however, the personnel who have relationships with U.S. customers or who manage the market risk of the foreign bank's swap portfolio are located regionally, outside the jurisdiction in which the foreign bank is domiciled. In some cases, entities other than the foreign bank (such as a U.S. branch, agency, or affiliate) transact with local customers in order to satisfy unique customer documentation, insolvency, tax, regulatory, or other considerations.); Davis Polk Letter I at 2-3 (suggesting that "operating and managing a global swaps business out of a single

<sup>561</sup> Section 3(a)(52) of the Exchange Act, 15 U.S.C. 78c(a)(52), defines "foreign financial regulatory authority" as "any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above." The term "foreign securities authority" is defined in Section 3(a)(50) of the Exchange Act as "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters."

<sup>562</sup> Proposed Rule 3a71-5 under the Exchange Act. As discussed in Section II.C.3(b) above, the Commission has authority to establish capital and margin requirements only for registered nonbank security-based swap dealers. For treatment of the capital and margin requirements for foreign bank security-based swap dealers, see Prudential Regulator Margin and Capital Proposal, 76 FR 27564.

<sup>563</sup> See CFTC Cross-Border Proposal, 77 FR 41223-27.

support of these perceived benefits, commenters have urged the Commission not to apply Title VII to cross-border transactions in a way that would either prohibit or disincentivize the existing security-based swap dealing business models of foreign security-based swap dealers.<sup>566</sup>

A number of commenters recommended that a foreign dealer that engages in security-based swap transactions with U.S. counterparties, but only through U.S. registered swap or security-based swap dealers, should not be subject to security-based swap dealer registration.<sup>567</sup> One commenter stated that in such situations, the Commission should either not require security-based swap dealer registration of the non-U.S. security-based swap dealer at all, or require a limited registration, whereby the non-U.S. security-based swap dealer would be subject to only capital and related prudential requirements and be permitted to rely on comparable home country regulation.<sup>568</sup> In situations where a foreign security-based swap dealer uses a U.S. domiciled subsidiary or affiliate as its agent to solicit and

booking entity presents many advantages from the perspective of foreign banks, customers and supervisors," including reduction in system risk, maximization of benefits of counterparty netting for customers, and consolidated supervision); Cleary IV at 3-4 (stating that the represented firms "conduct their swap dealing businesses through a variety of structures, based on multiple and in many cases interdependent legal, strategic and business considerations that pre-date Dodd-Frank," and urging the Commissions to address a number of "common cross-border transaction structures").

<sup>566</sup> See, e.g., IIB Letter at 6-7 ("[T]he Commissions should establish a framework for cross-border swap activities that preserves and leverages the strengths of existing market practices and home country supervision and regulation."); Cleary IV at 3-4 (urging the Commissions to give consideration to a number of common cross-border transaction structures in deciding how to implement Title VII).

<sup>567</sup> See, e.g., Financial Services Roundtable Letter at 25 (suggesting that "entities that would meet the definition of 'swap dealer' based on their non-U.S. activity, but that act in the U.S. only on an intermediated basis through a regulated U.S. swap dealer, should not be subject to U.S. regulation"); Davis Polk Letter II at 4, 7 (discussing reasons to exclude dealing activities with U.S.-registered swap dealers, including because "a swap between a foreign dealer and a U.S. registered swap dealer would be already subject to Title VII by the virtue of the latter's involvement").

<sup>568</sup> See Cleary Letter IV at 3-4 (recommending that the Commission either adopt an approach similar to the broker-dealer registration regime, "under which a non-U.S. swap dealer transacting with U.S. persons . . . intermediated by an affiliated U.S.-registered swap dealer" would not have to register as a swap dealer or a major swap participant, or adopt a limited registration approach whereby "the non-U.S. swap dealer would be subject to U.S. swap dealer registration and regulation solely with respect to the capital and related prudential requirements relevant to its status as a swap counterparty, which requirements could be satisfied through compliance with comparable home country requirements").

negotiate the terms of security-based swap transactions, several commenters suggested that the Commission allow for a bifurcated registration and regulation framework allowing the foreign security-based swap dealer to comply with Title VII's requirements by registering both the foreign dealer and its agent in limited capacities and allocating the compliance responsibilities between the two entities.<sup>569</sup> Other commenters remarked that the foreign security-based swap dealer should remain ultimately responsible for ensuring compliance with all the applicable Title VII requirements whether or not the regulated activities were carried out by the foreign security-based swap dealer or its agent.<sup>570</sup>

### 3. Discussion

The Commission is not at this time proposing any specific rules regarding security-based swap dealing activities undertaken through intermediation. At the same time, we recognize the importance of intermediation, particularly with respect to foreign security-based swap dealers accessing U.S. customers or product specialists located in the United States. Based on the Commission's experience in the securities markets, we expect that many foreign security-based swap dealers will operate within the U.S. market by utilizing their U.S. affiliates or other

<sup>569</sup> See, e.g., Société Générale Letter I at 4-6 (suggesting a bifurcated registration model allowing foreign banks to centrally book their U.S. swap and security-based swap business with a registered "Foreign Swap Dealer" who is responsible for obligations associated with a booking entity (e.g., complying with capital requirements), while complying with most of Title VII's regulations through a U.S. domiciled, registered "Non-Booking Swap Dealer"); and Davis Polk Letter II at 4-22 (proposing two registration scenarios, including one that would require a foreign bank to register with the Commission solely as a booking center for security-based swap transactions, while a U.S. affiliate of a foreign bank would also register with the Commission, and the foreign bank's obligations under Title VII would be divided between the two registered entities).

<sup>570</sup> See, e.g., Cleary Letter IV at 12 (recommending a limited designation registration whereby "the branch, department or division of a registrant involved in the regulated swap activity should be responsible for compliance with Dodd-Frank's requirements," but allowing for the outsourcing of "performance (but not responsibility for due performance) of those requirements to a U.S. affiliate that is registered as an introducing broker, futures commission merchant ("FCM") and/or securities broker-dealer"); Rabobank Letter at 3 (suggesting that "the non-U.S. branch registrant would use one or more U.S. affiliates as agents in arranging swaps with U.S. persons and would be permitted to delegate certain compliance functions to its U.S. affiliates, although such delegation would not relieve the non-U.S. branch registrant of its ultimate compliance responsibilities").

U.S. entities as agents<sup>571</sup> in the United States, while booking transactions facilitated by such U.S. personnel in a central booking entity located abroad. We preliminarily believe that the approach proposed in this release for the cross-border regulation of security-based swap dealing activity will not impede the use of these types of intermediation business models by foreign security-based swap dealers. More specifically, we believe that the Commission's proposed approach to the application of transaction-level requirements related to Foreign Business<sup>572</sup> and proposed framework for substituted compliance on entity-level requirements<sup>573</sup> should help to address commenter concerns that a foreign security-based swap dealer engaging in Foreign Business would be subject to potentially duplicative and conflicting transaction-level requirements in a foreign jurisdiction with respect to its Foreign Business.

While the foreign security-based swap dealer would remain responsible for ensuring that all relevant Title VII requirements applicable to a given security-based swap transaction are fulfilled, the dealer and its agent(s) may choose to allocate the specific responsibilities such as taking responsibility that all U.S. external

<sup>571</sup> The Commission previously proposed new Rule 15Fh-2(d), which would provide that the term "security-based swap dealer" would include, where relevant, an "associated person" of the security-based swap dealer. See External Business Conduct Standards Proposing Release, 76 FR 42402. Section 3(a)(70) of the Exchange Act, as added by Section 761(a)(6), defines the term "person associated with a security-based swap dealer or major security-based swap participant" as "(i) any partner, officer, director, or branch manager of such security-based swap dealer or major security-based swap participant (or any person occupying a similar status or performing similar functions); (ii) any person directly or indirectly controlling, controlled by, or under common control with such security-based swap dealer or major security-based swap participant; or (iii) any employee of such security-based swap dealer or major security-based swap participant." The term does not include, however, any person associated with a security-based swap dealer or major security-based swap participant "whose functions are solely clerical or ministerial." See *id.*

As the Commission noted, to the extent that a security-based swap dealer acts through, or by means of, an associated person of that security-based swap dealer, the associated person must comply as well with the applicable business conduct standards. See External Business Conduct Standards Proposing Release, 76 FR 42402-3. In support of this position, the Commission cited Section 20(b) of the Exchange Act, which provides that "[i]t shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person."

<sup>572</sup> See Section III.C.4, *supra*.

<sup>573</sup> See Section III.C.5, *supra*, and Section XI, *infra*.

business conduct requirements are complied with, margin is collected and segregated, and required trading records are maintained and available, to be undertaken by each entity depending on the intermediation model it adopts.<sup>574</sup>

Further, although a foreign security-based swap dealer could use an entity that is not a security-based swap dealer to act as its agent, the foreign security-based swap dealer would nonetheless be responsible for ensuring compliance with all the requirements applicable to security-based swap dealers under Title VII (and the federal securities laws) whether or not the regulated activities were carried out by the foreign security-based swap dealer or its non-security-based swap dealer agent.<sup>575</sup>

#### Request for Comment

The Commission requests comment on all aspects of the proposed approach to intermediation. In addition, the Commission requests comment in response to the following questions:

- Should the Commission revise our proposed approach to address directly the concerns of entities using the intermediation model to access the U.S. market? If so, what type of approach should the Commission use to address these concerns consistent with the protection of counterparties' interests and the purposes of Title VII?

- Should the Commission adopt a model on intermediation similar to the approach laid out in Rule 15a-6(a)(3) (17 CFR 240.15a-6(a)(3)) governing foreign broker-dealers, which would permit non-U.S. persons to conduct security-based swap dealing activity within the United States without registering with the Commission if those transactions were intermediated by a registered U.S. security-based swap dealer? If so, how would it work in the security-based swap context, and how would it address Title VII policy concerns?

- What would be the market impact of the proposed approach to intermediation? How would the application of the proposed approach to intermediation affect the competitiveness of U.S. entities in the

global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach to intermediation? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

#### E. Registration Application Re-Proposal

##### 1. Introduction

As discussed in Section XI.C below, the Commission is proposing a rule that would create a framework under which the Commission would consider permitting a foreign security-based swap dealer, where appropriate, to rely on a substituted compliance determination by the Commission with respect to certain of the requirements in Section 15F of the Exchange Act and the rules and regulations thereunder.<sup>576</sup> In discussing the application of this proposed framework below, the Commission indicated that certain entity-level requirements under Section 15F of the Exchange Act may be candidates for substituted compliance determinations.<sup>577</sup>

The Commission preliminarily believes that the most appropriate time for a foreign security-based swap dealer to notify the Commission of its intention to avail itself of an existing substituted compliance determination<sup>578</sup> would be at the time the foreign security-based swap dealer files an application to register with the Commission as a security-based swap dealer.<sup>579</sup> As part

<sup>576</sup> Proposed Rule 3a71-3(c) under the Exchange Act.

<sup>577</sup> See Section III.C.5, *supra*.

<sup>578</sup> The Commission is proposing to establish a separate process whereby foreign security-based swap dealers may request that the Commission make a substituted compliance determination with respect to a particular foreign jurisdiction. See Section XI, *infra*.

<sup>579</sup> The Commission's Registration Proposing Release does not use the term "foreign security-based swap dealer," but rather references a "nonresident security-based swap dealer." Proposed Rule 15Fb2-4(a) under the Exchange Act defines the term "nonresident security-based swap dealer" as a security-based swap dealer that is incorporated or organized any place that is not in the United States or that has its principal place of business in any place not in the United States. See Registration Proposing Release, 76 FR 65799-801.

The definition of "nonresident security-based swap dealer" in proposed Rule 15Fb2-4(a) is similar to, but potentially broader than, the definition of "foreign security-based swap dealer" in proposed Rule 3a71-3(a)(3) under the Exchange Act because it uses "or" instead of "and" in the

of its application, the foreign security-based swap dealer would already be providing the Commission with detailed information in support of its application. The intent of a foreign security-based swap dealer to avail itself of a previously granted substituted compliance determination would be relevant to the Commission's review of such application because it would impact how the Commission will conduct oversight of the security-based swap dealer. In addition, if a security-based swap dealer determines, after it registered with the Commission, that it intends to rely on a substituted compliance determination, proposed Rule 15Fb2-3 would require that it promptly update its application.<sup>580</sup>

Accordingly, the Commission preliminarily believes it is appropriate to require foreign security-based swap dealers to provide additional information in their applications for registration as security-based swap dealers, as described below.

The Commission previously proposed Form SBSE, Form SBSE-A, and Form SBSE-BD for the purpose of registering security-based swap dealers and major security-based swap participants.<sup>581</sup> All of these forms are generally based on Form BD, which is the consolidated form used by broker-dealers to register

definition. As a result, proposed Rule 15Fb2-4(a) would treat a U.S. corporation as a nonresident person if its principal place of business were outside the United States, whereas proposed Rule 3a71-3(a)(3) would not treat such an entity as a U.S. security-based swap dealer and, therefore, it would not be able to avail itself of substituted compliance determinations applicable to foreign security-based swap dealers.

The Commission preliminarily believes that defining the term "foreign security-based swap dealer" more narrowly for purposes of the proposals in this release is appropriate because proposed Rule 15Fb2-4(a) uses the term "nonresident security-based swap dealer" only for determining whether a nonresident security-based swap dealer would be required to appoint an agent for service of process in the United States and provide assurance that the Commission would have prompt access to books and records in the foreign jurisdiction. In proposed Rule 3a71-3(a)(3), by contrast, the definition of "foreign security-based swap dealer" would be used to determine who would be eligible to take advantage of the proposed substituted compliance framework, as well as how customer protection and segregation requirements would be applied. The Commission does not believe that it is appropriate to treat an entity as a foreign security-based swap dealer for these purposes if its principal place of business were outside the United States but it were incorporated in the United States, because of its connection to the U.S. security-based swap market. Nonetheless, the Commission would still want the assurances required of a "nonresident security-based swap dealer" described above, even if the dealer is incorporated in the United States but has a principal place of business outside the United States.

<sup>580</sup> See Registration Proposing Release, 76 FR 65822.

<sup>581</sup> See *id.* at 65784.

<sup>574</sup> The agent, in these circumstances, would need to consider whether it separately would need to register as a security-based swap dealer (if, for example, the agent acted as principal in a security-based swap with the counterparty, and then entered into a back-to-back transaction with the booking entity), a broker (*e.g.*, by soliciting or negotiating the terms of security-based swap transactions), or other regulated entity. Further, the allocation of functions between a foreign security-based swap dealer and a U.S. agent would not affect the aggregation calculation for determining whether the foreign security-based swap dealer exceeded the *de minimis* threshold. See Section III.B.3(c), *supra*.

<sup>575</sup> See note 574, *supra*.



with the Commission, states, and SROs.<sup>582</sup> Forms SBSE-A and SBSE-BD are shorter forms that have been modified to provide a more streamlined application process for entities that are registered or registering with the CFTC or registered or registering with the Commission as a broker-dealer.<sup>583</sup> Each of these forms is designed to be used to gather information concerning a registrant's business operations to facilitate the Commission's initial registration decisions, as well as ongoing examination and monitoring of registration.<sup>584</sup> While the Commission received four comments on the Registration Proposing Release, only one specifically expressed views on the Forms SBSE, SBSE-A, and SBSE-BD.<sup>585</sup>

## 2. Discussion

To address the Commission's proposed rule regarding substituted compliance, the Commission is re-proposing Forms SBSE, SBSE-A, and SBSE-BD to add two questions to Form SBSE and Form SBSE-A, add one question to all three Forms, and to modify Schedule F to all the Forms. In addition, we are proposing one new instruction to the Forms, which is unrelated to substituted compliance, to clarify that if an application is not filed properly or completely, it may be delayed or rejected.<sup>586</sup> Key differences from the originally proposed forms are discussed more fully below. The Commission is not proposing to modify or eliminate any of the other Forms, or any of the rules, proposed in the Registration Proposing Release.

Re-proposed Forms SBSE and SBSE-A would include two new questions, question 3 (which has three parts) and question 6.<sup>587</sup> The new question 3.A.

would ask whether an applicant is a foreign security-based swap dealer that intends to work with the Commission and its primary regulator to have the Commission determine whether the requirements of its primary regulator's regulatory system are comparable to the Commission's, or avail itself of a substituted compliance determination previously granted by the Commission with respect to the requirements of Section 15F of the Exchange Act and the rules and regulations thereunder. If the applicant responds in the affirmative to either part of the question, new question 3.B. would require that the applicant identify the foreign financial regulatory authority that serves as the applicant's primary regulator and for which the Commission has made, or may make, a substituted compliance determination. If the applicant indicates that it is relying on a previously granted substituted compliance determination, new question 3.C. would require the applicant to describe how it satisfies any conditions the Commission may have placed on the use of such substituted compliance determination. New question 3 would elicit basic information from an applicant to inform the Commission with respect to its intent to rely upon a substituted compliance determination.

New question 6 would ask whether the applicant is a U.S. branch of a non-resident entity. If the applicant responds in the affirmative, the applicant would need to identify the non-resident entity and its location. This question would provide the Commission with information regarding whether the firm would be subject to the rules of the foreign regulator or the rules of one of the U.S. banking regulators, which would, in turn, elicit which rules may be applicable to the entity's U.S. security-based swap business.

Re-proposed Forms SBSE and SBSE-A would also include new question 17, which would be identified as new question 15 in re-proposed Form SBSE-BD. This new question would ask if the applicant is registered with or subject to the jurisdiction of a foreign financial regulatory authority. If the applicant answered this question in the affirmative, it would be directed to provide additional information on Schedule F as discussed below. This question would apply to all applicants, not just foreign security-based swap

applicants, and would provide the Commission with information regarding other regulatory schemes that may be applicable to an applicant.

The proposed revisions to Schedule F would divide Schedule F into two sections. Section I would include the full text of the originally proposed Schedule F. Section II would elicit additional information regarding foreign regulators with which the applicant may be registered or that otherwise have jurisdiction over the applicant.

The Commission preliminarily believes that modifying Forms SBSE, SBSE-A, and SBSE-BD (including the changes to Schedule F), as described above, would be appropriate because it would provide foreign security-based swap dealers with a convenient and cost-effective way of informing the Commission of their intention to rely on or seek a substituted compliance determination, as discussed above. In addition, we believe these modifications to our original proposal would provide the Commission with additional information necessary to make a determination as to whether it is appropriate to grant or institute proceedings to deny registration to a person applying to become a non-resident security-based swap dealer.

## Request for Comment

The Commission requests comment on all aspects of the proposed modifications and additions to proposed Forms SBSE, SBSE-A and SBSE-BD (including the proposed changes to Schedule F). The Commission also specifically requests comment on the following:

- Please explain whether Form SBSE and Form SBSE-A are the appropriate places to identify whether an entity is intending to rely on a substituted compliance determination. If not, please explain why and what other method of notifying the Commission might be appropriate as well as when such notification to the Commission should be required to be made.

- Please explain whether Forms SBSE, SBSE-A, and SBSE-BD (and Schedule F) are the appropriate places to identify whether an entity is subject to oversight by a foreign regulator, and if so, which regulators. If so, why? If not, why not?

- Should any additional questions be added to Form SBSE to elicit information related to a registrant's reliance on a substituted compliance determination?

- Should any additional questions be added to Form SBSE-A to elicit information related to a registrant's

<sup>582</sup> See *id.* at 65802.

<sup>583</sup> See *id.* at 65804-5.

<sup>584</sup> See *id.* at 65802.

<sup>585</sup> See SIFMA Letter II. SIFMA indicated that it appreciated "the Commission's attempts to minimize registration burdens by aligning its proposed registration requirements for SBSDs and MSBSPs with those the CFTC is proposing for swap dealers and major swap participants as well as by creating a streamlined registration process for entities already registered with the Commission or the CFTC," and was "generally pleased that the Commission elected to make its existing broker-dealer registration forms the basis for its proposed registration requirements for SBSDs and MSBSPs" because "[m]arket participants are familiar with these requirements and may, in some cases, be registering broker-dealers as SBSDs." However, SIFMA did object to "several of the required disclosures on proposed Form SBSE," which are substantially similar to disclosures required on Form BD, which it claimed would "impose significant burdens on registrants."

<sup>586</sup> See Instruction B.1.b. on Forms SBSE, SBSE-A, and SBSE-BD.

<sup>587</sup> The Commission is not proposing to add these questions to the Form SBSE-BD, because that form is only applicable to entities that are already

registered as broker-dealers. These firms would not be eligible to rely on a substituted compliance determination because the substituted compliance determination only is with respect to the requirements in Section 15F of the Exchange Act, not the requirements in the Exchange Act to which registered broker-dealers are subject.

reliance on a substituted compliance determination?

- Should Form SBSE–BD also be modified to include any of the additional questions the Commission is proposing to include in re-proposed Form SBSE or Form SBSE–A? If so, which questions and why?

- The Commission previously indicated in the Intermediary Definitions Adopting Release that it would consider applications for limited purpose designations from the major security-based swap participant and security-based swap dealer definitions under Rules 3a67–1(b) and 3a71–1(c) under the Exchange Act, respectively,<sup>588</sup> and requested comment on this topic in the Registration Proposing Release.<sup>589</sup> Since that time, we have adopted and proposed, both jointly with the CFTC and individually, various rules that further clarify the regulations that will be applicable to security-based swap dealers,<sup>590</sup> and today we propose a substituted compliance framework to potentially address the concerns of

<sup>588</sup> As we noted in the Intermediary Definitions Adopting Release, 77 FR 30643–46 and 30696–97, the Commission will consider limited designation applications on an individual basis through analysis of the unique circumstances of each applicant, given that the types of entities that engage in security-based swap transactions are diverse and their organization and activities are varied. Any particular limited designation application will be analyzed in light of the unique circumstances presented by the applicant, and must demonstrate full compliance with the requirements that apply to the type, class, or category of security-based swap, or the activities involving security-based swaps, that fall within the security-based swap dealer or major security-based swap participant designation. A key challenge that any applicant for a limited purpose designation will face is the need to demonstrate that the applicant can comply with the statutory and regulatory requirements applicable to security-based swap dealers or major security-based swap participants while subject to a limited designation. Regardless of the type of limited designation being requested, the Commission will not designate a person as a security-based swap dealer or major security-based swap participant in a limited capacity unless it can demonstrate that it can fully comply with the applicable requirements.

<sup>589</sup> See Registration Proposing Release, 76 FR 65795. The Commission received one comment on this topic, from SIFMA (see note 585, *supra*). SIFMA indicated that it “SIFMA strongly believes that the Commission should allow for limited SBSB or MSBSP registration along a number of dimensions.” For instance, SIFMA suggested that the Commission allow entities to separately register individual trading desks, allow an entity to register as an SBSB in one class or type of security-based swap but not another (e.g., “an entity that acts as a dealer in single-name credit default swaps but not total return swaps on single securities should be able to register as an SBSB in the former but not the latter”), and “allow entities to register as an SBSB or MSBSP for their activities with U.S. persons, keeping activities with non-U.S. persons outside the scope of registration and related regulation.”

<sup>590</sup> See, e.g., the Product Definitions Adopting Release, 77 FR 48208, and the Capital, Margin, and Segregation Proposing Release, 77 FR 70214.

foreign security-based swap dealers. Given these developments, are there any situations addressed by previous comments where limited registration designation would no longer be appropriate? Are there any situations, addressed by previous comments or otherwise, where a limited registration designation may be appropriate for security-based swap dealers? If so, in what situations would a limited registration designation be warranted, and how should the registration forms be amended to facilitate such limited registration? If not, why not?

#### IV. Major Security-Based Swap Participants

##### A. Introduction

Title VII defines a new type of entity regulated by the Commission, the “major security-based swap participant.”<sup>591</sup> The statutory definition of major security-based swap participant encompasses persons whose security-based swap activities do not cause them to be dealers, but nonetheless could pose a high degree of risk to the U.S. financial system generally.<sup>592</sup> This term was further defined in the Intermediary Definitions Adopting Release, focusing on the potential market impact and risks associated with a person’s security-based swap positions.<sup>593</sup> In this respect, the major security-based swap participant definition differs from the security-based swap dealer definition,

<sup>591</sup> See Section 3(a)(67) of Exchange Act, 15 U.S.C. 78c(a)(67), as added by Section 761(a) of the Dodd-Frank Act.

<sup>592</sup> As discussed in the Intermediary Definitions Adopting Release, the tests of the major security-based swap participant definition use terms—particularly “systemically important,” “significantly impact the financial system” or “create substantial counterparty exposure”—that denote a focus on entities that pose a high degree of risk through their security-based swap activities. See Intermediary Definitions Adopting Release, 77 FR 30661 n.761. In addition, the link between the major participant definitions and risk was highlighted during the congressional debate on the statute. See 156 Cong. Rec. S5907 (daily ed. July 15, 2010).

<sup>593</sup> See Intermediary Definitions Adopting Release, 77 FR 30661. Under Rule 3a67–1 under the Exchange Act, 17 CFR 240.3a67–1, a major security-based swap participant is any entity that maintains security-based swap positions exceeding one of the following three thresholds: (1) \$1 billion current uncollateralized exposure or \$2 billion combined current uncollateralized exposure and potential future exposure in a major category of security-based swaps (excluding certain hedging positions); (2) \$2 billion current uncollateralized exposure or \$4 billion combined current uncollateralized exposure and potential future exposure in all security-based swaps; or (3) highly leveraged financial entities with \$1 billion current uncollateralized exposure or \$2 billion combined current uncollateralized exposure and potential future exposure in a major category of security-based swaps. See Intermediary Definitions Adopting Release, 77 FR 30751–54.

which generally focuses on a person’s activities and how it holds itself out to the market. The amount or significance of those activities is relevant only in the context of the *de minimis* exception.<sup>594</sup> As a result, we believe that the cross-border issues that are raised by the definition of major security-based swap participant differ from those raised by the definition of security-based swap dealer. The application of the major security-based swap participant definition to cross-border activities was not addressed in the Intermediary Definitions Adopting Release.<sup>595</sup>

##### B. Comment Summary

A variety of commenters provided their views on the application of the major security-based swap participant definition and its related thresholds in the cross-border context, generally suggesting that the major participant tests focus on the systemic risk that an entity’s swap transactions poses to the U.S. market.<sup>596</sup> Commenters further suggested that major security-based swap participant threshold calculations should exclude security-based swap transactions that do not involve a U.S. counterparty.<sup>597</sup> Several FPSFIs further

<sup>594</sup> See Intermediary Definitions Adopting Release, 77 FR 30661.

<sup>595</sup> The Commission indicated that the cross-border application of the major security-based swap participant definition would be addressed in a separate release. See Intermediary Definitions Adopting Release, 77 FR 30692 n.1181.

<sup>596</sup> See, e.g., Financial Services Roundtable Letter at 25 (stating that “non-US entities should not be subject to regulation as major participants unless their activities in US markets exceed the relevant thresholds, even if their aggregate global activity would exceed those thresholds” and warning that “the regulatory burden is sufficiently high that such entities may choose to exit the US markets, or deny US market participants access to non-US markets, rather than submit to regulation”); APG Asset Management Letter at 4 (recommending that the thresholds be amended to exclude from the computations the outward credit exposures of the computing party to non-U.S. persons, and supporting the CFTC’s statement in its proposed registration release that the major participant analysis should be focused on an entity’s activities with U.S. counterparties or using U.S. mails or instrumentalities); and AIMA Letter at 4–5 (suggesting that in the case of managed funds, only U.S. funds or funds otherwise regulated in the U.S. should be subject to potential major participant designation).

<sup>597</sup> See, e.g., Jones Day Letter at 7–8 (recommending that “[f]oreign swap transactions not involving a U.S. counterparty, *i.e.*, between two foreign counterparties[,] are more appropriately the province of the supervisory authorities in the relevant non-U.S. jurisdiction and should, therefore, be excluded from calculations of substantial swap positions”); Milbank Tweed Letter at 3 (“Clearly, the thresholds should not be applied to a non-U.S. participant’s transactions with all of its counterparties. Equally, all transactions with U.S. counterparties can reasonably be included. To take account of transactions with non-U.S. counterparties that might meet the ‘direct and

requested specific exclusions from the major security-based swap participant definition, suggesting that as a matter of comity, swap transactions involving foreign central banks as a counterparty,<sup>598</sup> international financial institutions, and/or foreign SWFs should be excluded from the major participant definitions.<sup>599</sup>

Certain entities managed or controlled by foreign governments also have asked for exemptions or exclusions from Commission registration or the Dodd-Frank Act's substantive requirements. For example, SWFs commented that they believe SWFs should be excluded from the definition of major security-based swap participant and thus the related regulatory obligations.<sup>600</sup> These entities argued that the Commission should not subject SWFs to registration requirements based on principles of international comity and cooperation and noted that SWFs are typically subject to comparable home country supervision that would render SEC regulation largely duplicative. They also argued that excluding SWFs from the major security-based swap participant definition would not increase systemic risks given that SWFs make long-term investments across diverse asset classes, use swaps or security-based swaps to hedge portfolio risks rather than generate returns, and are more likely to ensure that risk management measures are in place because of SWFs' heightened concerns regarding reputational risk.<sup>601</sup>

Another entity, which operates with an explicit government guarantee of its swap and security-based swap obligations, argued that it should be excluded from the major participant definition due to its lack of risk to the

significant connection' standard, we suggest the Commissions consider including only those transactions by a potential non-U.S. major swap participant that are with non-U.S. registered swap dealers or non-U.S. registered major swap participants.'")

<sup>598</sup> For this purpose, we consider the Bank for International Settlements, in which the Federal Reserve and foreign central banks are members, to be a foreign central bank. See <http://www.bis.org/about/orggov.htm>.

<sup>599</sup> See, e.g., Norges Bank Letter at 4–5 (recommending exemptions for foreign governments and their agencies); KfW letter at 8 (FPSFIs); World Bank Group Letter II at 1–2 (multilateral development institutions); China Investment Letter at 2 (SWFs); and GIC Letter at 2, 5–6 (SWFs).

<sup>600</sup> See China Investment Letter at 2–4 (further explaining that exempting SWFs from the definition of MSBSP would not result in reduced transparency, given that the SWF would still have to comply with a number of other Dodd-Frank Act requirements) and GIC Letter at 2, 5–6.

<sup>601</sup> See China Investment Letter at 3–4 and GIC Letter at 3.

market resulting from this government support.<sup>602</sup>

### C. Proposed Approach

In light of the comments received on the application of the major security-based swap participant definition in the cross-border context and the principles discussed above,<sup>603</sup> the Commission is proposing a rule and interpretive guidance regarding the application of the major security-based swap participant definition to cross-border activities.

#### 1. In General

The Commission is proposing a rule under which a U.S. person would consider all security-based swap transactions entered into by it, while a non-U.S. person would consider only transactions entered into with U.S. persons,<sup>604</sup> when determining whether the person falls within the major security-based swap participant definition.<sup>605</sup> Under this proposed approach, a non-U.S. person would calculate its security-based swap positions under the three prongs of the major security-based swap participant definition<sup>606</sup> based solely on its transactions with U.S. persons (including foreign branches of U.S. banks). All security-based swap transactions by a non-U.S. person with other non-U.S. person counterparties, regardless of whether they are conducted within the United States or whether the non-U.S. person counterparties are guaranteed by a U.S. person, would be excluded from the major security-based swap participant analysis.

The proposed rule would use the same definition of "U.S. person" as proposed in the context of foreign security-based swap dealer registration.<sup>607</sup> As previously discussed, this definition generally follows a territorial approach to defining U.S. person.<sup>608</sup> The proposed approach to the U.S. person definition is intended to identify individuals or legal persons that, by virtue of their location within

<sup>602</sup> See KfW Letter at 8.

<sup>603</sup> See Section II.C, *supra*.

<sup>604</sup> Proposed Rule 3a67–10(a)(2) under the Exchange Act (defining the term "U.S. person" by cross-reference to the definition of U.S. person in proposed Rule 3a71–3(a)(7) under the Exchange Act, as discussed in Section III.B.5, *supra*).

<sup>605</sup> Proposed Rule 3a67–10(c) under the Exchange Act.

<sup>606</sup> See Rule 3a67–1 under the Exchange Act, 17 CFR 240.3a67–1; see also note 593, *supra*.

<sup>607</sup> Proposed Rule 3a67–10(a)(2) under the Exchange Act; see also proposed Rule 3a71–3(a)(7) under the Exchange Act, as discussed in Section III.B.5, *supra*.

<sup>608</sup> See Section III.B.5, *supra*, (discussing the definition of "U.S. person").

the United States or their legal or other relationship with the United States, are likely to impact the U.S. financial market and the U.S. financial system.<sup>609</sup> Therefore, we preliminarily believe that requiring a non-U.S. person to take into account its security-based swap positions with U.S. persons, as proposed to be defined, for purposes of the major security-based swap participant definition would provide an appropriate indication of the degree of default risk posed by such non-U.S. person's security-based swap positions to the U.S. financial system, which we view as the focus of the major security-based swap participant definition.<sup>610</sup> Consistent with the rules further defining the definition of major security-based swap participant adopted in the Intermediary Definitions Adopting Release, such risk to the U.S. financial system would be measured by calculating such non-U.S. person's aggregate outward exposures<sup>611</sup> to U.S. persons (that is, what such non-U.S. person owes, or potentially could owe, on its security-based swaps with U.S. persons).<sup>612</sup> If such non-U.S. person's aggregate outward exposures to U.S. persons exceed one of the thresholds set forth in the rules further defining "major security-based swap

<sup>609</sup> *Id.*

<sup>610</sup> See Section 3(a)(67) of Exchange Act, 15 U.S.C. 78c(a)(67). In particular, one of the thresholds of the statutory definition of major security-based swap participant focuses on the serious adverse effects on the financial stability of the U.S. banking system or financial markets as a result of substantial counterparty exposure created by a person's security-based swap positions. See Section 3(a)(67)(A)(ii)(II) of the Exchange Act, 15 U.S.C. 78c(a)(67)(A)(ii)(II). In addition, Section 3(a)(67)(B) of the Exchange Act requires the Commission to define the term "substantial position" in Sections 3(a)(67)(A)(ii)(I) and (III) of the Exchange Act at the threshold that the Commission determines to be prudent for the effective monitoring, management, and oversight of entities that are systemically important or can significantly impact the financial system of the United States. See Section 3(a)(67)(B) of the Exchange Act, 15 U.S.C. 78c(a)(67)(B).

<sup>611</sup> See Intermediary Definitions Adopting Release, 77 FR 30666–71; Rules 3a67–3(b) and (c) under the Exchange Act, 17 CFR 240.3a67–3(b) and (c).

<sup>612</sup> The determination of whether a security-based swap transaction must be included in a non-U.S. person's major security-based swap participant calculation is based on the U.S. person status of the non-U.S. person's counterparty to such transaction, regardless of whether the counterparty is a security-based swap dealer, end user, CCP, or other market participant. For example, where a non-U.S. person enters into a security-based swap transaction with a security-based swap dealer, and that transaction is submitted for clearing and novated from the dealer to a CCP, the non-U.S. person would look to the U.S. person status of the CCP that became its counterparty as a result of such novation when determining whether the transaction must be included in such non-U.S. person's major security-based swap participant calculation.

participant,"<sup>613</sup> the non-U.S. person would be required to register as a major security-based swap participant.

Given the focus of the major security-based swap participant definition on the degree of risk to the U.S. financial system,<sup>614</sup> the Commission preliminarily believes that the location in which security-based swap transactions are conducted is not relevant to the calculation of a person's security-based swap positions for purposes of determining such person's status as a major security-based swap participant. Such an approach would differ from the approach we are proposing with respect to the security-based swap dealer definition, where we would count transactions connected with security-based swap dealing activity conducted within the United States toward a potential security-based swap dealer's *de minimis* threshold even if the transactions were with non-U.S. persons.<sup>615</sup> This difference in approach is driven by the different focuses of the statutory definitions of the terms security-based swap dealer and major security-based swap participant. While the statutory major security-based swap participant definition is focused specifically on risk,<sup>616</sup> the statutory security-based swap dealer definition is focused on, in addition to risk, the nature of the activities undertaken by an entity, its interactions with counterparties, and its role within the security-based swap market.<sup>617</sup> These different statutory emphases lead us to treat major security-based swap participants differently from security-based swap dealers with respect to whether activities conducted within the United States should be counted toward their respective thresholds.

In addition, as stated above, the U.S. person definition applies to the entire entity, including its branches and offices that may be located in a foreign jurisdiction.<sup>618</sup> Therefore, under the proposed approach, a non-U.S. person would need to include its security-based swap transactions with foreign branches of U.S. banks when calculating its security-based swap positions for purposes of the major security-based swap participant definition.

Some commenters on the CFTC Cross-Border Proposal have suggested that a

non-U.S. person should be allowed to exclude swap transactions with foreign branches of U.S. banks for purposes of determining whether it is a major swap participant because otherwise non-U.S. persons would have a strong incentive to limit or even stop trading with U.S. banks that operate outside the United States via foreign branches.<sup>619</sup> We are mindful of these concerns. However, because foreign branches are not separate legal persons,<sup>620</sup> the Commission believes that the potential losses that a U.S. bank would suffer due to a non-U.S. person counterparty's default, and the potential impact on the U.S. banking system and the U.S. financial system generally, would not differ depending on whether the non-U.S. person counterparty entered into the security-based swap with the home office of the U.S. bank or with a foreign branch of the U.S. bank. Therefore, the Commission preliminarily believes that it is appropriate to require a non-U.S. person to include its security-based swap transactions with foreign branches of U.S. banks for purposes of determining its major security-based swap participant status.

By contrast, the Commission preliminarily believes that a non-U.S. person (the "potential non-U.S. person major security-based swap participant") does not need to include its security-based swap transactions with non-U.S. person counterparties in determining whether it is a major security-based swap participant. As stated above, the focus of the major security-based swap participant definition is on the degree of risk posed by a person's security-based swap positions to the U.S. financial system.<sup>621</sup> In the case of transactions with non-U.S. person counterparties, the risk that a potential non-U.S. person major security-based swap participant will not pay what it owes (or potentially could owe) under its security-based swaps to its non-U.S. counterparties is not transmitted directly and fully to the U.S. financial system in the way that such risk would be transmitted if the potential non-U.S. person major security-based swap participant engaged in security-based swap transactions with U.S. person counterparties. Instead, the non-U.S. person counterparties bear the direct and full risk of loss.<sup>622</sup> We recognize that there

may be indirect spillover effects related to the security-based swap positions arising from the activity conducted by a potential non-U.S. person major security-based swap participant and a non-U.S. person counterparty (e.g., a U.S. person that has an ownership interest in such a non-U.S. person counterparty would potentially face losses on the value of its investment in such a non-U.S. person counterparty due to failure of the potential non-U.S. person major security-based swap participant), but the Commission preliminarily believes that the major security-based swap participant tests do not need to address the potential indirect spillover risk to the U.S. financial system from foreign investments by U.S. persons in non-U.S. persons, or other non-security-based swap activities by U.S. persons with non-U.S. persons.<sup>623</sup>

The Commission recognizes that this proposed approach results in different treatment of U.S. and non-U.S. persons under the major security-based swap participant definition (i.e., a non-U.S. person would consider its security-based swap transactions with only U.S. persons, while a U.S. person would consider all of its security-based swap transactions). However, the Commission preliminarily believes that this approach is appropriate in light of the focus in the major security-based swap participant definition on the U.S. financial system. More specifically, the need for separate analysis of U.S. and non-U.S. entities results from the fact that all of a U.S. person's security-based swap transactions are part of and create risk to the U.S. financial system, regardless of whether such entity's counterparties are U.S. persons or non-U.S. persons. The same is not true of non-U.S. persons, however, because the security-based swap transactions entered into by a non-U.S. person with other non-U.S. persons are not fundamentally part of the U.S. financial system, while such non-U.S. person's security-based swap transactions with U.S. persons would directly impact the U.S. financial system. Thus, we preliminarily believe that the statutory major security-based swap participant definition's focus on the U.S. financial system, justifies treating U.S. and non-U.S. persons differently for purposes of the major participant analysis based on

<sup>613</sup> See Rule 3a67-3 and Rule 3a67-5 under the Exchange Act, 17 CFR 240.3a67-3 and 17 CFR 240.3a67-5 (defining "substantial position" and "substantial counterparty exposure").

<sup>614</sup> See note 610, *supra*.

<sup>615</sup> See Section III.B.6, *supra*.

<sup>616</sup> See note 610, *supra*.

<sup>617</sup> See note 177 and accompanying text, *supra*.

<sup>618</sup> See Section III.B.5, *supra*.

<sup>619</sup> See, e.g., Citigroup Letter at 3.

<sup>620</sup> See Section III.B.5, *supra*.

<sup>621</sup> See note 610, *supra*.

<sup>622</sup> This is the case even if the non-U.S. person counterparties' obligations under the security-based swaps with the potential non-U.S. person major security-based swap participant are guaranteed by a U.S. person. As discussed in more detail below, the Commission proposes to address the risk posed

by a non-U.S. person's security-based swap positions guaranteed by a U.S. person to the U.S. financial system through its treatment of guarantees for purposes of the major security-based swap participant definition. See Section IV.C.2(a), *infra*.

<sup>623</sup> The Commission preliminarily believes that such risk is more appropriately addressed under Titles I and II of the Dodd-Frank Act.

the disparate impacts of their security-based swap transactions on the U.S. financial system.

We recognize that a non-U.S. person's transactions with other non-U.S. person counterparties could still have an impact on the U.S. financial system, including where those transactions threatened the financial integrity of a non-U.S. person counterparty and such person had significant security-based swap positions with U.S. persons. However, the amount of risk the non-U.S. person poses to the U.S. financial system would most directly stem from the size of its direct positions with U.S. persons. As a result, the Commission preliminarily believes it is appropriate to limit the international application of the major security-based swap participant definition to a non-U.S. person's security-based swaps entered into with U.S. persons.

## 2. Guarantees

The application of the major security-based swap participant definition to security-based swap positions guaranteed by a parent, other affiliate, or guarantor raises unique issues in the cross-border context. These issues were not addressed in the Intermediary Definitions Adopting Release.<sup>624</sup>

As a general principle, the Commission and the CFTC did note in the Intermediary Definitions Adopting Release that an entity's security-based swap positions are attributed to a parent, other affiliate, or guarantor for purposes of the major participant analysis to the extent that the counterparties to those positions have recourse to that parent, other affiliate, or guarantor in connection with the position.<sup>625</sup> Positions are not attributed in the absence of recourse.<sup>626</sup> The Commission and the CFTC further stated that attribution of these positions

<sup>624</sup> In the Intermediary Definitions Adopting Release, the Commissions stated they intended to address guarantees provided to non-U.S. entities, and guarantees by non-U.S. holding companies, in separate releases. See Intermediary Definitions Adopting Release, 77 FR 30689 n.1134. In this release, we are not altering the interpretive approach with respect to the attribution of guarantees that was adopted by the Commissions in the Intermediary Definitions Adopting Release, but rather we are proposing an interpretive approach that would apply the principles adopted in the Intermediary Definitions Adopting Release in the cross-border context.

<sup>625</sup> See Intermediary Definitions Adopting Release, 77 FR 30689, and the accompanying note 1132 on that page.

<sup>626</sup> See *id.* As indicated in note 160 above, the term "guarantee" as used in this release refers to a contractual agreement pursuant to which one party to a security-based swap transaction has recourse to its counterparty's parent, other affiliate, or guarantor with respect to the counterparty's obligations owed under the transaction.

for purposes of the major participant definitions is intended to reflect the risk focus of the major participant definitions by providing that entities will be regulated as major participants when they pose a high level of risk in connection with the swap and security-based swap positions they guarantee.

The application of these general principles in the cross-border context is discussed below, including the attribution of guaranteed security-based swap positions to U.S. persons and non-U.S. persons, respectively, when they provide guarantees on performance of the security-based swap obligations of other persons, the limited circumstances where attribution of guaranteed security-based swap positions is not required, and operational compliance.

### (a) Guarantees Provided by U.S. Persons to Non-U.S. Persons

One cross-border issue that arises from the general approach to guarantees set forth in the Intermediary Definitions Adopting Release is how the attribution of guarantees for purposes of the major security-based swap participant definition would apply to a guarantee provided by a U.S. person for performance on the obligations of a non-U.S. person, such as a U.S. holding company providing a guarantee on the obligations of a foreign subsidiary. As noted in the Intermediary Definitions Adopting Release, the attribution of guaranteed positions for purposes of the major participant definitions is intended to reflect the risk that a guarantor might pose to, and the systemic impact of such risk may impose on, the U.S. financial system as a result of the guarantees that it provides.<sup>627</sup> The Commission preliminarily believes that these risk concerns are the same when U.S. persons act as guarantors for foreign persons regardless of whether the underlying security-based swap transactions that they guarantee are entered into with U.S. persons or non-U.S. persons, given that the risk borne by the U.S. person guarantor would not be impacted by the status of the guaranteed non-U.S. person's counterparty as either a U.S. person or non-U.S. person. As a result, the Commission is proposing that, other than in the limited circumstances described below,<sup>628</sup> all security-based swaps entered into by a non-U.S. person and guaranteed by a U.S. person be attributed to such U.S. person guarantor for purposes of determining such U.S.

<sup>627</sup> See *id.*

<sup>628</sup> See Section IV.C.2(c), *infra* (discussing the limited circumstances where attribution of guaranteed security-based swap positions to the guarantor would not apply).

person guarantor's major security-based swap participant status, regardless of whether the underlying transaction was entered into with a U.S. person counterparty or non-U.S. person counterparty.<sup>629</sup>

### (b) Guarantees Provided by Non-U.S. Persons to U.S. Persons and Guarantees Provided by Non-U.S. Persons to Non-U.S. Persons

Another cross-border issue related to the Commission's approach to the attribution of guarantees is how guarantees provided by non-U.S. persons are treated for purposes of the major security-based swap participant definition. As previously noted, the statutory major security-based swap participant definition's focus on the accumulation of security-based swap risk by non-U.S. persons is primarily centered on the impact such risk could have on the U.S. financial system.<sup>630</sup> Where a non-U.S. person provides a guarantee on performance of the security-based swap obligations of a U.S. person (e.g., a non-U.S. holding company providing a guarantee on performance of the obligations owed by its U.S. subsidiary under security-based swaps entered into by the U.S. subsidiary), the counterparties of such U.S. person would be taking the credit risk of the non-U.S. person guarantor as well as the U.S. person. If the non-U.S. person guarantor defaults, the full amount of risk accumulated under the guaranteed U.S. person's security-based swap positions would impact the U.S. financial system. As a result, subject to the limited circumstances described in the Intermediary Definitions Adopting Release,<sup>631</sup> a non-U.S. person providing

<sup>629</sup> In all circumstances where a U.S. person guarantor is required to attribute to itself all security-based swap transactions entered into by the guaranteed non-U.S. person, the guaranteed non-U.S. person would still be required to consider those security-based swap transactions that it enters into with U.S. person counterparties for purposes of determining whether it is a major security-based swap participant pursuant to the proposed Rule 3a67-10(c)(2) under the Exchange Act. See Section IV.C.1, *supra* (discussing proposed Rule 3a67-10(c) under the Exchange Act). Once the guaranteed non-U.S. person becomes a major security-based swap participant and registers with the Commission, the U.S. guarantor would no longer be required to attribute to itself the security-based swap positions entered into by the guaranteed non-U.S. person. See Intermediary Definitions Adopting Release, 77 FR 30689. This same result would also occur where a guaranteed non-U.S. person becomes subject to capital regulation by the Commission or the CFTC (e.g., a registered major swap participant, swap dealer, security-based swap dealer, futures commission merchant, or broker-dealer). See *id.*

<sup>630</sup> See note 610, *supra*.

<sup>631</sup> See Intermediary Definitions Adopting Release, 77 FR 30730 (discussing the limited circumstances where attribution of guaranteed security-based swap positions of a U.S. person to the guarantor would not apply).

a guarantee on performance of the security-based swap obligations of a U.S. person would attribute to itself all of the U.S. person's security-based swap positions that are guaranteed by the non-U.S. person guarantor for purposes of determining the non-U.S. person guarantor's major security-based swap participant status.<sup>632</sup>

By contrast, where a non-U.S. person provides a guarantee on performance of the security-based swap obligations of another non-U.S. person (e.g., a non-U.S. holding company providing a guarantee on performance of the obligations owed by its non-U.S. subsidiary under security-based swaps entered into by the non-U.S. subsidiary), the ultimate counterparty credit risk associated with the transaction would generally reside outside of the United States with the non-U.S. guarantor. In this scenario, the potential impact on the U.S. financial system would be limited to transactions entered into by the guaranteed non-U.S. person with U.S. person counterparties. Therefore, the Commission preliminarily believes that, other than in the limited circumstances described below,<sup>633</sup> where a non-U.S. person guarantees performance on the security-based swap transactions of another non-U.S. person, the non-U.S. guarantor need only attribute to itself such guaranteed security-based swap transactions entered into with U.S. person counterparties for purposes of determining its major security-based swap participant status.<sup>634</sup>

#### (c) Limited Circumstances Where Attribution of Guaranteed Security-Based Swap Positions Does Not Apply

In addition to setting forth general principles regarding the attribution of guaranteed swap or security-based swap

positions to the guarantor for the major participant definitions, the Intermediary Definitions Adopting Release also provided interpretive guidance related to the limited circumstances under which attribution of guaranteed swap or security-based swap positions is not required.<sup>635</sup> Specifically, it stated that even in the presence of a guarantee, it is not necessary to attribute a person's swap or security-based swap positions to a parent or other guarantor if the person already is subject to capital regulation by the Commission or the CFTC (i.e., swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, FCMs, and broker-dealers) or if the person is a U.S. entity regulated as a bank in the United States.<sup>636</sup> In providing this interpretive guidance, the Commission and the CFTC explained that the positions of those regulated entities already will be subject to capital and other requirements, making it unnecessary to separately address, via major participant regulations, the risks associated with guarantees of those positions of a regulated entity.<sup>637</sup>

The Intermediary Definitions Adopting Release did not address the application of the interpretive guidance regarding attribution of guaranteed positions where a guarantee is provided to support a non-U.S. person's performance on the obligations under security-based swaps in the cross-border context. The Commission preliminarily believes that the interpretation jointly adopted by the Commission and the CFTC in the Intermediary Definitions Adopting Release regarding security-based swap positions of a person subject to capital regulation by the CFTC or the Commission should equally apply to a non-U.S. person whose security-based swap positions are guaranteed by another person. Therefore, the Commission is proposing to interpret that it is not necessary to attribute a non-U.S. person's security-based swap positions to a parent or other guarantor if such non-U.S. person already is subject to capital regulation by the Commission or the CFTC (i.e., swap dealers, security-based swap dealers, major swap participants, major security-based swap participants, FCMs and broker-dealers).

In addition, in the cross-border context and with respect to a non-U.S.

person, if such non-U.S. person is not subject to capital regulation by the Commission or the CFTC, consistent with the rationale for the approach to attribution of security-based swap positions of a person that is a U.S. entity regulated as a bank in the United States, it would not be necessary to attribute such non-U.S. person's security-based swap positions to its guarantor if such non-U.S. person is subject to capital standards that are consistent with the capital standards such non-U.S. person would have been subject to if such non-U.S. person were a bank subject to the prudential regulators' capital regulation. Therefore, the Commission preliminarily believes that it is not necessary to attribute such non-U.S. person's security-based swap positions to its guarantor for purposes of determining the guarantor's major security-based swap participant status, if such non-U.S. person 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 (the "Basel Accord").<sup>638</sup> This proposed approach also is consistent with the capital standards proposed by the prudential regulators for a foreign bank that is a swap dealer, major swap participant, security-based swap dealer or major security-based swap participant, which require such foreign bank to comply with regulatory capital rules already made applicable to such foreign bank as part of the existing prudential regulatory regime.<sup>639</sup> The Commission preliminarily believes that security-based swap positions of a non-U.S. person subject to foreign regulatory capital requirements consistent with the Basel Accord would be subject to risk-based capital requirements that take into account the unique risks (including the

<sup>632</sup> See note 629, *supra*.

<sup>633</sup> See Section IV.C.2(c), *infra* (discussing the limited circumstances where attribution of guaranteed security-based swap positions of a non-U.S. person to the guarantor would not apply).

<sup>634</sup> Where a non-U.S. person guarantor is required to attribute to itself the security-based swap positions entered into by a non-U.S. person that are guaranteed by the first non-U.S. person, the guaranteed non-U.S. person also would be required to consider all security-based swap transactions entered into by itself with U.S. person counterparties for purposes of determining its major security-based swap participant status in accordance with proposed Rule 3a67-10(c)(2) under the Exchange Act. See Section IV.C.1, *supra* (discussing proposed Rule 3a67-10(c) under the Exchange Act). Once the guaranteed non-U.S. person becomes a major security-based swap participant and registers with the Commission, the non-U.S. guarantor would no longer be required to attribute to itself the security-based swap positions entered into by the guaranteed non-U.S. person. See Intermediary Definitions Adopting Release, 77 FR 30689.

<sup>635</sup> See Intermediary Definitions Adopting Release, 77 FR 30689.

<sup>636</sup> *Id.* This interpretive guidance applies to both U.S. persons and non-U.S. persons that are subject to registration and regulation in the enumerated categories.

<sup>637</sup> See Intermediary Definitions Adopting Release, 77 FR 30689.

<sup>638</sup> This is consistent with the capital standards of the prudential regulators with respect to foreign banks that are bank holding companies subject to the Federal Reserve Board of Governors' supervision. See § 225.2(r)(3) of the Regulation Y ("For purposes of determining whether a foreign banking organization qualifies under paragraph (r)(1) of this section: (A) A foreign banking organization whose home country supervisor . . . has adopted capital standards consistent in all respects with the Capital Accord of the Basle Committee on Banking Supervision (Basle Accord) may calculate its capital ratios under the home country standard . . ."), 12 CFR 225.2(r)(3).

<sup>639</sup> See Prudential Regulator Margin and Capital Proposal, 76 FR 27582 ("The proposed rule generally requires a covered swap entity to comply with regulatory capital rules already made applicable to that covered swap entity as part of its prudential regulatory regime. . . . In the case of a foreign bank or the U.S. branch or agency of a foreign bank, the capital rules that are made applicable to such covered entity pursuant to § 225.2(r)(3) of the Board's Regulation Y, 12 CFR 225.2(r)(3) . . .").

credit risk, market risk, and other risks) arising from security-based swap transactions, in such a way as to make it unnecessary to separately address, via major security-based swap participant regulation, the risks associated with guarantees of those security-based swap positions.

#### (d) Operational Compliance

Finally, the Commission believes that it is necessary to provide interpretive guidance regarding operational compliance and the special issues that may result from the attribution of security-based swap positions to a parent or guarantor. As the Commission and the CFTC noted in the Intermediary Definitions Adopting Release, these include issues regarding the application of the transaction-focused requirements applicable to registered major participants (*e.g.*, certain requirements related to trading records and transaction confirmations), given that the entity that is the direct counterparty to the swap or security-based swap may be better positioned to comply with those requirements.<sup>640</sup> In the Intermediary Definitions Adopting Release, the Commission and the CFTC stated that “an entity that becomes a major participant by virtue of swaps or security-based swaps directly entered into by others must be responsible for compliance with all applicable major participant requirements with respect to those swaps or security-based swaps (and must be liable for failures to comply), but may delegate operational compliance with transaction-focused requirements to entities that directly are party to the transactions. The entity that is the major participant, however, cannot delegate compliance duties with the entity-level requirements applicable to major participants (*e.g.*, requirements related to registration and capital).”<sup>641</sup>

The Commission preliminarily believes that the same approach should apply in the cross-border context when the guarantor and the guaranteed person are located in different jurisdictions (*e.g.*, U.S. holding companies that act as guarantors of the security-based swap obligations of their non-U.S. dealing subsidiaries). In each case, the major security-based swap participant may delegate compliance duties for transaction-focused requirements to the entities that are counterparties to the transactions, but the major security-based swap participant would remain responsible for ensuring that the Title VII requirements applicable to such

transactions are fulfilled. However, major security-based swap participants must comply with all relevant entity-level requirements themselves that are not transaction-focused, such as registration and capital. Entity-level requirements that have a transaction focus, such as margin, may be delegated to the guaranteed entities that directly are party to the transactions. However, the major security-based swap participants would remain responsible for ensuring compliance with these requirements.

#### 3. Foreign Public Sector Financial Institutions (FPSFIs)

The proposed approach to the cross-border application of the major security-based swap participant definition described above provides a general framework for applying the definition to non-U.S. persons. That framework does not separately address questions raised by commenters regarding how the major security-based swap participant definition applies to FPSFIs. Specifically, some commenters requested explicit exclusions from the major security-based swap participant definition for these types of entities.<sup>642</sup>

We note that FPSFIs encompass a wide range of institutions and organizations, ranging from divisions of foreign central banks, to international financial institutions established under treaties, to multilateral development banks formed, owned, and controlled by sovereign members, to sovereign wealth funds and other investment corporations owned by foreign governments. Some FPSFIs' obligations are guaranteed or backed by foreign governments; others may not be. The purposes and activities of these institutions and organizations vary. For example, some FPSFIs (such as the Bank for International Settlements) provide banking services to foreign central banks who are their members. Some FPSFIs provide credits and grants to promote economic development in developing countries (*e.g.*, multilateral development banks) or distribute funds of regional recovery programs to promote regional economies (*e.g.*, KfW for the European Recovery Program). Other FPSFIs conduct investment activities around the world and their exclusive customers are the foreign governments to which they are linked. Depending on their purposes and activities, FPSFIs may engage in different types of swaps or security-based swaps to various degrees, although the Commission is not aware of data reflecting the nature and amount of such transactions across the FPSFI

population. One commenter stated that it enters into swaps to manage interest rates and foreign exchange risks but does not use swaps to generate returns.<sup>643</sup>

Several commenters requested that FPSFIs be excluded from the major security-based swap participant definition. They provided various reasons and basis to support their requests. Some FPSFIs commented that they are subject to exceptionally high risk controls and have extremely strong capital bases and therefore pose no risk to systemic stability.<sup>644</sup> Others argued that they already are subject to comparable or comprehensive substantive regulation of their respective governments in their home countries and therefore, subjecting them to the major security-based swap participant regulation would create regulatory duplication or conflicts.<sup>645</sup> One FPSFI argued that it only conducts swap activities with dealers, which would be regulated under Title VII, and therefore it is not necessary to subject it to duplicative regulation and supervision.<sup>646</sup> Another FPSFI, which operates with an explicit government guarantee of its swap and security-based swap obligations, argued that it should be excluded from the major participant definition due to its lack of risk to the market resulting from this government support.<sup>647</sup> Intergovernmental organizations, such as multilateral development banks, argued that multilateral development institutions are never subject to national regulations and their privileges and immunities should be fully respected.<sup>648</sup>

After considering the concerns of these commenters, we recognize that FPSFIs raise unique and complex issues because of the diversity of the special purposes they are serving, their differing governance structures and sources of financial strength, and their supranational, intergovernmental, or sovereign nature. The Commission also recognizes that we have received relatively little information from commenters regarding the types, levels, and natures of security-based swap activity that FPSFIs regularly engage in (although some information has been

<sup>643</sup> See China Investment Letter at 3–4. Cf. World Bank Letter II states that “not all multilateral development banks use derivatives in their development operations, or do so only on a limited basis.” See World Bank Letter II at 1 n.1.

<sup>644</sup> See BIS Letter II at 3 and World Bank Letter I at 7.

<sup>645</sup> See GIC Letter at 3–4 and KfW Letter at 3 and 8.

<sup>646</sup> See China Investment Letter at 3–4.

<sup>647</sup> See KfW Letter at 8.

<sup>648</sup> See World Bank Letter II at 2–3.

<sup>640</sup> Intermediary Definitions Adopting Release, 77 FR 30689.

<sup>641</sup> *Id.*

<sup>642</sup> See note 599, *supra*.



received regarding their swap transactions) and that, consequently, the Commission has comparatively little basis on which to understand their roles in the security-based swap markets and, as appropriate, exclude them from the major security-based swap participant definition. Therefore, we are not proposing to specifically address the treatment of FPSFIs at this time. Instead, we are soliciting comment to help determine the basis on which it may be appropriate to exclude FPSFIs from the proposed rule regarding application of the major security-based swap participant definition to non-U.S. persons. In particular, we invite public comment regarding the types, levels, and nature of the security-based swap activity that various types of FPSFIs may engage in on a regular basis, the roles of FPSFIs in the security-based swap market, the mitigating factors and reasons that FPSFIs may not pose systemic risk as a result of their security-based swap activity, and whether it would be more appropriate for the Commission to address FPSFI concerns on an individual basis. We also request considerations, information, and data regarding potential definitions of a FPSFI for purposes of the major security-based swap definition. Responses that are supported by empirical data and analysis are encouraged in assisting the Commission in considering whether excluding FPSFIs from the definition of the major security-based swap participant is warranted.

#### *D. Title VII Requirements Applicable to Major Security-Based Swap Participants*

##### 1. Transaction-Level Requirements Related to Customer Protection

###### (a) Overview

As previously noted, the Dodd-Frank Act is generally concerned with the protection of the U.S. financial system and counterparties in the U.S. security-based swap market.<sup>649</sup> This general principle is particularly relevant to the customer protection, including segregation, requirements in Title VII, which are focused on the protection of the counterparties or customers of security-based swap dealers. As a result, the Commission preliminarily believes that it is not necessary to the objective of Title VII to subject foreign major security-based swap participants to certain of the customer protection requirements in Title VII with respect to their transactions with non-U.S. persons. Accordingly, the Commission is proposing rules that would identify

specific transaction-level requirements that would not apply to foreign major security-based swap participants with respect to their transactions with non-U.S. persons.

###### (b) Proposed Rules

The proposed rules would provide that foreign major security-based swap participants would not be subject, solely with respect to their transactions with non-U.S. persons, to certain of the transaction-level requirements that apply to major security-based swap participants.<sup>650</sup> Specifically, under the proposed rules registered foreign major security-based swap participants would not have to comply with business conduct standards as described in Section 15F(h) of the Exchange Act, and the rules and regulations thereunder, other than the rules and regulations prescribed by the Commission relating to diligent supervision pursuant to Section 15F(h)(1)(B)<sup>651</sup> and the rules and regulations thereunder, with respect to their transactions with non-U.S. persons.<sup>652</sup> In addition, under the proposed rules, registered foreign major security-based swap participants that are not registered broker-dealers would not have to comply with requirements related to the segregation of assets held as collateral in Section 3E of the Exchange Act and the rules and regulations thereunder with respect to their transactions with non-U.S. persons.<sup>653</sup>

Our rationale for this proposed approach to the application of transaction-level requirements for foreign major security-based swap participants is substantially the same as that discussed previously in the context of foreign security-based swap dealers.<sup>654</sup> This rationale includes our

<sup>650</sup> Proposed Rule 3a67–10(b) and proposed Rule 18a–4(f) under the Exchange Act.

<sup>651</sup> 15 U.S.C. 78o–10(h)(1)(B).

<sup>652</sup> See Section III.C.3(a)(i), *supra*. As discussed previously, Section 15F(h)(1)(B) requires security-based swap dealers to conform with such business conduct standards relating to diligent supervision as the Commission shall prescribe.

<sup>653</sup> See proposed Rule 18a–4(f) under the Exchange Act.

<sup>654</sup> See generally Section III.C.4(b), *supra*. In addition, all “nonresident major security-based swap participants,” as defined in proposed Rule 15Fb2–4(a) under the Exchange Act, would be required: (1) To appoint and identify to the Commission an agent in the United States (other than the Commission or a Commission member, official or employee) for service of process; (2) to certify that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission; and (3) to provide the Commission with an opinion of counsel concurring that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and

belief that applying these customer protections and segregation requirements to security-based swap transactions with non-U.S. persons outside the United States would not advance the objectives of Title VII to protect the U.S. financial system or U.S. counterparties. At the same time, this approach would preserve customer protections for U.S. person counterparties who would expect to benefit from the protections afforded by Title VII.

###### (2) Entity-Level Requirements

Entity-level requirements in Title VII primarily address concerns relating to the major security-based swap participant as a whole, with a particular focus on safety and soundness of the entity to reduce systemic risk in the U.S. financial system. The most significant entity-level requirements are capital and margin requirements. Because these requirements address the financial, operational, and business integrity of the entity engaged in security-based swap activity, the Commission preliminarily believes that a registered foreign major security-based swap participant should be required to adhere to these standards. As noted above, other requirements that the Commission believes should apply at the entity, rather than the transactional, level include, but are not limited to, risk management procedures, books and records requirements, conflicts of interest systems and procedures, and designation of a chief compliance officer.<sup>655</sup> These entity-level requirements ensure the safety and soundness of the entire registrant and are thus distinguishable from the transaction-level requirements discussed above, which apply to transactions with individual counterparties and thus may be applied differently based on the U.S. person status of a counterparty.

##### 3. Substituted Compliance

The Commission is not proposing, at this time, to establish a policy and procedural framework under which we would consider permitting compliance by a foreign major security-based swap participant with comparable regulatory requirements in a foreign jurisdiction to substitute for compliance with requirements of the Exchange Act, and the rules and regulations thereunder, applicable to major security-based swap

can, as a matter of law, submit to onsite inspection and examination by the Commission. See proposed Rule 15Fb2–4(b) under the Exchange Act, as discussed in the Registration Proposing Release, 76 FR 65799–801.

<sup>655</sup> See Section III.C.3(b), *supra*.

<sup>649</sup> See note 4, *supra*.

participants, as it is proposing to do for foreign security-based swap dealers.<sup>656</sup>

Unlike foreign security-based swap dealers whose primary businesses are in securities, security-based swaps, swaps, banking and other financial and investment banking activities, the non-U.S. persons that may need to register as nonbank major security-based swap participants may engage in a diverse range of business activities different from, and broader than, the activities conducted by broker-dealers or security-based swap dealers (otherwise they may be required to register as a security-based swap dealer and/or broker-dealer) or the activities conducted by banks. For example, as stated in the Capital, Margin and Segregation Proposing Release, persons that may need to register as nonbank major security-based swap participants may engage in commercial activities that require them to have substantial fixed assets to support manufacturing and/or result in them having significant assets comprised of unsecured receivables.<sup>657</sup> Therefore, it is not clear what types of entity-level regulatory oversight, if any, especially with respect to capital and margin, a foreign major security-based swap participant would be subject to in the foreign regulatory system.

Accordingly, in light of the limited information currently available to us regarding what types of foreign entities may become major security-based swap participants, if any, and the foreign regulation of such entities, we are not, at this time, proposing to extend the proposed policy and procedural framework for substituted compliance to foreign major security-based swap participants. Nevertheless, we will continue to consider the appropriateness of permitting substituted compliance for major security-based swap participants in light of comments received on this proposal and market developments more generally and will consider what further steps to take, if any, at adoption. In this regard, we request considerations, information, and data regarding potential foreign major security-based swap participants. Responses that are supported by empirical data and analysis are encouraged in assisting the Commission in considering whether permitting substituted compliance by foreign major security-based swap participants would be warranted.

#### Request for Comment

The proposed rules and interpretations regarding the application of the major security-based swap participant definition and transaction-level and entity-level requirements to registered major security-based swap participants discussed above represent the Commission's preliminary views. The Commission seeks comment on the proposed rules and interpretations in all aspects. Interested persons are encouraged to provide supporting data and analysis and, when appropriate, suggest modifications to proposed rule text and interpretations. Responses that are supported by data and analysis provide great assistance to the Commission in considering the practicality and effectiveness of the proposed application as well as considering the benefits and costs of proposed requirements. In addition, the Commission seeks comment on the following specific questions:

- Should the major security-based swap participant definition focus only on a non-U.S. person's security-based swap transactions entered into with U.S. persons, or should the major security-based swap participant definition incorporate some or all of a non-U.S. person's other security-based swap transactions? Which transactions? For example, should a non-U.S. person include security-based swap transactions with non-U.S. person counterparties guaranteed by U.S. persons in such non-U.S. person's major security-based swap participant calculation? Why or why not?
- Should the proposed approach toward determining whether a non-U.S. person should count its security-based swap transactions that are cleared through CCPs be adopted? Why or why not? Should the Commission adopt a different approach to the treatment of security-based swap transactions cleared through CCPs for purposes of the cross-border application of the major security-based swap participant test? If so, how should cleared transactions be treated for purposes of the cross-border application of the major security-based swap participant test?
- Should a non-U.S. person be permitted to exclude its security-based swap transactions entered into with foreign branches of U.S. banks from the calculation for purposes of determining whether it is a major security-based swap participant? Why? If a non-U.S. person's security-based swaps with foreign branches of U.S. banks are not required to be considered in determining such non-U.S. person's major security-based swap participant

status, how should the risk (in terms of outward exposures) that such non-U.S. person poses to U.S. banks be addressed?

- Should the Commission permit a non-U.S. person to exclude from its major security-based swap participant calculations its security-based swap positions arising from transactions with the foreign branches of U.S. banks if such non-U.S. person is subject to capital standards adopted by its home country supervisor that are consistent in all respect with the Basel Accord? Are there other conditions or standards the Commission should consider that a non-U.S. person may satisfy or comply with that should allow a non-U.S. person to exclude its security-based swap positions arising from transactions with foreign branches of U.S. banks from its major security-based swap participant calculation?
  - Are there competitiveness concerns related to the proposed different treatment of U.S. persons and non-U.S. persons for purposes of calculating their status under the major security-based swap participant definition? If so, what are these concerns, and how should they be addressed?
  - Should the proposed approach towards the attribution of security-based swap positions guaranteed by U.S. persons and non-U.S. persons be altered? What justifications would support an alternate approach?
  - Should the Commission adopt the proposed approach to the attribution of guaranteed security-based swap positions whereby the positions of guaranteed entities subject to capital standards adopted by its home country supervisor that are consistent in all respects with the Basel Accord would not need to be attributed? Is Basel Accord capital standard an appropriate standard for determining whether it is not necessary to attribute guaranteed security-based swap positions to a guarantor, or should another standard be used? Is this proposed standard clear, or is additional guidance necessary? In addition to the proposed capital standard, should the Commission's approach to the attribution of guaranteed security-based swap positions also include a requirement that the guaranteed entities be subject to effective capital oversight by its home country supervisor as determined by the Commission in order not to attribute the guaranteed security-based swap positions to the guarantor?
    - Are there FPSFIs that would fall within the definition of major security-based swap participant based on the proposed rules and interpretive guidance? If so, should the Commission

<sup>656</sup> See Section XI.C, *infra*.

<sup>657</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70315.

provide relief to such FPSFIs? If so, what type of relief, what types of entities should be eligible for such relief, and what factors would justify such relief? Would it be more appropriate for the Commission to address these concerns on an individual basis?

- Should the Commission adopt the proposed approach to the application of certain customer protection requirements and segregation requirements to foreign major security-based swap participants with respect to their transactions with non-U.S. persons? If so, are there other transaction-level requirements that should be included within this proposed approach?

- Should substituted compliance be provided to foreign major security-based swap participants with respect to entity-level requirements? Transaction-level requirements? If so, how should the Commission make such a determination? In particular, what standard should be used for determining whether existing regulation merits a substituted compliance determination?

- What would be the market impact of the proposed approach to major security-based swap participants? How would the application of the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach to major security-based swap participants? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## V. Security-Based Swap Clearing Agencies

### A. Introduction

Title VII of the Dodd-Frank Act adds a number of provisions to the Exchange Act relating to the registration and regulation of clearing agencies that provide clearance and settlement services for security-based swaps.<sup>658</sup> Such provisions augment the Commission's existing authority to register and regulate clearing agencies in Section 17A of the Exchange Act.<sup>659</sup> In particular, Section 17A(g) of the

Exchange Act, as added by Section 763(b) of the Dodd-Frank Act, requires clearing agencies that use interstate commerce to perform the functions of a clearing agency with respect to security-based swaps to register with the Commission.<sup>660</sup> Section 17A(k) of the Exchange Act, as added by Section 763(b) of the Dodd-Frank Act, provides the Commission with authority to exempt a security-based swap clearing agency from registration if the Commission determines that the clearing agency is subject to comparable, comprehensive supervision and regulation by the CFTC or the appropriate government authorities in the home country of the clearing agency.<sup>661</sup> The Dodd-Frank Act also added provisions to Section 17A of the Exchange Act relating to voluntary clearing agency registration and the establishment of clearing agency standards.<sup>662</sup> Finally, Section 17A(j) requires the Commission to adopt rules governing persons that are registered as clearing agencies for security-based swaps.<sup>663</sup>

Because of the global nature of the security-based swap market, the Commission recognizes that there may be some uncertainty regarding when a foreign security-based swap clearing agency<sup>664</sup> that provides central counterparty ("CCP") services<sup>665</sup> for

security-based swaps would be required to register with the Commission as a clearing agency. Accordingly, we are proposing interpretive guidance regarding the application of the registration requirement in Section 17A(g) of the Exchange Act for security-based swap clearing agencies that act as CCPs.<sup>666</sup> We also address our exemptive authority under Section 17A(k) to exempt a foreign security-based swap clearing agency from the registration requirement in Section 17A(g).<sup>667</sup> In addition, we discuss the potential application of alternative standards to certain foreign clearing agency registrants.

The proposed interpretation discussed below represents the Commission's preliminary views regarding the application of the registration requirement in Section 17A(g) for security-based swap clearing agencies acting as CCPs in the cross-border context. Our proposal reflects a balancing of the principles described above, including, in particular, the goal of the Dodd-Frank Act to address the risk to the U.S. financial system.<sup>668</sup> We

<sup>660</sup> 15 U.S.C. 78q-1(g). Note that Section 929W of the Dodd-Frank Act added another subsection (g) to Section 17A of the Exchange Act. The subsection (g) added by Section 763(b) of the Dodd-Frank Act is the focus of the discussion in this section.

<sup>661</sup> 15 U.S.C. 78q-1(k). The exemptive authority contained in Section 17A(k) of the Exchange Act only pertains to clearing agencies that would be required to register under Section 17A of the Exchange Act for the clearing of security-based swaps. It does not alter the Commission's existing exemptive authority found in Section 17A(b)(1) and Section 36 of the Exchange Act.

<sup>662</sup> Section 17A(h) of the Exchange Act, as added by Section 763(b) of the Dodd-Frank Act, permits a person, in certain cases, to voluntarily register as a clearing agency with the Commission. 15 U.S.C. 78q-1(h). Section 17A(i) of the Exchange Act, as added by Section 763(b) of the Dodd-Frank Act, requires security-based swap clearing agencies to comply with standards established by the Commission. 15 U.S.C. 78q-1(i).

<sup>663</sup> 15 U.S.C. 78q-1(j).

<sup>664</sup> In using the terms "foreign" and "non-resident" in connection with a security-based swap clearing agency, the Commission means a security-based swap clearing agency that is not a U.S. person, as that term is defined in proposed Rule 3a71-3(a)(7) under the Exchange Act, as discussed in Section III.B.5, *supra*. In this regard, the Commission notes that legal persons that have their principal place of business in the United States would be considered "U.S. persons" under the proposed definition regardless of their place of incorporation or organization. *See* proposed Rule 3a71-3(a)(7)(i)(B) under the Exchange Act.

<sup>665</sup> As discussed more fully below, generally speaking, a CCP is an entity that interposes itself between the counterparties to a securities transaction. *See* 17 CFR 240.17Ad-22(a)(1).

<sup>666</sup> In this section, the Commission is proposing interpretive guidance only regarding the registration requirement in Section 17A(g) of the Exchange Act as it applies to clearing agencies that provide CCP services. The Commission is not addressing the registration requirement in Section 17A(b) of the Exchange Act, which was unchanged by the Dodd-Frank Act. The Commission also is not addressing the registration of clearing agencies that provide other types of services for security-based swaps and other securities. Elsewhere, the Commission has provided a temporary exemption from the clearing agency registration requirements to clearing agencies that provide non-CCP types of clearance and settlement services for security-based swaps. *See* Order Pursuant to Section 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions from Clearing Agency Registration Requirements under Section 17A(b) of the Exchange Act for Entities Providing Certain Clearing Services for Security-Based Swaps, Exchange Act Release No. 64796 (July 1, 2011). Accordingly, the Commission expects to address clearing agencies that provide non-CCP services in a future release.

<sup>667</sup> The Commission also has adopted final rules to exempt transactions by CCPs in security-based swaps from all provisions of the Securities Act, other than the anti-fraud provisions in Section 17(a), as well as from Exchange Act registration requirements and provisions of the Trust Indenture Act. *See* Exemptions for Security-Based Swaps issued by Certain Clearing Agencies, Securities Act Release No. 9308 (Mar. 30, 2012), 77 FR 20536 (Apr. 5, 2012). The exemption is conditioned on the CCP being registered or exempt from registration with the Commission, on the determination that the security-based swap is required to be cleared or that the CCP is permitted to clear it pursuant to its rules, that the security-based swap is sold only to an ECP, and that certain information be made available to a counterparty or to the public.

<sup>668</sup> *See* Section II.C, *supra*. In addition, as noted above, to promote effective and consistent global regulation of swaps and security-based swaps, the Dodd-Frank Act requires the Commission and the CFTC to consult and coordinate with foreign regulatory authorities on the "establishment of

<sup>658</sup> *See* Section 763(b) of the Dodd-Frank Act.

<sup>659</sup> *See* 15 U.S.C. 78q-1 and 17 CFR 240.17Ab2-1.

recognize, however, that the proposed interpretation represents one of a number of possible alternative approaches in applying Title VII in the cross-border context. Accordingly, the Commission invites comment regarding all aspects of the proposal discussed below, including potential alternative approaches. Responses that are supported by data and analysis provide great assistance to the Commission in considering the practicality and effectiveness of the proposed application as well as considering the benefits and costs of proposed requirements.

### B. Proposed Title VII Approach

#### 1. Clearing Agency Registration

Section 17A(g) of the Exchange Act, entitled “Registration Requirement,” provides that “[i]t shall be unlawful for a clearing agency, unless registered with the Commission, directly or indirectly to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to a security-based swap.”<sup>669</sup> The Commission preliminarily believes that Title VII was intended to apply to clearing agencies that perform clearing agency functions within the United States, regardless of their principal place of business or their place of incorporation or organization.<sup>670</sup> For reasons discussed below, the proposed interpretive guidance would provide that a security-based swap clearing agency performs the functions of a CCP within the United States if it has a U.S. person as a member.

#### (a) Clearing Agencies Acting as CCPs

Clearing agencies are broadly defined under the Exchange Act and undertake a variety of functions.<sup>671</sup> One such

consistent international standards” with respect to the regulation of swaps and security-based swaps. Public Law 111–203 section 752(a).

<sup>669</sup> 15 U.S.C. 78q–1(g).

<sup>670</sup> See Section II.B, *supra*.

<sup>671</sup> Section 3(a)(23)(A) of the Exchange Act defines the term “clearing agency” to mean any person who: (i) acts as an intermediary in making payments or deliveries or both in connection with transactions in securities; (ii) provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities; (iii) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry, without physical delivery of securities certificates (such as a securities depository); or (iv) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates

function is to act as a CCP,<sup>672</sup> which is an entity that interposes itself between the counterparties to a securities transaction. For example, when a security-based swap contract between two counterparties that are members of a CCP is executed and submitted for clearing, it is typically replaced by two new contracts—separate contracts between the CCP and each of the two original counterparties. At that point, the original counterparties are no longer counterparties to each other. Instead, each acquires the CCP as its counterparty, and the CCP assumes the counterparty credit risk of each of the original counterparties that are members of the CCP. Structured and operated appropriately, CCPs may improve the management of counterparty risk and may provide additional benefits such as multilateral netting of trades.<sup>673</sup>

Although technology and risk management practices frequently change and vary from CCP to CCP, the following are some of the functions performed by the subset of clearing agencies that are CCPs:<sup>674</sup>

- The extinguishing of a security-based swap 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 security-based swap contracts;
- The calculation and collection of initial and variation margin during the life of the security-based swap contract;
- The determination of settlement obligations under a security-based swap contract;
- The determination of a default under a security-based swap contract;

(such as a securities depository). 15 U.S.C. 78c(a)(23)(A).

<sup>672</sup> See Clearing Agency Standards Adopting Release, 77 FR 66221 n.17 (“[a]n entity that acts as a CCP for securities transactions is a clearing agency as defined in the Exchange Act and is required to register with the Commission”).

<sup>673</sup> See *id.*

<sup>674</sup> The Commission does not believe that the opening and maintenance of bank accounts or investment accounts in the United States by a CCP that are not directly accessible by members of a security-based swap clearing agency constitutes the performance of functions of a CCP for these purposes. See, e.g., Exchange Act Release No. 39643 (Feb. 11, 1998), 63 FR 8232, 8234 (Feb. 18, 1998) (discussing a foreign unregistered clearing agency’s use of a U.S. depository, which did not in and of itself trigger the registration requirement). In addition, the Commission does not believe that the use of U.S.-based persons to perform services on behalf of a CCP in the ordinary course of business that do not involve clearing agency functions (e.g., financial guaranties, banking services, or payroll operations) constitutes the performance of functions of a clearing agency.

- The collection of funds from members for contributions to a clearing fund;
- The implementation of a loss-sharing arrangement among members to respond to a member insolvency or default; and
- The multilateral netting of trades.<sup>675</sup>

In performing these functions, CCPs help facilitate over-the-counter trading, and trading on exchanges and other platforms, through the assumption of counterparty risk by the CCP from the original counterparties. During times of market stress, a CCP would mitigate the potential for a market participant’s failure to be transmitted to other market participants, and would increase transparency of the risks borne by its members, as well as confidence of the market participants in the performance of their transactions.<sup>676</sup>

Furthermore, the agreements among members and between members and a CCP play a key role in the CCP’s performance of the functions of a clearing agency. The Exchange Act permits clearing agencies to deny membership if a person does not meet a clearing agency’s financial responsibility, operational capacity, experience and competence standards.<sup>677</sup> In a scenario where risk is mutualized under loss-sharing arrangements, the strength of the CCP hinges upon the strength of its members. The legal arrangements between a CCP and its members are of significant importance to the operational resilience of the CCP itself.

<sup>675</sup> See, e.g., CDS Clearing Exemption Orders, note 74, *supra*.

<sup>676</sup> See Report of the Senate Committee on Banking, Housing, and Urban Affairs regarding The Restoring American Financial Stability Act of 2010, S. Rep. No. 111–176 at 31 (stating that by “mandating the use of central clearinghouses, institutions would become much less interconnected, mitigating risk and increasing transparency.”). At the same time, concentrating risk from several counterparties into a CCP could actually introduce risks through the prospect of moral hazard, such as if the costs of imprudent decisions by one clearing member were shifted to other clearing members or to the general public through bail-out of a CCP. See, e.g., Craig Pirrong, “Mutualization of Default Risk, Fungibility, and Moral Hazard: The Economics of Default Risk Sharing in Cleared and Bilateral Markets,” University of Houston, Working Paper (2010), available at: [http://business.nd.edu/uploadedFiles/Academic\\_Centers/Study\\_of\\_Financial\\_Regulation/pdf\\_and\\_documents/clearing\\_moral\\_hazard\\_1.pdf](http://business.nd.edu/uploadedFiles/Academic_Centers/Study_of_Financial_Regulation/pdf_and_documents/clearing_moral_hazard_1.pdf). Such cost-shifting mechanisms might induce members to take on more risk than they otherwise would in a bilateral setting.

<sup>677</sup> See, e.g., 15 U.S.C. 78q–1(b)(4); see also 17 CFR 240.17Ad–22(d)(2) (requiring registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to require participants to meet certain operational capacity standards).

## (b) Proposed Interpretive Guidance

The Commission is proposing interpretive guidance that a security-based swap clearing agency performing the functions of a CCP within the United States would be required to register pursuant to Section 17A(g) of the Exchange Act.<sup>678</sup> In our preliminary view, a foreign security-based swap clearing agency that provides CCP services, as described above, to a member that is a U.S. person for security-based swaps would be performing the functions of a CCP within the United States and, therefore, would be required to register pursuant to Section 17A(g) of the Exchange Act. The Commission preliminarily believes that such an approach is consistent with the Dodd-Frank Act's goal of reducing systemic risk in the U.S. financial system.<sup>679</sup> Foreign security-based swap clearing agencies that provide CCP services to U.S. members could pose a risk to the United States due to the risk mutualization among members of these clearing agencies.<sup>680</sup> Further, the more complete information about relationships between security-based swap market participants that registration would provide to regulators and the marketplace may help reduce the risk of crises.<sup>681</sup> Accordingly, to address the risk to the U.S. financial system posed by foreign security-based swap clearing agencies with U.S. members, the Commission preliminarily is proposing to require foreign security-based swap clearing agencies that provide CCP services to U.S. members to register pursuant to Section 17A(g) of the Exchange Act.

The Commission anticipates, however, that some U.S. persons may choose to clear transactions at a foreign security-based swap clearing agency on an indirect basis through a correspondent clearing arrangement with a non-U.S. member of the clearing agency.<sup>682</sup> We preliminarily do not

believe that such a correspondent clearing arrangement of a U.S. person with a non-U.S. person member alone would cause the foreign security-based swap clearing agency to be required to register with the Commission because the clearing agency's business is conducted directly with its member firms, which in this example would be located outside of the United States. Correspondent clearing arrangements do not pose the same type of direct risk to the U.S. financial system that foreign security-based swap clearing agencies with U.S. members pose because customers, unlike clearing agency members, do not take mutual responsibility for the obligations of the clearing agency.<sup>683</sup>

## 2. Exemption from Registration under Section 17A(k)

Section 17A(k) of the Exchange Act, as added by Section 763(b) of the Dodd-Frank Act, provides that the Commission may grant a conditional or unconditional exemption from clearing agency registration for the clearing of security-based swaps if the Commission determines that the clearing agency is subject to comparable, comprehensive supervision and regulation by the CFTC or the appropriate government authorities in the home country of the clearing agency.<sup>684</sup>

The Commission preliminarily believes that it may be appropriate to consider an exemption as an alternative to registration in circumstances where the clearing agency is subject to comparable, comprehensive supervision and regulation by appropriate government authorities in the home country of the clearing agency, and the nature of the clearing agency's activities and performance of functions within the United States suggest that registration is not necessary to achieve the Commission's regulatory objectives. Exemptions that are carefully targeted could help to improve clearing agency supervision overall by allowing the Commission to devote resources most efficiently where U.S. interests are most directly implicated, while reducing duplication of efforts in areas where its interests are aligned with those of other regulators. Section 17A(k) further provides that any such exemption may

(summarizing the Commission's position taken in past exemptive orders).

<sup>683</sup> As noted above, the interpretation proposed here applies solely to the registration requirement in Section 17A(g) of the Exchange Act with respect to clearing agencies that provide CCP services for security-based swaps; it does not change the Commission's interpretation of Section 17A(b) of the Exchange Act. See note 666, *supra*.

<sup>684</sup> 15 U.S.C. 78q-1(k).

be subject to appropriate conditions that may include, but are not limited to, requiring the clearing agency to be available for inspection by the Commission and to make available all information requested by the Commission.<sup>685</sup>

The Commission is not at this point specifying how such determinations might be made. The Commission notes that market structure and clearing agency supervision and regulation vary in other jurisdictions, and these variances in combination would affect the Commission's ability to make a determination under Section 17A(k) of the Exchange Act in a particular case, as well as the conditions that would be applied to any exemption. In addition to these factors, differences among individual clearing agencies on matters such as organizational governance, rules for members, and risk management procedures would inform individual exemption determinations.

## 3. Application of Alternative Standards to Certain Registrants

In addition, the Commission may consider, as an alternative to an exemption from registration, proposing rules that are specific to foreign-based CCPs that are registered with the Commission under Section 17A(g). We believe that this approach is contemplated by Section 17A(i) of the Exchange Act, which permits the Commission to adopt rules for registered CCPs that clear security-based swaps and conform our regulatory standards and supervisory practices to reflect evolving United States and international standards.<sup>686</sup> This approach may be particularly appropriate where the Commission determines not to grant a general exemption from registration under Section 17A(k) of the Exchange Act, based on consideration of the factors described above, but where consistency with some regulatory standards suggests that a targeted regulatory approach may be warranted.

<sup>685</sup> *Id.*

<sup>686</sup> Specifically, Section 17A(i) of the Exchange Act, entitled "Standards for Clearing Agencies Clearing Security-Based Swap Transactions": (i) Requires registered clearing agencies that clear security-based swaps to comply with such standards that the Commission may establish by rule; (ii) contemplates that the Commission may conform such standards or its oversight practices to reflect evolving United States and international standards; and (iii) except where the Commission determines otherwise by rule or regulation, confirms that a clearing agency shall have reasonable discretion in establishing the manner in which it complies with any such standards. 15 U.S.C. 78q-1(i).

<sup>678</sup> 15 U.S.C. 78q-1.

<sup>679</sup> See note 4, *supra*.

<sup>680</sup> See, e.g., Clearing Agency Standards Adopting Release, 77 FR 66267 (stating that "[a]ll clearing agencies that act as CCPs in the United States collect contributions from their members to guaranty funds or clearing funds for the mutualization of losses under extreme but plausible market scenarios").

<sup>681</sup> See note 676, *supra*.

<sup>682</sup> Traditionally, the Commission has required registration (or an exemption from registration) as a clearing agency if a foreign clearing agency provides services for U.S. securities directly to U.S. persons. The Commission has not viewed intermediated access by U.S. persons to a foreign clearing agency's services (for example, through a foreign broker) as sufficiently direct to trigger registration requirements. See Proposed Amendments to Rule 15a-6, 73 FR 39198

## Request for comment

The Commission requests comment on all aspects of the proposed interpretation, including the following:

- Should performing the functions of a CCP for only one U.S. person member of the CCP warrant requiring a foreign security-based swap clearing agency to register with the Commission? If not, why not? Further, are there other kinds of activities in the United States or outside the United States that would warrant requiring a CCP to be registered? If so, what are they?

- To what extent might the proposed approach create incentives for foreign CCPs to restrict access to U.S. person members? Please explain.

- Are there any other circumstances where a foreign security-based swap CCP should be required to register with the Commission? For example, is there a circumstance where a CCP that has no U.S. members but clears security-based swaps with a U.S. security as an underlying security should be required to register with the Commission as a clearing agency? Similarly, is there a circumstance where a CCP that has no U.S. members and does not conduct activities within the United States but that clears security-based swaps for the U.S. customers of its members should be required to register with the Commission as a clearing agency? Would the provision of omnibus or individual segregation of U.S. customer funds affect this analysis? Why or why not? Should a security-based swap CCP that relies on a financial guaranty of a U.S. person in allowing a non-U.S. person to become a member be required to register with the Commission? If not, why not?

- How will Commission registration of, exemption from registration for, or promulgation of alternative standards applicable to registered foreign security-based swap CCPs affect the central clearing of security-based swaps? How would it affect the management of counterparty credit risk? How would it affect systemic risk? What impact would it have on the continued development of the global security-based swap market?

- What factors should the Commission consider in determining whether a foreign security-based swap CCP is subject to comparable, comprehensive supervision and regulation by appropriate government authorities in the home country of the CCP? What level of similarity should be required in order for a home country supervision and regulatory framework to be considered comparable and comprehensive when compared to that of the United States?

- How should the Commission determine the home country of a CCP for purposes of Section 17A(k) of the Exchange Act? Should it be the country in which the CCP is incorporated or organized or the country in which it conducts the principal amount of its clearance and settlement activities?

- What other facts and circumstances should the Commission review in determining whether an exemption may be granted under Exchange Act Section 17A(k)? What terms and conditions should be required in connection with an exemption from registration? For example, should the Commission consider whether a jurisdiction has implemented any international standards, such as the CPSS-IOSCO Principles for Financial Market Infrastructures in its regulatory framework?<sup>687</sup> In addition, should the existence of a cooperative agreement with the home country be a factor?

- What would be the market impact of the proposed approach to the registration of foreign CCPs? How would the application of the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## VI. Security-Based Swap Data Repositories

### A. Introduction

Under the Dodd-Frank Act, SDRs are intended to play a key role in enhancing transparency in the security-based swap market by retaining complete records of security-based swap transactions, maintaining the integrity of those records, and providing effective access to those records to relevant authorities and the public consistent with their respective information needs.<sup>688</sup> Title VII provides the Commission with authority to adopt rules governing SDRs.<sup>689</sup> Using this authority, the

<sup>687</sup> See CPSS-IOSCO, Principles for Financial Market Infrastructures (Apr. 2012) (“FMI Principles”), available at: <http://www.bis.org/publ/cpss101a.pdf>.

<sup>688</sup> See SDR Proposing Release, 75 FR 77307.

<sup>689</sup> See Section 13(n)(9) of the Exchange Act, 15 U.S.C. 78m(n)(9), as added by Section 763(i) of the Dodd-Frank Act.

Commission has proposed rules governing the SDR registration process, duties, and core principles, including duties related to data maintenance and access by relevant authorities and those seeking to use the SDR’s repository services.<sup>690</sup>

As noted above, the security-based swap market is global in scope and transactions often involve counterparties in different jurisdictions.<sup>691</sup> The Commission recognizes that, as a result, there may be uncertainty regarding the application of Section 13(n) of the Exchange Act<sup>692</sup> and the rules and regulations thereunder (collectively, “SDR Requirements”).<sup>693</sup> In addition, the Commission is concerned that an overly broad application of the SDR Requirements may unnecessarily restrict global regulators’ access to, and sharing of, security-based swap data in various jurisdictions and present difficulties in enhancing transparency in the global security-based swap market.<sup>694</sup> To address these concerns, and as explained more fully below, the Commission is proposing to limit the application of the SDR Requirements to certain persons that perform the functions of an SDR, including proposing a new rule to provide non-U.S. persons performing the functions of an SDR within the United States with exemptive relief from the SDR Requirements. In addition, to facilitate relevant authorities’ access to security-based swap data collected and maintained by Commission-registered SDRs, the Commission is proposing interpretive guidance to specify how SDRs may comply with the notification requirement set forth in Section 13(n)(5)(G) of the Exchange Act<sup>695</sup> and previously proposed Rule 13n-4(b)(9) thereunder. The Commission also is specifying how the Commission proposes to determine whether a relevant authority is appropriate for purposes of receiving security-based swap data from an SDR. In addition, the Commission is proposing a new rule to provide SDRs with exemptive relief from the indemnification requirement

<sup>690</sup> See SDR Proposing Release, 75 FR 77306.

<sup>691</sup> See Section II.A, *supra*.

<sup>692</sup> 15 U.S.C. 78m(n)(9), as added by Section 763(i) of the Dodd-Frank Act.

<sup>693</sup> See Section 13(n) of the Exchange Act, 15 U.S.C. 78m(n), as added by Section 763(i) of the Dodd-Frank Act, and proposed Rules 13n-1 to 13n-11 under the Exchange Act.

<sup>694</sup> Cf. Société Générale Letter I at 2 (suggesting that U.S. and EU regulators limit their jurisdiction to the part of the security-based swap business that they can most practically regulate, even if they have jurisdiction over a broader range of that business).

<sup>695</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

set forth in Section 13(n)(5)(H)(ii) of the Exchange Act<sup>696</sup> and previously proposed Rule 13n-4(b)(10) thereunder.

In formulating this proposal, the Commission has sought to balance the policy considerations discussed above<sup>697</sup> and the particular concerns related to security-based swap reporting discussed below. The Commission recognizes that other approaches may exist in achieving the mandate of the Dodd-Frank Act, in whole or in part. Accordingly, the Commission invites comment regarding all aspects of the proposal described below, including potential alternative approaches. Data and comment from market participants and other interested parties regarding the likely effect of the Commission's proposed rules and interpretative guidance as well as potential alternative approaches will be particularly useful to the Commission in evaluating possible modifications to the proposal.

### B. Application of the SDR Requirements in the Cross-Border Context

#### 1. Introduction

Section 3(a)(75) of the Exchange Act defines a "security-based swap data repository" to mean "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps."<sup>698</sup> Section 13(n)(1) of the Exchange Act provides that "[i]t shall be unlawful for any person, unless registered with the Commission, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a security-based swap data repository."<sup>699</sup>

Although the Commission has previously proposed a rule governing the registration process for SDRs,<sup>700</sup> which includes requirements for "non-resident security-based swap data repository[ies],"<sup>701</sup> the Commission has

not explicitly explained under what circumstances in the cross-border context would a person performing the functions of an SDR be required to register with the Commission pursuant to Section 13(n)(1) of the Exchange Act<sup>702</sup> and previously proposed Rule 13n-1 thereunder, and to comply with the other SDR Requirements.<sup>703</sup> As discussed further below, the Commission is proposing interpretative guidance to discuss such circumstances and a new rule to provide exemptive relief from the SDR Requirements.

#### 2. Comment Summary

The Commission received several comment letters concerning the registration and regulation of SDRs in the cross-border context. As a general matter, commenters suggested that the Commission should apply principles of international comity.<sup>704</sup>

In addition, two commenters expressed concerns about the potential impact of duplicative registration

incorporated in or having its principal place of business in any place not in the United States; or (iii) [i]n the case of a partnership or other unincorporated organization or association, one having its principal place of business in any place not in the United States." Proposed Rule 13n-1(g) under the Exchange Act would require any non-resident SDR applying for registration with the Commission to certify and provide an opinion of counsel that it can, as a matter of law, provide the Commission with prompt access to its books and records and submit to onsite inspection and examination by the Commission.

<sup>702</sup> 15 U.S.C. 78m(n)(1), as added by Section 763(i) of the Dodd-Frank Act.

<sup>703</sup> In addition to the SDR Requirements, the Commission has proposed, and is re-proposing in this release, Regulation SBSR, which, if adopted as re-proposed, would impose certain obligations on SDRs registered with the Commission. See Section VIII, *infra*. In a separate proposal relating to implementation of Section 763(i) of the Dodd-Frank Act (adding Exchange Act Section 13(n)(5)(E)), 15 U.S.C. 78m(n)(5)(E)), the Commission has proposed rules that would require SDRs registered with the Commission to collect data related to monitoring the compliance and frequency of end-user clearing exemption claims. See End-User Exception Proposing Release, 75 FR 9992. Because these proposed rules and regulations, on their face, apply only to Commission-registered SDRs, the Commission preliminarily believes that these requirements, if adopted as proposed, would not apply to unregistered SDRs, including those that avail themselves of the SDR Exemption, discussed below.

<sup>704</sup> See DTCC Letter III at 3 (urging the Commission, in its regulation of SDRs, to aim for regulatory comity); Davis Polk Letter I at 7 (recommending that the Commission work with foreign authorities to permit SDRs in all major jurisdictions to register with the appropriate regulators in each jurisdiction); see also Société Générale Letter I at 2 (suggesting that the Commission consider international comity and public policy goals of derivatives regulation to limit its regulation of swap business); ISDA/SIFMA Letter I at 18 ("The Commission should consult with foreign regulators before establishing the extra-territorial scope of the rules promulgated under Title VII.").

requirements imposed on SDRs.<sup>705</sup> Specifically, one of these commenters remarked that the Commission's previously proposed rules governing SDRs "would seem to force a non-resident SDR to be subject to multiple regimes and to the jurisdiction of several authorities" and that the SDR Proposing Release made no "reference to equivalency of regulatory regimes or cooperation with the authorities of the country of establishment of the non-resident SDRs."<sup>706</sup> To address this concern, the commenter suggested that the Commission adopt a regime under which foreign SDRs would be deemed to comply with the SDR Requirements if the laws and regulations of the relevant foreign jurisdiction were equivalent to those of the Commission and an MOU has been entered into between the Commission and the relevant foreign authority.<sup>707</sup> The commenter noted that the recommended "regime would have the following advantages: (i) facilitating cooperation among authorities from different jurisdictions; (ii) ensuring the mutual recognition of [SDRs]; and (iii) establishing convergent regulatory and supervisory regimes which is necessary in a global market such as the OTC derivatives one."<sup>708</sup>

Recognizing that some SDRs would function solely outside of the United States and, therefore, would be regulated by an authority in another jurisdiction, commenters suggested possible approaches to the SDR registration regime. One commenter, for example, believed that "a non-U.S. SDR should not be subject to U.S. registration so long as it collects and maintains information from outside the U.S., even if such information is collected from non-U.S. swap dealer or [major security-based swap participant] registrants."<sup>709</sup> Another commenter supported "cross-registration" of SDRs, whereby SDRs in all major jurisdictions may register with the appropriate regulators in each jurisdiction.<sup>710</sup>

#### 3. Proposed Approach

In light of the concerns raised by commenters and the policy

<sup>705</sup> See Cleary Letter IV at 31; ESMA Letter.

<sup>706</sup> ESMA Letter at 1.

<sup>707</sup> See *id.* at 2.

<sup>708</sup> *Id.*

<sup>709</sup> See Cleary Letter IV at 31.

<sup>710</sup> Davis Polk Letter I at 7 ("Cross-registration of SDRs is not only necessary given the global nature of the swaps market, it also reduces duplicative data reporting. Cross-registration would also facilitate the creation of uniform reporting rules and procedures that would enable easy comparison of transaction data from different jurisdictions.").

<sup>696</sup> 15 U.S.C. 78m(n)(5)(H)(ii), as added by Section 763(i) of the Dodd-Frank Act.

<sup>697</sup> See Section II.C, *supra* (discussing principles guiding the Commission's proposed approach to applying Title VII in the cross-border context).

<sup>698</sup> 15 U.S.C. 78c(a)(75), as added by Section 761(a) of the Dodd-Frank Act.

<sup>699</sup> 15 U.S.C. 78m(n)(1), as added by Section 763(i) of the Dodd-Frank Act.

<sup>700</sup> See proposed Rule 13n-1 under the Exchange Act.

<sup>701</sup> See proposed Rule 13n-1(a)(2) under the Exchange Act, which defines "non-resident security-based swap data repository" (hereinafter "non-resident SDR") as "(i) [i]n the case of an individual, one who resides in or has his principal place of business in any place not in the United States; (ii) [i]n the case of a corporation, one



considerations discussed above,<sup>711</sup> the Commission is proposing (i) interpretive guidance regarding the application of the SDR Requirements to U.S. persons that perform the functions of an SDR; and (ii) interpretive guidance regarding the application of the SDR Requirements to non-U.S. persons that perform the functions of an SDR within the United States and a new rule providing exemptive relief from the SDR Requirements for such non-U.S. persons, subject to a condition.

(a) U.S. Persons Performing SDR Functions Are Required to Register With the Commission

Consistent with the approach taken elsewhere in this release,<sup>712</sup> the Commission preliminarily believes that any U.S. person<sup>713</sup> that performs the functions of an SDR<sup>714</sup> would be required to register with the Commission pursuant to Section 13(n)(1) of the Exchange Act<sup>715</sup> and previously proposed Rule 13n-1 thereunder. The Commission preliminarily believes that requiring U.S. persons that perform the functions of an SDR to register with the Commission and comply with the SDR Requirements, as well as other requirements applicable to SDRs registered with the Commission,<sup>716</sup> is necessary to achieve the policy objectives of Title VII.<sup>717</sup> Requiring U.S. persons that perform the functions of an SDR to be operated in a manner

<sup>711</sup> See Section II.C, *supra* (discussing principles guiding the Commission's proposed approach to applying Title VII in the cross-border context).

<sup>712</sup> See Section V.B, *supra*, and Section VII.B, *infra*.

<sup>713</sup> Under this proposed interpretation, the term "U.S. person" would have the same meaning as set forth in proposed Rule 3a71-3(a)(7) under the Exchange Act, as discussed in Section III.B.5, *supra*. As a practical matter, the Commission preliminarily believes that all non-resident SDRs would likely be non-U.S. persons given the similar distinguishing factors in the definitions of "non-resident security-based swap data repository" and "non-U.S. person."

<sup>714</sup> Generally speaking, the Commission preliminarily believes that the "functions of a security-based swap data repository" include, at a minimum, the core services or functions that are embedded in the statutory definition of a "security-based swap data repository." See Section 3(a)(75) of the Exchange Act, 15 U.S.C. 78c(a)(75), as added by Section 761(a) of the Dodd-Frank Act (defining "security-based swap data repository" to mean "any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps").

<sup>715</sup> 15 U.S.C. 78m(n)(1), as added by Section 763(i) of the Dodd-Frank Act.

<sup>716</sup> See note 703, *supra*.

<sup>717</sup> See Section II.C, *supra* (discussing principles guiding the Commission's proposed approach to applying Title VII in the cross-border context).

consistent with the Title VII regulatory framework and subject to the Commission's oversight, would, among other things, help ensure that relevant authorities are able to monitor the build-up and concentration of risk exposure in the security-based swap market, reduce operational risk in that market, and increase operational efficiency.<sup>718</sup> As the Commission noted in the SDR Proposing Release, SDRs themselves are subject to certain operational risks that may impede the ability of SDRs to meet these goals,<sup>719</sup> and the Title VII regulatory framework is intended to address these risks.

(b) Interpretive Guidance and Exemption for Non-U.S. Persons That Perform the Functions of an SDR Within the United States

In the context of the cross-border reporting of security-based swap data, the Commission recognizes that some uncertainty may arise regarding when the SDR Requirements, and other requirements applicable to SDRs registered with the Commission,<sup>720</sup> apply to non-U.S. persons that perform the functions of an SDR. The Commission preliminarily believes that a non-U.S. person that performs the functions of an SDR within the United States would be required to register with the Commission, absent an exemption.<sup>721</sup>

In order to provide legal certainty to market participants and address concerns raised by commenters, and consistent with the proposed interpretive guidance discussed above, the Commission is proposing, pursuant to our authority under Section 36 of the

<sup>718</sup> See SDR Proposing Release, 75 FR 77307 ("The enhanced transparency provided by an SDR is important to help regulators and others monitor the build-up and concentration of risk exposures in the [security-based swap] market . . . . In addition, SDRs have the potential to reduce operational risk and enhance operational efficiency in the [security-based swap] market.")

<sup>719</sup> See *id.* ("The inability of an SDR to protect the accuracy and integrity of the data that it maintains or the inability of an SDR to make such data available to regulators, market participants, and others in a timely manner could have a significant negative impact on the [security-based swap] market. Failure to maintain privacy of such data could lead to market abuse and subsequent loss of liquidity.")

<sup>720</sup> See note 703, *supra*.

<sup>721</sup> See Section 13(n)(1) of the Exchange Act, 15 U.S.C. 78m(n)(1), as added by Section 763(i) of the Dodd-Frank Act (requiring persons that, directly or indirectly, make use of the mails or any means or instrumentality of interstate commerce to perform the functions of an SDR, to register with the Commission). The Commission recognizes that some non-U.S. persons that perform the functions of an SDR may do so entirely outside the United States and thus are not required to register with the Commission.

Exchange Act,<sup>722</sup> an exemption from the SDR Requirements for non-U.S. persons that perform the functions of an SDR within the United States, subject to a condition. Specifically, the Commission is proposing Rule 13n-12 ("SDR Exemption"), which states as follows: "A non-U.S. person<sup>723</sup> that performs the functions of a security-based swap data repository within the United States shall be exempt from the registration and other requirements set forth in Section 13(n) of the [Exchange] Act . . . and the rules and regulations thereunder, provided that each regulator with supervisory authority over such non-U.S. person has entered into a supervisory and enforcement memorandum of understanding ('MOU') or other arrangement with the Commission that addresses the confidentiality of data collected and maintained by such non-U.S. person, access by the Commission to such data, and any other matters determined by the Commission."<sup>724</sup>

The Commission preliminarily believes that a non-U.S. person would be performing "the functions of a security-based swap data repository within the United States" if, for example, it enters into contracts, such as user or technical agreements, with a U.S. person to enable the U.S. person to report security-based swap data to such non-U.S. person. As another example, a non-U.S. person would be performing "the functions of a security-based swap data repository within the United States" if it has operations in the United States, such as maintaining security-based swap data on servers physically located in the United States, even if its principal place of business is not in the United States.<sup>725</sup> Given the constant

<sup>722</sup> Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from certain provisions of the Exchange Act or certain rules or regulations thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. 15 U.S.C. 78mm.

<sup>723</sup> Proposed Rule 13n-12(a)(1) under the Exchange Act defines "non-U.S. person" to mean any person that is not a U.S. person. Proposed Rule 13n-12(a)(2) under the Exchange Act defines "U.S. person" by cross-reference to the definition of "U.S. person" in re-proposed Rule 3a71-3(a)(7) under the Exchange Act, as discussed in Section III.B.5 above.

<sup>724</sup> Proposed Rule 13n-12(b) under the Exchange Act.

<sup>725</sup> The Commission notes that if a person performing the functions of an SDR has operations in the United States to the extent that such operations constitute a principal place of business, then the person would fall within the proposed definition of "U.S. person." As proposed, the term "U.S. person" includes a partnership, corporation, trust, or other legal person having its principal place of business in the United States. See Section

innovation in the market and the fact-specific nature of the determination, it is not possible to provide here a comprehensive discussion of every activity that would constitute a non-U.S. person performing “the functions of a security-based swap data repository within the United States.”

The Commission preliminarily believes that the SDR Exemption is necessary or appropriate in the public interest, and consistent with the protection of investors. Because the reporting requirements of Title VII and re-proposed Regulation SBSR can be satisfied only if a security-based swap transaction is reported to an SDR that is registered with the Commission,<sup>726</sup> the Commission preliminarily believes that the primary reason for a person subject to the reporting requirements of Title VII and re-proposed Regulation SBSR to report a security-based swap transaction to an SDR that is not registered with the Commission would likely be to satisfy reporting obligations that it or its counterparty has under foreign law. Such person would still be required to fulfill its reporting obligations under Title VII and re-proposed Regulation SBSR by reporting its security-based swap transaction to an SDR registered with the Commission, absent other relief from the Commission,<sup>727</sup> even if the transaction were also reported to a non-U.S. person that relies on the SDR Exemption. The Commission preliminarily believes that this proposed approach to the SDR Requirements appropriately would balance the Commission’s interest in having access to security-based swap data involving U.S. persons, while addressing commenters’ concerns regarding the potential for duplicative

III.B.5(b)ii, *supra*. As a result, under the interpretation proposed in Section VI.B.3(a) above, such person would be required to register as an SDR with the Commission.

<sup>726</sup> The Commission notes that a non-U.S. person that performs the functions of an SDR may choose to register with the Commission as an SDR to enable that person to accept data from persons that are reporting a security-based swap pursuant to the reporting requirements of Title VII and re-proposed Regulation SBSR. See 15 U.S.C. 78m(m)(1)(G) and 78m–1(a)(1), as added by Sections 763(i) and 766(a) of the Dodd-Frank Act and Section VIII, *infra* (discussing re-proposed Regulation SBSR). The Commission may consider also granting, pursuant to its authority under Section 36 of the Exchange Act, 15 U.S.C. 78mm, exemptions to such non-U.S. person that registers with the Commission from certain of the SDR Requirements on a case-by-case basis. In determining whether to grant such an exemption, the Commission may consider, among other things, whether there are overlapping requirements in the Exchange Act and applicable foreign law.

<sup>727</sup> See discussion of Regulation SBSR in Section VIII, *infra*, and discussion of substituted compliance in Section XI.D, *infra*.

regulatory requirements<sup>728</sup> as well as furthering the goals of the Dodd-Frank Act.

The SDR Exemption would be subject to the condition that each regulator with supervisory authority over the non-U.S. person that performs the functions of an SDR within the United States enters into a supervisory and enforcement MOU or other arrangement with the Commission, as specified in proposed Rule 13n–12(b) under the Exchange Act. The Commission anticipates that in determining whether to enter into such an MOU or other arrangement with a relevant authority, the Commission would consider whether the relevant authority would keep data collected and maintained by the non-U.S. person that performs the functions of an SDR within the United States confidential<sup>729</sup> and whether the Commission would have access to data collected and maintained by such non-U.S. person.<sup>730</sup> The Commission anticipates that it would consider other matters, including, for example, whether the relevant authority agrees to provide the Commission with reciprocal assistance in securities matters within the Commission’s jurisdiction and whether a supervisory and enforcement MOU or other arrangement would be in the public interest.<sup>731</sup> The Commission preliminarily believes that, in lieu of requiring non-U.S. persons that perform the functions of an SDR within the United States to register with the Commission, the condition in the SDR Exemption is appropriate to address the Commission’s interest in having access to security-based swap data involving

<sup>728</sup> See Section VI.B.2, *supra* (summarizing comment letters concerning the registration of SDRs in the cross-border context).

<sup>729</sup> The Commission contemplates that the relevant authority would keep data collected and maintained by such non-U.S. person confidential in a manner that is consistent with Section 24 of the Exchange Act and Rule 24c–1 thereunder. See 15 U.S.C. 78x and 17 CFR 240.24c–1.

<sup>730</sup> The Commission contemplates that the Commission’s access to data collected and maintained by such non-U.S. person would be in a manner that is consistent with Section 13(n)(5)(D) of the Exchange Act and previously proposed Rule 13n–4(b)(5) thereunder. See 15 U.S.C. 78m(n)(5)(D), as added by Section 763(i) of the Dodd-Frank Act.

<sup>731</sup> The Commission has previously entered numerous cooperative agreements with foreign authorities. See Cooperative Arrangements with Foreign Regulators, available at: [http://www.sec.gov/about/offices/oia/oia\\_cooparrangements.shtml](http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml). Based on the Commission’s experience with negotiating MOUs and other agreements with foreign authorities, the Commission believes that the MOU or agreement described in proposed Rule 13n–12(b) could, in many cases, be negotiated in a timely manner based on existing confidentiality and information sharing agreements so that the exemptive relief provided under proposed Rule 13n–12(b) would be available before the registration of an SDR seeking to claim the exemption would be required.

U.S. persons and U.S. market participants that is maintained by non-U.S. persons that perform the functions of an SDR within the United States and protecting the confidentiality of such security-based swap data involving U.S. persons and U.S. market participants.

#### Request for comment

The Commission requests comment on all aspects of the Commission’s proposed interpretive guidance and the SDR Exemption, including the following:

- Is the Commission’s proposed interpretive guidance and the SDR Exemption appropriate and sufficiently clear? Why or why not? Do you agree with the Commission’s proposed interpretive guidance and SDR Exemption? Is it overly broad or narrow? If so, why? Is there a better alternative?
- Under the Commission’s proposed interpretive guidance and SDR Exemption, will SDRs be subject to duplicative regulatory requirements? If so, will the Commission’s proposed interpretive guidance and SDR Exemption reduce the costs of compliance with duplicative regulatory requirements? Why or why not?
- How may the Commission’s proposed interpretive guidance and SDR Exemption affect the duplicative reporting of security-based swap data? Would the Commission’s ability to exercise oversight of our registrants be compromised if it did not have the ability to learn and/or obtain all security-based swap data from non-U.S. persons that perform the functions of an SDR within the United States that have chosen not to register with the Commission and that are not subject to a substituted compliance order? Why or why not?
- Are there any circumstances where a U.S. person performing the functions of an SDR should not be required to register with the Commission? If so, what are those circumstances?
- Should the Commission require all non-U.S. persons that perform the functions of an SDR within the United States to register with the Commission? Why or why not?
- Non-U.S. persons that perform the functions of an SDR within the United States may rely on the SDR Exemption. Are there any circumstances where non-U.S. persons that perform the functions of an SDR within the United States should be required to register with the Commission? If so, what are those circumstances? Do any of the following facts and circumstances, either individually or in combination, warrant requiring non-U.S. persons that perform

the functions of an SDR within the United States to register with the Commission: maintaining security-based swap data pertaining to a U.S. person or U.S. financial product; facilitating or supporting in the United States the submission of security-based swap data by U.S. persons; having any operations within the United States; entering into contracts, such as user or technical agreements, in order to accept security-based swap data from U.S. persons? If so, which one(s) and why? If not, why not? What types of activities and SDR functions performed within the United States do not warrant requiring a non-U.S. person that performs the functions of an SDR within the United States to be registered with the Commission? What if, for example, a non-U.S. person that performs the functions of an SDR within the United States accepts only data from persons that are "U.S. persons" solely because they are foreign branches of U.S. persons?

- Does the proposed definition of "U.S. person" or "non-U.S. person" in the SDR Exemption need to be clarified or modified? If so, which terms and how should they be defined?

- Do you agree with the proposed condition in the SDR Exemption? Why or why not? Should the condition include additional requirements? If so, what requirements would be appropriate? Are the Commission's estimates of the time required to establish an MOU reasonable? Why or why not? Should the condition apply only to certain non-U.S. persons that perform the functions of an SDR within the United States? Please explain. Should the condition apply if, for example, the only connection to the United States by a non-U.S. person that performs the functions of an SDR within the United States is that it maintains a back-up server physically located in the United States? Should the condition apply only to non-U.S. persons that perform the functions of an SDR within the United States that collect security-based swap data from a reporting side that includes at least one counterparty that is a U.S. person?

- Do you believe that most, if not all, non-U.S. persons that perform the functions of an SDR within the United States will maintain at least some security-based swap data involving U.S. persons or U.S. market participants? Why or why not?

- Is the Commission's reference in the SDR Exemption to a "non-U.S. person that performs the functions of a security-based swap data repository" sufficiently clear? If not, what is a better alternative? Should the Commission

replace, for example, "non-U.S. person" with "non-resident security-based swap data repository," as defined in previously proposed Rule 13n-1(a)(2) under the Exchange Act, instead? Why or why not? Are there circumstances that would be covered by using "non-U.S. person that performs the functions of a security-based swap data repository" in the SDR Exemption rather than using "non-resident security-based swap data repository that performs the functions of a security-based swap data repository" in the SDR Exemption, and vice versa? If so, what circumstances and does it matter for practical purposes?

- Is the SDR Exemption's reference to "within the United States" sufficiently clear? What are the implications of this reference in the SDR Exemption?

- Are there any other factors that the Commission should consider in our interpretive guidance or the SDR Exemption, but that are not addressed above? If so, please explain.

- What would be the market impact of proposed approach to the registration of SDRs? How would the application of proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

### *C. Relevant Authorities' Access to Security-Based Swap Information and the Indemnification Requirement*

Section 13(n)(5)(G) of the Exchange Act<sup>732</sup> and previously proposed Rule 13n-4(b)(9) thereunder provide that an SDR shall on a confidential basis, pursuant to Section 24 of the Exchange Act, and the rules and regulations thereunder, upon request, and after notifying the Commission of the request ("Notification Requirement"), make available all data obtained by the SDR, including individual counterparty trade and position data, to each appropriate prudential regulator, the Financial Stability Oversight Council, the CFTC, the Department of Justice, the Federal Deposit Insurance Corporation and any

<sup>732</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

other person that the Commission determines to be appropriate, including, but not limited to, foreign financial supervisors (including foreign futures authorities), foreign central banks, and foreign ministries. Further, Section 13(n)(5)(H) of the Exchange Act<sup>733</sup> and previously proposed Rule 13n-4(b)(10) provide that before sharing information with any entity described in Section 13(n)(5)(G)<sup>734</sup> or previously proposed Rule 13n-4(b)(9),<sup>735</sup> respectively, an SDR must obtain a written agreement from the entity stating that the entity shall abide by the confidentiality requirements described in Section 24 of the Exchange Act,<sup>736</sup> and the rules and regulations thereunder, relating to the information on security-based swap transactions that is provided; in addition, the entity shall agree to indemnify the SDR and the Commission for any expenses arising from litigation relating to the information provided under Section 24 of the Exchange Act<sup>737</sup> and the rules and regulations thereunder ("Indemnification Requirement").

The Commission believes that the goals of Sections 13(n)(5)(G) and 13(n)(5)(H) of the Exchange Act<sup>738</sup> are, among other things, to obligate SDRs to make available security-based swap information to relevant authorities and maintain the confidentiality of such information. More broadly, the goal of the Dodd-Frank Act is, among other things, to promote the financial stability of the U.S. by improving accountability and transparency in the financial system.<sup>739</sup>

As discussed further below, the Commission recognizes that the Indemnification Requirement raises a number of concerns, including, among other things, the inability of certain relevant authorities to provide, as a matter of law or practice, an open-ended indemnification agreement and the possibility of security-based swap data being fragmented among trade repositories globally if foreign authorities establish trade repositories

<sup>733</sup> 15 U.S.C. 78m(n)(5)(H), as added by Section 763(i) of the Dodd-Frank Act.

<sup>734</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>735</sup> Proposed Rules 13n-4(b)(9) and (10) essentially repeat the requirements of Sections 13(n)(5)(G) and (H) of the Exchange Act, respectively, with the exception of the addition in proposed Rule 13n-4(b)(9) of the Federal Deposit Insurance Corporation to the relevant authorities specified in Section 13(n)(5)(G) of the Exchange Act.

<sup>736</sup> 15 U.S.C. 78x.

<sup>737</sup> *Id.*

<sup>738</sup> 15 U.S.C. 78m(n)(5)(G) and (H), as added by Section 763(i) of the Dodd-Frank Act.

<sup>739</sup> See note 4, *supra*.

in their jurisdictions to ensure access to data that they need to perform their regulatory mandates and legal responsibilities.<sup>740</sup>

In this section, the Commission will first describe the alternatives to the Notification Requirement and Indemnification Requirement that were discussed in the SDR Proposing Release. The Commission will then summarize the comments received, primarily in response to the SDR Proposing Release. Finally, the Commission will discuss our proposed interpretive guidance regarding relevant authorities' access to security-based swap information and our proposed exemptive relief from the Indemnification Requirement.

#### 1. Information Sharing Under Sections 21 and 24 of the Exchange Act

In the SDR Proposing Release, the Commission highlighted two alternative ways for relevant authorities to obtain data maintained by SDRs directly from the Commission (rather than directly from SDRs) without providing an indemnification agreement.<sup>741</sup>

Specifically, the Commission noted that there is existing independent authority in the Exchange Act for certain domestic and foreign authorities to obtain data maintained by SDRs directly from the Commission (rather than directly from SDRs) pursuant to Sections 21(a) and 24(c) of the Exchange Act<sup>742</sup> in certain circumstances and without application of the Indemnification Requirement.<sup>743</sup>

Section 21(a)(2) of the Exchange Act<sup>744</sup> provides that the Commission may provide assistance to a foreign securities authority. The term "foreign securities authority" is broadly defined in Section 3(a)(50) of the Exchange Act<sup>745</sup> to include "any foreign government, or any governmental body or regulatory organization empowered by a foreign government to administer or enforce its laws as they relate to securities matters." The Commission

may provide assistance under Section 21(a)(2) of the Exchange Act<sup>746</sup> to the foreign securities authority in connection with an investigation being conducted by the foreign securities authority to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the authority administers or enforces. Section 21(a)(2) further provides that, as part of this assistance, the Commission may conduct an investigation to collect information and evidence pertinent to the foreign securities authority's request for assistance.<sup>747</sup> The Commission believes that Section 21(a)(2) provides the Commission with independent authority to assist foreign securities authorities in certain circumstances by, for example, collecting security-based swap data from an SDR and providing such authorities with the data.

Pursuant to Section 24(c) of the Exchange Act<sup>748</sup> and Rule 24c-1 thereunder,<sup>749</sup> the Commission may share nonpublic information<sup>750</sup> in our possession with, among others, any "federal, state, local, or foreign government, or any political subdivision, authority, agency or instrumentality of such government . . . [or] a foreign financial regulatory authority."<sup>751</sup> Because the Exchange Act provides the Commission with the statutory authority to share information in our possession with other authorities, the Commission is of the view that if security-based swap transaction data is in our possession, then it may share this information with other authorities. In

<sup>746</sup> 15 U.S.C. 78u(a)(2).

<sup>747</sup> Section 21(a)(2) of the Exchange Act requires that, in considering whether to provide assistance to a foreign securities authority, the Commission determine whether the requesting authority has agreed to provide reciprocal assistance in securities matters to the United States, and whether compliance with the request would prejudice the public interest of the United States.

<sup>748</sup> 15 U.S.C. 78x(c).

<sup>749</sup> 17 CFR 240.24c-1.

<sup>750</sup> Under Rule 24c-1 under the Exchange Act, the term "nonpublic information" means "records, as defined in Section 24(a) of the [Exchange] Act, and other information in the Commission's possession, which are not available for public inspection and copying." 17 CFR 240.24c-1.

<sup>751</sup> Section 3(a)(52) of the Exchange Act defines "foreign financial regulatory authority" to mean "any (A) foreign securities authority, (B) other governmental body or foreign equivalent of a self-regulatory organization empowered by a foreign government to administer or enforce its laws relating to the regulation of fiduciaries, trusts, commercial lending, insurance, trading in contracts of sale of a commodity for future delivery, or other instruments traded on or subject to the rules of a contract market, board of trade, or foreign equivalent, or other financial activities, or (C) membership organization a function of which is to regulate participation of its members in activities listed above." 15 U.S.C. 78c(a)(52).

this regard, the Commission notes that the indemnification requirement set forth in Section 13(n)(5)(H)(ii) of the Exchange Act<sup>752</sup> does not apply to the Commission, and would be inapplicable to the Commission's provision of security-based swap data to relevant authorities pursuant to our independent authority in Section 24(c) of the Exchange Act.<sup>753</sup>

#### 2. Comment Summary

Four commenters submitted comments relating to relevant authorities' access to security-based swap information, three of which were in response to the SDR Proposing Release and one of which was in response to a joint public roundtable regarding the cross-border application of Title VII held by the Commission and the CFTC on August 1, 2011.<sup>754</sup> Commenters were generally supportive of relevant authorities having access to security-based swap data maintained by SDRs when such access is within the scope of the authorities' mandate, but these commenters expressed particular concerns relating to the Indemnification Requirement and relevant authorities' unfettered access to security-based swap data.

As a general matter, one commenter stated that an SDR should be able to provide: (i) Enforcement authorities with necessary trading information; (ii) regulatory agencies with counterparty-specific information about systemic risk based on trading activity; (iii) aggregate trade information on market-wide activity and aggregate gross and net open interest for publication; and (iv) real-time reporting from SB SEFs and bilateral counterparties and related dissemination.<sup>755</sup> The same commenter supported relevant authorities' access to reports from SDRs that are scheduled on a regular basis or triggered by certain events, and believed that the Commission's regulatory model regarding regulatory access should be "location agnostic, without preferential access for [a] prudential regulator, except to perform its prudential duties."<sup>756</sup> The commenter also believed that "it is important to preserve [the] spirit of cooperation and coordination between regulators around the world" in the context of ensuring

<sup>752</sup> 15 U.S.C. 78m(n)(5)(H)(ii).

<sup>753</sup> 15 U.S.C. 78x(c).

<sup>754</sup> See Cleary Letter IV at 30-31; DTCC Letter I at 2 and III at 22-23; ESMA Letter at 2; MFA Letter I at 3.

<sup>755</sup> DTCC Letter IV at 5.

<sup>756</sup> DTCC Letter III at 12.

<sup>740</sup> See Section VI.C.3(c), *infra*.

<sup>741</sup> See SDR Proposing Release, 75 FR 77319.

<sup>742</sup> 15 U.S.C. 78u(a) and 15 U.S.C. 78x(c).

<sup>743</sup> Section 13(n)(5)(H) of the Exchange Act, 15 U.S.C. 78m(n)(5)(H), as added by Section 763(i) of the Dodd-Frank Act. See SDR Proposing Release, 75 FR 77319. The Indemnification Requirement does not apply to requests for information made pursuant to Sections 21(a) and 24(c) of the Exchange Act. Further, since relevant authorities requesting information under these provisions would go directly to the Commission, the Notification Requirement would also be inapplicable. Thus, these requirements would not apply to requests by relevant authorities for security-based swap data when the Commission is exercising its independent statutory authority to assist relevant authorities pursuant to Section 21(a) or 24(c) of the Exchange Act.

<sup>744</sup> 15 U.S.C. 78u(a)(2).

<sup>745</sup> 15 U.S.C. 78c(a)(50).

global regulators' access to security-based swap data.<sup>757</sup>

Two commenters concurred with the Commission's statements in the SDR Proposing Release that relevant authorities will likely be unable to agree to provide SDRs and the Commission with indemnification, as required by Section 13(n)(5)(H)(ii) of the Exchange Act prior to receiving security-based swap data maintained by SDRs.<sup>758</sup> One of these commenters described the Indemnification Requirement as contravening the purpose of SDRs by diminishing transparency if regulators are not allowed to have ready access to information and thereby jeopardizing market stability.<sup>759</sup> Specifically, the commenter believed that the Indemnification Requirement should not apply where relevant authorities are carrying out their regulatory responsibilities, in accordance with international agreements and while maintaining the confidentiality of data provided to them.<sup>760</sup> Recognizing that the Indemnification Requirement is mandated by the Dodd-Frank Act, however, the commenter suggested that in order to ensure consistent application of the requirement and to "minimize any disruption to the global repository framework," the Commission should provide model indemnification language for all SDRs to use.<sup>761</sup> Further, the commenter believed that "any indemnity should be limited in scope to minimize the potential reduction in value of registered SDRs to the regulatory community."<sup>762</sup>

In discussing the Indemnification Requirement, another commenter reiterated the notion that relevant authorities must ensure the confidentiality of security-based swap data provided to them.<sup>763</sup> The

<sup>757</sup> *Id.* at 12 (discussing the spirit of cooperation and coordination between regulators in the context of implementation of guidance provided by the ODRF regarding global regulators' access to security-based swap data maintained by a trade repository in the United States).

<sup>758</sup> See DTCC Letter I at 3; Cleary Letter IV at 31; see also SDR Proposing Release, 75 at 77318–19 ("With respect to the indemnification provision, the Commission understands that regulators may be legally prohibited or otherwise restricted from agreeing to indemnify third parties, including SDRs as well as the Commission. The indemnification provision could chill requests for access to data obtained by SDRs, thereby hindering the ability of others to fulfill their regulatory mandates and responsibilities.").

<sup>759</sup> See DTCC Letter I at 3 (discussing how the Indemnification Requirement would result in the reduction of information accessible to regulators on a timely basis and would greatly diminish regulators' ability to carry out oversight functions).

<sup>760</sup> DTCC Letter III at 12.

<sup>761</sup> *Id.*

<sup>762</sup> *Id.*

<sup>763</sup> ESMA Letter at 2.

commenter believed that the Indemnification Requirement "undermines the key principle of trust according to which exchange of information [among relevant authorities] should occur."<sup>764</sup> Thus, the commenter recommended that the Commission's rules help streamline the Indemnification Requirement for an "efficient exchange of information."<sup>765</sup>

One commenter voiced concerns about unfettered access to security-based swap information by regulators, including foreign financial supervisors, foreign central banks, and foreign ministries, beyond their regulatory authority and mandate.<sup>766</sup> This commenter was concerned that the statutory language incorporated in previously proposed Rule 13n–4(b)(9), which provides that in addition to the entities specifically listed in the rule, an SDR could make available data to "any other person that the Commission determines to be appropriate," is vague and could result in an SDR providing access to persons without proper authority.<sup>767</sup> The commenter suggested that the Commission adopt an approach similar to the CFTC's proposed Rule 49.17(d),<sup>768</sup> and that the Commission and the CFTC "endeavor to adopt similar procedures to control regulator requests for security-based swap information."<sup>769</sup>

### 3. Proposed Guidance and Exemptive Relief

Consistent with the goals of the Dodd-Frank Act<sup>770</sup> and the purposes of SDRs,<sup>771</sup> and after considering the

<sup>764</sup> *Id.*

<sup>765</sup> *Id.*

<sup>766</sup> MFA Letter I at 3.

<sup>767</sup> *Id.* at 4.

<sup>768</sup> As adopted, CFTC Rule 49.17(d) requires any "Appropriate Domestic Regulator" or "Appropriate Foreign Regulator" requesting access to swap data obtained and maintained by a swap data repository to first file a request for access with the swap data repository and certify the statutory authority for such request. The swap data repository then must promptly notify the CFTC of such request and the swap data repository subsequently would provide access to the requested swap data. CFTC Rule 49.17(b)(1) defines "Appropriate Domestic Regulator" and CFTC Rule 49.17(b)(2) provides that "Appropriate Foreign Regulators" are those that have an existing memorandum of understanding with the CFTC or otherwise as determined through an application process. See CFTC Final Rule, Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 FR 54538 (Sept. 1, 2011) ("CFTC SDR Adopting Release").

<sup>769</sup> MFA Letter I at 4.

<sup>770</sup> Dodd-Frank Act, Public Law 111–203 at Preamble (goals include promoting "the financial stability of the United States by improving accountability and transparency in the financial system").

<sup>771</sup> See SDR Proposing Release, 75 FR 77307 (stating that "SDRs are intended to play a key role in enhancing transparency in the [security-based

comments received to date, the Commission is proposing additional guidance regarding relevant authorities' access to security-based swap information and proposing exemptive relief from the Indemnification Requirement. For the reasons discussed further below, the Commission preliminarily believes that our proposed guidance and exemption from the Indemnification Requirement is necessary or appropriate to, among other things, further the goals of the Dodd-Frank Act and the purposes of SDRs while preserving the confidentiality of the security-based swap information maintained by SDRs, as necessary. The Commission also preliminarily believes that our proposed guidance and exemption will, as one commenter suggested, help provide for an "efficient exchange of information."<sup>772</sup>

#### (a) Notification Requirement

Section 13(n)(5)(G) of the Exchange Act requires an SDR, upon request, to "make available all data obtained by the SDR, including individual counterparty trade and position data," to certain specified relevant authorities, as well as "other persons that the Commission determines to be appropriate."<sup>773</sup> However, the SDR may make such data available only "after notifying the Commission of the request."<sup>774</sup> The Commission preliminarily believes that an SDR can fulfill its obligation to notify "the Commission of the request" under Section 13(n)(5)(G) of the Exchange Act<sup>775</sup> and previously proposed Rule 13n–4(b)(9) by notifying the Commission, upon the initial request for security-based swap data by a relevant authority, of the request for security-based swap data from the SDR, and maintaining records of the initial request and all subsequent requests.<sup>776</sup>

swap) market by . . . providing effective access to [security-based swap transaction] records to relevant authorities. . . .")

<sup>772</sup> See ESMA Letter at 2.

<sup>773</sup> Section 13(n)(5)(G) of the Exchange Act, 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act (specifying each appropriate prudential regulator, the Financial Stability Oversight Council, the CFTC, and the Department of Justice); see also proposed Rule 13n–4(b)(9) under the Exchange Act (adding the Federal Deposit Insurance Corporation).

<sup>774</sup> Section 13(n)(5)(G) of the Exchange Act, 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rule 13n–4(b)(9) under the Exchange Act.

<sup>775</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>776</sup> Pursuant to previously proposed Rule 13n–7(b) under the Exchange Act, the SDR would be required to maintain records of the initial request and all subsequent requests, including details of any on-line access by relevant authorities to security-based swap data maintained by the SDR,

The Commission would consider the notice provided and records maintained as satisfying the Notification Requirement.<sup>777</sup> The Commission preliminarily believes that this approach is an efficient way for an SDR to satisfy its statutory notification obligation.<sup>778</sup>

(b) Determination of Appropriate Regulators

Section 13(n)(5)(G) of the Exchange Act requires an SDR, upon request, to “make available all data obtained by the [SDR], including individual counterparty trade and position data,” to certain specified relevant authorities, as well as “each appropriate prudential regulator” and “other persons that the Commission determines to be appropriate,” including, but not limited to, foreign financial supervisors (including foreign futures authorities), foreign central banks, and foreign ministries.<sup>779</sup> The Commission contemplates that a relevant authority will be able to request that the Commission make a determination that the relevant authority is appropriate for requesting security-based swap data from an SDR. The Commission preliminarily believes that it will make such a determination through the issuance of a Commission order.

In making such a determination, the Commission expects that we would consider a variety of factors, and our order may include, among other things, conditions on determining that a

relevant authority is appropriate for purposes of receiving security-based swap data directly from SDRs. The Commission preliminarily believes that such determination will likely be conditioned on a supervisory and enforcement MOU or other arrangement between the Commission and the relevant authority.<sup>780</sup> Given the necessity of maintaining the confidentiality of the proprietary and highly sensitive data maintained by an SDR, such an MOU or arrangement<sup>781</sup> would be designed to protect the confidentiality of the security-based swap data provided to the relevant authority by an SDR.<sup>782</sup> The Commission anticipates that in determining whether to enter into such an MOU or other arrangement with a relevant authority, the Commission may consider whether, among other things, the relevant authority needs security-based swap information from an SDR to fulfill its regulatory mandate or legal responsibilities and the relevant authority agrees to protect the confidentiality of the security-based swap information provided to it. The Commission preliminarily believes that this MOU or arrangement could also satisfy the condition in proposed Rule 13n-4(d)(3) for an SDR to avail itself of the Indemnification Exemption, which is discussed below.<sup>783</sup>

In addition, the Commission preliminarily believes that in making the determination, it would be reasonable for the Commission to consider whether the relevant authority has a legitimate need for access to the security-based swaps maintained by an SDR in order to help safeguard such

information.<sup>784</sup> Confirming that the relevant authority has a legitimate need could reduce the risk of unauthorized disclosure, misappropriation, or misuse of security-based swap data. In this regard, the Commission would be furthering the objectives of the Dodd-Frank Act, which created a number of protections for proprietary and highly sensitive data, including “individual counterparty trade and position data,” maintained by an SDR.<sup>785</sup> The Commission, therefore, preliminarily believes that a reasonable approach for our determination of an appropriate authority is for the Commission to consider the scope of the relevant authority’s regulatory mandate and legal responsibilities. The Commission preliminarily believes that our consideration of these factors will further the Dodd-Frank Act’s objective to safeguard security-based swap data and should address a commenter’s concerns over unfettered access to such proprietary data.<sup>786</sup> The Commission also anticipates considering, among other things, whether the relevant authority agrees to provide the Commission with reciprocal assistance in securities matters within the Commission’s jurisdiction, and whether such a determination would be in the public interest. The Commission may take into account any other factors as the Commission determines are appropriate in making our determination.

In addition, the Commission preliminarily believes that it is not necessary to prescribe by rule—as one commenter suggested<sup>787</sup>—a specific process such as the one proposed by the

by such relevant authority. See proposed Rule 13n-7(b) under the Exchange Act (requiring, among other things, keeping at least one copy of all documents required under the Exchange Act and records made or received by the SDR in the course of its business as such for not less than five years, and promptly furnishing such documents to any representative of the Commission upon request).

<sup>777</sup> One commenter stated that “regulators want direct electronic access to data in SDRs where that data is needed to fulfill regulatory responsibilities” rather than access “by request, with notice to another regulatory authority.” See DTCC Letter III at 11–12. The Commission preliminarily believes that SDRs can provide direct electronic access to relevant authorities under its interpretation. In such a case, the SDR would have to provide the Commission with actual notification upon the initial time that the relevant authority accesses the SDR’s security-based swap data, and retain records of any electronic access by the relevant authority.

<sup>778</sup> As discussed in the SDR Proposing Release, an SDR must keep its notifications to the Commission and requests by relevant authorities confidential. See SDR Proposing Release, 75 FR 77318. Failure by an SDR to treat such notifications and requests confidential could render ineffective or could have adverse effects on the underlying basis for the requests. See *id.* If, for example, a regulatory use of the data is improperly disclosed, such disclosure could possibly signal a pending investigation or enforcement action, which could have detrimental effects. See *id.*

<sup>779</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act. See also proposed Rule 13n-4(b)(9) under the Exchange Act.

<sup>780</sup> Similarly, the CFTC requires “appropriate foreign regulator[s]” to have an MOU or similar type of arrangement with the CFTC or, as determined by the CFTC on a case-by-case basis, CFTC Rule 49.17(b)(2), 17 CFR 49.17(b)(2).

<sup>781</sup> This MOU or other arrangement is separate from the written agreement under Section 13(n)(5)(H)(i) of the Exchange Act and previously proposed Rule 13n-4(b)(10) thereunder, both of which require the SDR to receive a written agreement from each relevant authority pertaining to the confidentiality of the security-based swap transaction information that is provided by the SDR. The MOU or other arrangement is between the Commission and the relevant authority, whereas the written agreement is between the SDR and the relevant authority.

<sup>782</sup> The CFTC requires certain foreign regulators “to provide sufficient facts and procedures to permit the [CFTC] to analyze whether the [foreign regulator] employs appropriate confidentiality procedures and to satisfy itself that the information will be disclosed only as permitted by Section 8(e) of the [Commodity Exchange Act].” CFTC Rule 49.17(b)(2), 17 CFR 49.17(b)(2). The Commission expects that the relevant authority will need to provide to the Commission similar information before the Commission will enter into the MOU or other arrangement.

<sup>783</sup> See Section VI.C.3(c), *infra*.

<sup>784</sup> See MFA Letter I at 3 (voicing concerns about unfettered access to security-based swap information by regulators, including foreign financial supervisors, foreign central banks, and foreign ministries, beyond their regulatory authority and mandate).

<sup>785</sup> See Section 13(n)(5)(G) of the Exchange Act, 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act (directing SDRs to provide data, including individual counterparty trade and position data, on a confidential basis only to circumscribed list of authorities or other persons that the Commission determines to be appropriate); Section 13(n)(5)(H)(i) of the Exchange Act, 15 U.S.C. 78m(n)(5)(H)(i), as added by Section 763(i) of the Dodd-Frank Act (requiring that, prior to an SDR sharing such information, the SDR must receive a written agreement from each entity stating that the entity shall abide by certain confidentiality requirements); and Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(j) of the Dodd-Frank Act (requiring SDRs to maintain the privacy of any and all security-based swap transaction information that they receive from a security-based swap dealer, counterparty, or any other registered entity).

<sup>786</sup> See MFA Letter I at 3.

<sup>787</sup> See MFA Letter I at 4 (suggesting that the Commission adopt an approach similar to the CFTC’s proposed Rule 49.17(d)).

CFTC<sup>788</sup> that sets forth criteria for relevant authorities and the SDR to use in order to facilitate relevant authorities' access to security-based swap data maintained by the SDR. The Commission preliminarily believes that our determination of an appropriate authority, pursuant to the process described above, represents a reasonable approach to provide appropriate access by relevant authorities, while at the same time providing safeguards against access by persons without proper authority.<sup>789</sup> The Commission also preliminarily believes that SDRs should have the flexibility to consider whether to provide relevant authorities with access to requested security-based swap data.<sup>790</sup> The Commission preliminarily believes that a specific rule that delineates a process governing relevant authorities' access requests, as suggested by the commenter, would limit the flexibility of SDRs in considering whether to provide relevant authorities with access to requested security-based swap data.

The Commission contemplates that, in our sole discretion, we would determine whether to grant or deny a request for a determination that the relevant authority is appropriate for purposes of requesting security-based swap data from an SDR.<sup>791</sup> In addition, the Commission could revoke our determination at any time.<sup>792</sup> For

<sup>788</sup> See CFTC Notice of Proposed Rulemaking: Swap Data Repositories, 75 FR 80898 (Dec. 23, 2010). The CFTC has since adopted CFTC Rule 49.17(d), 17 CFR 49.17(d), which does not include several of its proposed requirements, such as requiring relevant authorities to detail the basis for their requests. See CFTC SDR Adopting Release, 76 FR 54538.

<sup>789</sup> See MFA Letter I at 4 (voicing concern that vague standard could result in an SDR providing access to persons without proper authority).

<sup>790</sup> The Commission preliminarily believes that an SDR's consideration of whether to provide relevant authorities with access to requested security-based swap data is implicitly subsumed in an SDR's statutory duty to maintain the privacy of security-based swap information that it receives. See Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rule 13n-4(b)(8) under the Exchange Act (requiring SDRs to maintain the privacy of any and all security-based swap transaction information that the SDR receives from a security-based swap dealer, counterparty, or certain registered entity) and proposed Rule 13n-9 under the Exchange Act (requiring an SDR to protect the privacy of security-based swap transaction information that the SDR receives by, among other things, establishing safeguards, policies, and procedures that are reasonably designed to protect such information and that address, without limitation, the SDR limiting access to confidential information, material, nonpublic information, and intellectual property).

<sup>791</sup> The Commission may issue a determination order that is for a limited time.

<sup>792</sup> As a general matter, the Commission provides a list of MOUs and other arrangements on its Web site, which is one way for an SDR to monitor and

example, the Commission may revoke a determination or request additional information from a relevant authority to support continuation of the determination if a relevant authority fails to keep confidential security-based swap data provided to it by an SDR.

#### (c) Option for Exemptive Relief from the Indemnification Requirement

##### i. Impact of the Indemnification Requirement

As noted above, Section 13(n)(5)(G) of the Exchange Act<sup>793</sup> and previously proposed Rule 13n-4(b)(9) thereunder provide that an SDR shall on a confidential basis, pursuant to Section 24 of the Exchange Act, and the rules and regulations thereunder, upon request, and after notifying the Commission of the request, make available all data obtained by the SDR to each appropriate prudential regulator, the Financial Stability Oversight Council, the CFTC, the Department of Justice, the Federal Deposit Insurance Corporation and any other person that the Commission determines to be appropriate. Section 13(n)(5)(H)(ii) of the Exchange Act requires that before an SDR shares security-based swap information with a relevant authority requesting such information from the SDR, the relevant authority must "agree to indemnify the security-based swap data repository and the Commission for any expenses arising from litigation relating to the information provided under section 24 [of the Exchange Act]." <sup>794</sup> Based on the Commission's understanding that certain relevant authorities may be unable to agree to indemnify any SDR and the Commission, the Commission preliminarily believes that the Indemnification Requirement could significantly frustrate the purpose of Section 13(n)(5)(G) of the Exchange Act<sup>795</sup> by preventing SDRs from making available security-based swap information to relevant authorities.

As stated in the SDR Proposing Release, "under the Dodd-Frank Act, SDRs are intended to play a key role in enhancing transparency in the [security-based swap] market by retaining complete records of [security-based swap] transactions, maintaining the

determine whether a relevant authority has entered into an applicable MOU or other arrangement. The MOUs and other arrangements can be found at the following link: [http://www.sec.gov/about/offices/oia/oia\\_cooparrangements.shtml](http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml).

<sup>793</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>794</sup> 15 U.S.C. 78m(n)(5)(H)(ii), as added by Section 763(i) of the Dodd-Frank Act.

<sup>795</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

integrity of those records, and providing effective access to those records to relevant authorities and the public in line with their respective information needs." <sup>796</sup> Commenters <sup>797</sup> as well as relevant authorities, however, have expressed concerns about how the Indemnification Requirement would contravene the purposes of the Dodd-Frank Act, and more specifically, the statutory purposes of SDRs.<sup>798</sup> The Commission preliminarily believes that the Indemnification Requirement should not be applied rigidly so as to frustrate such purposes.

Specifically, the Commission recognizes that certain domestic authorities, including some of those expressly identified in Section 13(n)(5)(G) of the Exchange Act<sup>799</sup> and the Commission, cannot, as a matter of law, provide an open-ended indemnification agreement. For example, the Antideficiency Act prohibits certain U.S. federal agencies from obligating or expending federal funds in advance or in excess of an appropriation, apportionment, or certain administrative subdivisions of those funds (e.g., through an unlimited or unfunded indemnification).<sup>800</sup> Similarly, the Commission understands that foreign authorities may also be prohibited under applicable foreign laws from satisfying the Indemnification Requirement.<sup>801</sup> As such, the Commission agrees with three commenters' views that the Indemnification Requirement could hinder the ability of relevant authorities

<sup>796</sup> SDR Proposing Release, 75 FR 77307.

<sup>797</sup> See, e.g., Cleary Letter IV at 31 ("[T]he indemnification requirement could be a significant impediment to effective regulatory coordination, since non-US regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions."); DTCC Letter I at 3 (discussing how the Indemnification Requirement would result in the reduction of information accessible to regulators on a timely basis and would greatly diminish regulators' ability to carry out oversight functions); ESMA Letter at 2 (noting that the Indemnification Requirement "undermines the key principle of trust according to which exchange of information [among relevant authorities] should occur").

<sup>798</sup> See, e.g., DTCC Letter IV at 5 (noting that SDRs should be able to provide, among other things, enforcement authorities with necessary trading information and regulatory agencies with certain counterparty-specific information). As stated above, the Commission believes that the goal of Sections 13(n)(5)(G) and 13(n)(5)(H) of the Exchange Act is, among other things, to obligate SDRs to make available security-based swap information to relevant authorities, provided that the confidentiality of the information is preserved.

<sup>799</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>800</sup> 31 U.S.C. 1341, 1517(a).

<sup>801</sup> See Cleary Letter IV at 31; DTCC Letter I at 3; ESMA Letter at 2.



to fulfill their regulatory mandates and legal responsibilities.<sup>802</sup>

Moreover, the Commission understands from foreign authorities that their regulatory regimes will require them to have direct access to data maintained by trade repositories, including SDRs registered with the Commission, in order to fulfill their regulatory mandates and legal responsibilities.<sup>803</sup> Many foreign regulators<sup>804</sup> and market participants have indicated, however, that because foreign authorities cannot, as a matter of law or practice, comply with the Indemnification Requirement, the practical effect of having an open-ended indemnification requirement may be the fragmentation of security-based swap data across multiple SDRs, as foreign authorities establish trade repositories in their jurisdictions to ensure access to data that they need to perform their regulatory mandates and legal responsibilities.<sup>805</sup> Such fragmentation may lead to duplicative reporting requirements in multiple jurisdictions, higher reporting costs for market participants, and less transparency in the security-based swap market.<sup>806</sup> In light of these concerns, the Commission preliminarily believes that an exemption from the Indemnification Requirement may be necessary or appropriate, as a practical matter, to minimize fragmentation of security-based swap data that could otherwise be

consolidated and reduce duplicative reporting requirements.<sup>807</sup>

ii. Proposed Rule 13n-4(d): Indemnification Exemption

The Commission is proposing, pursuant to our authority under Section 36 of the Exchange Act,<sup>808</sup> a tailored exemption from the Indemnification Requirement. To avoid a result that could significantly frustrate the purpose of Section 13(n)(5)(G) and the purpose of SDRs, the Commission preliminarily believes that the Indemnification Exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors,<sup>809</sup> particularly given that the exemption is narrowly tailored and could be applied in only limited circumstances.

Specifically, the Commission is proposing Rule 13n-4(d) (“Indemnification Exemption”), which states as follows: “A registered security-based swap data repository is not required to comply with the indemnification requirement set forth in Section 13(n)(5)(H)(ii) of the [Exchange] Act and [Rule 13n-4(b)(9) thereunder] with respect to disclosure of security-based swap information by the security-based swap data repository if: (1) [a]n entity described in [Rule 13n-4(b)(9)] requests security-based swap information from the security-based swap data repository to fulfill a regulatory mandate and/or legal responsibility of the entity; (2) [t]he request of such entity pertains to a person or financial product subject to the jurisdiction, supervision, or oversight of the entity; and (3) [s]uch entity has entered into a supervisory and enforcement memorandum of understanding or other arrangement with the Commission that addresses the confidentiality of the security-based swap information provided and any other matters as determined by the Commission.”

In proposing the Indemnification Exemption, the Commission is mindful of the comments received. The Commission intends for the Indemnification Exemption to—as one commenter suggested—“preserve [the]

<sup>807</sup> The Commission preliminarily believes that the Indemnification Requirement does not apply when an SDR is registered with the Commission and is also registered or licensed with a foreign authority and that authority is obtaining security-based swap information directly from the SDR pursuant to that foreign authority’s regulatory regime.

<sup>808</sup> 15 U.S.C. 78mm (providing the Commission with general exemptive authority \* \* \* “to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors”).

<sup>809</sup> 15 U.S.C. 78mm.

spirit of cooperation and coordination between regulators around the world” in the context of ensuring global regulators’ access to security-based swap data.<sup>810</sup> By identifying specific conditions that are applicable to requests by any relevant authority, the Commission also intends for the Indemnification Exemption to be—as one commenter suggested—“location agnostic,”<sup>811</sup> whereby relevant authorities are treated similarly regardless of whether they are domestic authorities or foreign authorities.<sup>812</sup> In addition, the Indemnification Exemption is consistent with one commenter’s suggestion that the Commission should not apply the Indemnification Requirement where relevant authorities are carrying out their regulatory responsibilities, in accordance with international agreements and while maintaining the confidentiality of data provided to them.<sup>813</sup> In order for an SDR to share security-based swap information with a relevant authority without an indemnification agreement, the three proposed conditions specified in the Indemnification Exemption, as discussed further below, must be met.

First, the relevant authority’s request for security-based swap information from an SDR must be for the purpose of fulfilling the relevant authority’s regulatory mandate and/or legal responsibility. The Commission preliminarily believes that this condition is aligned with the Dodd-Frank Act’s requirements to protect security-based swap information, including proprietary and highly sensitive data, maintained by an SDR from unauthorized disclosure, misappropriation, or misuse of security-based swap information.<sup>814</sup> In

<sup>810</sup> See DTCC Letter III at 12 (discussing implementation of guidance provided by the ODRF regarding global regulators’ access to security-based swap data maintained by a trade repository in the United States).

<sup>811</sup> See DTCC Letter III at 12 (suggesting that the Commission’s regulatory model regarding regulatory access should be “location agnostic”).

<sup>812</sup> The Commission intends for the Indemnification Exemption to provide relief for both foreign authorities and domestic authorities that require access to security-based swap data maintained by SDRs in order to fulfill a regulatory mandate or legal responsibility. The Commission preliminarily believes that an SDR may rely on the Indemnification Exemption in connection with requests from relevant authorities, including SROs, registered futures associations, and international financial institutions.

<sup>813</sup> See DTCC Letter III at 12.

<sup>814</sup> See Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(i) of the Dodd-Frank Act (requiring SDRs to maintain the privacy of any and all security-based swap transaction information that they receive from a

<sup>802</sup> See Cleary Letter IV at 31; DTCC Letter I at 3; ESMA Letter at 2.

<sup>803</sup> For example, in the case of Europe, under European Market Infrastructure Regulation (“EMIR”), trade repositories established in third countries that provide services to entities established in the European Union must apply for recognition by ESMA, which conditions its approval on, among other things, “[European] Union authorities, including ESMA, hav[ing] immediate and continuous access” to information in such trade repositories. Regulation No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, 2012 O.J. (L 201) 1, 49.

<sup>804</sup> See CFTC and SEC, Joint Report on International Swap Regulation (Jan. 31, 2012) (noting that the indemnification provisions have “caused concern among foreign regulators, some of which have expressed unwillingness to register or recognize [a swap data repository] unless [they are] able to have direct access to necessary information” and that foreign regulators “are considering the imposition of a similar requirement that would restrict the CFTC’s and SEC’s access to information at [trade repositories] abroad”).

<sup>805</sup> See Section XV.H.2(b)iii, *infra* (discussing the potential effects of fragmentation of security-based swap data among trade repositories across multiple jurisdictions).

<sup>806</sup> See, e.g., Cleary Letter IV at 31 (The Indemnification Requirement “could be a significant impediment to effective regulatory coordination, since non-U.S. regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions”).

particular, the Commission preliminarily believes that this condition is consistent with an SDR's statutory duty to maintain the privacy of security-based swap information that it receives.<sup>815</sup> In complying with its duty to maintain the privacy of security-based swap information, an SDR would need to determine when it can or cannot provide security-based swap information to others. The Commission preliminarily believes that, for the limited purposes of satisfying the Indemnification Exemption, it is appropriate for the SDR to include in its consideration of whether to provide security-based swap information to relevant authorities whether a relevant authority's specific request for security-based swap information is indeed within its regulatory mandate or legal responsibilities before the SDR provides the information to the relevant authority.<sup>816</sup> Finally, the Commission notes that establishing such a condition in the Indemnification Exemption is consistent with guidelines that one commenter indicated that it followed on a voluntary basis in providing relevant authorities with access to security-based swap information.<sup>817</sup>

security-based swap dealer, counterparty, or any other registered entity); Section 13(n)(5)(G) of the Exchange Act, 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act (directing SDRs to provide data, including individual counterparty trade and position data, on a confidential basis only to circumscribed list of authorities or other persons that the Commission determines to be appropriate); and Section 13(n)(5)(H)(i) of the Exchange Act, 15 U.S.C. 78m(n)(5)(H)(i), as added by Section 763(i) of the Dodd-Frank Act (requiring that, prior to an SDR sharing such information, the SDR must receive a written agreement from each entity stating that the entity shall abide by certain confidentiality requirements).

<sup>815</sup> See Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rule 13n-4(b)(8) under the Exchange Act (requiring SDRs to maintain the privacy of any and all security-based swap transaction information that the SDR receives from a security-based swap dealer, counterparty, or certain registered entity) and proposed Rule 13n-9 under the Exchange Act (requiring an SDR to protect the privacy of security-based swap transaction information that the SDR receives by, among other things, establishing safeguards, policies, and procedures that are reasonably designed to protect such information and that address, without limitation, the SDR limiting access to confidential information, material, nonpublic information, and intellectual property).

<sup>816</sup> The Commission preliminarily believes that in complying with an SDR's statutory privacy duty, the SDR has the flexibility to consider whether to provide relevant authorities with access to requested security-based swap data and will most likely decide that it is reasonable to consider whether a relevant authority's request for security-based swap information is within its regulatory mandate or legal responsibilities before the SDR provides the information.

<sup>817</sup> See DTCC Letter III at 12 (stating that it "routinely provides [swap] transaction data to U.S.

Second, the relevant authority's request must pertain to a person or financial product subject to that authority's jurisdiction, supervision, or oversight. If, for instance, the relevant authority requests information on a security-based swap that pertains to a counterparty or underlier that is subject to the authority's jurisdiction, supervision, or oversight, then this condition to the Indemnification Exemption would be satisfied. The Commission preliminarily believes that the person or financial product need not be registered or licensed with the authority in order for this condition to be satisfied. Similar to the first condition of the Indemnification Exemption, the Commission preliminarily believes that this condition is aligned with the Dodd-Frank Act's requirements to protect security-based swap information, including proprietary and highly sensitive data, maintained by an SDR from unauthorized disclosure, misappropriation, or misuse of security-based swap information.<sup>818</sup> In particular, the Commission preliminarily believes that the second condition is consistent with an SDR's statutory duty to maintain the privacy of security-based swap information that it receives.<sup>819</sup> In complying with its duty to maintain the privacy of security-based swap information, an SDR would need to determine when it can or cannot provide security-based swap information to others. The Commission preliminarily believes that, for the limited purposes of satisfying the Indemnification Exemption, it is appropriate for the SDR to include in its consideration of whether to provide security-based swap information to

regulators (and . . . routinely provides data related to [swap] transactions in the U.S. by U.S. persons on European underlyings to European regulators), as contemplated by the ODRF" guidelines that provide guidance on relevant authorities' information needs and level of access to data); see also DTCC Letter IV at 7-8.

<sup>818</sup> See Sections 13(n)(5)(F), (G), and (H)(i) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), (G), and (H)(i), as added by Section 763(i) of the Dodd-Frank Act.

<sup>819</sup> See Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rule 13n-4(b)(8) under the Exchange Act (requiring SDRs to maintain the privacy of any and all security-based swap transaction information that the SDR receives from a security-based swap dealer, counterparty, or certain registered entity) and proposed Rule 13n-9 under the Exchange Act (requiring an SDR to protect the privacy of security-based swap transaction information that the SDR receives by, among other things, establishing safeguards, policies, and procedures that are reasonably designed to protect such information and that address, without limitation, the SDR limiting access to confidential information, material, nonpublic information, and intellectual property).

relevant authorities whether a relevant authority's specific request pertains to a person or financial product that is subject to the authority's jurisdiction, supervision, or oversight.<sup>820</sup> Finally, the Commission notes that establishing such a condition in the Indemnification Exemption is consistent with guidelines that one commenter indicated that it followed on a voluntary basis in providing relevant authorities with access to security-based swap information.<sup>821</sup>

Third, the requesting relevant authority must enter into a supervisory and enforcement MOU or other arrangement with the Commission that addresses the confidentiality of the security-based swap information provided and any other matters as determined by the Commission.<sup>822</sup> For those entities not expressly identified in Section 13(n)(5)(G) of the Exchange Act<sup>823</sup> or the rules thereunder, such an MOU or other arrangement can be entered into during the Commission's determination process, as discussed in Section VI.C.3(b) above. On the other hand, entities expressly identified in Section 13(n)(5)(G) of the Exchange Act and the rules thereunder, which are not subject to the Commission's process to determine appropriate regulators, would need to enter into such an MOU or other arrangement to satisfy this condition of the Indemnification Exemption. The Commission anticipates that in determining whether to enter into such a supervisory and enforcement MOU or other arrangement with a relevant authority, the Commission will consider whether, among other things, the

<sup>820</sup> The Commission preliminarily believes that in complying with an SDR's statutory privacy duty, the SDR has the flexibility to consider whether to provide relevant authorities with access to requested security-based swap data and will most likely decide that it is reasonable to consider whether a relevant authority's request for security-based swap information pertains to a person or financial product that is subject to the authority's jurisdiction, supervision, or oversight before the SDR provides the information.

<sup>821</sup> See DTCC Letter III at 12 (stating that it "routinely provides [swap] transaction data to U.S. regulators (and . . . routinely provides data related to [swap] transactions in the U.S. by U.S. persons on European underlyings to European regulators), as contemplated by the ODRF" guidelines that provide guidance on relevant authorities' information needs and level of access to data); see also DTCC Letter IV at 7-8.

<sup>822</sup> As a general matter, the Commission provides a list of MOUs and other arrangements on its Web site, which is one way for an SDR to monitor and determine whether a relevant authority has entered into an applicable MOU or other arrangement for purposes of satisfying the third condition of the Indemnification Exemption. The MOUs and other arrangements can be found at the following link: [http://www.sec.gov/about/offices/oia/oia\\_cooparrangements.shtml](http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml).

<sup>823</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

relevant authority needs security-based swap information from an SDR to fulfill its regulatory mandate or legal responsibilities; the relevant authority agrees to protect the confidentiality of the security-based swap information provided to it; the relevant authority agrees to provide the Commission with reciprocal assistance in securities matters within the Commission's jurisdiction; and a supervisory and enforcement MOU or other arrangement would be in the public interest.

The Commission preliminarily believes that the third condition in the Indemnification Exemption is—as one commenter suggested—an effective way to streamline the Indemnification Requirement for an “efficient exchange of information.”<sup>824</sup> The Commission also preliminarily believes that the third condition in the Indemnification Exemption is appropriate to help protect the confidentiality of the security-based swap data provided to relevant authorities, and also to further the purposes of the Dodd-Frank Act. In this regard, the Commission preliminarily believes that where a relevant authority cannot agree to indemnification, a supervisory and enforcement MOU or other arrangement, which a relevant authority can legally enter into, may be a reasonable alternative because, similar to an indemnification agreement, a supervisory and enforcement MOU or other arrangement would serve as another mechanism to protect the confidentiality of security-based swap data provided to a relevant authority by committing the authority to maintain such confidentiality.<sup>825</sup> In light of the confidentiality agreement required under Section 13(n)(5)(H)(i) of the Exchange Act and previously proposed Rule 13n-4(b)(10)<sup>826</sup> as well as the importance of maintaining good relations and trust among relevant authorities, the Commission also

preliminarily believes that a relevant authority will have strong incentives to take reasonable measures and precautions to comply with its obligation to protect the confidentiality of the security-based swap information received from an SDR. In lieu of providing an indemnification agreement, a supervisory and enforcement MOU or other arrangement would provide an SDR and the Commission with an additional layer of protection in maintaining the confidentiality of security-based swap information shared by the SDR.<sup>827</sup>

For the reasons stated above, the Commission preliminarily believes that the Indemnification Exemption is a reasonable alternative to the Indemnification Requirement. The Commission recognizes, however, that a supervisory and enforcement MOU or other arrangement would not necessarily provide SDRs that invoke the exemption with the same level of protection that an indemnification agreement would provide (*i.e.*, coverage for any expenses arising from litigation relating to information provided to a relevant authority) and thus, an SDR may prefer the benefits of the Indemnification Requirement rather than rely on the Indemnification Exemption. Therefore, under the Commission's proposed exemption, an SDR would have the option to require an indemnification agreement from a relevant authority should the SDR choose to do so rather than rely on the Indemnification Exemption.

The Commission expects that where an SDR seeks to obtain an indemnification agreement from a relevant authority, the SDR should negotiate in good faith an indemnification agreement. In this regard, the Commission agrees with one commenter's view that “any indemnity should be limited in scope”<sup>828</sup> and expects that an SDR will not unreasonably hinder the ability of relevant authorities to obtain security-based swap information from the SDR.<sup>829</sup> Regarding the same commenter's suggestion that the Commission provide model

indemnification language,<sup>830</sup> the Commission does not believe that it is appropriate to prescribe by rule specific language that an SDR would be required to use when requesting indemnification from relevant authorities. Because such language could vary on a case-by-case basis depending on various factors, such as the laws applicable to the relevant authority, the Commission preliminarily believes that it is appropriate to allow for flexibility in negotiation of an indemnification agreement.

#### Request for comment

The Commission requests comment on all aspects of the proposed guidance, interpretation, and the Indemnification Exemption, including the following:

- Is the Commission's proposed interpretation of the Notification Requirement appropriate and sufficiently clear? Why or why not? Is it overly broad or narrow? If so, why? Does the Commission's proposed interpretation provide the Commission with sufficient information to fulfill our responsibilities?

- Should the Commission require SDRs to provide the Commission with actual notice of all of requests for security-based swap data by relevant authorities? Why or why not? If so, what should such notice include? Why?

- What would be the advantage of requiring SDRs to provide actual notice to the Commission of requests for security-based swap data by relevant authorities before making the data available to the relevant authorities?

- With regard to the Notification Requirement, should the Commission adopt a rule that is consistent with the approach taken by the CFTC in its Rule 49.17(d)(4), 17 CFR 49.17(d)(4), which requires a swap data repository to promptly notify the CFTC regarding any request received by an appropriate foreign or domestic regulator to gain access to the swap data maintained by such swap data repository? Why or why not?

- Should the Commission provide an exemption from the Notification Requirement similar to the Indemnification Exemption? Why or why not? For example, should proposed Rule 13n-4(d) be revised to begin with “[a] registered security-based swap data repository is not required to comply with the notification requirements set forth in Section 13(n)(5)(G) of the Act and paragraph (b)(9) of this section and the indemnification requirement set forth in Section 13(n)(5)(H)(ii) of the Act and paragraph (b)(10) of this section . . .”? Why or why not?

<sup>824</sup> See ESMA Letter at 2 (recommending an MOU between the Commission and relevant authorities to address duplicative regulatory regimes and facilitate cooperation among authorities from different jurisdictions).

<sup>825</sup> See 15 U.S.C. 8325(a), as added by Section 752 of the Dodd-Frank Act (providing that the Commission and foreign regulators “may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest . . .”).

<sup>826</sup> As stated above, the MOU or other arrangement is separate from the written agreement under Section 13(n)(5)(H)(i) of the Exchange Act and previously proposed Rule 13n-4(b)(9) thereunder stating that the relevant authority shall abide by the confidentiality requirements described in Section 24 of the Exchange Act relating to the information on security-based swap transactions that is provided by the SDR. The MOU or other arrangement is between the Commission and the relevant authority, whereas the written agreement is between the SDR and the relevant authority.

<sup>827</sup> The Commission notes that the MOU or other arrangement would not constitute a waiver on the part of the Commission or SDR to pursue legal action against a relevant authority and liability, if any, will be determined in accordance with applicable law. The Commission also does not interpret the indemnification as extending to an SDR's own wrongful acts.

<sup>828</sup> See DTCC Letter III at 12.

<sup>829</sup> For example, the Commission does not expect that an indemnification agreement would include a provision requiring a relevant authority to indemnify the SDR from the SDR's own wrongful or negligent acts.

<sup>830</sup> See DTCC Letter III at 12.

• Should the Commission propose a rule with regard to the application of the Notification Requirement? Why or why not? If so, what should the rule stipulate?

• In determining whether a person is appropriate to obtain security-based swap data from SDRs, should the Commission establish the process set forth in this release for persons to request a Commission determination? Why or why not? Should the Commission make such a determination by order? Why or why not? Should the Commission delegate this determination to the staff? Why or why not?

• In determining whether a person is appropriate to obtain security-based swap data from SDRs, should the Commission require a supervisory and enforcement MOU or other arrangement? Why or why not? If so, what matters should be addressed in the MOU or other arrangement? What factors should the Commission take into consideration when determining whether to enter into an MOU or other arrangement with the person?

• In determining whether a person is appropriate to obtain security-based swap data from SDRs, does the Commission need to understand the scope of a relevant authority's regulatory mandate or legal responsibilities? Why or why not? What other factors should the Commission take into account in making such a determination?

• Should the Commission's process for determining whether a person is appropriate to obtain security-based swap data from SDRs be memorialized in a rule? If so, what should the rule stipulate?

• Should the Commission require by rule or in our determination orders that SDRs not provide relevant authorities with access to security-based swap data beyond their regulatory mandates or legal responsibilities? Why or why not? Should the Commission adopt a process such as the one adopted by the CFTC in its Rule 49.17(d), 17 CFR 49.17(d), which requires certain regulators seeking to gain access to the swap data maintained by a swap data repository to certify that they are acting within the scope of their jurisdiction?

• Are there any reasons why the Commission should determine a person appropriate to obtain security-based swap data from one or more SDRs, but not all SDRs? If so, what are they?

• Should the Commission, when it determines that a person is appropriate to obtain security-based swap data from SDRs, include limitations on such determination? Why or why not? For example, should the Commission limit

the determination to a certain period of time or to certain individual persons at a relevant authority?

• Under what circumstances should the Commission be able to revoke our determination order? Under what circumstances would it be appropriate for the Commission to request a relevant authority to provide additional information in order to maintain such a determination?

• Should the Commission provide additional clarification with respect to how parties comply with the confidentiality requirements in Section 24 of the Exchange Act? In what aspect would clarification be helpful?

• Is the Commission's proposed interpretation of the Indemnification Requirement appropriate and sufficiently clear? Should the Commission interpret the Indemnification Requirement more broadly or narrowly? If so, explain.

• Should the Commission interpret the Indemnification Requirement to be limited to the liability that a relevant authority otherwise would have to an SDR pursuant to the laws applicable to that relevant authority, such as the Federal Tort Claims Act, which is applicable to domestic authorities?

• Is the Commission's Indemnification Exemption appropriate and sufficiently clear? If not, what would be a better alternative? Please also explain the costs and benefits of any alternative, including how the alternative would be consistent with and further the goals of Title VII.

• Is the Indemnification Exemption overly broad or narrow? If so, what would be a better alternative? Please also explain the costs and benefits of any alternative, including how the alternative would be consistent with and further the goals of Title VII.

• Are there ways to narrowly tailor the Indemnification Exemption further without hindering a relevant authority's ability to obtain security-based swap data information from SDRs?

• Should the SDRs have the option to require a relevant authority to provide an indemnification agreement even if the three conditions in the Indemnification Exemption can be satisfied? Why or why not? Does providing SDRs with such an option raise any competitiveness concerns?

• If the Commission were to modify the Indemnification Exemption so that SDRs do not have the option to require an indemnification agreement pursuant to Section 13(n)(5)(H)(ii) of the Exchange Act even if the three conditions in the exemption are satisfied, would this be appropriate and

consistent with the Indemnification Requirement?

• What is the likelihood of an SDR not availing itself of the Indemnification Exemption even if the three conditions are met? Are there any measures that the Commission should take to address or mitigate this scenario? Are there any restrictions that the Commission should impose on an SDR that requires an indemnification agreement even if it can avail itself of the Indemnification Exemption?

• Should an SDR be required to make and keep records of its decision to rely on the Indemnification Exemption?

• Are the Indemnification Exemption and the Commission's proposed interpretive guidance sufficient to address the possibility that SDRs may be registered with ESMA and national regulators at the European Union ("EU") member state level will obtain security-based swap information from ESMA? Are there any regulatory regime or circumstances that the Commission should take into consideration that is not addressed by the Indemnification Exemption or the Commission's interpretive guidance? Please explain.

• Will organizations such as FINRA and other self-regulatory organizations, the National Futures Association, the IMF, and the International Bank for Reconstruction and Development be able to meet the three conditions of the Indemnification Exemption? Why or why not? If not, should the Indemnification Exemption be modified to explicitly exempt such organizations from the Indemnification Requirement? Why or why not? If so, which organizations and why?

• Does the Indemnification Exemption adequately address the concerns of relevant authorities with respect to the Indemnification Requirement? Are there any circumstances that would warrant an exemption from the Indemnification Requirement, but that would not satisfy all the conditions in the Indemnification Exemption? If so, how could the Indemnification Exemption be modified and narrowly tailored to capture such circumstances so as not to have the effect of nullifying the Indemnification Requirement?

• Is it appropriate to provide SDRs with the flexibility to determine, on a case-by-case basis, whether a relevant authority that is requesting security-based swap information is acting within the scope of its regulatory mandate or legal responsibilities? Why or why not?

• Should the Commission impose any additional requirements on SDRs to confirm that a relevant authority is requesting security-based swap

information for the purpose of fulfilling its regulatory mandate or legal responsibilities? For example, should the Commission prescribe, as a condition in the Indemnification Exemption, that the SDR obtain a written confirmation from the requesting relevant authority that it is acting within its regulatory mandate or legal responsibilities?

- Should the Commission impose any additional requirements on SDRs to confirm that a relevant authority is requesting security-based swap information that pertains to a person or financial product subject to the jurisdiction, supervision, or oversight of the authority? For example, should the Commission prescribe, as a condition in the Indemnification Exemption, that the SDR obtain a written confirmation from the requesting relevant authority that its request pertains to a person or financial product subject to the jurisdiction, supervision, or oversight of the authority?

- Would an MOU between the Commission and a relevant authority in lieu of an indemnification agreement provide protection of security-based swap information shared with the relevant authority comparable to that of an indemnification agreement? If not, why not?

- Should the Commission specify in the Indemnification Exemption any other matters that may be in a supervisory and enforcement MOU or other arrangement? If so, what?

- On January 25, 2012, the European Commission proposed reforms to strengthen online privacy rights and to modernize the principles set forth in the EU's 1995 Data Protection Directive ("EU Directive") to protect personal data. Will the EU Directive affect the ability of SDRs to provide security-based swap data to other relevant authorities, including the Commission? If so, please explain. Will the EU Directive affect the ability of the EU and its member countries to provide reciprocal assistance in securities matters, as contemplated by the supervisory and enforcement MOU or other arrangement discussed above? If so, please explain.

- Should the Commission impose any additional conditions in the Indemnification Exemption? If so, what? Are there any conditions in the Indemnification Exemption that the Commission should not require? If so, what conditions and why?

- For the purpose of satisfying the Indemnification Exemption, should an SDR be required to maintain policies and procedures setting forth how to determine (i) whether security-based

swap information being requested is needed to fulfill a regulatory mandate and/or legal responsibility of the requesting entity, (ii) whether a relevant authority's requests pertain to a person or financial product subject to the authority's jurisdiction, supervision, or oversight, or (iii) whether the requesting relevant authority has entered into a supervisory and enforcement MOU or other arrangement with the Commission? To the extent such policies and procedures require each requesting relevant authority to provide a written representation with respect to one or more of the conditions in the Indemnification Exemption, should such written representations be considered sufficient to satisfy the relevant conditions in the Indemnification Exemption?

- Are there better ways that the Commission could address the Indemnification Requirement besides the Indemnification Exemption that would be consistent with and further the goals of Title VII? Please explain the costs and benefits of any alternative.

- What is the likely impact of the Indemnification Exemption on the security-based swap market? Would the Indemnification Exemption potentially promote or impede the establishment of SDRs?

- Is the Commission's proposed interpretation of how the Indemnification Requirement applies to SDRs dually registered with the Commission and a foreign regulator appropriate and sufficiently clear? If not, why not? Should the Commission apply the Indemnification Requirement when an SDR is registered with the Commission and is also registered or licensed with a foreign authority and that foreign authority is obtaining information from the SDR pursuant to its regulatory regime? Why or why not? Should there be any additional conditions in such instances? If so, what conditions and why?

- Should the Commission provide guidance on what it means for a "person or financial product" to be "subject to [an] authority's jurisdiction, supervision, or oversight"? Why or why not?

- What would be the market impact of the proposed approach to providing an exemption from the Indemnification Requirement? How would the proposed application of the Indemnification Requirement, including the proposed exemption, affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive

disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the Indemnification Requirement? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## VII. Security-Based Swap Execution Facilities

### A. Introduction

As discussed throughout this release, the market for security-based swaps is global in scope, with transactions in security-based swaps often involving counterparties in different jurisdictions. The Commission recognizes that, as a result, there may be uncertainty regarding the application of our proposed SB SEF registration requirements for a security-based swap market whose principal place of business is outside of the United States. The Commission believes, therefore, that guidance and clarification on the application of our proposed registration requirements would be useful with respect to security-based swap markets operating in the cross-border context.

Under the Dodd-Frank Act, new Section 3D(a)(1) of the Exchange Act provides that "no person may operate a facility for the trading or processing of security-based swaps, unless the facility is registered as a security-based swap execution facility or as a national securities exchange under this section."<sup>831</sup> In our release proposing rules governing SB SEFs,<sup>832</sup> the Commission expressed the view that the registration requirement of Section 3D(a)(1) would apply only to a facility that meets the definition of "security-based swap execution facility" in Section 3(a)(77) of the Exchange Act.<sup>833</sup> The SB SEF Proposing Release, however, did not explicitly address the circumstances under which a foreign<sup>834</sup>

<sup>831</sup> 15 U.S.C. 78c-4(a)(1).

<sup>832</sup> See SB SEF Proposing Release, 76 FR 10948. The proposed rules governing SB SEFs are contained in proposed Regulation SB SEF.

<sup>833</sup> See SB SEF Proposing Release, 76 FR 10949 n.10. Section 3(a)(77) of the Exchange Act defines "security-based swap execution facility" to mean "a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of security-based swaps between persons and (B) is not a national securities exchange." 15 U.S.C. 78c(a)(77).

<sup>834</sup> In using the terms "foreign" and "non-resident" in connection with a security-based swap

security-based swap market would be required to register with the Commission under Section 3D of the Exchange Act.<sup>835</sup> As discussed below, the Commission herein proposes to interpret when the registration requirements of Section 3D of the Exchange Act would apply to a foreign security-based swap market.<sup>836</sup> The Commission also discusses below the circumstances under which it may consider granting an exemption from registration for a foreign security-based swap market.

The proposed interpretations described below represent the Commission's proposed approach to applying the SB SEF registration requirements to foreign security-based swap markets. We recognize that other approaches may achieve the goals of the Dodd-Frank Act, in whole or in part. Accordingly, we invite comment regarding all aspects of the proposal described below, and each proposed interpretation contained therein, including potential alternative approaches. Data and comment from market participants and other interested parties regarding the likely effect of each proposed interpretation and potential alternative approaches would be particularly useful to the Commission in evaluating modifications to the proposals.

#### *B. Registration of Foreign Security-Based Swap Markets*

As noted above, in our SB SEF Proposing Release, the Commission expressed the view that the registration requirement of Section 3D(a)(1) would apply only to a facility that meets the definition of "security-based swap execution facility" in Section 3(a)(77) of the Exchange Act.<sup>837</sup> A "security-based swap execution facility" is defined as "a trading system or platform in which multiple participants have the ability to execute or trade security-based swaps by accepting bids and offers made by multiple participants in the facility or

market, the Commission intends that these terms refer to a security-based swap market that is not a U.S. person.

<sup>835</sup> In the SB SEF Proposing Release, the Commission contemplated that non-resident persons may apply for registration as a SB SEF. In this regard, the Commission proposed Rule 801(f) of Regulation SB SEF, which would require any non-resident person applying for registration as a SB SEF to certify and provide an opinion of counsel that it can, as a matter of law, provide the Commission with prompt access to its books and records and submit to onsite inspection and examination by representatives of the Commission. See SB SEF Proposing Release, 76 FR 11001.

<sup>836</sup> Entities that do not meet the definition of SB SEF may nonetheless be required to register in another capacity under the Exchange Act.

<sup>837</sup> See note 833 and accompanying text, *supra*.

system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of security-based swaps between persons and (B) is not a national securities exchange."<sup>838</sup>

As outlined further below, the Commission preliminarily believes that, when evaluating whether a foreign security-based swap market would have to register under Section 3D(a)(1), activities by the foreign security-based swap market that provide U.S. persons, or non-U.S. persons located in the United States, the ability to directly execute or trade security-based swaps on the foreign security-based swap market or facilitate the execution or trading of security-based swaps by U.S. persons, or non-U.S. persons located in the United States, on the foreign security-based swap market should be considered.<sup>839</sup> The Commission also preliminarily believes that, if a foreign security-based swap market takes affirmative actions to induce the execution or trading of security-based swaps on its market by U.S. persons, or non-U.S. persons located in the United States, including by inducing such execution or trading through marketing its services relating to the ability to execute or trade security-based swaps on its market to U.S. persons, or non-U.S. persons located in the United States, or otherwise initiating contact with such persons for the purpose of inducing such execution or trading, then those activities could be viewed as facilitating the execution or trading of security-based swaps on its market and could cause the foreign security-based swap market to fall within the scope of the registration requirements of Section 3D of the Exchange Act.

The Commission believes that it would be useful to provide some discussion of the types of activities that it preliminarily believes would place a foreign security-based swap market within the scope of Section 3D of the Exchange Act under the Commission's proposed interpretation. Given the constant innovation of trading mechanisms and methods, as well as technological and communication developments, however, it would not be possible to provide a comprehensive, final discussion of every activity for which a foreign security-based swap market would be considered to be providing U.S. persons or non-U.S. persons located in the United States the ability to execute or trade security-based

<sup>838</sup> 15 U.S.C. 78c(a)(77).

<sup>839</sup> See *id.* Non-U.S. persons located in the United States could include, for example, U.S. branches of foreign entities.

swaps, or to be facilitating the execution or trading of security-based swaps, on its market, thereby triggering the requirement to register as a SB SEF under Section 3D(a)(1).

The Commission preliminarily believes that when a foreign security-based swap market provides U.S. persons, or non-U.S. persons located in the United States, with the direct ability to trade or execute security-based swaps on the foreign security-based swap market by accepting bids and offers made by one or more participants on the foreign security-based swap market, then such market would be required to register as a SB SEF. The Commission notes that a foreign security-based swap market could grant such direct access to U.S. persons, and non-U.S. persons located in the United States, through a variety of means, such as (i) providing proprietary electronic screens, market terminals, monitors or other devices for trading security-based swaps on its market; (ii) granting direct electronic access to the foreign security-based swap market's trading system or network, including by providing data feeds or codes for use with software operated through the computer of a U.S. person, or non-U.S. person located in the United States, or by allowing such persons to access the foreign security-based swap market through third-party service vendors or public networks (such as the Internet); or (iii) allowing its members or participants to provide U.S. persons or non-U.S. persons located in the United States with direct electronic access to trading in security-based swaps on the foreign security-based swap market.

The Commission also preliminarily believes that, if a foreign security-based swap market were to grant membership or participation in the foreign security-based 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 security-based swaps by accepting bids and offers made by one or more participants on the foreign security-based swap market, then such market would be required to register as a SB SEF.

Although the Commission preliminarily believes that the foregoing activities are the types of activities that would warrant application of the registration requirement of Section 3D, the Commission emphasizes that these activities are not intended to be an exclusive or exhaustive discussion of all the activities that could trigger the registration requirements of Section 3D by a foreign security-based swap market. In addition, as trading and

communication mechanisms and methods evolve, other activities that aim at providing U.S. persons, or non-U.S. persons located in the United States, the ability to directly execute or trade security-based swaps by accepting bids and offers made by multiple participants on a foreign security-based swap market, or that aim to facilitate the execution or trading of security-based swaps by U.S. persons or non-U.S. persons located in the United States on a trading platform or system operated by a foreign security-based swap market, could cause a foreign security-based swap market to fall within the ambit of the registration requirements of Section 3D.<sup>840</sup>

The Commission anticipates that some U.S. persons or non-U.S. persons located in the United States may choose to transact on a foreign security-based swap market on an indirect basis through a non-U.S. person that is not located in the United States and that is a member or participant of a foreign security-based swap market. The Commission preliminarily believes that, to the extent that the U.S. person, or non-U.S. person located in the United States, initiates the contact and the foreign security-based swap market does not attempt to solicit such business, such a transaction would not on its own warrant requiring the foreign security-based swap market to register under Section 3D of the Exchange Act.<sup>841</sup> However, as discussed above, to the extent that a foreign security-based swap market initiates contacts with U.S. persons or non-U.S. persons located in the United States to induce or facilitate the execution or trading of security-based swaps by such persons on its market, such activity would trigger the requirement to register under Section 3D.<sup>842</sup>

The Commission also anticipates that, given the global nature of the security-based swap business, a foreign security-based swap market could, at some point, seek to enter into a business combination with a registered SB SEF. Under the Commission's proposed

interpretation, such business combination also could trigger the registration requirements of Section 3D of the Exchange Act for the foreign security-based swap market, depending on the nature and extent of integration of the entities' operations and activities. In this regard, the Commission's experience in recent years with national securities exchanges that have engaged in cross-border combinations may be illustrative for these purposes. Several national securities exchanges in recent years have entered into transactions to combine under common ownership with certain non-U.S. markets, such as NYSE Group, Inc.'s transaction with Euronext N.V. to form NYSE Euronext in 2007;<sup>843</sup> Eurex Frankfurt AG's acquisition of the International Securities Exchange, LLC in 2007;<sup>844</sup> and The Nasdaq Stock Market, Inc.'s transaction with Borse Dubai Limited to form NASDAQ OMX Group, Inc. in 2008.<sup>845</sup> In each case, the U.S. and the foreign markets, under their respective parent companies, generally have continued to operate as separate legal entities, maintained separate liquidity pools in their respective jurisdictions without integrating trading interest among markets under common ownership, and continued to be regulated subject to their own home country's requirements. Similarly, a registered SB SEF and a foreign security-based swap market could come under common ownership but continue to be separate legal entities, maintain separate liquidity pools for their security-based swap businesses without integrating trading interest among affiliated markets, and be separately regulated in their own home jurisdictions. However, if a registered SB SEF and foreign security-based swap market were to integrate their security-based swap trading facilities, for example, by the foreign security-based swap market providing direct access to the SB SEF's participants, or by the foreign security-based swap market and the registered SB SEF integrating their liquidity pools,<sup>846</sup> under the

Commission's proposed interpretation, such actions would trigger the registration requirements of Section 3D of the Exchange Act for the foreign security-based swap market because the market would then be operating a facility for trading security-based swaps within the United States.

### C. Registration Exemption for Foreign Security-Based Swap Markets

The prior section discusses when a foreign security-based swap market would be required to register as a SB SEF under Section 3D of the Exchange Act. The Commission recognizes, however, that the security-based swap market is global in nature and therefore one or more foreign security-based swap markets may seek relief from the Commission to allow some of the activities discussed above that would trigger the SB SEF registration requirement to continue without the foreign security-based swap market having to register as a SB SEF under Section 3D of the Exchange Act.

Following the publication of the SB SEF Proposing Release, the Commission received comments from the public expressing concerns about the implications of the proposed rules and the requirements of Section 3D of the Exchange Act for foreign security-based swap markets and the global markets for security-based swaps generally.<sup>847</sup> Several commenters urged the Commission to work with foreign regulators to develop harmonized rules for the trading of security-based swaps.<sup>848</sup> Some commenters believed that harmonization or flexibility with regard to foreign security-based swap markets would help reduce the risk of regulatory arbitrage.<sup>849</sup> One commenter stated that such harmonization would reduce the burdens of duplicative or conflicting requirements that could be faced by security-based swap markets operating in multiple jurisdictions.<sup>850</sup>

Although a number of foreign jurisdictions are in the process of developing standards for the regulation of security-based swaps and security-based swap markets, at this time few foreign jurisdictions have enacted legislation or adopted standards for the regulation of security-based swap

<sup>840</sup> In the alternative, the foreign security-based swap market could elect to apply for registration as a national securities exchange. See 15 U.S.C. 78f.

<sup>841</sup> The U.S. person or non-U.S. person located in the United States may, however, be required to register as a broker under Section 15(a)(1) of the Exchange Act. See 15 U.S.C. 78o(a)(1).

<sup>842</sup> For example, if a foreign security-based swap market were to allow its members or participants to provide U.S. persons, or non-U.S. persons located in the United States with direct electronic access to trading in security-based swaps on the foreign security-based swap market, this access would be considered direct access by a U.S. person, or a non-U.S. person located in the United States and, as noted above, would require the foreign security-based swap market to register.

<sup>843</sup> See Exchange Act Release No. 55293 (Feb. 14, 2007), 72 FR 8033 (Feb. 22, 2007).

<sup>844</sup> See Exchange Act Release No. 56955 (Dec. 13, 2007), 72 FR 71979 (Dec. 19, 2007).

<sup>845</sup> See Exchange Act Release No. 57099 (Jan. 4, 2008), 73 FR 1901 (Jan. 10, 2008).

<sup>846</sup> An integrated trading pool for security-based swaps would indicate that there is a unitary market for the security-based swaps. In such a scenario, persons with direct access to or membership in the registered SB SEF effectively would have the same direct access or membership privileges in the foreign security-based swap market by virtue of their access to the integrated trading pool, and thus would have the ability to directly execute or trade security-based swaps on the foreign security-based swap market.

<sup>847</sup> See, e.g., Thomson Letter at 3–4, BlackRock Letter at 12–13, Bloomberg Letter at 6–7, ISDA/SIFMA II Letter at 2, WMBAA Letter at 10–11, Cleary Letter III at 4, and Cleary Letter IV at 5, 13.

<sup>848</sup> See Thomson Letter, BlackRock Letter, ISDA/SIFMA Letter II, and WMBAA Letter.

<sup>849</sup> See Thomson Letter, Bloomberg Letter, and WMBAA Letter.

<sup>850</sup> See Bloomberg Letter.



markets.<sup>851</sup> The Commission, however, is in discussions with its foreign counterparts to explore steps toward harmonizing standards for such regulation in the future.<sup>852</sup> In the meantime, the Commission is considering how best to address commenters' concerns about the risks of regulatory arbitrage and duplicative regulatory burdens on security-based swap markets that operate on a cross-border basis, in a manner consistent with the requirements of the Dodd-Frank Act and the federal securities laws generally.

The Commission preliminarily believes that it may be appropriate to consider an exemption as an alternative approach to SB SEF registration depending on the nature or scope of the foreign security-based swap market's activities in, or the nature or scope of the contacts the foreign security-based swap market has with, the United States. Exemptions that are carefully tailored to achieve the objectives of Section 3D could help to improve security-based swap market supervision overall by allowing the Commission to focus our resources on areas where it has a substantial interest, while reducing duplication of efforts in areas where our interests are aligned with those of other regulators.

The Commission could exempt from the registration requirements of Section 3D a foreign security-based swap market that is subject to comparable, comprehensive supervision and regulation under appropriate governmental authorities in its home country.<sup>853</sup> The availability of such an exemption could serve to reduce any potential duplicative regulatory burdens faced by security-based swap markets that operate on a cross-border basis and that otherwise would be required to register both in the United States and in a non-U.S. jurisdiction.

Before the Commission would consider issuing an exemption from the registration requirements of Section 3D for a particular foreign security-based swap market, the Commission could consider whether the foreign security-based swap market is subject to

comparable, comprehensive supervision and regulation by the appropriate governmental authorities in its home country, as compared to the supervision and regulation of SB SEFs under the Dodd-Frank Act and the Commission's implementing regulations. This process could include a review of the foreign jurisdiction's laws, rules, regulatory standards and practices governing the foreign security-based swap market and would entail consultation and cooperation with the foreign security-based swap market's home country governmental authorities.

The Commission expects that any such registration exemption could be subject to appropriate conditions that could include, but not be limited to, requiring a foreign security-based swap market to certify that it would provide the Commission with prompt access to its books and records, including, for example, data relating to orders, quotes, and transactions, as well as provide an opinion of counsel that, as a matter of law, it is able to provide such access. The Commission also could require, as a condition to receiving an exemption from registration, that a foreign security-based swap market would appoint an agent for service of process in the United States who is not an employee or official of the Commission. These potential conditions would be consistent with the proposed requirements for non-resident registered SB SEFs<sup>854</sup> and would allow the Commission to exercise, as necessary or appropriate, supervisory oversight of a foreign security-based swap market that receives an exemption from Section 3D's registration requirements. The Commission also could require that, before issuing an exemption from registration, the Commission and the appropriate financial regulatory authority or authorities in the foreign jurisdiction enter into a MOU that addresses the oversight and supervision of that market.

In certain cases, the Commission also could require, as a condition to granting such an exemption, that a foreign security-based swap market meet some of the requirements applicable to registered SB SEFs. Such a condition may be useful where the Commission is unable to make a determination regarding the broader comparability of the home jurisdiction's regulation and supervision, but where there is comparability with respect to some of the requirements applicable to registered SB SEFs and to a foreign

security-based swap market (or class of security-based swap markets) in its home country. Therefore, the terms and conditions of any exemption that the Commission may grant to a foreign security-based swap market (or class of security-based swap markets) could depend on the degree to which the foreign jurisdiction's laws, rules, regulatory standards, and practices governing security-based swaps "compare" to those of the United States.

In considering the above, the Commission may consider any requirements of the home country that would conflict with the requirements applicable to SB SEFs under the Dodd-Frank Act. For example, Section 3D of the Exchange Act seeks to ensure fair and open access to SB SEFs by requiring that a SB SEF establish and enforce rules that include means to provide market participants with impartial access to the market.<sup>855</sup> The Commission also could consider whether a home country regulator imposes a regulation or policy limiting fair and open access to its security-based swap markets.

The Commission notes that security-based swap market structure and security-based swap market supervision and regulation could vary in other jurisdictions and could affect the Commission's ability to make a comparability determination. In addition, such differences in supervision and regulation would necessitate that each exemption request be reviewed on a jurisdiction-by-jurisdiction basis by the Commission. The conditions to any such exemption also would be based on the differences in the market structure and supervisory regime in the jurisdiction under consideration in comparison to U.S. oversight of SB SEFs.

As noted above, few foreign jurisdictions have adopted a comprehensive framework for the regulation of security-based swap markets and the Commission has not yet adopted rules governing SB SEFs. Thus, the Commission believes that it is premature to specify the precise criteria that the Commission may use for our evaluation and comparison of the regulatory and supervision programs for foreign security-based swap markets, should the Commission choose to consider exempting from registration as a SB SEF a foreign security-based swap market that becomes subject to regulation in its home country at a future date. Nonetheless, the Commission believes that it is useful now to elicit comment from interested

<sup>851</sup> See FSB Progress Report April 2013 at 1 ("While progress has been made in moving [OTC derivatives] markets towards centralized infrastructure, less than half of the FSB member jurisdictions currently have legislative and regulatory frameworks in place to implement the G20 commitments and there remains significant scope for increases in trade reporting, central clearing and exchange and electronic platform trading in global OTC derivatives markets.").

<sup>852</sup> See Section I.C, *supra*.

<sup>853</sup> Any such exemption would be issued by order pursuant to the Commission's authority under Section 36 of the Exchange Act. 15 U.S.C. 78mm.

<sup>854</sup> See SB SEF Proposing Release, 76 FR 11001, proposed Rule 801(f), and proposed Form SB SEF.

<sup>855</sup> 15 U.S.C. 78c-4(d)(2)(B).

persons regarding our proposed approach, should it choose to consider providing such an exemption.

The Commission preliminarily believes that the proposed approach, which may condition any exemption for a foreign security-based swap market on the existence of comparable, comprehensive supervision and regulation under the appropriate financial regulatory authority or authorities in the foreign security-based swap market's home country, should provide comparable regulatory oversight and supervision as that afforded by the Commission's regulation and supervision of SB SEFs. The standard of "comparability" discussed above should allow the Commission sufficient flexibility to make exemption determinations based on the similarity of the requirements and practices of the foreign jurisdiction's regulatory program governing security-based swaps. In this regard, the Commission preliminarily believes that the comparability standard could extend not only to the written laws and rules of the foreign jurisdiction, but also to the jurisdiction's comprehensive supervision and regulation of its security-based swap markets, including the jurisdiction's oversight of its markets and enforcement of its laws and rules. The breadth of the proposed comparability standard (*i.e.*, to consider actual practices as well as written laws and rules) could help ensure that the regulatory protections provided in the foreign jurisdiction's security-based swap markets are substantially realized by sufficiently vigorous supervision and enforcement.

Finally, as discussed below,<sup>856</sup> the Commission proposes to permit substituted compliance, under certain circumstances, with respect to the mandatory trade execution requirement in Section 3C(h)(1) of the Exchange Act, if the Commission finds that a foreign-based security-based swap market (or class of security-based swap markets) is subject to comparable, comprehensive supervision and regulation by a foreign financial regulatory authority in such foreign jurisdiction.<sup>857</sup> While the proposed comparability standard for our granting an exemption from SB SEF registration could be similar to the proposed comparability standard for a substituted compliance determination with respect to the mandatory trade execution requirement, which is discussed below, the factors that the Commission could find relevant to a

comparability determination with respect to SB SEF registration would not necessarily be the same factors that it would consider when making a comparability determination with respect to mandatory trade execution. This is because Section 3D of the Exchange Act is focused on the registration of SB SEFs and compliance by registered SB SEFs with the 14 enumerated core principles governing SB SEFs,<sup>858</sup> whereas Section 3C(h)(1) of the Exchange Act is focused on the circumstances where execution of a security-based swap on a SB SEF (or an exchange) is required.<sup>859</sup> However, the Commission solicits comment on the appropriateness or feasibility of our proposed approach.

#### Request for Comment

The Commission generally requests comment on the discussion regarding SB SEFs, including the following:

- The Commission requests comment on all aspects of our discussion regarding when a foreign security-based swap market would be required to register as a SB SEF under Section 3D and on the non-exhaustive discussion of the types of activities, noted above, that would trigger registration of the foreign security-based swap market as a SB SEF. The Commission also requests comment on all aspects of our proposal to consider requests for an exemption from SB SEF registration for a foreign security-based swap market under certain circumstances.

- The Commission seeks commenters' views on the potential impact of applying the proposed SB SEF registration requirements to foreign security-based swap markets that engage in activities that would require such markets to register as a SB SEF. Are there aspects of the proposed SB SEF rules and registration requirements that present issues for foreign security-based swap markets that would be required to register as a SB SEF? If so, please explain in detail.

- The Commission requests commenters' views on whether the non-exhaustive discussion of the types of activities, noted above, which would trigger the application of Section 3D registration requirements to a foreign security-based swap market, is appropriate to aid foreign security-based swap markets in assessing whether they would be required to register as a SB SEF. Are there other activities that foreign security-based swap markets currently engage in that should be evaluated for consideration as to

whether those activities would trigger Section 3D registration requirements? If so, please describe those activities in detail. Are there specific items set forth in the non-exhaustive discussion of the types of activities noted above or any other specific activities engaged in by foreign security-based swap markets that should not trigger Section 3D registration requirements? If so, commenters should describe those activities in detail and explain their rationale. Does the proposed interpretation regarding the application of Section 3D and the proposed non-exhaustive discussion of the types of activities provide sufficient guidance for a foreign security-based swap market to assess whether it would have to register, or seek an exemption from registration, as a SB SEF? If not, what kind of further guidance would be helpful for making that determination? Does the proposed approach provide sufficient guidance to a foreign security-based swap market that may seek an exemption? If not, what kind of further guidance would be helpful?

- The Commission seeks comment on the appropriateness of the proposed interpretation that the registration requirements of Section 3D should be triggered by certain activities directed at "U.S. persons, or non-U.S. persons located in the United States." Are the categories of persons captured by this proposed approach too broad? Too narrow? Please specify and explain. For example, foreign branches would be included by the proposed approach, such that a foreign security-based swap market's provision of direct access or participation in its market to a foreign branch, or activities facilitating execution or trading of security-based swaps on its market by such a foreign branch, would trigger the Section 3D registration requirement. Do commenters agree with this approach? If not, why not? What would be a better approach? If so, how so?

- The Commission requests comment on what would be the appropriate circumstances under which the Commission should consider granting an exemption from the registration requirements of Section 3D. Should the Commission consider granting an exemption from registration for a foreign security-based swap market when the nature or scope of its activities in the United States are limited? If so, why? Or should the Commission also consider granting an exemption for a foreign security-based swap market when the nature or scope of its activities in the United States are more extensive? Why or why not? What would be the advantages and disadvantages of either

<sup>856</sup> See Section XI.F, *infra*.

<sup>857</sup> See proposed Rule 3Ch-2 under the Exchange Act.

<sup>858</sup> See 15 U.S.C. 78c-4.

<sup>859</sup> See 15 U.S.C. 78c-3(h)(1).

approach? What would be the appropriate criteria for the Commission to apply when it considers whether to grant an exemption from the registration requirements of Section 3D? Please specify and explain.

- The Commission seeks comment on whether the proposed standard of comparability is an appropriate standard for the Commission to determine whether to grant an exemption from Section 3D's registration requirements for a foreign security-based swap market. Should a different standard be used? If so, what should be the standard and why? Should it be stricter or more lenient than the proposed standard? If it should be stricter or more lenient, in what respects and in what manner? Why or why not? As proposed, when making a comparability determination, the Commission would look not just at the rules of a foreign jurisdiction, but also at the comprehensiveness of the supervision and regulation by the appropriate governmental authorities of that jurisdiction. Is the Commission's holistic approach to making a comparability determination appropriate? Why or why not? Comment also is requested regarding whether the Commission should put in place a more detailed standard for granting an exemption, for example, by providing specific criteria that the Commission would look to in determining whether there is comparable, comprehensive regulation and supervision of a foreign security-based swap market by the appropriate financial regulatory authority or authorities in the home country. If so, what criteria should the Commission include and why? Commenters also are requested to explain how the Commission should develop such criteria in the absence of existing regulations in other jurisdictions at the present time. Are there specific procedures or comparability considerations that commenters believe that the Commission would find useful to incorporate in our proposed exemption approach at this time? If so, please describe. What would be the advantages of adopting such measures now? What would be the disadvantages of adopting such measures now?

- The Commission solicits comment on the appropriateness or feasibility of distinguishing between the comparability determination for purposes of an exemption from registration as a SB SEF and for purposes of substituted compliance for the mandatory trade execution requirement. Should the Commission consider the same factors in making a

comparability determination for mandatory trade execution and a comparability determination for SB SEF registration? If so, what factors would be relevant and appropriate to both determinations? Please describe. What factors, if any, would only be relevant or appropriate to a comparability determination for SB SEF registration or a comparability determination for mandatory trade execution, respectively? Please describe.

- The Commission seeks comment on the proposed process for granting an exemption from Section 3D's registration requirements for a foreign security-based swap market. Is the process explained in a sufficiently clear manner? Does the process provide foreign security-based swap markets with an efficient method for obtaining exemptions? If not, what aspects of the process would be burdensome for foreign security-based swap markets? Are there other ways to streamline the exemption process? Please describe.

- What would be the market impact of the proposed approach to the registration of foreign security-based swap markets? How would the proposed application of the SB SEF registration requirement affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach to the registration of foreign security-based swap markets? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## VIII. Regulation SBSR—Regulatory Reporting and Public Dissemination of Security-Based Swap Information

### A. Background

Section 13A(a)(1) of the Exchange Act<sup>860</sup> provides that all security-based swaps that are not accepted for clearing shall be subject to regulatory reporting. Section 13(m)(1)(G) of the Exchange Act<sup>861</sup> provides that each security-based swap (whether cleared or uncleared) shall be reported to a registered SDR, and Section 13(m)(1)(C) of the Exchange Act<sup>862</sup> generally provides that transaction, volume, and pricing data of

all security-based swaps shall be publicly disseminated in real time, except in the case of block trades.<sup>863</sup> On November 19, 2010, the Commission proposed Regulation SBSR to implement these requirements.<sup>864</sup>

Rule 908 of Regulation SBSR as initially proposed was designed to clarify the application of Regulation SBSR to cross-border security-based swaps. Proposed Rule 908(a) would require a security-based swap to be reported and publicly disseminated if the security-based swap: (i) Has at least one counterparty that is a U.S. person; (ii) was executed in the United States or through any means of interstate commerce; or (iii) was cleared through a registered clearing agency having its principal place of business in the United States. Proposed Rule 908(b) provided that, notwithstanding any other provision of Regulation SBSR, no counterparty to a security-based swap would incur any obligation under Regulation SBSR unless it is: (i) A U.S. person; (ii) a counterparty to a security-based swap executed in the United States or through any means of interstate commerce; or (iii) a counterparty to a security-based swap cleared through a clearing agency having its principal place of business in the United States. Thus, under the Commission's initial proposal, a security-based swap—wherever it is executed or cleared—would be required to be reported pursuant to Regulation SBSR if at least one counterparty were a U.S. person. Furthermore, a security-based swap—even if both counterparties were non-U.S. persons—would be required to be reported if the security-based swap were executed in the United States or through any means of interstate commerce, or cleared through a clearing agency having its principal place of business in the United States.

Rule 901(a)(1), as initially proposed, also provided that, where only one counterparty to a security-based swap is a U.S. person, the U.S. person would be the “reporting party” (*i.e.*, the party that incurs the duty to report the security-based swap pursuant to Regulation SBSR). Rule 901(a)(3), as initially proposed, provided that, where neither

<sup>863</sup> Section 13(m)(1)(E) of the Exchange Act, 15 U.S.C. 78(m)(1)(E), provides that, with respect to cleared security-based swaps, the rule promulgated by the Commission related to public dissemination shall contain provisions that “specify the criteria for determining what constitutes a large notional security-based swap transaction (block trade) for particular market and contracts” and “specify the appropriate time delay for reporting large notional security-based swap transactions (block trades) to the public.”

<sup>864</sup> See Regulation SBSR Proposing Release, 75 FR 75208.

<sup>860</sup> 15 U.S.C. 78m–1(a)(1).

<sup>861</sup> 15 U.S.C. 78m(m)(1)(G).

<sup>862</sup> 15 U.S.C. 78m(m)(1)(C).

counterparty to a security-based swap that must be reported is a U.S. person, the counterparties must select which of them would be the reporting party.

To date, the Commission has received 48 comment letters specifically in response to proposed Regulation SBSR, many of which raised issues relating to the cross-border aspects of the proposal. The Commission has received other letters that, while not specifically referencing proposed Regulation SBSR, raised cross-border issues that are germane to proposed Regulation SBSR.<sup>865</sup> In response to these comments—which are described further herein—and upon further consideration of issues related to cross-border security-based swap transactions across all of the various areas of Title VII, the Commission is proposing various modifications to proposed Regulation SBSR, particularly Rule 908 thereof, which address cross-border transactions.

One significant modification being proposed here would take into account situations in which a U.S. person, although not a “direct counterparty,” as defined below, to a security-based swap, guarantees the performance of one of the direct counterparties. As discussed above,<sup>866</sup> the Commission is proposing to apply various Title VII provisions to the security-based swap transactions of non-U.S. persons that are guaranteed by U.S. persons—including the regulatory reporting and public dissemination requirements of Regulation SBSR, as discussed below.<sup>867</sup> A second significant modification is to propose a “substituted compliance” regime. As explained in more detail below, the Commission is now proposing a framework that would allow certain Title VII requirements to be satisfied by compliance with the rules of a foreign jurisdiction rather than the specific requirements under U.S. rules. Below, the Commission describes the circumstances under which compliance with the rules of such a foreign jurisdiction could, under re-proposed Regulation SBSR, be “substituted” for compliance with the specific regulatory reporting and public dissemination requirements of Regulation SBSR.<sup>868</sup>

A number of new definitions are being added to re-proposed Rule 900 in light of the changes being proposed.<sup>869</sup>

For example, new paragraph (g) of Rule 900 would define the term “counterparty” to mean “a person that is a direct counterparty or indirect counterparty of a security-based swap.” A direct counterparty would be “a person that enters directly with another person into a contract that constitutes a security-based swap.” An indirect counterparty would be “a person that guarantees the performance of a direct counterparty to a security-based swap or that otherwise provides recourse to the other side for the failure of the direct counterparty to perform any obligation under the security-based swap.” Although a guarantor is not a direct counterparty to the security-based swap, the duties to be performed under the security-based swap, and thus the risks associated with the security-based swap, ultimately fall to the guarantor.<sup>870</sup> Therefore, the Commission preliminarily believes that it is appropriate to deem a guarantor to be a counterparty to the security-based swap for purposes of the regulatory reporting requirements of Title VII and the rules proposed thereunder. As discussed in detail below, the concept of “reporting party” used in Regulation SBSR as initially proposed would be replaced by the newly proposed term “reporting side,” to reflect the fact that reporting obligations could attach to both direct and indirect counterparties.<sup>871</sup>

The Commission has received and continues to consider comments on the Regulation SBSR Proposing Release that address areas other than those relating to cross-border security-based swap activity. In this release, the Commission is re-proposing only changes relating to cross-border security-based swap activity, technical and conforming changes necessitated by these larger revisions, and certain other minor changes that would help to clarify these re-proposed revisions (such as numbering each definition in re-proposed Rule 900, so that each defined term can more readily be identified). Changes to Regulation SBSR in other

not be used elsewhere in the Commission’s Title VII rules.

<sup>870</sup> See Section II.B.2(d), *supra*.

<sup>871</sup> Re-proposed Rule 900(ee) would define “side” as “a direct counterparty and any indirect counterparty that guarantees the direct counterparty’s performance of any obligation under a security-based swap.” Re-proposed Rule 900(cc) would define “reporting side” as “the side of a security-based swap having the duty to report information in accordance with [Regulation SBSR] to a security-based swap data repository, or if there is no security-based swap data repository that would receive the information, to the Commission.”

areas could, if appropriate, be addressed in a future release.<sup>872</sup>

Regulation SBSR, as re-proposed today, represents the Commission’s preliminary views regarding the application of Title VII’s provisions relating to regulatory reporting and public dissemination of cross-border security-based swap transactions, and how those provisions would apply to non-U.S. persons who act in capacities regulated under the Dodd-Frank Act. The Commission invites comment regarding all aspects of the approaches taken by the Commission and each provision of re-proposed Regulation SBSR, including potential alternative approaches. In particular, data and comment from market participants and other interested parties regarding the likely effect of each re-proposed rule regarding application of a specific Title VII requirement, the effect of such proposed application in the aggregate, and potential alternative approaches will be particularly useful to the Commission in evaluating possible modifications to re-proposed Regulation SBSR.

#### *B. Modifications to the Definition of “U.S. Person”*

Rule 900 of re-proposed Regulation SBSR contains a revised definition of “U.S. person.” As initially proposed, “U.S. person” was defined as “a natural person that is a U.S. citizen or U.S. resident or a legal person that is organized under the corporate laws of any part of the United States or has its principal place of business in the United States.” Two persons who commented specifically on the Regulation SBSR proposal<sup>873</sup> argued that “U.S. person” as used in the Commission’s Title VII rules should have the same definition as in Regulation S.<sup>874</sup>

Proposed Regulation SBSR was the only one of the Commission’s proposals for implementing Title VII to propose to use and define the term “U.S. person.” Because the Commission is now addressing cross-border issues across multiple Title VII rules, the Commission has given further thought to the definition of “U.S. person” as initially

<sup>872</sup> For example, the Commission in the Regulation SBSR Proposing Release did not propose how to define a “block trade.” As noted in Regulation SBSR Proposing Release, the Commission intends to do so in a separate proposal. See Regulation SBSR Proposing Release, 75 FR 75228.

<sup>873</sup> See Cleary Letter III at 2, 6–9; Davis Polk Letter I at note 6 (arguing that using the existing Regulation S definition, rather than creating a new definition, “would avoid confusion and also provide consistency of application”).

<sup>874</sup> 17 CFR 230.901 to 230.905.

<sup>865</sup> All such letters are cited in Appendix D.

<sup>866</sup> See Section II.B.2(d), *supra*.

<sup>867</sup> See Sections VIII.C and VIII.D, *infra*.

<sup>868</sup> See Section XI.D, *infra*.

<sup>869</sup> In some cases, a definition used in Rule 900 would cross-reference a term defined elsewhere in the Commission’s Title VII rules. In other cases, a definition might be specific to Regulation SBSR and

proposed in Regulation SBSR. The Commission now believes that using a single definition of “U.S. person” in all Title VII rulemaking would promote consistency and transparency in understanding and complying with these various rules. However, as described above,<sup>875</sup> the Commission preliminarily believes that the Regulation S definition of “U.S. person” is not appropriate for Title VII rules. Proposed Rule 900(pp) would define “U.S. person” to have the same meaning as in proposed Rule 3a71–3(a)(7) under the Exchange Act.<sup>876</sup>

Under both the proposed and re-proposed definitions of “U.S. person,” a natural person resident in the United States would be a U.S. person, as would a legal person that is organized or incorporated under the laws of the United States or having its principal place of business in the United States. Furthermore, under both definitions, a foreign branch of a U.S. person would not be recognized as having an existence separate from the U.S. person.<sup>877</sup> The proposed rule also would cover partnerships, trusts, and other legal persons, as set forth in proposed Rule 3a71–3(a)(7) under the Exchange Act. The re-proposed definition of “U.S. person” also would clarify certain situations that were not specifically addressed in the initial proposal. For example, the initially proposed definition of “U.S. person” did not address whether—and, if so, when—an account would be considered a U.S. person. The re-proposed definition would provide that an account, whether discretionary or non-discretionary, of a U.S. person would be a U.S. person.

New paragraph (q) of re-proposed Rule 900 would define the term “non-U.S. person” as a person that is not a U.S. person.

#### Request for Comment

The Commission requests comment on all aspects of the re-proposed definition of “U.S. person” in Regulation SBSR. In particular:

- Should the definition of “U.S. person” in Regulation SBSR be consistent with that proposed for the Commission’s other Title VII rules? Why or why not? If so, what should that definition be and why? Would having a

different definition of “U.S. person” in Regulation SBSR create ambiguity or conflict with other Title VII rules being issued by the Commission? If not, why not?

#### C. Additional Modifications to Scope of Regulation SBSR

##### 1. Revisions to Proposed Rule 908(a)

Rule 908(a), as initially proposed, provided that a security-based swap would be subject to regulatory reporting and public dissemination under Regulation SBSR if the security-based swap: (i) Has at least one counterparty that is a U.S. person; (ii) is executed in the United States or through any means of interstate commerce; or (iii) is cleared through a registered clearing agency having its principal place of business in the United States. Thus, Rule 908(a), as originally proposed, would not impose reporting or public dissemination requirements in connection with a security-based swap solely because the obligations of one of the direct counterparties is guaranteed by a U.S. person. As noted above, the re-proposed definition of “U.S. person”—like the initially proposed definition—would not treat a direct counterparty that is guaranteed by a U.S. person as itself, solely due to the existence of the guarantee, a U.S. person. However, as noted below, the Commission is concerned about instances where—because of a guarantee extended by a U.S. person—the risk of a transaction resides in the United States, even if the direct counterparties of the transaction are domiciled outside the United States. Thus, upon further consideration, the Commission is now proposing to apply Title VII’s regulatory reporting requirements to security-based swaps having at least one counterparty, whether direct or indirect, that is a U.S. person.

Guarantees provided by U.S. persons to their foreign affiliates or other non-U.S. persons could have the effect of concentrating significant risks within the United States that may rise to the systemic level. If a U.S. person guarantees the performance of a non-U.S. person, the financial resources of that U.S. person could be called upon to satisfy the contract. This activity is capable of posing risks to the stability of the U.S. financial system. The Commission preliminarily believes that, if it does not require regulatory reporting of security-based swaps that are guaranteed by U.S. persons, in addition to security-based swaps having a U.S. person direct counterparty, the Commission and other federal financial regulators would be less likely to detect

the build-up of potentially significant risks within individual institutions or more widespread systemic risks to the U.S. financial system. The Dodd-Frank Act is intended to promote the financial stability of the United States by, among other things, reducing risks to the U.S. financial system by allowing regulators better access to necessary market data.<sup>878</sup>

In addition, the Commission is now proposing to require regulatory reporting of all security-based swaps entered into by non-U.S. person security-based swap dealers and major security-based swap participants, wherever they may be executed.<sup>879</sup> This is a change from how the initial proposal applied to a security-based swap executed by a non-U.S. person security-based swap dealer or major security-based swap participant. Under the initial proposal, such a security-based swap would not be required to be reported solely based on an entity’s status as a security-based swap dealer or major security-based swap participant, unless the security-based swap was executed in the United States or through any means of interstate commerce, or was cleared by a clearing agency having its principal place of business in the United States.

A non-U.S. person security-based swap dealer or major security-based swap participant generally would be subject to all rules applicable to security-based swap dealers or major security-based swap participants, regardless of its principal place of business or where it is organized.<sup>880</sup> Having access to all of the security-based swap transactions entered into by a security-based swap dealer or major security-based swap participant is an important aspect of understanding its compliance with the applicable Title VII requirements, including without limitation, compliance with the capital, margin, and other applicable entity-level and transaction-level requirements. The Commission notes that Section 15F(f)(1)(a) of the Exchange Act provides that each registered security-based swap dealer and major

<sup>878</sup> See, e.g., S. Comm. on Banking, Hous., & Urban Affairs, The Restoring American Financial Stability Act of 2010, S. Rep. No. 111–176, at 32 (“As a key element of reducing systemic risk and protecting taxpayers in the future, protections must include comprehensive regulation and rules for how the OTC derivatives market operates. Increasing the use of central clearinghouses, exchanges, appropriate margining, capital requirements, and reporting will provide safeguards for American taxpayers and the financial system as a whole”) (emphasis added); note 4, *supra*.

<sup>879</sup> See re-proposed Rule 908(a)(1)(iii) of Regulation SBSR.

<sup>880</sup> See Sections III.C and IV.D, *supra*.

<sup>875</sup> See Section III.B.10, *supra*.

<sup>876</sup> See Section III.B.5, *supra*.

<sup>877</sup> See Regulation SBSR Proposing Release, 75 FR 75240 (“The Commission intends for this proposed definition [of U.S. person] to include branches and offices of U.S. persons”). See also Section III.B.5(b)ii, *supra* (proposing that an entity’s status as a U.S. person would be determined at the legal-entity level and thus apply to the entire legal entity, including any foreign operations such as branches that are part of the U.S. legal entity).

security-based swap participant shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and financial condition of the registered security-based swap dealer or major security-based swap participant.<sup>881</sup> Therefore, the Commission is now proposing to require that all security-based swaps of all security-based swap dealers and major security-based swap participants, regardless of where such security-based swaps are executed or where these entities have their principal place of business or are organized, be subject to regulatory reporting to a registered SDR.<sup>882</sup>

To reflect these changes and to reincorporate other provisions that are not being substantially revised, the Commission is re-proposing Rule 908(a) as follows. The rule would be divided into two subparagraphs, (1) and (2), which would address regulatory reporting and public dissemination, respectively. Specifically, re-proposed Rule 908(a)(1) would provide that a security-based swap transaction would be subject to regulatory reporting if:

- (i) The security-based swap is a transaction conducted within the United States;
- (ii) There is a direct or indirect counterparty that is a U.S. person on either side of the transaction;
- (iii) There is a direct or indirect counterparty that is a security-based swap dealer or major security-based swap participant on either side of the transaction; or
- (iv) The security-based swap is cleared through a clearing agency having its principal place of business in the United States.

Re-proposed Rule 908(a)(1)(i) would preserve the principle from the original proposal that a security-based swap would be subject to regulatory reporting if it is executed in the United States.<sup>883</sup> As noted above,<sup>884</sup> the concept of a security-based swap transaction being solicited, negotiated, executed, or booked in the United States has been

integrated into the new term “transaction conducted within the United States,” which also is being used in other Title VII proposals of the Commission. Proposed Rule 3a71–3(a)(5) under the Exchange Act would define “transaction conducted within the United States” as “a security-based swap transaction that is solicited, negotiated, executed, or booked within the United States, by or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty to the transaction.”<sup>885</sup>

The Commission received no comments that specifically addressed our use of the phrase “through any means of interstate commerce” in three places in Regulation SBSR, as initially proposed.<sup>886</sup> However, upon further consideration, the Commission is concerned that this language could unduly require a security-based swap to be reported if it had only the slightest connection with the United States. Therefore, the Commission has decided to delete the phrase “through any means of interstate commerce” from re-proposed Regulation SBSR. Instead, the Commission is proposing to require reporting of a security-based swap that falls within the definition of “transaction conducted within the United States,” which would describe more precisely the nature of the activities in the United States that could result in a security-based swap becoming subject to Regulation SBSR. The Commission generally believes that security-based swaps that are solicited, negotiated, executed, or booked within the United States—by or on behalf of either counterparty to the transaction, and regardless of the location, domicile, or residence status of either counterparty to the transaction—generally should be subject to Regulation SBSR.

Re-proposed Rule 908(a)(1)(ii)—which would require regulatory reporting of any security-based swap if there is a direct or indirect counterparty that is a U.S. person on either side of the transaction—embodies the principle in the initial proposal that a security-based swap, wherever executed, must be reported if it has at least one counterparty that is a U.S. person. This revised prong, however, also would apply the reporting requirement to any security-based swap, wherever

executed, that has at least one indirect counterparty<sup>887</sup> that is a U.S. person, even when no direct counterparty is a U.S. person. The original proposal, because it did not include guarantors as counterparties, would not have required regulatory reporting in such case. As discussed above, the Commission now preliminarily believes that—to satisfy Congressional intent that security-based swaps be subject to regulatory reporting, thereby informing the Commission and other financial regulators of potential systemic risks—any security-based swap having at least one direct counterparty that is a U.S. person should be reported. The Commission also preliminarily believes that, because guarantees extended by U.S. persons create risk to the U.S. financial system, regulatory reporting of security-based swaps should extend to any security-based swap transaction in which one or both direct counterparties is guaranteed by a U.S. person. In the absence of regulatory reporting of such security-based swaps, the Commission’s ability to detect and analyze potentially significant sources of risk to the U.S. financial system could be limited.

Re-proposed Rule 908(a)(1)(iii) would, for reasons described above, require regulatory reporting of any security-based swap executed by a security-based swap dealer or major security-based swap participant, regardless of the entity’s place of domicile and regardless of the place of execution.

Re-proposed Rule 908(a)(1)(iv) would preserve the principle from the original proposal that a security-based swap would be subject to regulatory reporting if it is cleared through a clearing agency having its principal place of business in the United States.<sup>888</sup> As noted in the Regulation SBSR Proposing Release, the Commission preliminarily believes that, if a security-based swap is cleared by a clearing agency having its principal place of business in the United States, U.S. regulators should have access to information regarding the security-based swap through a registered SDR.<sup>889</sup> This approach is premised on the view that, when a security-based swap is cleared through a clearing agency, the initial transaction is novated and two new transactions take its place, with the clearing agency becoming the seller to the buyer and the buyer to the seller. If the clearing agency is located within the

<sup>881</sup> 15 U.S.C. 78o–8(f)(1)(A). The Commission further notes that Section 15F(f)(2) of the Exchange Act, 15 U.S.C. 78o–8(f)(2), requires the Commission to “adopt rules governing reporting and recordkeeping for security-based swap dealers and major security-based swap participants.”

<sup>882</sup> As discussed below, however, the Commission is proposing that certain security-based swaps of non-U.S. person security-based swap dealers and major security-based swap participants would not be subject to public dissemination. In addition, certain security-based swaps that would otherwise be subject to regulatory reporting and public dissemination under Regulation SBSR could qualify for substituted compliance. See Section XI.D, *infra*.

<sup>883</sup> See Rule 908(a)(2) of Regulation SBSR, as originally proposed.

<sup>884</sup> See Section III.B.6, *supra*.

<sup>885</sup> See note 308, *supra* (explaining that the word “counterparty” as used within this term has the same meaning as “direct counterparty” in re-proposed Rule 900(j) of Regulation SBSR).

<sup>886</sup> See Rules 900 (definition of “participant”), 908(a), and 908(b) of Regulation SBSR, as initially proposed.

<sup>887</sup> “Indirect counterparty” would be defined as “a guarantor of a direct counterparty’s performance of any obligation under a security-based swap.” See re-proposed Rule 900(o) of Regulation SBSR.

<sup>888</sup> See Rule 908(a)(3) of Regulation SBSR, as originally proposed.

<sup>889</sup> See Regulation SBSR Proposing Release, 75 FR 75240.

United States, the new transactions necessarily would be executed within the United States.<sup>890</sup>

While subparagraph (1) of re-proposed Rule 908(a) would address when a security-based swap would be subject to regulatory reporting, subparagraph (2) would address when a security-based swap would be subject to public dissemination. Re-proposed Rule 908(a)(2) would provide that a security-based swap shall be subject to public dissemination if:

(i) The security-based 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<sup>891</sup>);

(iv) One side includes a U.S. person and the other side includes a non-U.S. person that is a security-based swap dealer; or

(v) The security-based swap is cleared through a clearing agency having its principal place of business in the United States.

The Commission notes that Section 13(m)(1)(B) of the Exchange Act<sup>892</sup> “authorize[s] the Commission to make security-based swap transaction and pricing data available to the public in such form and at such times as the Commission determines appropriate to enhance price discovery.” Re-proposed Rule 908(a)(2) reflects the Commission’s revised preliminary determination regarding an appropriate way to enhance price discovery in the U.S. market for security-based swaps. As noted below, since issuing the Regulation SBSR Proposing Release, the Commission has obtained and analyzed more extensive data regarding the overlap between the U.S. market and the global market for security-based swaps.<sup>893</sup> These data suggest that a vast majority of security-based swap transactions directly involved at least one non-U.S. domiciled counterparty.<sup>894</sup> Furthermore, these transactions frequently may be conducted with one direct counterparty located in one

jurisdiction with the other direct counterparty located in another jurisdiction, further suggesting that no easy distinction can be made between the U.S. market and foreign or global markets. The Commission is concerned that limiting the application of Title VII’s public dissemination requirement only to transactions that are wholly conducted within the United States or to transactions where both direct counterparties are U.S. persons would significantly reduce the potential benefits of post-trade transparency in the security-based swap market. The Commission stated in the Regulation SBSR Proposing Release that, “[b]y reducing information asymmetries, post-trade transparency has the potential to lower transaction costs, improve confidence in the market, encourage participation by a larger number of market participants, and increase liquidity in the [security-based swap] market.”<sup>895</sup> The Commission also noted that, “[i]n other markets, greater post-trade transparency has increased competition among market participants and reduced transaction costs.”<sup>896</sup>

Re-proposed Rule 908(a)(2) eliminates use of the term “interstate commerce” and instead incorporates the new concept of “transaction conducted within the United States,” which is being used throughout the Commission’s proposed Title VII cross-border rules, to help delineate precisely the types of security-based swap transactions that would be subject to public dissemination under Regulation SBSR. Furthermore, re-proposed Rule 908(a)(2) is designed to achieve the goal of improving the transparency, fairness, and efficiency of the U.S. security-based swap market, as reflected in Section 13(m)(1)(B) of the Exchange Act. Re-proposed Rule 908(a)(2) also is designed, as far as practicable, to minimize competitive disparities that might result under the proposed public dissemination regime, as well as to minimize incentives for market participants to structure their operations for the purpose of evading Regulation SBSR.<sup>897</sup> Each individual subparagraph

of re-proposed Rule 908(a)(2) is discussed below.

Re-proposed Rule 908(a)(2)(i), similar to re-proposed Rule 908(a)(1)(i), generally would preserve the principle from the original proposal that a security-based swap would be subject to public dissemination if it were executed in the United States.<sup>898</sup> That concept has been integrated into the new term “transaction conducted within the United States,” which also is being used in the Commission’s other Title VII proposals.

Re-proposed Rule 908(a)(2)(ii) would provide that a security-based swap would be subject to public dissemination if there is a direct or indirect counterparty that is a U.S. person on *each* side of the transaction. Under the initial proposal, a security-based swap involving two non-U.S. person direct counterparties, but where each direct counterparty is guaranteed by a U.S. person, would not be required to be publicly disseminated. The Commission now preliminarily believes that, where U.S. persons have an interest on both sides of the transaction, even if indirectly, the transaction generally should be viewed as part of the U.S. security-based swap market and, as such, should be subject to Title VII’s public dissemination requirement. Moreover, to the extent that U.S. persons might be incented to structure their trading operations through guaranteed foreign subsidiaries to avoid public dissemination that otherwise would apply to trades executed between U.S. person direct counterparties, the Commission seeks to minimize that incentive by re-proposing Rule 908(a)(2)(ii) to require public dissemination of a security-based swap transaction if a U.S. person is present on

appropriate to help prevent the evasion of the particular provisions of the Exchange Act that were added by the Dodd-Frank Act that are being implemented by the approach and prophylactically will help ensure that the purposes those provisions of the Dodd-Frank Act are not undermined. *See* Section II.B.2(e), *supra*; *see also* Section II.B.2(d), *supra*.

For example, if the reporting requirements do not apply to transactions among non-U.S. persons that receive guarantees from U.S. persons and foreign branches of U.S. banks, then U.S. persons would have an incentive to evade the reporting requirements by conducting transactions with other U.S. persons through guaranteed foreign affiliates or foreign branches. Altering the form of the transaction in this manner would allow U.S. persons to continue to avail themselves of transparency in the U.S. security-based swap market while themselves evading the requirements intended to enhance that transparency, even though the substance of the transaction remains unchanged.

<sup>898</sup> *See* Rule 908(a)(2) of Regulation SBSR, as originally proposed. *See also* Regulation SBSR Proposing Release, 75 FR 75239–40.

<sup>890</sup> *See id.* (noting that the concept of being “executed in the United States or through any means of interstate commerce” includes being cleared through a clearing agency having its principal place of business in the United States).

<sup>891</sup> The term “foreign branch” would be defined in re-proposed Rule 900(n) of Regulation SBSR to cross-reference the definition in proposed Rule 3a71–3(a)(1) under the Exchange Act. *See* Section III.B.7, *supra*, for a definition of that term.

<sup>892</sup> 15 U.S.C. 78m(m)(1)(B).

<sup>893</sup> *See* Section XIV.F.2(d)ii, *infra*.

<sup>894</sup> *See* Section II.A.1, *supra*.

<sup>895</sup> Regulation SBSR Proposing Release, 75 FR 75224.

<sup>896</sup> *Id.* at 75225 (citing studies of the impact of TRACE (Trade Reporting and Compliance Engine) on the corporate bond market).

<sup>897</sup> We preliminarily believe that the proposed approach with respect to regulatory reporting and public dissemination is not being applied to persons who are “transact[ing] a business in security-based swaps without the jurisdiction of the United States,” within the meaning of Section 30(c). *See* Sections II.B.2(a)–II.B.2(d), *supra*. However, the Commission also preliminarily believes that the proposed approach with respect to regulatory reporting and public dissemination is necessary or



each side, whether directly or indirectly.

Re-proposed Rule 908(a)(2)(iii) would provide that a security-based swap would be subject to public dissemination if at least one direct counterparty is a U.S. person (except in the case of a transaction conducted through a foreign branch<sup>899</sup>). This prong generally reincorporates the original proposal's approach that a security-based swap executed anywhere in the world and having just one U.S. person counterparty would be subject to public dissemination. The Commission generally believes that a security-based swap transaction having even just one U.S. person direct counterparty generally should be viewed as part of the U.S. security-based swap market and, as such, should be subject to Title VII's public dissemination requirement. The Commission preliminarily believes that the benefits of requiring public dissemination of all security-based swaps involving at least one U.S. person direct counterparty would inure to other U.S. persons that transact in the same or similar instruments.

However, re-proposed Rule 908(a)(2)(iii) would provide a limited exception to the general rule that any transaction involving a U.S. person direct counterparty would be subject to public dissemination; re-proposed Rule 908(a)(2)(iii) would not apply if the transaction is conducted through a foreign branch.<sup>900</sup> The Commission is concerned that, if it did not take this approach, non-U.S. market participants might avoid entering into security-based swaps with the foreign branches of U.S. banks so as to avoid their security-based swaps being publicly disseminated. The Commission notes that registration with the local regulatory authority to engage in banking business is inherent in the proposed definition of "foreign branch." This approach would restrict the proposed exception to public dissemination for transactions conducted through a foreign branch.<sup>901</sup>

<sup>899</sup> The term "transaction conducted through a foreign branch" would be defined in re-proposed Rule 900(hh) of Regulation SBSR to cross-reference the definition of that term in proposed Rule 3a71-3(a)(4) under the Exchange Act, as discussed in Section III.B.7 above.

<sup>900</sup> However, a security-based swap having a direct counterparty that is a foreign branch could be subject to public dissemination for other reasons—e.g., if the transaction included a U.S. person on the other side. See re-proposed Rule 908(a)(2)(ii) of Regulation SBSR.

<sup>901</sup> Thus, for example, a security-based swap involving a U.S. person that sends staff to a foreign country to negotiate and execute the transaction but does not have a recognized foreign branch in that country would be required to be publicly disseminated, and would not qualify for the proposed exclusion in re-proposed Rule

The Commission further notes that the proposed exclusion for transactions conducted through a foreign branch is equivalent to the proposed approach for transactions conducted by foreign affiliates that are guaranteed by a U.S. person. In the case of a security-based swap transaction executed outside the United States between a non-U.S. person and either the guaranteed foreign affiliate or the foreign branch of the U.S. bank, re-proposed Rule 908(a)(2) would not require public dissemination of the transaction. Re-proposed Rule 908(a)(2)(iii) would not require public dissemination if the transaction were conducted through a foreign branch. Re-proposed Rule 908(a)(2)(ii) would not require public dissemination if the only U.S. person involved in the transaction were the U.S. person providing the guarantee.

Re-proposed Rule 908(a)(2)(iv) would provide that a security-based swap would be subject to public dissemination if one side includes a U.S. person and the other side includes a non-U.S. person that is a security-based swap dealer, as defined in Section 3(a)(71) of the Exchange Act and the rules and regulations thereunder. The Commission notes that re-proposed Rule 908(a)(2)(ii) would require public dissemination of a transaction if both sides include a U.S. person. Under re-proposed Rule 908(a)(2)(iv), however, public dissemination would be required when only one side includes a U.S. person, provided the other side includes a non-U.S. person security-based swap dealer. The Commission preliminarily believes that both types of transaction generally should be considered part of the U.S. security-based swap market and, as such, should be subject to Title VII's public dissemination requirement. As the Commission has previously stated, post-trade transparency of security-based swap transactions would reduce information asymmetries and could have the potential to lower transaction costs, improve confidence in the market, encourage participation by a larger number of market participants, and increase liquidity in the security-based swap market.<sup>902</sup> Post-trade transparency of security-based swap transactions also has the potential to improve valuation models and thereby contribute to more efficient capital allocation.<sup>903</sup> The Commission preliminarily believes that *not* subjecting transactions between U.S.

908(a)(2)(iii) for transactions conducted through a foreign branch.

<sup>902</sup> See Regulation SBSR Proposing Release, 75 FR 75267.

<sup>903</sup> See *id.* at 75267–68.

persons (whether directly or indirectly) or between a U.S. person and a non-U.S. person security-based swap dealer to post-trade transparency would undermine these goals. The fact that both sides of the transaction include a U.S. person, or that one side includes a U.S. person and the other side includes a person that conducts enough U.S. business to warrant requiring it to register with the Commission, suggests that they are engaging in the types of transactions that might be engaged in by other U.S. persons or others who are required to register with the Commission. Furthermore, in the absence of re-proposed Rule 908(a)(2)(iv), a non-U.S. person security-based swap dealer could encourage foreign affiliates that are guaranteed by a U.S. parent to transact business with it outside the United States in order to evade the public dissemination requirement.<sup>904</sup> If re-proposed Rule 908(a)(2)(iv) applied, all transactions between a security-based swap dealer (regardless of whether it is a U.S. person) and a U.S. person (whether as a direct or indirect counterparty), would be required to be publicly disseminated, regardless of where such transactions are conducted. Finally, the Commission notes that Section 13(m)(1)(D) of the Exchange Act gives the Commission authority to require registered entities—such as security-based swap dealers—regardless of whether or not they are U.S. persons, to publicly disseminate security-based swap transaction and pricing data.

However, the Commission notes that re-proposed Rule 908(a)(2) would not require public dissemination of a security-based swap transacted outside the United States between two non-U.S. persons that are security-based swap dealers (assuming that neither side is guaranteed by a U.S. person). Non-U.S. person security-based swap dealers are likely to have significant operations in foreign security-based swap markets. A transaction between two such non-U.S. person security-based swap dealers conducted outside the United States is less likely than a transaction conducted within the United States or a transaction

<sup>904</sup> The Commission notes that re-proposed Rule 908(a)(2)(iii) of Regulation SBSR would require public dissemination if only one direct counterparty is a U.S. person, regardless of the status, nationality, or place of domicile of the other direct counterparty. Thus, re-proposed Rule 908(a)(2)(iii) already would require public dissemination in the case of a security-based swap between a non-U.S. person security-based swap dealer and a U.S. person *direct* counterparty. Re-proposed Rule 908(a)(2)(iv) of Regulation SBSR would, in addition, require public dissemination in the case of a security-based swap between a non-U.S. person security-based swap dealer and a U.S. person *indirect* counterparty.

involving a U.S. person on the other side to affect the U.S. security-based swap market. Therefore, the Commission is not proposing to require public dissemination of transactions conducted outside the United States between two non-U.S. person security-based swap dealers.

Re-proposed Rule 908(a)(2)(v) would preserve the principle from the original proposal that a security-based swap would be subject to public dissemination if it is cleared through a clearing agency having its principal place of business in the United States.<sup>905</sup> As noted in the Regulation SBSR Proposing Release, the Commission preliminarily believes that, if non-U.S. persons determined to clear a security-based swap transaction through a clearing agency having its principal place of business in the United States, this suggests that the clearing agency has made the security-based swap eligible for clearing because at least some U.S. counterparties might wish to trade the security-based swap as well.<sup>906</sup> The Commission preliminarily believes, therefore, that requiring public dissemination of the security-based swap transaction would promote price discovery for market participants in the United States and elsewhere.<sup>907</sup>

A security-based swap transaction would need to meet only one prong of re-proposed Rule 908(a)(2) to trigger the public dissemination requirement. For example, assume a security-based swap is solicited, negotiated, executed, and cleared in London between (A) the London branch of a U.S. financial institution and (B) a London-based firm (*i.e.*, a non-U.S. person) that has registered with the Commission as a security-based swap dealer. Re-proposed Rule 908(a)(2)(i) would not apply, because the transaction is not conducted within the United States. Re-proposed Rule 908(a)(2)(v) would not apply, because the security-based swap is not cleared in the United States. Re-proposed Rule 908(a)(2)(ii) would not apply, because there is not a direct or indirect counterparty that is a U.S. person on both sides of the transaction. Re-proposed Rule 908(a)(2)(iii) would not apply because neither side includes a direct counterparty that is a U.S. person that would trigger public dissemination; here, the U.S. person direct counterparty is acting through a foreign branch, which is carved out of re-proposed Rule 908(a)(2)(iii).

However, this transaction would be subject to public dissemination under re-proposed Rule 908(a)(2)(iv): one side includes a U.S. person (in this case, the London branch of the U.S. bank) and the other side includes a non-U.S. person security-based swap dealer. The result would be the same if, instead of a London branch of a U.S. financial institution, one of the direct counterparties were the London-based affiliate of a U.S. person that guarantees the performance of the London subsidiary (*i.e.*, the transaction is between, on one side, a security-based swap dealer and, on the other side, an indirect counterparty that is a U.S. person).

#### Request for Comment

The Commission requests comment on all aspects of the re-proposed Rule 908(a), including the following:

- Do you agree with the approach taken in re-proposed Rule 908(a) that a security-based swap should be subject to regulatory reporting and public dissemination regardless of the nationality or place of domicile of the counterparties if it is a transaction conducted in the United States? Why or why not? Do you agree with the Commission's use of the term "transaction conducted within the United States" in re-proposed Rule 908? Why or why not?

- Do you agree with the approach taken in re-proposed Rule 908(a) that a security-based swap cleared through a clearing agency having its principal place of business in the United States should be subject to the regulatory reporting and public dissemination requirements? Why or why not?

- Do you agree with the Commission's general approach of treating guarantors as counterparties for purposes of security-based swap trade reporting requirements? Why or why not? Do you believe that a security-based swap should be subject to regulatory reporting solely because one side includes a guarantor that is a U.S. person? Why or why not? Would the Commission's ability to exercise prudential and regulatory oversight of the securities markets be compromised if it did not have the ability to learn about all security-based swap positions held by U.S. persons, including guarantors? Why or why not?

- Do you believe that a security-based swap should be subject to regulatory reporting solely because one side includes a security-based swap dealer or major security-based swap participant, regardless of the nationality or place of domicile of that entity? Why or why not? Would the Commission's ability to

exercise prudential and regulatory oversight of entities registered with it be compromised if it did not have the ability to learn about all security-based swap positions held by such entities? Why or why not?

- In general, do you agree with how re-proposed Rule 908(a) would apply to security-based swaps entered into by non-U.S. person security-based swap dealers and major security-based swap participants? Why or why not?

- Do you agree with the requirement, in re-proposed Rule 908(a)(2)(ii), that a security-based swap should be subject to public dissemination if there is a direct or indirect counterparty that is a U.S. person on each side of the transaction? Why or why not? What would be the benefits of requiring public dissemination in this scenario? What would be the costs? Please be specific.

- Do you agree with the requirement, in re-proposed Rule 908(a)(2)(iii), that a security-based swap should be subject to public dissemination if at least one direct counterparty is a U.S. person, even if the transaction is not conducted within the United States? Why or why not? What would be the benefits of requiring public dissemination in this scenario? What would be the costs? Please be specific. Do you agree with the exception to this general rule for transactions conducted through a foreign branch of a U.S. person? Why or why not? Should the exception be limited to foreign branches? Why or why not? Are there any alternatives that the Commission should consider? If so, what are they?

- Do you agree with the requirement, in re-proposed Rule 908(a)(2)(iv), that would provide that a security-based swap, even if not a transaction conducted within the United States, would be subject to public dissemination if one side includes a U.S. person and the other side includes a non-U.S. person security-based swap dealer? Why or why not? What would be the benefits of requiring public dissemination in this scenario? What would be the costs? Please be specific.

- Should the Commission require public dissemination of security-based swaps cleared by any clearing agency registered with the Commission, even if its principal place of business is outside the United States? Why or why not?

- In general, do you agree the distinctions drawn in the scenarios set forth in re-proposed Rule 908(a) regarding which security-based swaps would be subject to the regulatory reporting and public dissemination? Why or why not?

<sup>905</sup> See Rule 908(a)(3) of Regulation SBSR, as originally proposed.

<sup>906</sup> See Regulation SBSR Proposing Release, 75 FR 75240.

<sup>907</sup> See *id.*

## 2. Revisions to Proposed Rule 908(b)

In the initial proposal, the Commission explained when duties would be imposed on non-U.S. person counterparties of security-based swaps when some connection to the United States might be present. Rule 908(b), as initially proposed, provided that no duties would be imposed on a counterparty unless one of the following conditions were true:

- The counterparty is a U.S. person;
- The security-based swap is executed in the United States or through any means of interstate commerce; or
- The security-based swap is cleared through a clearing agency having its principal place of business in the United States.

Under the initial proposal, if none of these conditions were true, a foreign counterparty “would not become a ‘participant’ of an SDR and would not become subject to proposed Regulation SBSR”<sup>908</sup>—even if the security-based swap itself and its counterparty were subject to Regulation SBSR.

In light of other revisions being made to Regulation SBSR discussed above, the Commission is now proposing several conforming revisions to proposed Rule 908(b). First, consistent with the other revisions described above, Rule 908(b) is being re-proposed to account for the possibility that a non-U.S. person security-based swap dealer or major security-based swap participant could incur a duty to report. Second, consistent with the broader conceptual framework set forth in this release, the “interstate commerce clause,” used in the initial proposal to describe a security-based swap that may generate reporting duties for counterparties under Regulation SBSR,<sup>909</sup> is being replaced with the new concept of a “transaction conducted within the United States” that is being used throughout the Commission’s proposed cross-border rules.<sup>910</sup> Therefore, re-proposed Rule 908(b) would provide that a direct or indirect counterparty to a security-based swap would not incur any obligation under Regulation SBSR unless the counterparty were:

- A U.S. person;
- A security-based swap dealer or major security-based swap participant; or

<sup>908</sup> Regulation SBSR Proposing Release, 75 FR 75240.

<sup>909</sup> See Rule 908(b)(2) of Regulation SBSR, as originally proposed.

<sup>910</sup> See Section III.B.6, *supra* (discussing the proposed definition of “transaction conducted within the United States”).

- A counterparty to a transaction conducted within the United States.<sup>911</sup>

### Request for Comment

The Commission requests comment on all aspects of the re-proposed Rule 908(b), including the following:

- Do you agree with the removal of the “interstate commerce clause” contained in Rules 908(a)(2) and 908(b)(2), as originally proposed, and its replacement with the new concept of “transaction conducted within the United States”? Does this new concept provide additional clarity? If not, what alternative formulations of the concept should the Commission consider, and why? Please be specific.

### D. Modifications to “Reporting Party” Rules and Assigning Duty To Report

The Commission also is re-proposing aspects of Regulation SBSR that would specify who must report the security-based swap. Rule 900, as initially proposed, would define “reporting party” as “the counterparty to a security-based swap with the duty to report information in accordance with [Regulation SBSR] to a registered security-based swap data repository, or if there is no registered security-based swap data repository that would receive the information, to the Commission.” Because the Commission is now proposing to extend the reporting requirement to security-based swaps executed outside the United States if the performance of one or both direct counterparties under the security-based swap is guaranteed by a U.S. person,<sup>912</sup> the Commission also is re-proposing the rules that would assign the duty to

<sup>911</sup> In addition, the Commission is re-proposing the definition of the term “participant” in Rule 900 to make changes conforming to re-proposed Rule 908(b) of Regulation SBSR. The term “participant” was designed to include any counterparty to a security-based swap that might incur duties under Regulation SBSR. Rule 906(a) of Regulation SBSR, as proposed and re-proposed, would impose certain duties on participants other than those required to initially report the transaction. The originally proposed definition of “participant” would track proposed Rule 908(b) and include a U.S. person that is a counterparty to a security-based swap that is required to be reported to a registered SDR, or a non-U.S. person that is a counterparty to a security-based swap that is: (i) Required to be reported to a registered SDR; or (ii) executed in the United States or through any means of interstate commerce, or cleared through a clearing agency having its principal place of business in the United States. As re-proposed, “participant” would be defined simply as “a person that is a counterparty to a security-based swap that meets the criteria of [Rule 908(b)].” This would include both direct and indirect counterparties.

<sup>912</sup> The Commission notes that, under both the initial and current proposals, security-based swaps would be subject to Regulation SBSR if they are executed within the United States, regardless of who the counterparties are or whether they are guaranteed by U.S. persons.

report in a number of ways. Overall, these revisions are designed to assign the responsibility to report a security-based swap transaction to persons that the Commission preliminarily believes have greater capacity to fulfill that responsibility, and in a manner consistent with the reporting hierarchy set forth in Section 13A(a)(3) of the Exchange Act.<sup>913</sup>

First, the Commission is revising the proposed term “reporting party” to “reporting side.” A “side” would be defined in new paragraph (ee) of re-proposed Rule 900 to mean “a direct counterparty and any indirect counterparty.” “Reporting side” would be defined as “the side of a security-based swap having the duty to report information in accordance with §§ 242.900–911 to a registered security-based swap data repository, or if there is no registered security-based swap data repository that would receive the information, to the Commission.” Under this formulation, if a side has the duty to report a security-based swap transaction, any counterparty on that side—direct or indirect—would have responsibility for carrying out the reporting obligation. The Commission preliminarily believes that it would be impractical and unnecessarily complicated to attempt to assign the reporting duty to either the direct or indirect counterparty specifically, and is instead proposing to assign the duty to the side jointly.<sup>914</sup>

Furthermore, the Commission is revising our proposed approach to assigning the reporting duty to minimize consideration of the domicile of the counterparties, and to focus more on their status (*i.e.*, whether or not a counterparty is a security-based swap dealer or major security-based swap participant). The initial proposal laid out three scenarios for assigning the reporting duty: Both direct counterparties are U.S. persons, only one direct counterparty is a U.S. person, and neither direct counterparty is a U.S.

<sup>913</sup> 15 U.S.C. 78m–1(a)(3). Section 13A(a)(3) of the Exchange Act assigns to specific kinds of counterparties the duty to report uncleared security-based swaps to an SDR or to the Commission.

<sup>914</sup> The Commission anticipates that the direct counterparty and any indirect counterparty on the reporting side would decide which of them would carry out the duty to report the transaction. Alternately, the direct and indirect counterparties on the reporting side could elect to have a third party carry out the duty to report on their behalf, although the direct and indirect counterparties on the reporting side—not the agent—would incur legal liability for the agent’s failure to report the transaction in a timely and complete manner.

person.<sup>915</sup> The definition of “U.S. person”—as proposed and re-proposed—does not include a security-based swap dealer or major security-based swap participant that is organized under the laws of a foreign jurisdiction and has its principal place of business outside the United States, even though it is a security-based swap dealer or major security-based swap participant under Title VII. Thus, under the initial proposal, for a security-based swap between (A) an end user or other counterparty that is a U.S. person and is not a security-based swap dealer or major security-based swap participant (a “non-registered U.S. counterparty”) and (B) a security-based swap dealer or major security-based swap participant that is a non-U.S. person, the non-registered U.S. counterparty would have been the reporting party.

Several commenters argued that this requirement would unfairly place the reporting burden on the non-registered U.S. counterparty. These commenters generally argued that, due to their status as security-based swap dealers and major security-based swap participants, even security-based swap dealers and major security-based swap participants that are not U.S. persons have greater technological capability than non-registered U.S. counterparties to carry out the reporting function.<sup>916</sup> These commenters generally maintained that non-registered U.S. counterparties would incur significant costs to build the systems necessary to report security-based swaps.<sup>917</sup> Certain commenters noted the unequal treatment and potential consequences that could result if non-registered U.S. counterparties incurred the reporting obligation for security-based swaps that they entered into with non-U.S. security-based swap dealers and non-U.S. major security-

based swap participants.<sup>918</sup> One commenter specifically recommended that security-based swap dealers and major security-based swap participants that are not U.S. persons be subject to the same regulatory reporting responsibilities as security-based swap dealers and major security-based swap participants that are U.S. persons, when transacting with non-registered U.S. counterparties.<sup>919</sup>

The Commission generally agrees with these arguments. The Commission preliminarily believes that non-U.S. person security-based swap dealers and major security-based swap participants, like U.S. person security-based swap dealers and major security-based swap participants, have greater technological capability than non-registered U.S. persons to carry out the reporting function. Furthermore, the Commission preliminarily sees no reason not to assign the duty to report to non-U.S. person security-based swap dealers and major security-based swap participants in appropriate circumstances. Although such entities are not U.S. persons, the fact that they are security-based swap dealers and major security-based swap participants necessarily implies that they have substantial contacts with the U.S. security-based swap market and thus could incur significant regulatory duties arising from their U.S. business. Accordingly, the Commission is re-proposing Rule 901(a) to provide that a security-based swap dealer or major security-based swap participant that is not a U.S. person could incur the duty to report a security-based swap in various cases. Re-proposed Rule 901(a) now provides as follows:

- If both sides of the security-based swap include a security-based swap dealer, the sides would be required to select the reporting side.
- If only one side of the security-based swap includes a security-based swap dealer, that side would be the reporting side.
- If both sides of the security-based swap include a major security-based swap participant, the sides would be required to select the reporting side.
- If one side of the security-based swap includes a major security-based swap participant and the other side includes neither a security-based swap

dealer nor a major security-based swap participant, the side including the major security-based swap participant would be reporting side.

- If neither side of the security-based swap includes a security-based swap dealer or major security-based swap participant: (i) if both sides include a U.S. person or neither side includes a U.S. person, the sides would be required to select the reporting side; and (ii) if only one side includes a U.S. person, that side would be the reporting side.

Re-proposed Rule 901(a)(2) would preserve the reporting hierarchy of proposed Rule 901(a), while additionally taking into account the possibility that a direct counterparty to a security-based swap might have a guarantor that is better suited for carrying out the reporting duty. Thus, the newly proposed approach set forth in re-proposed Rule 901(a) looks to the status of each person on a side (*i.e.*, whether it is a security-based swap dealer or major security-based swap participant), not the status of only the direct counterparties. Under the initial proposal, if a non-U.S. person were a direct counterparty to a security-based swap executed outside the United States, that non-U.S. person would under no circumstances have had a duty to report the security-based swap, even if it were guaranteed by a U.S. person or if it were a security-based swap dealer or major security-based swap participant. The Commission is now proposing to refocus the reporting duty primarily on the status of the counterparties, rather than on their nationality or place of domicile.

Under re-proposed Rule 901(a), the only time that the domicile of the counterparties could determine who must report is if neither side includes a security-based swap dealer or major security-based swap participant. In such case, if one side includes a U.S. person while the other side does not, the side with the U.S. person would be the reporting side. Similar to the initial proposal, however, if both sides include a U.S. person or neither side includes a U.S. person, the sides would be required to select the reporting side.

These proposed revisions to Regulation SBSR are designed to more efficiently align the duty to report with the entities that the Commission preliminarily believes are best suited to carrying out that duty. The Commission has previously noted that it “understands that many reporting parties already have established linkages to entities that may register as SDRs, which could significantly reduce the out-of-pocket costs associated with

<sup>915</sup> See Rules 901(a)(1), (2), and (3) of Regulation SBSR, as originally proposed. See also Regulation SBSR Proposing Release, 75 FR 75211.

<sup>916</sup> See DTCC I at 8; ICI Letter at 5 (stating that security-based swap dealers are the only market participants that currently have the standardization necessary to report the required security-based swap data); ISDA/SIFMA Letter I at 19; SIFMA Letter I at 3 (arguing that an end user should not incur higher transaction costs or potential legal liabilities depending on the domicile of its counterparty); Vanguard Letter at 6 (stating that non-U.S. security-based swap dealers and major security-based swap participants would be more likely to have appropriate systems in place to facilitate reporting).

<sup>917</sup> See DTCC I at 27; ICI Letter at 5 (stating that investment funds would incur significant costs to build the necessary systems); Vanguard Letter at 6 (stating that end users would be required to commit significant capital and resources to build out their reporting systems). See also MarkitSERV Letter I at 9 (suggesting that, in light of capacity and resource constraints, a non-registered U.S. counterparty would seek to delegate any reporting obligations).

<sup>918</sup> See ISDA/SIFMA Letter I at 19 (requiring end users to report could result in end users declining to trade with non-U.S. security-based swap dealers, which could increase systemic risk by decreasing liquidity and further concentrating the U.S. security-based swap market); Cleary Letter II at 18 (requiring end users to report could result in their declining to trade with non-U.S. security-based swap dealers, thereby potentially reducing price competition).

<sup>919</sup> See SIFMA Letter I at 2.

establishing the reporting function.”<sup>920</sup> These proposed revisions also are designed to minimize the burdens faced by non-registered U.S. counterparties that might enter into security-based swaps with non-U.S. person security-based swap dealers or major security-based swap participants, as well as to clarify and simplify the reporting rules more generally.

The following examples explain the operation of re-proposed Rule 901(a).

• *Example 1.* A non-registered U.S. counterparty executes a security-based swap with a security-based swap dealer that is a non-U.S. person. Neither side has a guarantor. The security-based swap dealer would be the reporting side.

• *Example 2.* Same facts as Example 1, except that the non-registered U.S. counterparty is guaranteed by a security-based swap dealer. Because both sides include a person that is a security-based swap dealer, the sides would be required to select which is the reporting side.

• *Example 3.* A security-based swap is executed in London between a foreign subsidiary of a U.S. person and a French hedge fund. The performance of the foreign subsidiary is guaranteed by its U.S. parent, a major security-based swap participant. The side consisting of the major security-based swap participant and its foreign subsidiary would be the reporting side.

• *Example 4.* The New York branch of a German bank executes, in New York, a security-based swap with the New York branch of a Brazilian bank. Neither foreign bank is a security-based swap dealer or a major security-based swap participant and neither direct counterparty is guaranteed by a U.S. person. The sides must select which would be the reporting side.

• *Example 5.* A U.S. hedge fund executes a security-based swap in London with a foreign bank that is registered as a dealer in its home jurisdiction, but is not a security-based swap dealer or major security-based swap participant under Title VII. Neither direct counterparty is guaranteed by a U.S. person. The U.S. hedge fund would be the reporting side, because its side includes the only U.S. person.

#### Request for Comment

The Commission generally requests comment on all aspects of issues regarding cross-border inter-affiliate transactions, including the following:

• Do you agree with the proposed definitions of “counterparty,” “direct counterparty,” and “indirect counterparty”? Why or why not?

• Do you agree with the new proposed definitions of “side” and “reporting side”? Why or why not? If you disagree with these proposed definitions, what alternative formulations should the Commission consider, and why?

• Do you believe that the re-proposed provisions would appropriately reduce the potential reporting burdens of non-registered U.S. counterparties? Why or why not?

• Do you agree with the shifting of reporting burdens as detailed in re-proposed Rule 901(a)? Why or why not? Do you believe it is appropriate to require a security-based swap dealer or major security-based swap participant that is not a U.S. person to incur the duty to report a security-based swap? Why or why not?

• Should re-proposed Rule 901(a) focus only on the status of the direct counterparties (*i.e.*, whether or not they are security-based swap dealers or major security-based swap participants) rather than also taking into account the status of any indirect counterparties? Why or why not?

• Do you agree, as provided in re-proposed Rule 901(a), that the domicile of the counterparties should determine who must report only if neither side includes a security-based swap dealer or major security-based swap participant? Why or why not?

• Do you believe that Rule 901(a), as re-proposed, would more efficiently align the burdens of reporting with the entities having the greatest technological capability to carry out the reporting function? If not, how could the Commission more efficiently align the burdens of reporting with the operational capabilities of security-based swap counterparties? Please be specific.

• Are the examples provided sufficiently clear to inform entities of their reporting obligations? Would additional examples be helpful? If so, please provide specific examples that should be addressed by the Commission.

#### E. Other Technical and Conforming Changes

In connection with the new provisions of re-proposed Regulation SBSR discussed above, the Commission is proposing to make various minor technical and conforming changes to other parts of the regulation. These changes are described below.

Rule 902(a), as initially proposed, would require a registered SDRs to publicly disseminate a transaction report of any security-based swap immediately upon receipt of information about the security-based swap, except in the case of a block trade. Re-proposed Rule 908, however, contemplates situations where a security-based swap would be required to be reported to a registered SDR but not publicly disseminated.<sup>921</sup> Therefore, the Commission is re-proposing Rule 902(a) to provide that a registered SDR would not have an obligation to publicly disseminate a transaction report for any such security-based swap.

Similarly, Rule 910(b)(4), as initially proposed, would provide that, in Phase 4 of the Regulation SBSR compliance schedule, “[a]ll security-based swaps reported to the registered security-based swap data repository shall be subject to real-time public dissemination as specified in § 242.902.” As noted above, under the re-proposal of Rule 908, certain security-based swaps would be subject to regulatory reporting but not public dissemination requirements. Therefore, the Commission is re-proposing Rule 910(b)(4) to provide that, “All security-based swaps received by the registered security-based swap data repository shall be treated in a manner consistent with §§ 242.902, 242.905, and 242.908.”<sup>922</sup>

In addition, the Commission is proposing certain changes to proposed Rules 901(c) and 901(d), which address the data elements to be reported to a registered SDR, to reflect that, under the re-proposal, certain security-based swaps may be subject to regulatory reporting but not public dissemination. Rule 901(c), as initially proposed, was titled “Information to be reported in real time.” Under Rule 902(a), as originally proposed, the registered SDR to which such information was reported would be required to promptly disseminate to the public such information (except in the

<sup>921</sup> This could occur in the case of a security-based swap between (i) a foreign branch of a U.S. bank, a non-U.S. person security-based swap dealer, or a non-U.S. person that has a guarantor from a U.S. person, and (ii) a non-U.S. person that is not guaranteed by a U.S. person; and further provided that neither side solicits, negotiates, executes, books, or submits to clear the transaction within the United States. See Section VIII.C, *supra*.

<sup>922</sup> Re-proposed Rules 902 and 908 of Regulation SBSR, when read together, would provide that certain security-based swaps reported to a registered SDR would not be publicly disseminated. The Commission also is adding the reference to Rule 905 here to provide that, after Phase 4, a registered SDR must publicly disseminate not only *initial* transaction reports (consistent with re-proposed Rules 902 and 908), but also *corrected* transaction reports (consistent with re-proposed Rule 905).

<sup>920</sup> Regulation SBSR Proposing Release, 75 FR 75265.

case of a block trade). However, the Commission preliminarily believes that, if a security-based swap were subject to regulatory reporting but not public dissemination, there is no need to require that information about the security-based swap be reported in real time. Therefore, the introductory language to Rule 901(c) is being re-proposed as follows: “For any security-based swap that must be publicly disseminated pursuant to §§ 242.902 and 242.908 and for which it is the reporting side, the reporting side shall report the following information in real time. If a security-based swap is required by §§ 242.901 and 242.908 to be reported but not publicly disseminated, the reporting side shall report the following information no later than the time that the reporting side is required to comply with paragraph (d) of this section.” In addition, re-proposed Rule 901(c) would be retitled “Primary trade information,” thus eliminating the reference to real-time reporting—since the information required to be reported under Rule 901(c) would no longer in all cases be required to be reported in real time. Furthermore, re-proposed Rule 901(d) would be retitled “Secondary trade information.”<sup>923</sup>

The Commission also is re-proposing Rule 905(b)(2) to clarify that, if a registered SDR receives corrected information relating to a previously submitted transaction report, it would be required to publicly disseminate a corrected transaction report only if the initial security-based swap were subject to public dissemination.<sup>924</sup>

Rule 901(c)(10), as initially proposed, provided that the following data element would be required to be reported: “If both counterparties to a security-based swap are security-based swap dealers, an indication to that effect.” As the Commission stated in the Regulation SBSR Proposing Release: “Prices of transactions involving a dealer and a non-dealer are typically ‘all-in’ prices that include a mark-up or mark-down, while interdealer transaction prices typically do not. Thus, the Commission believes that requiring an indication of whether a [security-based swap] was an interdealer transaction or a transaction between a

dealer and a non-dealer counterparty would enhance transparency by allowing market participants to more accurately assess the reported price for a [security-based swap].”<sup>925</sup> The Commission is now re-proposing Rule 901(c)(10) as follows: “If both sides of the security-based swap include a security-based swap dealer, an indication to that effect.” The re-proposed rule would clarify that a security-based swap dealer might be a direct or indirect counterparty to a security-based swap. The Commission continues to believe that, in either case, a security-based swap having a security-based swap dealer on each side could, all other things being equal, be priced differently than a security-based swap having a security-based swap dealer on only one side. Therefore, the Commission continues to believe that the existence of a security-based swap dealer on each side should be reported to the registered SDR and made known to the public.

The Commission is re-proposing Rule 901(d)(1)(ii) to require reporting of the broker ID, desk ID, and trader ID, as applicable, only of the *direct* counterparty on the reporting side. The Commission preliminarily believes that it would be impractical and unnecessary to report such data elements with respect to an indirect counterparty, as such elements might not be applicable to an indirect counterparty.<sup>926</sup> Similarly, Rule 901(d)(1)(iii) is being re-proposed to require reporting of a description of the terms and contingencies of the payment streams only of each *direct* counterparty to the other. The Commission is including the word “direct” to avoid extending Rule 901(d)(1)(iii) to indirect counterparty relationships, where payments generally would not flow to or from an indirect counterparty.

Proposed Rule 901(e) set forth provisions for reporting life cycle events of a security-based swap. The basic approach set forth in proposed Rule 901(e) was that, generally, the original reporting party of the initial transaction would have the responsibility to report any subsequent life cycle event; this approach remains unchanged in the re-proposal. However, if the life cycle event were an assignment or novation that removed the original reporting party, either the new counterparty or the original counterparty would have to be the reporting party. Further, Rule 901(e),

as initially proposed, would provide that the new counterparty would be the reporting party if it were a U.S. person, whereas the other counterparty would be the new reporting party if the new counterparty were not a U.S. person.

However, as discussed above, the Commission is now proposing the concept of a “reporting side,” which would include the direct and any indirect counterparty. Further, as discussed above, the Commission is proposing that non-U.S. person security-based swap dealers or major security-based swap participants would, in certain instances, incur a duty to report. Thus, the Commission is re-proposing Rule 901(e) to provide that the duty to report would switch to the other side only if the new side did not include a U.S. person (as in the originally proposed rule) or a security-based swap dealer or major security-based swap participant (references to which are being added to Rule 901(e)). The Commission preliminarily believes that, if the new side includes a security-based swap dealer or major security-based swap participant, the new side should retain the duty to report. This approach is designed to align reporting duties with the market participants that the Commission preliminarily believes are better suited to carrying them out because non-U.S. person security-based swap dealers and major security-based swap participants likely have already taken significant steps to establish and maintain the systems, processes and procedures, and staff resources necessary to report security-based swaps currently.<sup>927</sup>

#### Request for Comment

The Commission generally requests comment on all aspects of all the technical and conforming changes in re-proposed Regulation SBSR, including the following:

- Do you disagree with any of the technical and conforming changes in the re-proposed rules? If so, why?
- Do you agree with the proposed change to Rule 902(a) which provides that a registered SDR would not have an obligation to publicly disseminate a transaction report for any security-based swap that is required to be reported but not publically disseminated? Why or why not?
- Do you agree with the proposed change to Rule 910(b)(4) that would remove the requirement that “[a]ll security-based swaps reported to the registered security-based swap data

<sup>923</sup> In the original proposal, Rule 901(d) of Regulation SBSR was titled “Additional information that must be reported.” This additional information would be for regulatory purposes only and would not be publicly disseminated.

<sup>924</sup> Re-proposed Rule 905(b)(2) of Regulation SBSR also substitutes the word “counterparties”—which is a defined term in Regulation SBSR—for the word “parties,” which was used in the initial proposal but was not a defined term.

<sup>925</sup> Regulation SBSR Proposing Release, 75 FR 75214.

<sup>926</sup> An indirect counterparty typically would not have a desk or trader involved in the transaction, or engage the services of a broker, in the same manner as a direct counterparty.

<sup>927</sup> See Section VIII.D, *supra* (explaining rationale for proposing to align reporting duties with greater capability to carry out such duties).

repository [] be subject to real-time public dissemination as specified in § 242.902” and replace it with the requirement that “[a]ll security-based swaps received by the registered security-based swap data repository [] be treated in a manner consistent with §§ 242.902, 242.905, and 242.908”? Are there any alternative formulations of the re-proposed rule text that the Commission should consider? If so, what are they? Please be specific.

- Do you agree with the proposed changes to the data elements initially contained in proposed Rules 901(c) and 901(d)? Specifically, do you agree with the reformulation of the introductory language contained in re-proposed Rule 901(c) to reflect situations in which a security-based swap could be subject to regulatory reporting but not public dissemination? Why or why not? Do you agree with the retitling of re-proposed Rule 901(c) to “Primary trade information” to eliminate the reference to real-time reporting? Why or why not?

- Do you agree with the proposed change to re-proposed Rule 905(b)(2) to clarify that, if a registered SDR receives corrected information relating to a previously submitted transaction report, it would be required to publicly disseminate a corrected transaction report only if the initial security-based swap were subject to public dissemination? Why or why not?

- Do you agree with the proposed change to re-proposed Rule 901(c)(10) to clarify that a security-based swap dealer might be a direct or indirect counterparty to a security-based swap? Why or why not?

- Do you agree with the proposed change to re-proposed Rule 901(d)(1)(ii) to require the reporting of the broker ID, desk ID, and trader ID only of the direct counterparty on the reporting side? Why or why not? Similarly, do you agree with the requirement in re-proposed Rule 901(d)(1)(iii) for reporting of a description of the terms and contingencies of the payment streams only of each *direct* counterparty to the other in order to avoid extending the rule to indirect counterparty relationships? Why or why not?

- Do you agree with the proposed change to re-proposed Rule 901(e) to provide that the duty to report would switch to the other side only if the new side did not include a U.S. person or a security-based swap dealer or major security-based swap participant? Why or why not?

- Are there any other technical and conforming changes that the Commission should make to re-proposed Regulation SBSR?

#### F. Cross-Border Inter-Affiliate Transactions

Commenters raised concerns about applying Title VII reporting or dissemination requirements to cross-border inter-affiliate security-based swaps.<sup>928</sup> One commenter argued that, for a foreign entity registered as a bank holding company and subject to the consolidated supervision of the Federal Reserve, the reporting of inter-affiliate transactions would be superfluous because the Federal Reserve has “ample authority to monitor transactions among affiliates.”<sup>929</sup> The second commenter expressed concern about duplicative or conflicting regulation of inter-affiliate transactions. It stated that, for example, inter-affiliate security-based swaps “could be required to be publicly reported in multiple jurisdictions, even though they are not suitable for reporting in any jurisdiction.”<sup>930</sup> A third commenter argued that inter-affiliate security-based swaps generally—not referencing cross-border inter-affiliate transactions in particular—should not be subject to public dissemination requirements, stating that “public reporting could confuse market participants with irrelevant information and raise the costs to corporate groups of managing risk internally.”<sup>931</sup>

The Commission preliminarily believes that regulatory reporting and public dissemination serve different purposes and, while these two requirements are related, their application to cross-border inter-affiliate transactions should be considered separately. The Commission notes that the statutory provisions that require regulatory reporting and public dissemination of security-based swap transactions state that “each” security-based swap shall be reported; these statutory provisions do not by their terms distinguish such reporting based on particular characteristics (such as being negotiated at arm’s length). Section 13A(a)(1) of the Exchange Act<sup>932</sup> provides that each security-based swap that is not accepted for clearing shall be subject to regulatory reporting. Section 13(m)(1)(G) of the Exchange Act<sup>933</sup> provides that each security-based swap (whether cleared or uncleared) shall be reported to a registered SDR, and Section 13(m)(1)(C) of the Exchange

Act<sup>934</sup> generally provides that transaction, volume, and pricing data of security-based swaps shall be publicly disseminated. With respect to regulatory reporting of cross-border inter-affiliate security-based swaps, the Commission preliminarily believes that regulators should have ready access to information about the precise legal entities that hold risk positions in all security-based swaps. While it is true that the Federal Reserve or perhaps other regulators might exercise consolidated supervision over a group, this might not provide regulators with current and specific information about security-based swap positions taken by the group’s subsidiaries. As a result, it would likely be more difficult for the Commission to conduct general market analysis or surveillance of market behavior, and could create particular problems during a crisis situation when having accurate and timely information about specific risk exposures could be crucial. Therefore, the Commission continues to believe that each cross-border inter-affiliate security-based swap that otherwise satisfies any of the criteria in re-proposed Rule 908(a)(1) should be subject to regulatory reporting.

With respect to public dissemination of cross-border inter-affiliate transaction data, the Commission preliminarily believes that the analysis of this issue in the cross-border context is in many ways similar to the analysis of dissemination of inter-affiliate transaction data in the domestic context. In particular, many of the issues raised by commenters with respect to the public dissemination of inter-affiliate transactions generally appear to be relevant whether a transaction is conducted within the United States or conducted on a cross-border basis. These general issues include a concern about information distortion, market confusion, and interference with internal risk management of a corporate group.

First, commenters stated that inter-affiliate transactions—whether cross-border or not—are typically risk transfers with no market impact. They believe that the market-facing transactions already would have been publicly reported, so requiring that inter-affiliate transactions also be publically reported would duplicate information already known to the public. The commenters express the concern that such “double counting” would distort information that is critical for price discovery and measuring liquidity, the depth of trading, and

<sup>928</sup> See Japanese Banks Letter at 5; Multiple Associations Letter IV at 11–12.

<sup>929</sup> Japanese Banks Letter at 5.

<sup>930</sup> Multiple Associations Letter IV at 16.

<sup>931</sup> Cleary Letter II at 17–18.

<sup>932</sup> 15 U.S.C. 78m–1(a)(1).

<sup>933</sup> 15 U.S.C. 78m(m)(1)(G).

<sup>934</sup> 15 U.S.C. 78m(m)(1)(C).



exposure to swaps in the market.<sup>935</sup> They also believe that it would distort the establishment of regulatory thresholds and analysis, as well as enforcement activities that require an accurate assessment of the swaps market.<sup>936</sup>

Second, commenters stated that affiliates often enter into an inter-affiliate transaction on terms linked to an external trade being hedged, which they are concerned could create confusion in the market if publicly reported. If markets move because of the external trade before the inter-affiliate transaction is entered into on a SEF or reported as an off-exchange trade, market participants could misconstrue the market's true direction and depth simply because of the disconnect in timing between the two offsetting trades.<sup>937</sup>

Third, commenters stated that public dissemination of inter-affiliate transactions could interfere with the internal risk management practices of a corporate group. For example, one entity in a group may be better positioned to take on a certain type of risk, even though another entity must, for unrelated reasons, actually enter into the transaction with an external counterparty. Public disclosure of a transaction between affiliates could prompt other market participants to act in a way that would prevent the corporate group from following through with its risk management strategy by, for instance, causing adverse price movements in the market that the risk-carrying affiliate would use to hedge.<sup>938</sup>

Beyond these concerns regarding the public dissemination of inter-affiliate transactions, commenters addressing the public reporting of cross-border inter-affiliate transactions focused more generally on duplicative and conflicting regulations. Using public dissemination as an example, one commenter stated that inter-affiliate security-based swaps "could be required to be publicly reported in multiple jurisdictions, even though they are not suitable for reporting in any jurisdiction."<sup>939</sup> However, the Commission is not aware of any commenter proposing a treatment of cross-border inter-affiliate transactions under public dissemination requirements that differs substantively from proposals for the treatment of other inter-affiliate transactions.

The Commission has considered the issues raised by these commenters both

with respect to inter-affiliate transactions generally and in the cross-border context. The common thread of the issues identified by commenters to date is that public dissemination should not be required for a security-based swap that is undertaken to transfer the risk of an initial security-based swap (between X and Y) to an affiliate (*i.e.*, from X to XA) because it would have no price discovery value or could even give market observers a false understanding of the nature of the transaction.<sup>940</sup> The Commission acknowledges that the initial security-based swap between X and Y likely would have more price discovery value than the subsequent inter-affiliate transaction between X to XA, all else being equal. In this hypothetical, the initial transaction presumably represents the mutual agreement of parties operating on an arm's-length basis to execute a trade at a particular price, while the latter transaction generally would not involve negotiation of the terms, particularly as regards to price. It may not follow, however, that the subsequent inter-affiliate transaction would have no price discovery value whatsoever, particularly in a cross-border context where multiple public dissemination requirements may be involved. Arguing that an inter-affiliate security-based swap has no price discovery value appears to presuppose that the initial, arm's-length security-based swap had been publicly disseminated. This could be the case if the initial security-based swap were subject to the rules of a jurisdiction having public dissemination requirements.<sup>941</sup> However, if the initial security-based swap had not been publicly disseminated, public dissemination of the cross-border inter-affiliate transaction, assuming it were subject to Rule 908(a)(2) of re-proposed Regulation SBSR,<sup>942</sup> might be the only way for the market to obtain any pricing information about the series of transactions. These circumstances could be present if the initial security-based swap were not subject to the rules of a jurisdiction having public dissemination requirements. In this case, public dissemination of the cross-border inter-affiliate transaction, assuming it were subject to Rule

<sup>940</sup> See Cleary Letter II at 17–18; Multiple Associations Letter IV at 16.

<sup>941</sup> See Multiple Associations Letter IV at 12 ("The market-facing swaps already will have been reported and therefore, to require that inter-affiliate swaps also be reported will duplicate information").

<sup>942</sup> Re-proposed Rule 908(a)(2) of Regulation SBSR would describe when a cross-border security-based swap would be subject to public dissemination.

908(a)(2) of re-proposed Regulation SBSR,<sup>943</sup> might be the only way for the market to obtain any pricing information about the series of transactions.

As described above, commenters also raised a general concern about the potential for duplicative and conflicting regulation of cross-border inter-affiliate transactions. The Commission is sensitive to these concerns both generally and in the context of public dissemination.<sup>944</sup> The treatment of these issues in connection with public dissemination is not dissimilar to their treatment in other contexts under Title VII, including the context of regulatory reporting. Accordingly, the Commission preliminarily believes that the concern expressed by the commenters should be addressed by the proposed substituted compliance policy and framework discussed in detail below, as well as when the Commission considers the adopting release for public dissemination, which the Commission anticipates will address the issue of dissemination of inter-affiliate transactions.<sup>945</sup>

In light of these considerations, the Commission preliminarily believes that cross-border inter-affiliate security-based swaps should not be excluded from the public dissemination requirements to the extent that inter-affiliate security-based swaps are not excluded as a general matter. The Commission preliminarily believes that the considerations regarding whether or not to exclude inter-affiliate cross-border security-based swaps from public dissemination on the grounds that they could be misleading or have no price discovery value are similar to the considerations regarding whether or not to exclude inter-affiliate security-based swaps generally. Similarly, the Commission preliminarily believes that any steps short of exclusion that could be taken to maximize the price discovery value that inter-affiliate cross-border security-based swaps may have (while minimizing any concern that they might mislead the market) are similar to the steps that could be taken with respect to inter-affiliate security-based swaps generally. Although the Commission is not in this release re-proposing any provisions of Regulation SBSR regarding the public dissemination of inter-affiliate security-

<sup>943</sup> See *id.*

<sup>944</sup> Duplicative and conflicting regulation is one of the considerations the Commission takes into account in proposing the approach to application of Title VII requirements to security-based swap transactions in the cross-border context. See Section II.C, *supra*.

<sup>945</sup> See Section XI, *infra*.

<sup>935</sup> See Multiple Associations Letter IV at 11–12.

<sup>936</sup> See *id.*

<sup>937</sup> See *id.* at 12.

<sup>938</sup> Cleary Letter II at 17.

<sup>939</sup> See note 930, *supra*.

based swaps generally (whether or not cross-border),<sup>946</sup> as previously stated, the Commission invites public comment on whether there are specific concerns or reasons to support different treatment or analysis of public dissemination of cross-border inter-affiliate transactions from the treatment or analysis of the same issue in the domestic context, and, in particular, why cross-border inter-affiliate transactions may not be suitable for public dissemination.

For example, the concerns about the potentially limited price discovery value of inter-affiliate security-based swaps may be able to be addressed through the public dissemination of relevant data that may be indicative of such limitations, rather than suppressing these transactions entirely. In the Regulation SBSR Proposing Release, the Commission proposed to require a registered SDR to “publicly disseminate a transaction report of a security-based swap immediately upon receipt of information about the security-based swap from a reporting party.”<sup>947</sup> As the Commission noted in the Regulation SBSR Proposing Release, “[t]he transaction report that is disseminated would be required to consist of all the information reported by the reporting party pursuant to proposed Rule 901(c).”<sup>948</sup> One of the data elements enumerated in proposed Rule 901(c) would be “[i]f applicable, an indication that the transaction does not accurately reflect the market.”<sup>949</sup> Such data element should send a message to the market that the transaction was not conducted at arm’s length on the open market.<sup>950</sup> Market participants could take such information into account when interpreting or analyzing the

publicly-disseminated inter-affiliate transaction pricing information.

As noted above, one commenter expressed concern that public dissemination of an inter-affiliate transaction could interfere with the internal risk management of a corporate group by causing adverse price movements in the market that the risk-carrying affiliate might use to hedge. The commenter did not explain why the corporate group might be unable or might choose not to hedge the risk when the initial transaction is executed, or why the impact of the public dissemination of the subsequent inter-affiliate transaction might be different from the impact of the public dissemination of the initial transaction. The Commission preliminarily believes that, assuming that the corporate group does not hedge at the time the initial transaction was executed, a concern about the potential impact of public dissemination of the inter-affiliate transaction on the ability to hedge the position would be similar to the concern that commenters have expressed generally about public dissemination of block trades.<sup>951</sup> This concern about a potential impact of the public dissemination—either of the original transaction or the subsequent inter-affiliate transaction—may be addressed by delayed dissemination instead of suppressing dissemination of these transactions entirely. The broader issue of how to treat block trades, including how to define what is a block trade, is one that the Commission continues to evaluate. In addition, public dissemination of relevant data indicating the inter-affiliate nature of the transaction separately may help address concerns about potential impact on markets on which a hedge might occur if such markets are made aware that there may be special considerations that should be taken into account when assessing the extent to which the transaction may reflect the current market.

Regulation SBSR would require registered SDRs, in their policies and procedures, to enumerate the specific data elements of a security-based swap or life cycle event that would be

<sup>951</sup> Specifically, if the corporate group hedges the initial transaction at the time of execution, there would appear to be no need to hedge at the time of the inter-affiliate transaction, and thus no concern about the impact of the dissemination of the inter-affiliate transaction on the market in which the hedge is put on. Furthermore, if the corporate group chooses not to hedge the position until the time of the inter-affiliate transaction, the Commission questions why the concern about the impact of the disclosure of that transaction would be different than a concern about the dissemination of the original transaction.

required to be reported, and to specify one or more acceptable data formats, connectivity requirements, and other protocols for submitting information.<sup>952</sup> The Commission itself did not propose to specify each data element that would have to be reported, but instead identified broad categories of information that must be reported.<sup>953</sup> Furthermore, the Commission initially proposed to require, in Rule 907(a)(4), that a registered SDR have policies and procedures “[d]escribing how reporting parties shall report and, consistent with the enhancement of price discovery, how the registered security-based swap data repository shall publicly disseminate . . . security-based swap transactions that do not involve an opportunity to negotiate any material terms, other than the counterparty; and any other security-based swap transactions that, in the estimation of the registered security-based swap data repository, do not accurately reflect the market.”<sup>954</sup> However, the Commission invites public comment on whether concerns about the inter-affiliate security-based swaps not accurately reflecting the market can be addressed in the policies and procedures of registered SDRs that would be required under re-proposed Rule 907(a)(4).

For example, such policies and procedures could be designed to maximize the price discovery value of cross-border (or other) inter-affiliate security-based swaps and to minimize their ability to mislead. These policies and procedures could require not only that reporting sides mark whether a security-based swap is an inter-affiliate transaction, but also whether the initial security-based swap was executed in a jurisdiction with public dissemination requirements.<sup>955</sup> Further, these policies and procedures also could require the reporting side to indicate the approximate time when the initial

<sup>952</sup> See Rules 907(a)(1) and 907(a)(2) of Regulation SBSR, as originally proposed.

<sup>953</sup> For example, the Commission proposed to require the reporting of “[i]nformation that identifies the security-based swap instrument”—see Rule 901(c)(2) of Regulation SBSR, as originally proposed—but did not specify the exact manner in which such information must be reported, instead proposing to allow SDRs discretion to set such specifications in their policies and procedures. However, the Commission did propose to require reporting of certain discrete data elements. See, e.g., Rule 901(d)(vi) of Regulation SBSR (requiring reporting of the name of the clearing agency, if the security-based swap will be cleared).

<sup>954</sup> Rule 907(a)(4) of Regulation SBSR, as originally proposed.

<sup>955</sup> This could be either the United States or another jurisdiction that imposes post-trade transparency requirements similar to those in re-proposed Regulation SBSR.

<sup>946</sup> See Regulation SBSR Proposing Release, 75 FR 75215 (proposing that inter-affiliate security-based swaps should not be suppressed from the public data feed, but rather should be disseminated and appropriately tagged).

<sup>947</sup> See Rule 902(a) of Regulation SBSR, as originally proposed. If the SDR were closed when the reporting party submitted its transaction report, the SDR would be required to publicly disseminate the transaction report immediately upon re-opening. See *id.*

<sup>948</sup> Regulation SBSR Proposing Release, 75 FR 75228.

<sup>949</sup> Rule 901(c)(11) of Regulation SBSR, as originally proposed.

<sup>950</sup> The Commission preliminarily disagrees with the commenter that argued that “inclusion of these swaps in swaps market data will distort the establishment of position limits, analysis of open interest, determinations of block trade thresholds and performance of other important regulatory analysis, functions and enforcement activities that require an accurate assessment of the swaps market.” Multiple Associations Letter IV at 11–12. Security-based swaps that have been appropriately marked as inter-affiliate transactions also could be excluded from certain aggregated market data, depending on the purpose for which those data are being used.

security-based swap was executed.<sup>956</sup> This would permit market observers to gauge how much price discovery value to assign to the price provided in the inter-affiliate security-based swap transaction report that would be publicly disseminated under Rule 902 of re-proposed Regulation SBSR. Information about an initial trade done less than 24 hours before (obtained indirectly from the later-appearing trade report of the inter-affiliate cross-border security-based swap) could have significant price discovery value, while information from an initial trade executed over a week before could, all things being equal, have less.<sup>957</sup> The Commission invites public comment on these approaches to the treatment of inter-affiliate security-based swaps generally, as well as their relative advantages and disadvantages. In particular, the Commission invites public comment on how these approaches would affect the internal risk management practices of a corporate group. In addition, as previously stated, the Commission invites public comment on whether there are specific concerns or reasons to support different treatment or analysis of public dissemination of cross-border inter-affiliate transactions from the treatment or analysis of the same issue in the domestic context.

#### Request for Comment

The Commission generally requests comment on all aspects of issues regarding cross-border inter-affiliate security-based swaps, including the following:

- Do you believe that cross-border inter-affiliate security-based swaps should be excluded from the regulatory reporting requirements of Regulation SBSR? If so, under what circumstances should such security-based swaps be excluded, and why? What would be the harm of having such inter-affiliate security-based swaps reported to a registered SDR? What are the risks of not requiring regulatory reporting of inter-affiliate security-based swaps?
- Do you believe that cross-border inter-affiliate security-based swaps should be analyzed differently from domestic inter-affiliate security-based swaps? Why or why not?
- Do you believe that cross-border inter-affiliate security-based swaps

should be excluded from the public dissemination requirements of Regulation SBSR? Why or why not? What are the risks or benefits of *not* requiring public dissemination of inter-affiliate security-based swaps? How should the Commission balance these risks and benefits?

- Does your view about public dissemination for cross-border inter-affiliate security-based swaps change depending on whether an initial, arm's-length security-based swap was executed and publicly disseminated in a jurisdiction having public dissemination requirements? Why or why not? On what basis could or should the Commission exclude the cross-border inter-affiliate security-based swap from the public dissemination requirements if the initial, arm's-length security-based swap was executed and publicly disseminated in a jurisdiction having no public dissemination requirements, or public dissemination requirements that are not comparable to those in the United States?

- Does your view on the application of regulatory reporting and public dissemination requirements to inter-affiliate security-based swaps change if the affiliates are subject to consolidated supervision? If so, please explain.
- Can you suggest any additions to the policies and procedures of registered SDRs that could maximize the price discovery value, and minimize any potentially misleading aspects, of public trade reports of cross-border inter-affiliate security-based swaps? If so, what are they? Should the Commission more clearly specify in Rule 907(a)(4) how inter-affiliate security-based swaps should be publicly disseminated so as to maximize their price discovery value and minimize their potential for misleading market observers? If so, how?
- Do you have any other concerns about public dissemination of cross-border inter-affiliate security-based swaps so long as they are appropriately marked?

#### G. Foreign Privacy Laws Versus Duty To Report Counterparty ID

Rule 901(d), as initially proposed, set forth the data elements that would constitute the required regulatory report of a security-based swap (*i.e.*, information for use only by regulators that would not be included in the publicly disseminated report). One such element is the "participant ID" of the counterparty.<sup>958</sup> The Title VII

provisions relating to security-based swap trade reporting and proposed Regulation SBSR that would implement those provisions contemplate only one counterparty to a security-based swap having a duty to report. However, the Commission preliminarily believes that being able to assess the positions and behavior of both counterparties to the security-based swap would facilitate our ability to carry out our regulatory duties for market oversight.<sup>959</sup> Because only one party would be required to report, the only way to obtain the identity of the non-reporting party counterparty would be to require the reporting party to disclose its counterparty's identity.<sup>960</sup>

Three comments on proposed Regulation SBSR cautioned that U.S. persons may be restricted from complying with such a requirement in cases where a security-based swap is executed outside the United States.<sup>961</sup> One commenter stated that the London branch of a U.S. person would need its counterparty's consent to identify that

<sup>959</sup> U.S. regulators have a strong interest in being able to monitor the risk exposures of U.S. persons, particularly those involved in the security-based swap market, as the failure or financial distress of a U.S. person could impact other U.S. persons and the U.S. economy as a whole. U.S. regulators also have an interest in obtaining information about non-U.S. counterparties that enter into security-based swaps with U.S. persons, as the ability of such non-U.S. counterparties to perform their obligations under those security-based swaps could impact the financial soundness of U.S. persons. *See, e.g.*, S. Comm. on Banking, Hous., & Urban Affairs, *The Restoring American Financial Stability Act of 2010*, S. Rep. No. 111-176, at 32 ("As a key element of reducing systemic risk and protecting taxpayers in the future, protections must include comprehensive regulation and rules for how the OTC derivatives market operates. Increasing the use of central clearinghouses, exchanges, appropriate margining, capital requirements, and reporting will provide safeguards for American taxpayers and the financial system as a whole.") (emphasis added).

<sup>960</sup> Once the identity of the opposite counterparty to a security-based swap is known by a registered SDR, the SDR would be required to obtain certain additional information from that counterparty. *See* proposed Rule 906(a), which is not being revised by this re-proposal.

<sup>961</sup> In addition, two comments on the Commission's interim final temporary rule on the reporting of security-based swaps entered into before July 21, 2010, Securities Exchange Act Release No. 63094 (Oct. 13, 2010), 75 FR 64643 (Oct. 20, 2010), made similar points. *See* Deutsche Bank Letter at 5 ("In some cases, dissemination or disclosure of [counterparty] information could lead to severe civil or criminal penalties for those required to submit information to an SDR pursuant to the Interim Final Rules. These concerns are particularly pronounced because of the expectation that Reportable Swap data will be reported, on a counterparty identifying basis, to SDRs, which will be non-governmental entities, and not directly to the Commissions."); ISDA Letter II at 6 ("In many cases, counterparties to cross-border security-based swap transactions will face significant legal and reputational obstacles to the reporting of such information. Indeed, disclosure of such information may lead to civil penalties in some jurisdictions and even criminal sanctions in other jurisdictions.").

<sup>956</sup> For example, there could be indicators for the initial security-based swap having been executed within the past 24 hours, between one and seven days before, or longer than seven days before.

<sup>957</sup> However, even information about a trade done over a week ago (or more) could have price discovery value for security-based swap instruments that trade infrequently.

<sup>958</sup> *See* Rule 901(d)(1)(i) of Regulation SBSR, as initially proposed. *See also* Regulation SBSR Proposing Release, 75 FR 75217.

party under U.K. law.<sup>962</sup> The commenter added that, under French law, consent is required each time a report is made identifying the counterparty, and this restriction cannot be resolved by changes to the firm's terms of business.<sup>963</sup> Another commenter urged the Commission to "consider carefully and provide for consistency with, foreign privacy laws, some of which carry criminal penalties for wrongful disclosure of information,"<sup>964</sup> but did not provide further detail. A third commenter argued that allowing substituted compliance when both parties are not domiciled in the United States could avoid problems with foreign privacy laws conflicting with U.S. reporting requirements.<sup>965</sup>

The Commission seeks to understand more precisely if—and, if so, how—requiring a counterparty to report the transaction pursuant to Regulation SBSR (including disclosure of the counterparty's identity to a registered SDR) might cause it to violate local law in a foreign jurisdiction where it operates. Before determining whether any exception to reporting the counterparty's identity might be necessary or appropriate, the Commission seeks to obtain additional information about any such foreign privacy laws.

#### Request for Comment

The Commission generally requests comment on all aspects of issues relating to foreign privacy laws with respect to proposed Regulation SBSR, including the following:

- What jurisdictions have laws that might affect a reporting side's ability to report the participant ID of its counterparty? Please cite and describe specifically for each such law: To whom such restrictions would apply and under what circumstances; how the law might restrict reporting (e.g., what data elements that otherwise would be required to be reported under Regulation SBSR would be restricted); whether any exceptions under the law, particularly but not limited to consent provisions and provisions relating to compliance with applicable law, might be available to a reporting side that otherwise would be required to comply with re-proposed Rule 901(d)(1)(i), or explain why none of the exceptions would be available.

- If no such exceptions are available under the local law and you believe that

an exception by rule from re-proposed Rule 901(d)(1)(i) would be appropriate, how should that exception be crafted? Please suggest appropriate rule text.

- How, if at all, would a substituted compliance regime for regulatory reporting avoid problems with foreign privacy laws? Would the Commission and other U.S. financial regulators be able to obtain information about security-based swap counterparties from foreign trade repositories or foreign regulatory authorities to which such transactions had been reported?

#### H. Foreign Public Sector Financial Institutions

Six commenters expressed concern about applying the requirements of Title VII to the activities of FPSFIs, such as foreign central banks and multilateral development banks.<sup>966</sup> One commenter, the European Central Bank ("ECB"), noted that security-based swaps entered into by the Federal Reserve Banks are excluded from the CEA's definition of "swap"<sup>967</sup> and that the functions of foreign central banks and the Federal Reserve are broadly comparable. The ECB argued, therefore, that security-based swaps entered into by foreign central banks should likewise be excluded from the definition of "swap."<sup>968</sup> A second commenter, the World Bank (representing the International Bank for Reconstruction and Development, the International Finance Corporation, and other multilateral development institutions of which the United States is a member) also argued generally that the term "swap" should be defined to exclude any transaction involving a multilateral development bank.<sup>969</sup> The World Bank further noted that the EMIR—which is intended to serve as the E.U. counterpart to Title VII of the Dodd-Frank Act—would expressly exclude multilateral development banks from its coverage.<sup>970</sup>

<sup>966</sup> See BIS Letter *passim*; ECB at 2, 4; ECB Letter *passim*; ECB Letter II *passim*; EIB Letter *passim*; Nordic Investment Bank Letter at 1; World Bank Letter II *passim*.

<sup>967</sup> Section 1a(47)(B)(ix) of the CEA excludes from the definition of swap any agreement, contract, or transaction a counterparty of which is a Federal Reserve Bank, the Federal Government, or a Federal agency that is expressly backed by the full faith and credit of the United States. A security-based swap includes any swap, as defined in the CEA, that is based on, among other things, a narrow-based index or a single security or loan. See Section 3(a)(68) of the Exchange Act, 15 U.S.C. 78c3(a)(68). See also Product Definitions Adopting Release, 77 FR 48208.

<sup>968</sup> See ECB Letter I at 2; ECB Letter II at 2. See also EIB Letter at 1; Nordic Development Bank at 1.

<sup>969</sup> See World Bank Letter II at 6–7.

<sup>970</sup> See *id.* at 4. See also EIB Letter at 7 ("As a matter of comity, actions by U.S. financial

The ECB and BIS stated that foreign central banks enter into security-based swaps solely in connection with their public mandates, which require them to act confidentially in certain circumstances.<sup>971</sup> The ECB argued in particular that public disclosure of its market activities could compromise its ability to take necessary actions and "could cause signaling effects to other market players and finally hinder the policy objectives of such actions."<sup>972</sup> Another commenter, the Council of Europe Development Banks ("CEB"), while opposing application of Title VII requirements to multilateral development banks generally, did not object to the CFTC and SEC preserving their authority over certain aspects of swaps activity, including reporting requirements.<sup>973</sup> Similarly, the World Bank believed that the definition of "swap" could be qualified by a requirement that counterparties would treat such transactions as swaps solely for reporting purposes.<sup>974</sup>

The Commission preliminarily believes that security-based swaps to which an FPSFI is a counterparty ("FPSFI trades") should not, for that fact alone, be exempt from regulatory reporting.<sup>975</sup> Under Regulation SBSR, as initially proposed, an FPSFI trade would be required to be reported to a registered SDR if the counterparty were a U.S. person. The Commission continues to believe that, if an FPSFI executes a security-based swap with a counterparty that is a U.S. person, the security-based swap should be subject

regulators should be consistent with the laws of other jurisdictions that provide exemption from national regulation for government-owned multinational developments such as the [EIB]).

<sup>971</sup> See BIS Letter at 4–5; ECB Letter I at 3.

<sup>972</sup> ECB Letter I at 3. See also ECB Letter II at 2.

<sup>973</sup> See CEB Letter at 4. However, the CEB did not state a view as to whether FPSFI trades should be subject to post-trade transparency.

<sup>974</sup> See World Bank Letter II at 7.

<sup>975</sup> The Commission notes that all FPSFIs, even FPSFIs that are based in the United States, would be deemed non-U.S. persons under the Commission's Title VII rules. See proposed Rule 3a71–3(a)(7)(ii) ("The term 'U.S. person' does not include 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, affiliates, and pension plans, and any other similar international organizations, their agencies, affiliates, and pension plans"). See also Section III.B.5, *supra* (discussing proposed definition of "U.S. person"). As with any other security-based swap transaction having a direct counterparty that is a non-U.S. person, a transaction involving an FPSFI as a direct counterparty would be subject to Regulation SBSR's regulatory reporting requirements only if it met one of the conditions in re-proposed Rule 908(a)(1), and would be subject to Regulation SBSR's public dissemination requirements only if it met one of the conditions in re-proposed Rule 908(a)(2).

<sup>962</sup> See DTCC Letter II at 21.

<sup>963</sup> See *id.*

<sup>964</sup> ISDA/SIFMA Letter I at 20.

<sup>965</sup> See Cleary Letter II at 17–18.

to regulatory reporting. Under re-proposed Regulation SBSR, an FPSFI trade also would be required to be reported if the counterparty were a non-U.S. person security-based swap dealer or major security-based swap participant. In either case, without a regulatory report of such security-based swaps, the Commission would have an incomplete view of the risk positions held by security-based swap market participants that are U.S. persons or registered with the Commission. Regulatory reporting of such security-based swaps, despite the fact that an FPSFI is a counterparty, would facilitate the Commission's ability to carry out our regulatory oversight responsibilities with respect to registered entities and the security-based swap market. The Commission notes that this approach was endorsed by two commenters.<sup>976</sup>

Furthermore, the Commission believes that, at this time, a sufficient basis does not exist to support an exemption from public dissemination for FPSFI trades. The Commission preliminarily understands that FPSFI participation in the *security-based* swap market—rather than the swap market generally—may be limited. Comments submitted by FPSFIs generally were addressed to both the Commission and the CFTC and addressed participation in the swap market generally; it is unclear the extent to which these comments should be read to apply to the security-based swap market.<sup>977</sup> Furthermore, to the extent that FPSFI trades are subject to public dissemination under Regulation SBSR (*e.g.*, because the direct counterparty is a U.S. person other than a foreign branch of a U.S. bank), such trades could provide useful price discovery information to other market participants.

The Commission is seeking more information with respect to the basis for the claim that public dissemination of FPSFI trades, as contemplated by re-proposed Regulation SBSR, would “hinder the policy objectives”<sup>978</sup> of FPSFIs. The Commission notes that proposed Regulation SBSR contains provisions relating to public dissemination that are designed to protect the identity of security-based swap counterparties<sup>979</sup> and prohibit a registered SDR (with respect to

uncleared security-based swaps) from disclosing the business transactions and market positions of any person.<sup>980</sup> Furthermore, to the extent that an FPSFI trade is small enough not to constitute a block trade, the Commission questions the extent to which market observers would be able to distinguish the trade as having been conducted by an FPSFI. Given these provisions of Regulation SBSR, which are designed to prevent adverse market impacts due to disclosure of a counterparty's identity or the public dissemination of a block trade, the Commission preliminarily does not see a basis to exempt FPSFI trades from public dissemination. However, the Commission is open to receiving further information that might support an exemption.

#### Request for Comment

As noted above, certain FPSFI commenters stated that carrying out their policy mandates would require confidentiality in certain circumstances.<sup>981</sup> The Commission seeks additional information to assist our analysis of this issue, and requests answers to the following questions. In responding, please focus on the *security-based* swap market, not the market for other swaps. In addition, commenters are requested to answer only with respect to security-based swap activity that would be subject to Regulation SBSR, and not with respect to activity that, because of the place where the transaction is conducted or the nationality of the counterparties, would not be subject to Regulation SBSR in any case:

- How many FPSFIs engage in security-based swap activity with U.S. persons? How active are they in the security-based swap market generally?
- What policy goals might an FPSFI be attempting to carry out by participating in the security-based swap market?
- What trading strategies might an FPSFI conduct in the security-based swap market?
- Are there any characteristics of FPSFI activity in the security-based swap market that could make it easier for market observers to detect an FPSFI as a counterparty, or that could make it easier to detect an FPSFI's business transactions or market positions? If so, are there steps the Commission could take to minimize such information leakage short of suppressing all FPSFI trades from public dissemination? If so, what are they?

- Do FPSFIs typically trade standardized or more bespoke security-based swap instruments? If the former, would market observers be less likely to detect the participation of an FPSFI in the security-based swap market?

- What sizes do FPSFIs typically transact in? Does the size impact any concerns with publicly disseminating FPSFI trades? If so, how? Could the concerns of FPSFIs be addressed by crafting appropriate block thresholds and dissemination delays rather than by suppressing all FPSFI trades from public dissemination? Why or why not?

- Do you believe that FPSFI trades *should* be included in public dissemination? Why or why not? To what extent, and how, would price transparency and market efficiency be affected if FPSFI trades were suppressed from public dissemination?

#### *I. Summary and Additional Request for Comment*

The provisions of re-proposed Regulation SBSR discussed above represent the Commission's preliminary views regarding the application of Title VII's provisions relating to regulatory reporting and public dissemination of security-based swap transactions in the cross-border context. This re-proposal reflects a particular balancing of the principles and applicable requirements described above,<sup>982</sup> informed by, among other things, the particular nature of the security-based swap market, the structure of security-based swap dealing activity, and the Commission's experience in applying the federal securities laws in the cross-border context. The Commission recognizes that other approaches are possible and might more effectively achieve the goals of the Dodd-Frank Act, in whole or in part. Accordingly, the Commission invites comment regarding all aspects of re-proposed Regulation SBSR, and each re-proposed rule contained therein, including potential alternative approaches. Data and comment from market participants and other interested parties regarding the likely effect of each re-proposed rule and potential alternative approaches will be particularly useful to the Commission in evaluating possible modifications to the proposals.

The Commission requests comment on any other cross-border issues relating to regulatory reporting and public dissemination of security-based swaps that may not have been addressed above. In particular, the Commission requests comment on how the Commission's re-proposal addressing

<sup>976</sup> See CEB Letter at 4; World Bank Letter II at 7 (stating that, although swaps involving FPSFIs as counterparties generally should be exempt from the definition of “swap,” they should be treated as swaps solely for reporting purposes).

<sup>977</sup> But see BIS Letter at 3 (stating that the BIS generally does not transact security-based swaps such as credit default swaps or equity derivatives).

<sup>978</sup> ECB Letter I at 3.

<sup>979</sup> See Rule 902(c)(1), as initially proposed.

<sup>980</sup> See Rule 902(c)(2), as initially proposed.

<sup>981</sup> See BIS Letter at 5; ECB Letter at 3.

<sup>982</sup> See Section II, *supra*.

cross-border issues related to regulatory reporting and public dissemination might differ from the CFTC's cross-border guidance on these matters.<sup>983</sup> For example, the CFTC Cross-Border Proposal provides that a swap between two unregistered non-U.S. persons, each of which is guaranteed by a U.S. person, would not be subject to regulatory reporting or public dissemination requirements.<sup>984</sup> The Commission, on the other hand, is proposing that a security-based swap between two such direct counterparties *would* be subject to both regulatory reporting and public dissemination requirements.<sup>985</sup>

Furthermore, the CFTC Cross-Border Proposal provides that a swap between, on one side, an unregistered non-U.S. person that is guaranteed by a U.S. person and, on the other side, an unregistered non-U.S. person that is not guaranteed by a U.S. person also would not be subject to regulatory reporting or public dissemination requirements.<sup>986</sup>

The Commission is proposing that a security-based swap between two such direct counterparties would be subject to regulatory reporting<sup>987</sup> (but, in accord with the CFTC's proposal, not subject to public dissemination). Please describe any other differences that you believe might exist and what would be the impact of any such differences.

In addition, the Commission requests comment on the market impact of the approach to re-proposed Regulation SBSR. For example, how would the application of re-proposed Regulation SBSR affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would re-proposed Regulation SBSR place any market participants at a competitive disadvantage or advantage? If so, please explain. Would re-proposed Regulation SBSR be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement re-proposed Regulation SBSR?

## IX. Mandatory Security-Based Swap Clearing Requirement

### A. Introduction

Section 3C(a)(1) of the Exchange Act provides that it "shall be unlawful for any person to engage in a security-based swap unless that person submits such

security-based swap for clearing to a clearing agency that is registered under [the Exchange] Act or a clearing agency that is exempt from registration under [the Exchange] Act if the security-based swap is required to be cleared."<sup>988</sup> In this section, we are proposing a rule to specify when persons engaging in cross-border security-based swap transactions would be required to comply with a mandatory clearing determination.<sup>989</sup> Consistent with the approach we have taken elsewhere in this release,<sup>990</sup> the proposed rule is designed in general to help ensure that the mandatory clearing requirement applies to persons that engage in security-based swap transactions within the United States and who may pose financial or operational risk to the U.S. financial system that may be mitigated by requiring transactions to be centrally cleared.<sup>991</sup> The proposed rule also is

<sup>988</sup> 15 U.S.C. 78c-3(a)(1). Section 3C of the Exchange Act further requires the Commission to review each security-based swap (or any group, category, type, or class of security-based swaps) to make a determination that such security-based swap (or group, category, type, or class of security-based swap) should be required to be cleared. 15 U.S.C. 78c-3(b). The Commission has adopted final rules regarding process for submissions for review of security-based swaps for mandatory clearing and notice filing requirements for clearing agencies. See Clearing Procedures Adopting Release, 77 FR 41602. The proposed application of the mandatory clearing requirement in the cross-border context does not address, in any respect, our obligation to review security-based swaps and make mandatory clearing determinations under Section 3C(b) of the Exchange Act.

<sup>989</sup> The mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act will not apply unless and until the Commission makes a determination that a security-based swap is required to be cleared, and the Commission has not yet made any such determinations. In addition, the registration requirement for security-based swap clearing agencies in Section 17A(g) of the Exchange Act is not yet effective because further rulemaking is required regarding registration of and standards for security-based swap clearing agencies. See 15 U.S.C. 78q-1(i) and (j). The Commission recently adopted rules to establish minimum requirements for registered clearing agency risk management practices and operations. The rules identify certain minimum standards for all clearing agencies, including clearing agencies that clear security-based swaps. See Clearing Agency Standards Adopting Release, 77 FR 66220. The Commission continues to consider additional standards for adoption, including standards for confidentiality of trading information, conflicts of interest, and members of clearing agency boards of directors or committees, as outlined in the proposing release for clearing agency standards. See Exchange Act Release No. 64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011). Any new rules governing security-based swap clearing agencies could also affect counterparties that are required to clear security-based swaps.

<sup>990</sup> See, e.g., Section V, *supra* (discussing the registration requirement in Section 17A(g) of the Exchange Act for security-based swap clearing agencies); see also the general discussion of the Commission's approach to applying Title VII to cross-border activities in Section II.B, *supra*.

<sup>991</sup> See Testimony Regarding Reducing Risks and Improving Oversight in the OTC Credit Derivatives

designed to help avoid limiting the access of U.S. persons that conduct security-based swap activity through foreign branches or guaranteed non-U.S. persons to foreign security-based swap markets. To address concerns regarding the clearance and settlement of security-based swaps subject to the mandatory clearing requirement, as well as the potential for conflicting mandatory clearing requirements in different jurisdictions, we discuss under what circumstances the Commission would permit substituted compliance with the mandatory clearing requirement in Section XI.E below.<sup>992</sup>

Our proposed approach reflects a particular balancing of the principles discussed above.<sup>993</sup> We recognize that other approaches may achieve the goals of the Dodd-Frank Act and Section 17A of the Exchange Act, in whole or in part. Accordingly, we invite comment regarding all aspects of the proposed rule described here, including potential alternative approaches. Data and comment from market participants and other interested parties regarding the likely effect of the proposed rule and of potential alternative approaches will be particularly useful to the Commission in

Market Before the Subcomm. on Secs., Ins., & Inv., of the S. Comm. on Banking, Hous., & Urban Affairs, 110th Cong. (2008) (statement of James A. Overdahl, Chief Economist, Commission), available at: <http://www.sec.gov/news/testimony/2008/ts070908jao.htm> ("The 1975 Amendments [to the Exchange Act] were in direct response to the Paperwork Crisis of the late 1960's that nearly brought the securities industry to a standstill and directly or indirectly resulted in the failure of large numbers of broker-dealers. The causes of the Paperwork Crisis are similar to the issues that we have been trying to resolve in the OTC derivatives market. The crisis resulted from a combination of sharply increased volume and inattention to securities processing. As a result, the industry's clearance and settlement procedures were inefficient and lacked automation, thus implicating the finances of the securities firms. Today, almost forty years later, increasing automation in the processing of OTC derivatives transactions is one of the key goals of the OTC confirmations initiative, in which the Commission is a very active participant . . ."); see also CPSS, New Developments in Clearing and Settlement Arrangements for OTC Derivatives, at 9, 39 (Mar. 2007), available at: <http://www.bis.org/publ/cpss77.pdf> (noting "increasing concern about the size and rapid growth of confirmation backlogs for credit derivatives" and the growing importance of "operational reliability" to "safe and efficient clearing and settlement" as the "market infrastructure moves further in the direction of centralised processing of trades and post-trade events").

<sup>992</sup> Under the Commission's proposal, substituted compliance may be permitted for cross-border security-based swap transactions subject to the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act to enable counterparties to clear and settle such transactions at a clearing agency that is neither registered with the Commission nor exempt from registration, under certain conditions. See Section XI.E, *infra*.

<sup>993</sup> See Section II.C, *supra*.

<sup>983</sup> See note 21, *supra*.

<sup>984</sup> See CFTC Cross-Border Proposal, 77 FR 41237-38.

<sup>985</sup> See re-proposed Rules 908(a)(1)(ii) and 908(a)(2)(ii) of Regulation SBSR.

<sup>986</sup> See CFTC Cross-Border Proposal, 77 FR 41237-38.

<sup>987</sup> See re-proposed Rule 908(a)(1)(ii) of Regulation SBSR.

evaluating potential modifications to the proposal.

### B. Summary of Comments

The Commission has published several rulemaking proposals under Title VII of the Dodd-Frank Act that relate to clearing security-based swaps.<sup>994</sup> The Commission solicited public comment on each of these proposals. The Commission also solicited public comment on regulatory initiatives under the Dodd-Frank Act related to clearing security-based swaps.<sup>995</sup> Generally, these commenters requested that the Commission take actions to limit duplicative or conflicting regulations with respect to clearing security-based swaps.<sup>996</sup>

<sup>994</sup> See Exchange Act Release Nos. 63556 (Dec. 15, 2010), 75 FR 79992 (Dec. 21, 2010) (proposing a rule governing the end-user exception to the mandatory clearing requirement); 63107 (Oct. 14, 2010), 75 FR 65881 (Oct. 26, 2010) (proposing Regulation MC which would in part set ownership limitations and governance requirements for clearing agencies); see also notes 988 and 989, *supra* (discussing final rules adopted in the Clearing Procedures Adopting Release and rules proposed and adopted relating to clearing agency standards).

<sup>995</sup> See Exchange Act Release Nos. 63435 (Dec. 6, 2010), 75 FR 76705 (Dec. 9, 2010) (joint roundtable with CFTC regarding capital and margin requirements); 63112 (Oct. 15, 2010), 75 FR 64710 (Oct. 20, 2010) (joint roundtable with CFTC regarding issues related to clearing); 62864 (Sept. 8, 2010), 75 FR 55574 (Sept. 13, 2010) (joint roundtable with CFTC regarding swap execution facilities); 62725 (Aug. 16, 2010), 75 FR 51305 (Aug. 19, 2010) (joint roundtable with CFTC regarding governance and conflicts of interest).

<sup>996</sup> See, e.g., Davis Polk Letter I at 8 (“First, requiring foreign swap transactions to be cleared through a U.S.-regulated clearinghouse may conflict with any applicable foreign law that requires such transactions to be cleared at a home country (non-U.S.) clearinghouse. Second, such an approach would also legally compel a disproportionate amount of global swaps clearing to be conducted through U.S.-regulated clearinghouses. Third, such a requirement would also concentrate risk that is non-U.S. (because the transactions are with non-U.S. persons) in the U.S.-regulated clearinghouses, which would cause them and the U.S. financial system to bear additional non-U.S. risks.”); Davis Polk Letter II at 21–22 (proposing rule modifications that “would avoid imposing unnecessarily duplicative and inconsistent clearing and trade reporting obligations on swap dealers and their counterparties”); Cleary Letter IV at 27 (noting swaps between non-U.S. persons “are, in many cases, likely to be subject to local clearing requirements (which may (practically or legally) require use of a local clearing organization and so, in some cases, could conflict with Dodd-Frank’s clearing requirement”)); Japanese Banks Letter at 4 (“We believe that future Japanese regulation of swap activities of Japanese banks will render regulation of such banks subject to Title VII superfluous at best and potentially subject such banks to inconsistent regulations under U.S. and Japanese law.”); Multiple Associations Letter I at 9–10 (“We believe that [the Commission] and other U.S. regulatory agencies should anticipate where the rulemaking may overlap, and possibly conflict, and make every effort to actively coordinate with each other and with foreign regulators both as to harmonizing the substance of related regulations

Two commenters highlighted the global nature of the security-based swap market and raised concerns about the possible effect of foreign regulations on U.S. participants in the security-based swap market.<sup>997</sup> These commenters requested that U.S. and foreign regulators identify possible areas where rulemaking may overlap or conflict and actively coordinate to harmonize both the substance of related regulations and the timing of their implementation.<sup>998</sup> The commenters argued that, without such coordination, “the development of the swap markets will be vulnerable to false starts, significant revisions and inefficiencies, and possible regulatory arbitrage across, or the flight to, other jurisdictions.”<sup>999</sup>

Commenters representing several foreign banks requested that the Commission adopt implementing regulations under the Dodd-Frank Act “that enable and encourage foreign banks engaged in swap dealing activities to book their swaps businesses in a single well-capitalized, highly rated foreign-based banking institution.”<sup>1000</sup> These commenters did not comment specifically on the proposed rules, but rather argued in favor of a regulatory framework that relies on home country supervision where regulations operate at the entity level, and that relies on Title VII of the Dodd-Frank Act with respect to “U.S. swap transactions,” where regulations operate at the transaction level.<sup>1001</sup> In particular, these entities believe that the mandatory clearing requirement should not apply to “foreign swap transactions” (*i.e.*, transactions they defined as not involving a U.S. counterparty) or, more broadly, to transactions that a counterparty thereto is required to submit for clearing pursuant to foreign law.<sup>1002</sup>

and the timing of their implementation. Otherwise, the development of the Swap markets will be vulnerable to false starts, significant revisions and inefficiencies, and possible regulatory arbitrage across, or the flight to, other jurisdictions.”); Multiple Associations Letter II at 2 (stating that it is “essential that rules be appropriately tailored, work in tandem, and avoid unduly impairing market liquidity or adversely impacting investors” and that [i]t is not enough to phase-in implementation if the final rules themselves are unworkable or in conflict”).

<sup>997</sup> See Multiple Associations Letter I at 9 (“[I]t is unclear to what extent foreign regulation, in addition to regulation by the Commissions, may affect U.S. Swap market participants.”); Multiple Associations Letter II at 1 (noting that “an iterative approach to rulemaking has been taken when rules have an unusually large impact on market structure and participants”).

<sup>998</sup> Multiple Associations Letter I at 9.

<sup>999</sup> *Id.* at 9–10.

<sup>1000</sup> See Davis Polk Letter I at 2.

<sup>1001</sup> *Id.*

<sup>1002</sup> *Id.*; Cleary Letter IV at 27.

Commenters representing foreign financial institutions submitted a second, supplemental comment letter to elaborate on the above comments.<sup>1003</sup> In this letter, these commenters requested that the Commission modify the proposed definition of “security-based swap dealer” to make clear that “a security-based swap which is required to be cleared under foreign law (including by virtue of the fact that any counterparty thereto is required under foreign law to submit the same for clearing) is not required to be cleared under the [Dodd-Frank] Act.”<sup>1004</sup>

Moreover, commenters representing Japan’s three largest bank groups requested that the Commission “adopt implementing regulations under the Dodd-Frank Act with the effect that Japanese banks, including their U.S. branches, are not made subject to the application of Title VII requirements.”<sup>1005</sup> Should the Commission not take such action, these commenters requested that the regulations issued pursuant to Title VII: (i) Not apply to transactions between affiliates of a bank group regulated as a bank holding company<sup>1006</sup> and (ii) not apply to “a foreign dealer”—particularly one that is “subject to comprehensive home country regulation”—with respect to transactions entered into by the foreign dealer with a U.S.-based dealer regulated as a swap dealer or security-based swap dealer pursuant to Title VII.<sup>1007</sup>

In addition, multiple commenters endorsed the use of mandatory clearing generally to further the goals of the Dodd-Frank Act. One commenter described mandatory clearing as “the centerpiece of reform embodied in Title VII of the Dodd-Frank Act” that, accordingly, should be subject to “only a very few, narrow, and limited exceptions.”<sup>1008</sup> Another commenter similarly urged the Commission to “prioritize the finalization and implementation of clearing-related rules.”<sup>1009</sup> Another stated that the Commission’s “top priority should be to

<sup>1003</sup> See Davis Polk Letter II.

<sup>1004</sup> *Id.* at 4–5.

<sup>1005</sup> See Japanese Banks Letter at 4.

<sup>1006</sup> *Id.*

<sup>1007</sup> *Id.* at 5.

<sup>1008</sup> Better Markets Letter at 10.

<sup>1009</sup> Citadel Letter at 2 (further noting that “anything less needlessly inhibits transparency and competition in the SB swaps markets and will leave US financial markets vulnerable, damage American competitiveness, and weaken our long-term prospects for sound economic growth”); see also MFA Letter IV at 4 (urging the Commission to prioritize clearing rules to “lay the regulatory groundwork for more informed implementation” of other final rules planned under the Dodd-Frank Act).



implement requirements that reduce systemic risk, such as the use of centralized Swap clearinghouses.”<sup>1010</sup>

### C. Application of Title VII Mandatory Clearing Requirements to Cross-Border Transactions

#### 1. Statutory Framework

By its terms, the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act applies to any person that “engage[s] in a security-based swap . . . if the security-based swap is required to be cleared.”<sup>1011</sup> We are proposing to apply the statutory language “engage in a security-based swap” to mean any transaction in which a U.S. person is a counterparty<sup>1012</sup> to a security-based swap or guarantees the performance of a non-U.S. person under a security-based swap because of the involvement of a U.S. person in the transaction.<sup>1013</sup> We also are proposing to apply the statutory language “engage in a security-based swap” to include any transaction in which a person performs any of the activities that are key stages in a security-based swap transaction (*i.e.*, solicitation, negotiation, execution, or booking of the transaction)<sup>1014</sup> within the United States. As we noted above, a “transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5), includes soliciting, negotiating, executing, or booking a security-based swap transaction.<sup>1015</sup> Accordingly, subject to certain statutory exceptions<sup>1016</sup> and certain other

exceptions described below,<sup>1017</sup> we are proposing to apply the mandatory clearing requirement to any person that engages in a security-based 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 security-based swap is guaranteed by a U.S. person, or if the transaction is a “transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5) under the Exchange Act.<sup>1018</sup>

We preliminarily believe our proposed approach to the mandatory clearing requirement, including the interpretation of the statutory language discussed above and further discussed below, is consistent with the purposes of the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act. The Dodd-Frank Act is intended to promote the financial stability of the United States by, among other things, reducing risks to the U.S. financial system by ensuring that, whenever possible and appropriate, derivatives contracts are centrally cleared rather than traded exclusively in the OTC market.<sup>1019</sup> In making our mandatory clearing determination, the Commission is required to take into account certain factors, including, among other things, “the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure” in clearing agencies to support clearing of the product in

question, and “the effect on the mitigation of systemic risk.”<sup>1020</sup> The Commission preliminarily believes that the proposed approach generally would help to ensure that the goals of the Dodd-Frank Act to increase the use of available centralized market infrastructures to reduce operational risks and mitigate systemic risk are achieved,<sup>1021</sup> while not unnecessarily limiting the access of U.S. persons that conduct security-based swap activity through foreign branches or guaranteed non-U.S. persons to foreign security-based swap markets.

#### 2. Proposed Rule

In light of the interpretation of the statutory language “engage in a security-based swap” and the policy concerns discussed above, we are proposing a rule that would apply the mandatory clearing requirement to a person that engages in a security-based swap transaction if a counterparty to the transaction is (i) a U.S. person or (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person.<sup>1022</sup> We also are proposing a rule that would apply the mandatory clearing requirement to a person that engages in a security-based swap transaction if such transaction is a “transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5) under the Exchange Act.<sup>1023</sup> To limit

<sup>1020</sup> Section 3C(b)(4)(B) of the Exchange Act, 15 U.S.C. 78c–3(b)(4)(B).

<sup>1021</sup> The purpose of central clearing is to mitigate counterparty credit risk by shifting that risk from individual counterparties to CCPs, thereby helping protect counterparties from each other’s potential failures. Central clearing also requires that mark-to-market pricing and margin requirements be applied in a consistent manner. CCPs generally use liquid margin collateral to manage the risk of a CCP member’s failure, and rely on their margin calculations and their access to that liquid collateral to protect against sudden movements in market prices, including movements in market value after a counterparty’s default. A CCP that stands between counterparties for OTC derivatives is generally perceived to decrease systemic risk. Further, the use of CCPs may lead to standardization of contracts and processes, which improve market efficiency and reduce the operational risks attributable to human and processing errors. *See, e.g.*, Wellink, *supra* note 110, at 132–33; Culp, *supra* note 111, at 15–16; Manmohan Singh, “Collateral, Netting and Systemic Risk in the OTC Derivatives Market,” IMF Working Paper (2010), at 9–13, available at: <http://www.imf.org/external/pubs/ft/wp/2010/wp1099.pdf>.

<sup>1022</sup> Proposed Rule 3Ca–3(a)(1) under the Exchange Act. Under proposed Rule 3Ca–3(c) under the Exchange Act, the term “U.S. person” would have the same meaning as set forth in proposed Rule 3a71–3(a)(7) under the Exchange Act, as discussed in Section III.B.5, *supra*.

<sup>1023</sup> Proposed Rule 3Ca–3(a)(2) under the Exchange Act. Under proposed Rule 3Ca–3(c) under the Exchange Act, the term “transaction conducted within the United States” would have the same

Continued

<sup>1010</sup> Multiple Associations Letter I at 2.

<sup>1011</sup> Section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c–3(a)(1).

<sup>1012</sup> The use of the term “counterparty” in the proposed rule is intended to refer to the direct counterparty to the security-based swap transaction, not a party that provides a guarantee on the performance of the direct counterparty under the security-based swap. As discussed in Section VIII.C, *supra*, re-proposed Rules 900(j) and (o) under the Exchange Act would define the term “direct counterparty” as “a person that enters directly with another person into a contract that constitutes a security-based swap,” and an “indirect counterparty” as “a person that guarantees the performance of a direct counterparty to a security-based swap or that otherwise provides recourse to the other side for the failure of the direct counterparty to perform any obligation under the security-based swap.”

<sup>1013</sup> *See* Section II.B.2(d), *supra* (discussing the Commission’s treatment of guarantees).

<sup>1014</sup> As noted above, solicitation, negotiation, execution, and booking are activities that represent key stages in a potential or completed security-based swap transaction. *See* note 310 and accompanying text, *supra*. Persons that conduct any of these activities would be considered to be “engaged in a security-based swap” under the Commission’s proposed interpretation.

<sup>1015</sup> *See* Section III.B.6, *supra*.

<sup>1016</sup> The Exchange Act provides an exception from the mandatory clearing requirement in connection with security-based swaps that involve persons that are not financial entities and that use the security-based swaps to hedge or mitigate

commercial risk. *See* Section 3C(g) of the Exchange Act, 15 U.S.C. 78c–3(g). The Exchange Act also provides exemptions from the clearing requirement for security-based swaps entered into prior to the enactment of the Dodd-Frank Act, and for security-based swaps entered into prior to the application of the clearing requirement, so long as those instruments are reported to a registered SDR. *See* Sections 3C(e)(1) and (f)(1) of the Exchange Act, 15 U.S.C. 78c–3(e)(1) and (f)(1) (pre-enactment security-based swaps); Sections 3C(e)(2) and (f)(2) of the Exchange Act, 15 U.S.C. 78c–3(e)(2) and (f)(2) (post-enactment security-based swaps entered into prior to the application of the clearing requirement).

<sup>1017</sup> *See* Sections IX.C.3(a)ii and IX.C.3(b)ii, *infra*.

<sup>1018</sup> Proposed Rule 3Ca–3(a) under the Exchange Act.

<sup>1019</sup> *See, e.g.*, S. Comm. on Banking, Hous., & Urban Affairs, The Restoring American Financial Stability Act of 2010, S. Rep. No. 111–176, at 32 (“As a key element of reducing systemic risk and protecting taxpayers in the future, protections must include comprehensive regulation and rules for how the OTC derivatives market operates. Increasing the use of central clearinghouses, exchanges, appropriate margining, capital requirements, and reporting will provide safeguards for American taxpayers and the financial system as a whole.”); *id.* at 34 (“Some parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, uncleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible.”).

the scope of the proposal, we are proposing exceptions to the mandatory clearing requirement in the following two scenarios:

- If the security-based swap transaction is not a “transaction conducted within the United States,” the proposed rule would not apply the mandatory clearing requirement if one counterparty to the transaction is (i) a foreign branch of a U.S. bank<sup>1024</sup> or (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person,<sup>1025</sup> and if the other counterparty to the transaction is a non-U.S. person (i) whose performance under the security-based swap is not guaranteed by a U.S. person and (ii) who is not a foreign security-based swap dealer.<sup>1026</sup>
- If the security-based swap transaction is a “transaction conducted within the United States,” the proposed rule would not apply the mandatory clearing requirement if (i) neither counterparty to the transaction is a U.S. person; (ii) neither counterparty’s performance under the security-based swap is guaranteed by a U.S. person; and (iii) neither counterparty to the transaction is a foreign security-based swap dealer.<sup>1027</sup>

We discuss below the proposed rule regarding the application of the mandatory clearing requirement in more detail.

meaning as set forth in proposed Rule 3a71–3(a)(5) under the Exchange Act, as discussed in Section III.B.5, *supra*.

<sup>1024</sup> Under proposed Rule 3Ca–3(c) under the Exchange Act, the term “foreign branch” would have the same meaning as set forth in proposed Rule 3a71–3(a)(1) under the Exchange Act. See discussion in Section III.B.7, *supra*. A security-based swap transaction conducted through a foreign branch, as defined in proposed Rule 3a71–3(a)(4) under the Exchange Act, would be specifically excluded from the proposed definition of “transaction conducted within the United States.” See proposed Rule 3a71–3(a)(5)(ii) under the Exchange Act.

<sup>1025</sup> A security-based swap transaction involving a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person would not be a “transaction conducted within the United States” by virtue of the guarantee alone under proposed Rule 3a71–3(a)(5) under the Exchange Act, unless the transaction is solicited, negotiated, executed, or booked within the United States. We would consider such transaction to be engaged in within the United States, however, by virtue of the guarantee from the U.S. person, who acts as an “indirect counterparty” to the transaction. See note 1012, *supra*.

<sup>1026</sup> Proposed Rule 3Ca–3(b)(1) under the Exchange Act. Proposed Rule 3Ca–3(c) defines the term “foreign security-based swap dealer” by cross-reference to the definition of that term in proposed Rule 3a71–3(a)(3) of the Exchange Act (defining “foreign security-based swap dealer” to mean “a security-based swap dealer, as defined in section 3(a)(71) of the [Exchange] Act (15 U.S.C. 78c(a)(71)), and the rules and regulations thereunder, that is not a U.S. person”).

<sup>1027</sup> Proposed Rule 3Ca–3(b)(2) under the Exchange Act.

### 3. Discussion

(a) Security-Based Swap Transactions Involving U.S. Persons or Non-U.S. Persons Receiving Guarantees From U.S. Persons

#### i. Proposed Rule

The proposed rule would apply the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act, and the rules and regulations thereunder, to a person that engages in a security-based swap transaction if a counterparty to the transaction is (i) a U.S. person or (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person,<sup>1028</sup> subject to certain exceptions.<sup>1029</sup>

As discussed above,<sup>1030</sup> a U.S. person that is a counterparty to a security-based swap transaction bears the ongoing risk of the transaction. It is the financial resources of that U.S. person that will be called upon in performing any obligations pursuant to that transaction, and this activity is capable of posing risks to the stability of the U.S. financial system. Because these obligations and risks reside in the United States, the Commission preliminarily believes that when a U.S. person is a counterparty to a security-based swap transaction, such person necessarily engages in a security-based swap within the United States and, therefore, would be subject to the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act and the rules and regulations thereunder.

In the case of a non-U.S. person guaranteed by a U.S. person (“U.S. guarantor”), the guarantee provides the counterparty of the guaranteed entity direct recourse to the U.S. guarantor with respect to any obligations owed by the guaranteed entity under the security-based swap, and the U.S. guarantor exposes itself to the security-based swap risk as if it were a direct counterparty<sup>1031</sup> to the security-based swap through the security-based swap activity engaged in by the guaranteed entity. In many cases, the counterparty would not enter into the transaction (or would not do so on the same terms) with the guaranteed entity, and the guaranteed entity would not be able to engage in any security-based swaps, without the guarantee. Given the reliance by both the guaranteed entity and its counterparty on the

<sup>1028</sup> Proposed Rules 3Ca–3(a)(1)(i) and (ii) under the Exchange Act.

<sup>1029</sup> Proposed Rule 3Ca–3(b) under the Exchange Act.

<sup>1030</sup> See Section II.A.6, *supra*.

<sup>1031</sup> See note 1012, *supra*.

creditworthiness of the guarantor in the course of engaging in security-based swap transactions and for the duration of the transaction, we preliminarily believe that a security-based swap transaction in which one of the counterparties is a non-U.S. person whose performance under a security-based swap is guaranteed by a U.S. person is a transaction that is engaged in within the United States by virtue of the involvement of the U.S. guarantor in the security-based swap.<sup>1032</sup> Our proposed rule, therefore, would subject transactions involving at least one counterparty whose performance under the security-based swap is guaranteed by a U.S. person to the mandatory clearing requirement,<sup>1033</sup> subject to certain exceptions discussed below.<sup>1034</sup>

We recognize that this proposed approach would subject certain security-based swap transactions with non-U.S. persons to the mandatory clearing requirement if a U.S. person is a counterparty to the transaction (*e.g.*, U.S. dealer to foreign dealer transactions). We preliminarily believe that such an approach is appropriate, as a significant proportion of the risk borne by U.S. persons, and, therefore, the risk to the U.S. financial system as a result of the U.S. persons’ security-based swap activity, arises from transactions entered into with non-U.S. persons.<sup>1035</sup> Even where a U.S. person’s security-based swap activity occurs in part outside the United States (*e.g.*, the transaction is negotiated or executed outside the United States), this activity may pose risk to the U.S. financial system because security-based swap transactions give rise to ongoing obligations on the part of the U.S. person and credit risk exposures to its non-U.S. counterparties. Therefore, subjecting a transaction in which a U.S. person is a counterparty to the transaction to the mandatory clearing requirement would further the purposes of Title VII by ensuring that security-based swaps involving persons whose security-based swap activities create risk that Title VII is intended to address would be centrally cleared through a CCP.<sup>1036</sup>

<sup>1032</sup> See note 1025, *supra*.

<sup>1033</sup> Proposed Rule 3Ca–3(a)(1)(ii) under the Exchange Act.

<sup>1034</sup> Proposed Rule 3Ca–3(b) under the Exchange Act.

<sup>1035</sup> See Section II.A.6, *supra*.

<sup>1036</sup> We preliminarily believe that the proposed approach to the mandatory clearing requirement is not being applied to persons who are “transact[ing] a business in security-based swaps without the jurisdiction of the United States,” within the meaning of Section 30(c). See Section II.B.2(b), *supra*. However, the Commission also preliminarily believes that the proposed approach to the mandatory clearing requirement is necessary or

ii. Proposed Exception for Certain Transactions Involving Foreign Branches of U.S. Banks and Guaranteed Non-U.S. Persons

The Commission is proposing an exception from the mandatory clearing requirement described above for certain transactions that involve foreign branches of a U.S. bank or guaranteed non-U.S. persons, provided the transactions are not conducted within the United States. Specifically, under the proposed rule, the mandatory clearing requirement would not apply to a security-based swap transaction if one counterparty to the transaction is a foreign branch of a U.S. bank<sup>1037</sup> or a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person and if the other counterparty to the transaction is a non-U.S. person (i) whose performance under the security-based swap is not guaranteed by a U.S. person and (ii) who is not a foreign security-based swap dealer.<sup>1038</sup> Such exception would not apply if the security-based swap transaction were a transaction conducted within the United States, as defined in proposed Rule 3a71-3(a)(5) under the Exchange Act.<sup>1039</sup>

Without such an exception, U.S. persons conducting security-based swap activity out of foreign branches or guaranteed non-U.S. persons may have less access to foreign security-based swap markets because non-U.S. person counterparties may be less willing to enter into security-based swap transactions with them if such transactions are subject to a mandatory clearing requirement. We recognize that imposing the mandatory clearing requirement on a foreign branch of a U.S. bank or on a non-U.S. person whose performance under a security-

based swap is guaranteed by a U.S. person would be consistent with the view that a foreign branch of a U.S. bank is part of a U.S. person<sup>1040</sup> and that a U.S. guarantor is an indirect counterparty<sup>1041</sup> to the transaction entered into by the guaranteed non-U.S. person. We also recognize that such transactions pose risk to the U.S. financial system. At the same time, however, imposing the mandatory clearing requirement on U.S. persons that conduct their foreign security-based swap dealing activity through foreign branches or guaranteed non-U.S. persons, without any exceptions, could put such U.S. persons at a significant competitive disadvantage to non-U.S. persons who conduct security-based swap business in the same foreign local market and thereby limit the access of such U.S. persons to foreign security-based swap markets.<sup>1042</sup> After balancing the various policy considerations, including the Dodd-Frank Act's goal of mitigating risk to the U.S. financial system, we have preliminarily concluded that the proposed exception from the mandatory clearing requirement for transactions by U.S. persons conducting security-based swap activity out of foreign branches or guaranteed non-U.S. persons with non-U.S. persons whose performance under the security-based swap is not guaranteed by a U.S. person is appropriate, provided that it is not a transaction conducted within the United States.<sup>1043</sup>

This exception from the mandatory clearing requirement would not apply under the proposed rule, however, when the non-U.S. person counterparty of the foreign branch of the U.S. bank or the guaranteed non-U.S. person is a foreign security-based swap dealer.<sup>1044</sup>

As discussed above, a non-U.S. person would be required to register as a foreign security-based swap dealer if its transactions with U.S. persons or otherwise conducted within the United States, connected with its dealing capacity, exceed the *de minimis* threshold in the security-based swap dealer definition.<sup>1045</sup> Thus, a foreign security-based swap dealer would necessarily have a significant connection with the U.S. security-based swap market. As a result, the Commission preliminarily believes that it is not appropriate to provide an exception for U.S. persons conducting security-based swap activity out of foreign branches or guaranteed non-U.S. persons when they enter into security-based swaps with foreign security-based swap dealers.

We are not proposing to provide an exception from mandatory clearing for U.S. persons generally, however, although we recognize that such exception could increase access to foreign security-based swap markets for all U.S. persons. The Commission preliminarily believes that such a broad exception to the mandatory clearing requirement, in a market as global as the security-based swap market,<sup>1046</sup> would undermine the goal of the mandatory clearing requirement to reduce financial risk to the U.S. financial system. In light of the statutory goal, we preliminarily do not believe that the benefit of providing U.S. persons greater access to foreign security-based swap markets warrants expanding the exception beyond the scope we are proposing here. In this regard, we also note that a uniform mandatory clearing requirement for all U.S. persons other than foreign branches and guaranteed non-U.S. persons should facilitate the development of central clearing infrastructures and encourage the standardization of contract terms.<sup>1047</sup>

or guaranteed non-U.S. persons, a foreign security-based swap dealer would not be subject to the mandatory clearing requirement when it engages in a security-based swap transaction with a non-U.S. person, provided neither party's performance under the security-based swap is guaranteed by a U.S. person and the transaction is not conducted within the United States. Such a transaction would not be captured by proposed Rule 3Ca-3(a) under the Exchange Act (and, therefore, it is not necessary for such transaction to be included as an exception in paragraph (b) of Rule 3Ca-3).

<sup>1045</sup> See Section III.B.4, *supra*.

<sup>1046</sup> See Section II.A.1, *supra* (discussing the global nature of the security-based swap market).

<sup>1047</sup> See, e.g., note 991, *supra*. A robust infrastructure for clearing of security-based swaps should reduce operational risks resulting from backlogs and processing errors. See FMI Principles at 20, 94 (describing operational risk as the "risk that deficiencies in information systems or internal processes, human errors, management failures, or

appropriate to help prevent the evasion of the particular provisions of the Exchange Act that were added by the Dodd-Frank Act that are being implemented by the approach and prophylactically will help ensure that the purposes of those provisions of the Dodd-Frank Act are not undermined. See Section II.B.2(e), *supra*; see also Section II.B.2(d), *supra*.

For example, if the mandatory clearing requirement does not apply to transactions among non-U.S. persons that receive guarantees from U.S. persons and foreign branches of U.S. banks, then U.S. persons would have an incentive to conduct transactions with other U.S. persons through guaranteed foreign affiliates or foreign branches to avoid the mandatory clearing requirement, even though altering the form of the transactions would not alter the substance of the risk to U.S. markets that the Dodd-Frank Act was enacted to address and thus could undermine the purposes of the Dodd-Frank Act. See Section II.A.6, *supra*.

<sup>1037</sup> See note 1024, *supra*.

<sup>1038</sup> Proposed Rule 3Ca-3(b)(1) under the Exchange Act. See note 1026, *supra*.

<sup>1039</sup> Proposed Rule 3Ca-3(b)(1) under the Exchange Act.

<sup>1040</sup> See Section III.B.5, *supra*.

<sup>1041</sup> See note 1012, *supra*.

<sup>1042</sup> See, e.g., Sullivan & Cromwell Letter at 14 ("The jurisdictional scope of the swaps entity definitions is critical to the ability of U.S. banking organizations to maintain their competitive position in foreign marketplaces. Imposing the regulatory regime of Title VII on their Non-U.S. Operations would place them at a disadvantage to their foreign bank competitors because the Non-U.S. Operations would be subject to an additional regulatory regime which their foreign competitors would not."); Cleary Letter IV at 7 ("Subjecting such non-U.S. branches and affiliates to U.S. requirements could effectively preclude them from, or significantly increase the cost of, managing their risk in the local financial markets, since local financial institutions may be required to comply with Dodd-Frank to provide those services.").

<sup>1043</sup> In this regard, we note that such transaction may be subject to a mandatory clearing requirement in a foreign jurisdiction. See Section XI.E, *infra* (discussing substituted compliance).

<sup>1044</sup> Proposed Rule 3Ca-3(b)(1)(ii)(B) under the Exchange Act. Like U.S. persons conducting security-based swap activity out of foreign branches

(b) Transactions Conducted Within the United States

i. Proposed Rule

Under the proposed rule, a security-based swap transaction that is a “transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5) under the Exchange Act, would be subject to the mandatory clearing requirement.<sup>1048</sup> The Commission preliminarily believes that engaging in a security-based swap includes the performance by a person of any of the activities that represent key stages in a security-based swap transaction, including solicitation, negotiation, execution, or booking of a security-based swap transaction. As we have noted above, a “transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5), includes soliciting, negotiating, executing, or booking a security-based swap transaction.<sup>1049</sup> Accordingly, we preliminarily would interpret engaging in a security-based swap within the United States to encompass the same types of activities that characterize a transaction conducted within the United States, as that term is defined in proposed Rule 3a71–3(a)(5).<sup>1050</sup>

ii. Proposed Exception for Transactions Conducted Within the United States by Certain Non-U.S. Persons

The Commission recognizes that transactions between two non-U.S. persons whose performances under a security-based swap are not guaranteed by a U.S. person do not pose the same risk to the U.S. financial system that is posed by transactions with U.S. person counterparties or transactions in which a U.S. person provides a guarantee. In particular, while the operational risks associated with the transaction may reside in the United States and would potentially be reduced by required use of the central market infrastructure available to clear the products in question, we preliminarily believe that because the financial risks of the transaction would reside with non-U.S. persons outside the United States, it is not necessary to apply the mandatory clearing requirement to a transaction between two non-U.S. persons solely because the transaction is a “transaction conducted within the United States” as

disruptions from external events will result in the reduction, deterioration, or breakdown of services” and noting that operational risks “can be a source of systemic risk.”).

<sup>1048</sup> Proposed Rule 3Ca–3(a)(2) under the Exchange Act.

<sup>1049</sup> See Section III.B.6, *supra*.

<sup>1050</sup> Proposed Rule 3Ca–3(a)(2) under the Exchange Act.

defined in proposed Rule 3a71–3(a)(5) under the Exchange Act. Accordingly, the Commission is proposing an exception from the mandatory clearing requirement for security-based swap transactions that are “transactions conducted within the United States” when no counterparty to the transaction is (i) a U.S. person; (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person; or (iii) a foreign security-based swap dealer.<sup>1051</sup>

The Commission preliminarily believes it is appropriate to limit the exception from the mandatory clearing requirement when one or both of the non-U.S. person counterparties is a foreign security-based swap dealer. Non-U.S. persons whose transactions arising from dealing activity with U.S. persons or otherwise conducted within the United States exceed the *de minimis* threshold in the security-based swap dealer definition have a sufficient connection to the U.S. security-based swap market to lead the Commission to preliminarily conclude that it would not be appropriate to except transactions involving them from the mandatory clearing requirement when they conduct security-based swap transactions within the United States. Permitting non-U.S. persons to engage in security-based swap transactions within the United States with foreign security-based swap dealers without being subject to the mandatory clearing requirement would potentially limit the access of U.S. persons to foreign security-based swap markets because non-U.S. persons seeking to engage in security-based swaps within the United States may prefer to engage in security-based swaps with foreign security-based swap dealers rather than U.S. persons to avoid the mandatory clearing requirement.

Request for Comment

The Commission seeks comment on the proposed rule in all aspects. In addition, the Commission seeks comment on the following specific questions:

- Should the mandatory clearing requirement apply to all transactions conducted by a U.S. person, including transactions conducted out of a foreign branch, or by a guaranteed non-U.S. person? Why or why not? Should the mandatory clearing requirement apply to such transactions unless, for example, they are conducted in a foreign regime that has a mandatory clearing regime that is comparable to the mandatory clearing regime under the Dodd-Frank Act? In assessing comparability under

<sup>1051</sup> *Id.*

this approach, to what extent should results of mandatory clearing determinations under the foreign regime be taken into account? Should the determinations with respect to “local” products be viewed differently than products that are subject to mandatory clearing determinations in one or more other jurisdictions, *i.e.*, “global” products? Would some other standard for assessing a foreign regime in these circumstances be appropriate?

- Is the proposed approach over-broad or over-narrow? If so, why? Should a security-based swap that is required to be cleared under foreign law not be required to be cleared pursuant to Section 3C, as some commenters stated? If so, why?

- When the conduct occurring in the United States is limited only to negotiating or soliciting a transaction, does the transaction carry risk into the U.S. financial system? If not, is application of the mandatory clearing requirement to such transactions appropriate?

- How should the Commission weigh the operational risks that arise from requiring mandatory clearing? To what extent do the exceptions to the mandatory clearing requirement undermine the development of a central clearing infrastructure that will facilitate the prompt and accurate clearance and settlement of security-based swaps? Are persons excepted from the mandatory clearing requirement likely to develop the same operational capacity and safeguards to facilitate clearing as persons not excepted? If not, to what extent does this increase operational risk to the national system for clearance and settlement? To what extent, if any, should the exceptions to the mandatory clearing requirement be limited to minimize operational risks and market risks that may be experienced in the United States?

- Are there other rationales besides risk mitigation that justify imposing the mandatory clearing requirement? If so, what are they and why? Do these alternative rationales support a different application of the requirement to U.S. persons and non-U.S. persons? As regards foreign branches of U.S. banks? As regards non-U.S. persons who receive guarantees from U.S. persons and non-U.S. persons who do not receive guarantees from U.S. persons? As regards security-based swap dealers?

- How should the mandatory clearing requirement treat members of clearing agencies registered with the Commission? For instance, to what extent should the mandatory clearing requirement apply to members of clearing agencies registered with the

Commission if the member is not a U.S. person, does not have its performance guaranteed by a U.S. person, is not a security-based swap dealer, or is not conducting the transaction within the United States? Please be specific.

- How should the mandatory clearing requirement treat counterparties who are swap dealers? For instance, should non-U.S. persons who are swap dealers and whose performance under the swap is not guaranteed by a U.S. person be excepted from the mandatory clearing requirement in any circumstances? If so, under what circumstances? How should other financial entities be treated? How should major swap participants and major security-based swap participants be treated under the proposed rule? Should they be excepted from the mandatory clearing requirement, in certain circumstances, as we have proposed?

- Are the proposed exceptions from the mandatory clearing requirement appropriate? Should other transactions also be excepted? If so, which? Should other categories of persons also be excepted? If so, whom?

- Should any transactions conducted within the United States be subject to any exception from the mandatory clearing requirement? If so, why? For instance, should a transaction between two non-U.S. persons neither of whom is guaranteed by a U.S. person and neither of whom are security-based swap dealers, as excepted from the mandatory clearing requirement under proposed Rule 3Ca-3(b)(2), be subject to mandatory clearing? If so, why?

- Should any transactions where one counterparty is a U.S. person be subject to an exception from the mandatory clearing requirement? If so, which transactions and why? For instance, should transactions not conducted in the United States in which one counterparty is a foreign branch of a U.S. bank be subject to any exceptions, such as the exception in proposed Rule 3Ca-3(b)(1)?

- To what extent might the exceptions described in proposed Rule 3Ca-3(b) create competitive disparity between similarly situated persons competing in the same market? For instance, for transactions conducted within the United States, to what extent, if any, might proposed Rule 3Ca-3(b)(2) create competitive disparity between U.S. persons and non-U.S. persons? For transactions not conducted within the United States, to what extent, if any, might proposed Rule 3Ca-3(b)(1) create competitive disparity between counterparties who are security-based swap dealers and foreign branches of U.S. banks?

- Should the Commission impose any conditions to the exceptions from the mandatory clearing requirement? What conditions would be appropriate?

- If the proposed rule overlaps with a foreign mandatory clearing requirement, in what ways are the requirements likely to conflict? What would be the effects on efficiency, competition and capital formation in the event that there are overlapping or duplicative mandatory clearing requirements or varying exceptions to such requirements across multiple jurisdictions?

- What provisions of Section 3C, or the Exchange Act and rules thereunder generally, would a counterparty be unable to comply with if the security-based swap transaction was subject to more than one mandatory clearing requirement? What categories of transactions are likely to be subject to such multiple mandatory clearing requirements? To what extent, if any, would a counterparty's membership in a clearing agency that clears security-based swaps affect the likelihood that multiple mandatory clearing requirements would apply to a security-based swap transaction? To what extent, if any, would a guaranteed non-U.S. person be subject to multiple mandatory clearing requirements? To what extent, if any, does the home country of the reference entity under a security-based swap affect the likelihood that multiple mandatory clearing requirements would apply to the transaction? Does proposed Rule 3Ca-3 provide sufficient regulatory guidance regarding such transactions? Why or why not?

- What would be the market impact of proposed Rule 3Ca-3? How would the proposed application of the mandatory clearing requirement affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed rule place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed rule be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the mandatory clearing requirement? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## X. Mandatory Security-Based Swap Trade Execution Requirement

### A. Introduction

Section 3C(h)(1) of the Exchange Act requires, with respect to transactions

involving security-based swaps subject to the clearing requirement in Section 3C(a)(1) of the Exchange Act, that counterparties execute such transactions on an exchange or a security-based swap execution facility that is registered under Section 3D of the Exchange Act or exempt from registration under Section 3D(e) of the Exchange Act (the "mandatory trade execution requirement").<sup>1052</sup> Section 3C(h) thus provides that security-based swap transactions subject to the mandatory trade execution requirement cannot be executed on an OTC basis, but must instead be executed on an exchange or security-based swap execution facility that is registered or exempt from registration under the Exchange Act, unless an exception applies.<sup>1053</sup> As such, the mandatory trade execution requirement is important in helping to bring the trading of security-based swaps onto transparent, regulated markets, from more opaque OTC markets.<sup>1054</sup>

Because transactions in security-based swaps are often conducted globally with counterparties and intermediaries from multiple jurisdictions,<sup>1055</sup> we recognize uncertainty may exist regarding how to apply the mandatory trade execution requirement to cross-border security-based swap transactions.<sup>1056</sup> The

<sup>1052</sup> 15 U.S.C. 78c-3(h)(1).

<sup>1053</sup> 15 U.S.C. 78c-3(h). Section 3C(h)(2) of the Exchange Act provides two exceptions to compliance with the mandatory trade execution requirement: (i) if no exchange or security-based swap execution facility makes the security-based swap available to trade; or (ii) if the security-based swap transaction is subject to the clearing exception under Section 3C(g) of the Exchange Act. 15 U.S.C. 78c-3(h)(2). In this release, we are not addressing either of these exceptions, as they pertain to whether a particular security-based swap is subject to the mandatory trade execution requirement. Our focus here is on the obligations of the counterparties to a transaction involving a security-based swap that is subject to the mandatory execution requirement where neither of these exceptions applies.

<sup>1054</sup> See SB SEF Proposing Release, 76 FR 10949 ("The current market for [security-based] swaps is opaque, with little, if any, pre-trade transparency (the ability of market participants to see trading interest prior to a trade being executed) or post-trade transparency (the ability of market participants to see transaction information after a trade is executed). A key goal of the Dodd-Frank Act is to bring trading of [security-based] swaps onto regulated markets . . .").

<sup>1055</sup> See Section II.A.1, *supra*.

<sup>1056</sup> One commenter, writing on behalf of a group of various market participants, asked for clear guidance regarding the application of the mandatory trade execution requirement for cross-border transactions in security-based swaps. See Cleary Letter III and Cleary Letter IV. The commenter recommended that the mandatory trade execution requirement should only apply to transactions where at least one counterparty is a U.S. person. See Cleary Letter IV at 27. This commenter also argued that the mandatory trade

Commission is proposing Rule 3Ch–1 under the Exchange Act to specify the applicability of the mandatory trade execution requirement with respect to cross-border security-based swap transactions. Our proposed approach follows the territorial approach described above<sup>1057</sup> and imposes the mandatory trade execution requirement on transactions that would be subject to the mandatory clearing requirement<sup>1058</sup> unless they qualify for an exception.<sup>1059</sup> We discuss substituted compliance with the mandatory trade execution requirement in Section XI.F below.<sup>1060</sup>

We recognize that other approaches are possible to achieve the goals of the Dodd-Frank Act, in whole or in part. Accordingly, we invite comment regarding all aspects of the proposal described below, including potential alternative approaches. Data and comment from market participants and other interested parties regarding the likely effect of the proposed rule and potential alternative approaches will be particularly useful to the Commission in evaluating possible modifications to the proposal.

### B. Application of the Mandatory Trade Execution Requirement to Cross-Border Transactions

#### 1. Statutory Framework

Section 3C(h) of the Exchange Act provides that if a transaction is subject to the mandatory clearing requirement, counterparties shall execute the transaction on an exchange or on a registered or exempt SB SEF, unless an exception applies.<sup>1061</sup> Section 3C(a)(1) of the Exchange Act provides that it shall be unlawful for any person “to engage in a security-based swap unless that person submits such security-based swap for clearing . . . if the security-based swap is required to be cleared.”<sup>1062</sup> As discussed above, we are proposing to apply the statutory mandatory clearing requirement to any person who engages in a security-based

execution requirement should not apply to transactions involving two non-U.S. persons that utilize U.S. persons to carry out the transaction. We discuss this comment below.

<sup>1057</sup> See, e.g., Section VII, *supra* (discussing the registration of foreign security-based swap markets); see also the general discussion of the Commission’s territorial approach in Section II.B, *supra*.

<sup>1058</sup> See Section IX, *supra* (discussing the scope of the mandatory clearing requirement).

<sup>1059</sup> See note 1053, *supra*.

<sup>1060</sup> Under the Commission’s proposal, substituted compliance would be permitted for certain cross-border security-based swap transactions that would be subject to the mandatory trade execution requirement in Section 3C(h) of the Exchange Act and the rules and regulations thereunder. See discussion in Section XI.F, *infra*.

<sup>1061</sup> See 15 U.S.C. 78c–3(h).

<sup>1062</sup> See 15 U.S.C. 78c–3(a)(1).

swap transaction within the United States.<sup>1063</sup> We preliminarily believe that, to the extent that a cross-border transaction is subject to the mandatory clearing requirement under the proposed approach described above, it also would be subject to the mandatory trade execution requirement unless it qualifies for an exception.<sup>1064</sup> This approach is consistent with the statutory framework of Title VII of the Dodd-Frank Act, because a security-based swap transaction first must be subject to the mandatory clearing requirement before the counterparties to the transaction must comply with the mandatory trade execution requirement, unless an exception to the mandatory trade execution requirement applies. Thus, to the extent that we are proposing not to apply the mandatory clearing requirement to a particular transaction, the mandatory trade execution requirement would not apply to such transaction.

#### 2. Proposed Rule

Consistent with our proposed rule applying the mandatory clearing requirement<sup>1065</sup> and our general approach in applying Title VII in the cross-border context,<sup>1066</sup> the Commission is proposing Rule 3Ch–1 under the Exchange Act. Under the proposed rule, the mandatory trade execution requirement would apply to any person that engages in a security-based swap transaction in which at least one of the counterparties to the transaction is (i) a U.S. person<sup>1067</sup> or (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person.<sup>1068</sup> We also are proposing to apply the mandatory trade execution requirement to any person that engages in a security-based swap if such transaction is a

<sup>1063</sup> In Section IX above, the Commission proposes Rule 3Ca–3 under the Exchange Act. Subject to certain exceptions, proposed Rule 3Ca–3 would apply the mandatory clearing requirement to any person that engages in a security-based 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 security-based swap is guaranteed by a U.S. person, or if the transaction is a “transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5) under the Exchange Act. See Section IX.C, *supra*, and Section III.B.6, *supra* (discussing proposed Rule 3a71–3(a)(5)).

<sup>1064</sup> See note 1053, *supra*.

<sup>1065</sup> See proposed Rule 3Ca–3 under the Exchange Act.

<sup>1066</sup> See Section II.B, *supra*.

<sup>1067</sup> Under proposed Rule 3Ch–1(c) under the Exchange Act, the term “U.S. person” would have the same meaning as set forth in proposed Rule 3a71–3(a)(7) under the Exchange Act, as discussed in Section III.B.5 below.

<sup>1068</sup> Proposed Rule 3Ch–1(a)(1) under the Exchange Act.

“transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5) under the Exchange Act.<sup>1069</sup>

To limit the scope of the proposal, we are proposing exceptions to the mandatory trade execution requirement in the following two scenarios:<sup>1070</sup>

- If the security-based swap transaction is not a “transaction conducted within the United States,” the proposed rule would not apply the mandatory trade execution requirement if one counterparty to the transaction is (i) a foreign branch of a U.S. bank<sup>1071</sup> or (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person,<sup>1072</sup> and if the other counterparty to the transaction is a non-U.S. person (i) whose performance under the security-based swap is not guaranteed by a U.S. person and (ii) who is not a foreign security-based swap dealer.<sup>1073</sup>

- If the security-based swap transaction is a “transaction conducted within the United States,” the proposed rule would not apply the mandatory trade execution requirement if (i) neither counterparty to the transaction

<sup>1069</sup> Proposed Rule 3Ch–1(a)(2) under the Exchange Act.

<sup>1070</sup> Consistent with our intent to apply the mandatory trade execution requirement in the same way as the mandatory clearing requirement, these exceptions are identical to the exceptions from the mandatory clearing requirement. See proposed Rule 3Ca–3(b) under the Exchange Act, as discussed in Section IX, *supra*.

<sup>1071</sup> Under proposed Rule 3Ch–1(c) under the Exchange Act, the term “foreign branch” would have the same meaning as set forth in proposed Rule 3a71–3(a)(1) under the Exchange Act. See discussion in Section III.B.7, *supra*. A security-based swap transaction conducted through a foreign branch, as defined in proposed Rule 3a71–3(a)(4) under the Exchange Act, would be specifically excluded from the proposed definition of “transaction conducted within the United States.” See proposed Rule 3a71–3(5)(ii) under the Exchange Act, as discussed in Section III.B.6, *supra*.

<sup>1072</sup> A security-based swap transaction involving a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person would not be a “transaction conducted within the United States” by virtue of the guarantee alone because providing a guarantee on a transaction is not one of the factors that would cause a transaction to be a transaction conducted within the United States under proposed Rule 3a71–3(a)(5) under the Exchange Act. We would consider such transaction to be engaged in within the United States, however, by virtue of the guarantee from the U.S. person, who acts as an “indirect counterparty” to the transaction.

<sup>1073</sup> Proposed Rule 3Ch–1(b)(1) under the Exchange Act. Proposed Rule 3Ch–1(c) under the Exchange Act defines the term “foreign security-based swap dealer” by cross-reference to the definition of that term in proposed Rule 3a71–3(a)(3) of the Exchange Act (defining “foreign security-based swap dealer” to mean “a security-based swap dealer, as defined in section 3(a)(71) of the [Exchange] Act (15 U.S.C. 78c(a)(71)), and the rules and regulations thereunder, that is not a U.S. person”).

is a U.S. person; (ii) neither counterparty's performance under the security-based swap is guaranteed by a U.S. person; and (iii) neither counterparty to the transaction is a foreign security-based swap dealer.<sup>1074</sup> We discuss below the proposed rule regarding the application of the mandatory trade execution requirement in more detail.

### 3. Discussion

In considering how to apply the mandatory trade execution requirement, we have relied primarily on the express statutory relationship between the mandatory clearing requirement and the mandatory trade execution requirement. The statutory text, in our view, indicates that Congress viewed the clearing and trade execution requirements as complementary, since a security-based swap transaction that is subject to the mandatory clearing requirement is subject to the mandatory trade execution requirement, absent circumstances that trigger one of the exceptions to the mandatory trade execution requirement. In the following, we discuss the proposed rule regarding the application of the mandatory trade execution requirement in more detail.

#### (a) Security-Based Swap Transactions Involving U.S. Persons or Non-U.S. Persons Receiving Guarantees From U.S. Persons

##### i. Proposed Rule

The proposed rule would apply the mandatory trade execution requirement to transactions in which one of the counterparties is (i) a U.S. person or (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person,<sup>1075</sup> subject to certain exceptions.<sup>1076</sup> We preliminarily believe that applying the mandatory trade execution requirement to transactions in which U.S. persons are counterparties or provide guarantees of the performance of non-U.S. persons under a security-based swap would be consistent with the purposes of the Dodd-Frank Act to improve transparency in the U.S. financial system.<sup>1077</sup> As noted above, the mandatory trade execution requirement in Title VII is critical to this goal because this requirement is designed to promote the trading of security-based swap transactions on transparent,

regulated markets.<sup>1078</sup> Therefore, by applying the mandatory trade execution requirement to transactions in which U.S. persons are counterparties or provide guarantees of the performance of non-U.S. persons under a security-based swap, the proposed rule would further the goals of the Dodd-Frank Act to improve the transparency of the U.S. financial system.<sup>1079</sup>

##### ii. Proposed Exception for Certain Transactions Involving Foreign Branches of U.S. Banks and Guaranteed Non-U.S. Persons

Consistent with the Commission's proposed approach to the mandatory clearing requirement discussed above,<sup>1080</sup> the Commission is proposing an exception from the mandatory trade execution requirement described above for certain transactions that involve foreign branches of U.S. banks or guaranteed non-U.S. persons, provided the transactions are not conducted within the United States. Specifically, under proposed Rule 3Ch-1(b)(1), the mandatory trade execution requirement would not apply to a security-based swap transaction if one counterparty to the transaction is (i) a foreign branch of a U.S. bank<sup>1081</sup> or (ii) a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person and if the other counterparty to the transaction is a non-U.S. person (i) whose performance under the security-based swap is not guaranteed by a U.S.

person and (ii) who is not a foreign security-based swap dealer.<sup>1082</sup> Such exception would not apply if the security-based swap transaction were a transaction conducted within the United States, as defined in proposed Rule 3a71-3(a)(5) under the Exchange Act.<sup>1083</sup>

The Commission preliminarily believes that imposing the mandatory trade execution requirement on all security-based swap transactions in which a U.S. person is a counterparty or in which a U.S. person provides a guarantee to a non-U.S. person counterparty may adversely affect the ability of U.S. persons to access foreign security-based swap markets because non-U.S. persons may be less willing to enter into transactions with them if such transactions are subject to the mandatory trade execution requirement. Accordingly, we are proposing an exception from the mandatory trade execution requirement for transactions in which a counterparty to the transaction is a foreign branch of a U.S. bank or a non-U.S. person who receives a guarantee from a U.S. person on its performance under the security-based swap and the other counterparty is a non-U.S. person whose performance under the security-based swap is not guaranteed by a U.S. person and who is not a foreign security-based swap dealer.<sup>1084</sup>

We recognize that imposing the mandatory trade execution requirement on a foreign branch of a U.S. bank or on a non-U.S. person whose performance under a security-based swap is guaranteed by a U.S. person would be consistent with the view that a foreign branch of a U.S. bank is part of a U.S. person<sup>1085</sup> and that a U.S. guarantor is an indirect counterparty<sup>1086</sup> to the transaction entered into by the guaranteed non-U.S. person. We also recognize that subjecting such transactions to the mandatory trade execution requirement could help to bring the trading of security-based swaps onto transparent, regulated markets, from more opaque OTC market. At the same time, however, imposing the mandatory trade execution requirement on U.S. persons that conduct their foreign security-based swap dealing activity through foreign branches or guaranteed non-U.S. persons, without any exceptions, could put such U.S. persons at a significant

<sup>1078</sup> See note 1054, *supra*.

<sup>1079</sup> We preliminarily believe that the proposed approach with respect to the mandatory trade execution requirements is not being applied to persons who are "transact[ing] a business in security-based swaps without the jurisdiction of the United States," within the meaning of Section 30(c). See Section II.B.2(b), *supra*. However, the Commission also preliminarily believes that the proposed approach with respect to the mandatory trade execution requirements is necessary or appropriate to help prevent the evasion of the particular provisions of the Exchange Act that were added by the Dodd-Frank Act that are being implemented by the approach and prophylactically will help ensure that the purposes of those provisions of the Dodd-Frank Act are not undermined. See Section II.B.2(e), *supra*; see also Section II.B.2(d), *supra*.

For example, if the mandatory trade execution requirement does not apply to a transaction among non-U.S. persons that receive guarantees from U.S. persons and foreign branches of U.S. banks, then U.S. persons would have an incentive to evade the mandatory trade execution requirement by conducting transactions with other U.S. persons through guaranteed foreign affiliates or foreign branches. Altering the form of the transaction in this manner would allow U.S. persons to continue to avail themselves of transparency in the U.S. security-based swap market while evading the requirements intended to enhance that transparency, even though the substance of the transaction remains unchanged. See note 1054 and accompanying text, *supra*.

<sup>1080</sup> See Section IX, *supra*.

<sup>1081</sup> See note 1071, *supra*.

<sup>1082</sup> Proposed Rule 3Ch-1(b)(1) under the Exchange Act. See also note 1073, *supra*.

<sup>1083</sup> Proposed Rule 3Ch-1(b)(1) under the Exchange Act.

<sup>1084</sup> *Id.*

<sup>1085</sup> See Section III.B.5, *supra*.

<sup>1086</sup> See note 1012, *supra*.

<sup>1074</sup> Proposed Rule 3Ch-1(b)(2) under the Exchange Act.

<sup>1075</sup> Proposed Rules 3Ch-1(a)(1)(i) and (ii) under the Exchange Act.

<sup>1076</sup> Proposed Rule 3Ch-1(b) under the Exchange Act. See also note 1053, *supra*.

<sup>1077</sup> See Section II.B.2(d), *supra* (discussing guarantees in the cross-border context).



competitive disadvantage to non-U.S. persons who conduct security-based swap business in the same foreign local market and thereby limit the access of such U.S. persons to foreign security-based swap markets. After balancing the various policy considerations, including the Dodd-Frank Act's goal of promoting trading on transparent, regulated markets, we have preliminarily concluded that the proposed exception from the mandatory trade execution requirement for transactions by U.S. persons conducting security-based swap activity out of foreign branches, or transactions by guaranteed non-U.S. persons, with non-U.S. persons whose performance under the security-based swap is not guaranteed by a U.S. person (and who is not a foreign security-based swap dealer) is appropriate, provided that it is not a transaction conducted within the United States.

This exception from the mandatory trade execution requirement would not apply under the proposed rule, however, when the non-U.S. person counterparty of the foreign branch of the U.S. bank or the guaranteed non-U.S. person is a foreign security-based swap dealer.<sup>1087</sup> The reason for this proposed carve-out from the exception from the mandatory trade execution requirement is similar to the reason discussed above in the context of the mandatory clearing requirement. Because a foreign security-based swap dealer would necessarily have a significant connection with the U.S. security-based swap market because its dealing activity with U.S. persons or within the United States would trigger registration requirements, we preliminarily believe it is not appropriate to provide an exception for U.S. persons conducting security-based swap activity out of foreign branches or for guaranteed non-U.S. persons when they enter into security-based swaps with foreign security-based swap dealers.

#### (b) Transactions Conducted Within the United States

##### i. Proposed Rule

Under the proposed rule, a security-based swap transaction that is a transaction conducted within the United States, as defined in proposed Rule 3a71-3(a)(5) under the Exchange Act, would be subject to the mandatory trade execution requirement.<sup>1088</sup> As we have noted above, a "transaction conducted within the United States," as defined in proposed Rule 3a71-3(a)(5),

includes soliciting, negotiating, executing, or booking a security-based swap transaction.<sup>1089</sup> The Commission believes that applying the mandatory trade execution requirement to a security-based swap transaction when the activities that are key stages in that transaction are conducted within the United States furthers a goal of the mandatory trade execution requirement, namely, to bring the trading of security-based swaps within the United States onto regulated markets, unless an exception applies. Furthermore, such an approach is consistent with our proposed approach to the mandatory clearing requirement discussed above.<sup>1090</sup>

##### ii. Proposed Exception for Transactions Conducted Within the United States by Certain Non-U.S. Persons

We recognize that one commenter has recommended that transactions between two non-U.S. persons that utilize U.S. agents should not be subject to the mandatory trade execution requirement.<sup>1091</sup> The commenter noted that it is common for non-U.S. persons to utilize U.S. agents because of their expertise in the relevant market (such as in the case of a swap with an underlying U.S. security) or because of logistical matters (such as the time zones in which the parties conduct business).<sup>1092</sup> The commenter argued that applying the mandatory trade execution requirement to these transactions could curtail the use of U.S. agents to negotiate trades and encourage personnel in the United States to relocate elsewhere.<sup>1093</sup>

Consistent with our proposed approach to applying the mandatory clearing requirement to transactions conducted within the United States by non-U.S. persons, the Commission is proposing an exception from the mandatory trade execution requirement for security-based swap transactions that are transactions conducted within the United States when no counterparty to the transaction is (i) a U.S. person; (ii) a non-U.S. person whose performance under the security-based swap is

guaranteed by a U.S. person; or (iii) a foreign security-based swap dealer.<sup>1094</sup>

The Commission preliminarily believes that it is appropriate to limit the exception from the mandatory trade execution requirement when one or both of the non-U.S. person counterparties is a foreign security-based swap dealer. Non-U.S. persons whose transactions arising from dealing activity with U.S. persons or otherwise conducted within the United States exceed the *de minimis* threshold in the security-based swap dealer definition have a sufficient connection to the U.S. security-based swap market to lead the Commission to preliminarily conclude that it would not be appropriate to except transactions involving them from the mandatory trade execution requirement when they conduct security-based swap transactions within the United States. Permitting non-U.S. persons to engage in security-based swap transactions within the United States with foreign security-based swap dealers without being subject to the mandatory trade execution requirement would potentially limit the access of U.S. persons to foreign security-based swap markets because non-U.S. persons seeking to engage in security-based swaps within the United States may prefer to engage in security-based swaps with foreign security-based swap dealers rather than U.S. persons to avoid the mandatory trade execution requirement.

#### Request for Comment

The Commission seeks comment on all aspects of proposed Rule 3Ch-1, including the following:

- Should the mandatory trade execution requirement apply to all transactions conducted by a U.S. person, including transactions conducted out of a foreign branch of a U.S. bank or a non-U.S. person whose performance under a security-based swap is guaranteed by a U.S. person? Why or why not?
- Is it appropriate for the application of the mandatory trade execution requirement in the cross-border context to follow our approach to the mandatory clearing requirement? If not, why not? What alternative approach would better suit the relationship between these two requirements under the statute? Please explain.
- Is the proposed rule appropriate and sufficiently clear? Should additional details be included as to any aspect of the proposed rule? If so, what additional details should be provided and why?

<sup>1089</sup> See Section III.B.6, *supra*.

<sup>1090</sup> As discussed above, the statutory language for the mandatory clearing requirements apply to any person that "engages in a security-based swap," which the Commission proposes to interpret to include any transaction in which a person performs any of the activities that are key stages in a security-based swap transaction (*i.e.*, solicitation, negotiation, execution, or booking of the transaction). See Section IX.C, *supra*; see also Section 3C(a)(1) of the Exchange Act.

<sup>1091</sup> See Clearing Letter IV at 27-28.

<sup>1092</sup> See *id.*

<sup>1093</sup> See *id.*

<sup>1087</sup> Proposed Rule 3Ch-1(b)(1)(ii)(B) under the Exchange Act.

<sup>1088</sup> Proposed Rule 3Ch-1(a)(2) under the Exchange Act.

<sup>1094</sup> Proposed Rule 3Ch-1(b)(2).

- As discussed above, under proposed Rule 3Ch-1(a), the mandatory trade execution requirement would apply to a person that engages in a security-based swap transaction if such person is a U.S. person, such person is a non-U.S. person whose performance under such security-based swap transaction is guaranteed by a U.S. person, or such security-based swap transaction is a transaction conducted within the United States. Are the circumstances in which the Commission proposes to apply the mandatory trade execution requirement sufficiently clear? If not, why not? Are these the appropriate circumstances in which to apply the mandatory trade execution requirement? If not, why not? Are there additional types of counterparties or security-based swap transactions to which the mandatory trade execution requirement should be applied? If so, who or what are they, and why? Are there types of counterparties or security-based swap transactions that should not be covered by the proposed rule? If so, why not?

- Would the proposed rule apply the mandatory trade execution requirement in ways that appropriately promote the goals of Title VII? Would any objectives of Title VII be hindered by applying the mandatory trade execution requirement as proposed? Would there be any regulatory gaps created by the proposed rule? Please provide detail.

- By requiring transactions conducted within the United States to be subject to the mandatory trade execution requirement, would the proposed rule appropriately create competitive parity between U.S. and non-U.S. persons that act as intermediaries within the United States to conduct transactions in security-based swaps? Why or why not? Please explain. Please provide specific recommendations and explain how any recommended approach would better promote competition than the proposed rule. More generally, should security-based swap transactions be subject to the mandatory trade execution requirement solely because a transaction was solicited or negotiated within the United States?

- Under proposed Rule 3Ch-1(b), certain security-based swap transactions by foreign branches and guaranteed non-U.S. persons that are not conducted within the United States would be excluded from the mandatory trade execution requirement. The Commission generally solicits comments on the appropriateness of excluding the security-based swap transactions described in proposed Rule 3Ch-1(b) from the application of the mandatory trade execution requirement.

Should additional types of transactions be excluded from the application of the mandatory trade execution requirement? Should some or all of the transactions covered by proposed Rule 3Ch-1(b) not be excluded? If so, in either case, please explain why. Does proposed Rule 3Ch-1(b) appropriately balance the competitiveness of U.S. persons in the global security-based swaps market and the goals of Title VII? If not, how could this balance be better achieved? Should proposed Rule 3Ch-1(b) also apply to non-U.S. persons that are security-based swap dealers? Why or why not?

- What would be the market impact of proposed Rule 3Ch-1? How would the proposed application of the mandatory trade execution requirement affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed rule place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed rule be a more general burden on competition? If so, please explain. Would any burdens on competition be effectively mitigated by the proposed exception to mandatory trade execution in proposed Rule 3Ch-1(b)? Please explain. What other measures should the Commission consider to implement the mandatory trade execution requirement? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## XI. Substituted Compliance

### A. Introduction

As noted above, we are proposing to establish a policy and procedural framework pursuant to rules under the Exchange Act in which the Commission would consider permitting compliance with comparable regulatory requirements in a foreign jurisdiction to substitute for compliance with requirements in the Exchange Act, and rules and regulations thereunder, relating to security-based swaps (*i.e.*, substituted compliance). As proposed, under a Commission substituted compliance determination, a person would be able to satisfy relevant requirements in the Exchange Act, and the rules and regulations thereunder, by substituting compliance with corresponding requirements under a foreign regulatory system. A person relying on a substituted compliance determination still would be subject to the particular Exchange Act requirement that is the subject of the substituted compliance determination, but would be permitted to comply with such

requirement in an alternative fashion. Failure of a person to comply with the applicable foreign regulatory requirements would mean that such person would be in violation of the requirements in the Exchange Act.

The Commission is proposing to consider making substituted compliance determinations with respect to four distinct categories of requirements, each of which raises separate issues and will be discussed separately below. These categories are as follows: (i) Requirements applicable to registered security-based swap dealers in Section 15F of the Exchange Act and the rules and regulations thereunder; (ii) requirements relating to regulatory reporting and public dissemination of information on security-based swaps; (iii) requirements relating to clearing for security-based swaps; and (iv) requirements relating to trade execution for security-based swaps.

With respect to each of these categories of requirements, the Commission is proposing a “comparability” standard as the basis for making a substituted compliance determination. Generally, the Commission would endeavor to take a holistic approach in making substituted compliance determinations—that is, we would ultimately focus on regulatory outcomes as a whole with respect to the requirements within the same category rather than a rule-by-rule comparison. As noted above,<sup>1095</sup> efforts to regulate the derivatives market are underway, not only in the United States, but also in other jurisdictions. Since their 2009 statement, the G20 leaders have reiterated their commitment to OTC derivatives regulatory reform. And, as described above,<sup>1096</sup> the Commission has participated in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing the regulation of OTC derivatives and foreign regulatory reform efforts. We recognize that foreign regulatory systems differ in their approaches to achieving particular regulatory outcomes, and that foreign regulatory requirements may differ from those ultimately adopted by the Commission, but may nonetheless achieve regulatory outcomes comparable with the regulatory outcomes of the relevant provisions of the Exchange Act added by Title VII of the Dodd-Frank Act. In addition, we recognize that different regulatory systems may be able to achieve some or all of those regulatory outcomes by using more—or fewer—specific requirements than the

<sup>1095</sup> See Section I.C., *supra*.

<sup>1096</sup> *Id.*

Commission. For example, under certain circumstances, a foreign regulatory system may be able to achieve one of those regulatory outcomes in the absence of one or more specific requirements that the Commission has implemented under a particular set of provisions of the Dodd-Frank Act.

Accordingly, we do not envision that the Commission, in making a comparability determination, would look to whether a foreign jurisdiction has implemented specific rules and regulations that are comparable to rules and regulations adopted by the Commission. Rather, the Commission would determine whether the foreign regulatory system in a particular area, taking into consideration any relevant principles, regulations, or rules in other areas of the foreign regulatory system to the extent they are relevant to the analysis, achieves regulatory outcomes that are comparable to the regulatory outcomes of the relevant provisions of the Exchange Act. If it does, the Commission preliminarily believes that a comparability determination would be appropriate, notwithstanding differences in or the absence of specific requirements of particular regulatory provisions.

In addition, the Commission recognizes that other regulatory systems are informed by the business and market practices present in the foreign jurisdictions where those systems apply, and that such practices may differ in certain respects from practices described in this release. More broadly, other regulatory systems are informed by the characteristics of the markets for which they were designed, including the number and nature of their market participants to which they apply. In making a comparability determination, the Commission recognizes that it may need to take into account such practices and characteristics in understanding the design and application of another regulatory system and whether and how it may achieve regulatory outcomes comparable to the regulatory outcomes of the relevant provisions of the Exchange Act.

As explained below, how the Commission would find a foreign regulatory system “comparable” would vary depending on the category of requirements. Because the Commission is proposing to make substituted compliance determinations with respect to each of the aforementioned categories of requirements, it is possible that a foreign regulatory system would be comparable with respect to some, but not all, categories of requirements. For instance, a foreign regulatory system

may impose requirements on non-U.S. dealers that achieve regulatory outcomes comparable to the requirements applicable to registered security-based swap dealers in Section 15F of the Exchange Act, but the same foreign regulatory system may not achieve comparable regulatory outcomes regarding public reporting of trade information for security-based swaps. Similarly, a foreign regulatory system may impose requirements on clearing agencies that achieve regulatory outcomes comparable to the requirements applicable to registered security-based swap clearing agencies under Section 17A of the Exchange Act, but may not provide for comparable regulation of SB SEFs. By assessing each of these categories separately, the Commission would have the flexibility to make a substituted compliance determination with respect to one category of requirements but not another. However, the Commission would also retain the flexibility to consider the extent to which principles, regulations, or rules in one category may bear on a determination with respect to another category. Such an approach also would allow substituted compliance in certain categories to address competition and market efficiency concerns when a foreign regime is not comparable across the full range of Title VII policy objectives.

In addition, as described below, in making substituted compliance determinations, the Commission would consider a variety of factors that the Commission deems appropriate, including the nature of the global security-based swap market and the scope and objectives of the relevant foreign regulatory requirements. As part of this holistic review, the Commission would consider the various ways in which a foreign regulatory system achieves its overall goals and purposes, including those undertaken in response to the G20 commitments. As noted above, the Commission would also consider the extent to which applicable principles, regulations, or rules in one category may bear on a determination with respect to another category. In addition, the Commission recognizes that our proposed application of Title VII to cross-border activities may affect the policy decisions of these other regulators as they seek to address potential conflicts or duplication in the regulatory requirements that apply to market participants under their authority.

More specifically, the proposed policy and procedural framework for substituted compliance recognizes the potential, in a market as global as the

security-based swap market, for market participants who engage in cross-border security-based swap activity to be subject to conflicting or duplicative compliance obligations. As a result of the efforts to implement the G20 commitments in various jurisdictions described above, in some cases of cross-border activity, market participants may be subject to compliance obligations in a foreign jurisdiction that are similar to those imposed by the Exchange Act. The proposed framework would allow the Commission to provide for substituted compliance to address the effect of conflicting or duplicative regulations on competition and market efficiency and to facilitate a well-functioning global security-based swap market. In other cases, however, market participants may not be subject to conflicting or duplicative regulation because the foreign jurisdiction has not enacted comprehensive regulation of the security-based swap markets or is still in the process of implementing regulatory reforms that have been enacted. It also may be that the foreign jurisdiction’s regulation does not apply to the market participant or entity or the foreign jurisdiction has established regulations that differ, in material respects, from requirements in the Exchange Act (*e.g.*, requirements relating to real-time public reporting) and do not achieve comparable regulatory outcomes. In such cases, there would be less justification for allowing substituted compliance.

One alternative to making substituted compliance determinations by looking at separate categories of requirements would be to provide substituted compliance across the entire set of security-based swap requirements with respect to regimes that have implemented regulations consistent with the overall objectives of the G20 commitments. Preliminarily, however, we believe that making substituted compliance determinations on a regime-wide basis would be unworkable in light of the Commission’s responsibility to implement the specific statutory provisions of the Exchange Act added by Title VII of the Dodd-Frank Act. While these provisions of the Exchange Act are consistent with the G20 commitments, they also contain provisions designed to achieve particular regulatory outcomes that may not be part of another jurisdiction’s regulatory system. Thus, while the Commission would certainly consider the broader regulatory landscape in a foreign jurisdiction—including its approach to the G20 commitments—before making a substituted compliance

determination, the Commission would also need to consider the particular regulatory outcomes achieved under the Exchange Act provisions added by Title VII of the Dodd-Frank Act.

In the following, we propose rules and interpretive guidance addressing the policy and procedural framework under which we would consider permitting compliance with comparable regulatory requirements in a foreign jurisdiction to substitute for compliance with requirements of the Exchange Act, and the rules and regulations thereunder, relating to security-based swaps, with respect to each of the aforementioned categories of requirements.

#### Request for Comment

The Commission requests comment on all aspects of our general approach to substituted compliance, including the following questions:

- Should the Commission make substituted compliance determinations on a regime-wide basis for a jurisdiction rather than with respect to categories of requirements? If so, should the finding that the regulatory outcomes of a foreign regulatory system are not comparable with respect to the regulatory outcomes of one category of the Exchange Act requirements cause the Commission to find the entire foreign regulatory regime to be not comparable as a whole? More specifically, under a regime-wide approach, how should the Commission make substituted compliance determinations with respect to foreign regulatory systems that do not achieve regulatory outcomes comparable to the regulatory outcomes with respect to certain categories of the Exchange Act requirements, taking into account the Commission's responsibility and statutory authority to implement the requirements of the Exchange Act added by Title VII of the Dodd-Frank Act?

- Should the Commission take into consideration the various ways in which a foreign regulatory system achieves its overall goals and purposes that are consistent with the G20 commitments in making a substituted compliance determination with respect to a category of the Exchange Act requirements added by Title VII of the Dodd-Frank Act? Why or why not?

- Should the Commission take a more granular approach to substituted compliance determinations, for example, conducting a rule-by-rule or requirement-by-requirement comparison? Why or why not?

- Should the Commission identify more or less categories in our framework for substituted compliance? If so, how should those categories be demarcated?

#### B. Process for Making Substituted Compliance Requests

The Commission is proposing to amend our Rules of General Application to establish procedures pursuant to which it would consider applications for substituted compliance determinations with respect to each of the aforementioned categories of requirements.<sup>1097</sup> These procedures are similar to those now used by the Commission in considering exemptive order applications under Section 36 of the Exchange Act.<sup>1098</sup> All supporting documentation submitted pursuant to the proposed amendment would be made public.

Specifically, the proposed amendment would add new Rule 0–13 under the Exchange Act setting forth the general procedures for submission of requests for substituted compliance determinations. These procedures include the requirement that all applications for substituted compliance determinations must be in writing in the form of a letter, must include any supporting documents necessary to make the application complete, and otherwise must comply with 17 CFR 240.0–3 (Filing of Material with the Commission).<sup>1099</sup> All applications must be submitted to the Office of the Secretary of the Commission, and may be submitted either electronically<sup>1100</sup> or in paper format.<sup>1101</sup> In addition, all filings and supporting documentation filed pursuant to this proposed rule must be in the English language.<sup>1102</sup> If an application is incomplete, the Commission may request that the application be withdrawn unless the applicant can justify, based on all the facts and circumstances, why supporting materials have not been

<sup>1097</sup> Proposed Rule 0–13 under the Exchange Act.

<sup>1098</sup> See 17 CFR 240.0–12. Cf. 17 CFR 30.10 (Petitions for Exemptions), including Appendices A and C (CFTC's procedures for application by foreign persons with respect to foreign futures and foreign options transactions).

<sup>1099</sup> Proposed Rule 0–13(a) under the Exchange Act. In 17 CFR 240.0–3, the Commission sets forth general procedures for filing materials with the Commission.

<sup>1100</sup> Proposed Rule 0–13(b) under the Exchange Act.

<sup>1101</sup> Proposed Rule 0–13(d) under the Exchange Act.

<sup>1102</sup> Proposed Rule 0–13(c) under the Exchange Act. If a filing or submission filed pursuant to this rule requires the inclusion of a document that is in a foreign language, a party must submit instead a fair and accurate English translation of the entire foreign language document. A party may submit a copy of the unabridged foreign language document when including an English translation of a foreign language document in a filing or submission filed pursuant to this rule. A party must provide a copy of any foreign language document upon the request of Commission staff. *Id.*

submitted and undertakes to submit promptly the omitted materials.<sup>1103</sup>

The Commission would not consider hypothetical or anonymous requests for a substituted compliance order.<sup>1104</sup> Consistent with this position, every application (electronic or paper) must contain the name, address, telephone number, and email address of each applicant and the name, address, telephone number, and email address of a person to whom any questions regarding the application should be directed.<sup>1105</sup> In addition, each applicant must provide the Commission with any supporting documentation it believes necessary for the Commission to make the requested substituted compliance determination, including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor compliance with, and enforce, such requirements.<sup>1106</sup> Applicants also should cite to and discuss applicable precedent related to a substituted compliance determination.<sup>1107</sup> Any amendments to an application would be required to be prepared and submitted as set forth in the proposed procedures and marked to show what changes were made.<sup>1108</sup>

Under the proposed rule, after the filing of an application for a substituted compliance determination is complete, Division of Trading and Markets staff would review the application and make a recommendation to the Commission.<sup>1109</sup> After consideration of the recommendation by the Commission, the Commission's Office of the Secretary would issue an appropriate response and would notify the applicant.<sup>1110</sup> As part of our review, the Commission may, in our sole discretion, schedule a hearing on the

<sup>1103</sup> Proposed Rule 0–13(a) under the Exchange Act.

<sup>1104</sup> Proposed Rule 0–13(e) under the Exchange Act.

<sup>1105</sup> *Id.*

<sup>1106</sup> *Id.*

<sup>1107</sup> *Id.*

<sup>1108</sup> Proposed Rule 0–13(f) under the Exchange Act.

<sup>1109</sup> As with other matters, the Division of Trading and Markets would work with the Office of General Counsel, the Division of Risk, Strategy, and Financial Innovation, the Office of International Affairs, the Office of Compliance Inspections and Examinations, and the Division of Enforcement, as well as other divisions and offices within the Commission, in reviewing and making a recommendation regarding substituted compliance determinations.

<sup>1110</sup> Proposed Rule 0–13(g) under the Exchange Act.

matter addressed by the application.<sup>1111</sup> The Commission also may, in our sole discretion, choose to publish in the **Federal Register** a notice that the application has been submitted which invites public comment on the application.<sup>1112</sup> Requestors may, however, seek confidential treatment of their applications for substituted compliance determinations.<sup>1113</sup>

The Commission preliminarily believes that these proposed procedures would provide sufficient guidance regarding the process whereby persons may seek to make a request for a substituted compliance determination with respect to each of the categories of requirements, as described more fully below.

#### Request for Comment

The Commission seeks comment on all aspects of the proposed rule, including the following:

- Do the proposed procedures give sufficient guidance to persons regarding the procedures for making a substituted compliance determination? If not, why not? What other procedures should the Commission adopt?
- Should the substituted compliance framework contemplate foreign regulatory authorities, rather than or in addition to market participants, submitting substituted compliance determination requests? Why or why not?

#### C. Security-Based Swap Dealer Requirements

##### 1. Proposed Rule—Commission Substituted Compliance Determinations

The Commission is proposing a rule that would establish a framework in which the Commission may make a substituted compliance determination permitting a foreign security-based swap dealer that is registered with the Commission to satisfy requirements in Section 15F of the Exchange Act, and the rules and regulations thereunder, by complying with the corresponding rules and regulations established in a foreign

jurisdiction.<sup>1114</sup> Specifically, the proposed rule would provide that the Commission may, conditionally or unconditionally, by order, make a substituted compliance determination with respect to a foreign financial regulatory system that compliance with specified requirements under such foreign financial regulatory system by a registered foreign security-based swap dealer (or class thereof)<sup>1115</sup> may satisfy the corresponding requirements in Section 15F of the Exchange Act, and the rules and regulations thereunder, that would otherwise apply to such foreign security-based swap dealer (or class thereof).<sup>1116</sup> The proposed framework would permit the Commission to make a substituted compliance determination only if we find that the requirements of such foreign financial regulatory system are comparable to otherwise applicable requirements, taking into account factors that the Commission determines appropriate, such as, for example, the scope and objectives of the relevant foreign regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by a foreign financial regulatory authority or authorities in such system to support its oversight of such foreign security-based swap dealer (or any class thereof).<sup>1117</sup>

In making a substituted compliance determination, as noted above, the Commission's determination would focus on the similarities in regulatory objectives, rather than requiring that the foreign jurisdiction's rules be identical. Depending on our assessment of the comparability of the foreign regulatory

<sup>1114</sup> Proposed Rule 3a71–5 under the Exchange Act.

<sup>1115</sup> The Commission is proposing a framework under which it may consider making substituted compliance determinations applicable to bona fide foreign security-based swap dealers. This proposed approach would not extend to entities organized outside of the United States for the purpose of evading U.S. regulation. The Commission would consider a variety of factors to confirm the bona fide nature of a foreign security-based swap dealer for these purposes, including the location of management and risk controls related to such entity's security-based swap dealing activities and the nature of the counterparties.

<sup>1116</sup> Proposed Rule 3a71–5(a)(1) under the Exchange Act.

<sup>1117</sup> Proposed Rule 3a71–5(a)(2)(i) under the Exchange Act. In assessing oversight, the Commission would consider not only overall oversight activities, but also oversight specifically directed at conduct and activity that would be relevant to the substituted compliance determination. For example, it would be difficult for the Commission to make a comparability determination if oversight is directed solely at the local activities of foreign security-based swap dealers, as opposed to the cross-border activities of such dealers.

regime, the Commission could condition the substituted compliance determination by limiting it to a particular class or classes of registrants in the foreign jurisdiction.<sup>1118</sup> For instance, if the foreign jurisdiction imposes different levels of supervisory oversight with respect to classes of entities conducting security-based swap dealing activity, the Commission could limit a substituted compliance determination to permit only certain classes of supervised foreign security-based swap dealers to rely on a substituted compliance determination. The Commission would determine what conditions are appropriate on a case-by-case basis.

The proposed rule would require that, before making a substituted compliance determination, the Commission must have entered into a supervisory and enforcement MOU or other arrangement with the appropriate financial regulatory authority or authorities in that jurisdiction addressing oversight and supervision of applicable security-based swap dealers subject to the substituted compliance determination.<sup>1119</sup> Through such MOU or other arrangement, the Commission and the foreign financial regulatory authority or authorities would express their commitment to cooperate with each other to fulfill their respective regulatory mandates.

Although we intend generally to take a category-by-category approach to substituted compliance, under the proposed rule, the Commission could make a substituted compliance determination with respect to one Title VII requirement applicable to registered security-based swap dealers but not another.<sup>1120</sup> However, consistent with our category-by-category approach, we believe that certain requirements are interrelated such that the Commission would expect to make a substituted compliance determination for the entire group of related requirements. For example, the core entity-level requirements relate to the regulation of an entity's capital and margin. But certain other entity-level requirements (such as risk management, general recordkeeping and reporting, and diligent supervision) are so

<sup>1118</sup> Proposed Rule 3a71–5(a)(1) under the Exchange Act (permitting the Commission to make the substituted compliance determination "conditionally or unconditionally").

<sup>1119</sup> Proposed Rule 3a71–5(a)(2)(ii) under the Exchange Act. The Commission expects that any existing supervisory or enforcement MOU or other arrangement would need to be re-negotiated during the substituted compliance determination process to reflect the particulars of a determination.

<sup>1120</sup> Proposed Rule 3a71–5(a) under the Exchange Act.

<sup>1111</sup> Proposed Rule 0–13(i) under the Exchange Act.

<sup>1112</sup> Proposed Rule 0–13(h) under the Exchange Act. The notice would provide that any person may, within the period specified therein, submit to the Commission any information that relates to the Commission action requested in the application. The notice also would indicate the earliest date on which the Commission would take final action on the application, but in no event would such action be taken earlier than 25 days following publication of the notice in the **Federal Register**. *Id.*

<sup>1113</sup> Proposed Rule 0–13(a) under the Exchange Act. Requests for confidential treatment would be permitted to the extent provided under 17 CFR 200.81. *Id.*

interconnected with capital and margin oversight that we would expect to make substituted compliance determinations, where warranted with regard to capital and margin rules, on the entire package of entity-level regulations.

The proposed rule also would permit the Commission, on our own initiative, to modify the terms of, or withdraw, a substituted compliance determination for a particular foreign jurisdiction, after appropriate notice and opportunity for comment.<sup>1121</sup> For instance, due to changes in the foreign regulatory regime, or a failure of a foreign regulator to exercise its supervisory or enforcement authority in an effective manner, the Commission may determine to modify the terms of, or withdraw, a previous substituted compliance determination. The Commission also would have the ability to periodically review the substituted compliance determinations it has granted and decide whether the substituted compliance determination should continue to apply.

In addition, the proposed rule would permit a foreign security-based swap dealer to rely on an applicable substituted compliance determination by the Commission with regard to a particular jurisdiction to satisfy the specified requirements in Section 15F of the Exchange Act, and the rules and regulations thereunder, as applicable, by complying with the corresponding requirements established in the foreign jurisdiction.<sup>1122</sup> The proposed rule would require a foreign security-based swap dealer relying on a substituted compliance determination to satisfy the conditions of the Commission's substituted compliance determination.<sup>1123</sup>

Finally, the proposed rule would address the situation in which a foreign security-based swap dealer seeks to rely on the rules and regulations of a foreign jurisdiction to satisfy Commission requirements but the Commission has not previously made a substituted compliance determination with respect to that jurisdiction. In such a case, the proposed rule would permit the foreign security-based swap dealer, or a group of foreign security-based swap dealers, to request pursuant to the procedures set forth in proposed Rule 0–13 under the Exchange Act, that the Commission make a substituted compliance determination for the foreign jurisdiction with respect to specified

requirements in Section 15F of the Exchange Act.<sup>1124</sup> The proposed rule would require that the foreign security-based swap dealer (or foreign security-based swap dealers) be directly supervised by one or more financial regulatory authorities in that jurisdiction with respect to requirements similar to those in Section 15F of the Exchange Act, and the rules and regulations thereunder,<sup>1125</sup> and provide the certification and opinion of counsel as described in proposed Rule 15Fb2–4(c) under the Exchange Act.<sup>1126</sup>

Although the request for a substituted compliance determination could come from a particular foreign security-based swap dealer or group of dealers, the Commission would make such a determination, under the proposed rule, on a class or jurisdiction basis, depending on the regulator(s) and the foreign regulatory regime (rather than on a firm-by-firm basis).<sup>1127</sup> As a result, once the Commission has made a substituted compliance determination with respect to a particular foreign jurisdiction, it would apply to every foreign security-based swap dealer in the specified class or classes registered and regulated in that jurisdiction, subject to the conditions specified in the Commission's substituted compliance order.

The proposed rule would not provide for substituted compliance with respect to registration requirements described in Sections 15F(a)–(d) of the Exchange Act and the rules and regulations thereunder.<sup>1128</sup> As an initial matter, the

registration process serves two important notice functions for the Commission. First, it is through the submission of a registration application that security-based swap dealers notify the Commission that they are engaged in dealing activity in excess of the *de minimis* threshold. Second, the registration application process is how foreign security-based swap dealers notify the Commission that they intend to seek or to rely on an existing substituted compliance determination.<sup>1129</sup> In addition to these key notice functions, the registration process provides the Commission with information that is essential to the Commission's ability to provide effective oversight of foreign security-based swap dealers, particularly for those relying on substituted compliance determinations to satisfy their obligations under Section 15F requirements.<sup>1130</sup> As a result, we are not proposing to allow substituted compliance for the registration requirements in Section 15F of the Exchange Act.

## 2. Discussion

The goal of the proposed rule is to increase the efficiency of the security-based swap market and promote competition by helping to avoid subjecting foreign security-based swap dealers to potentially conflicting or duplicative compliance obligations, while still achieving the policy objectives of Title VII of the Dodd-Frank Act. The Commission preliminarily believes that the proposed rule, by requiring that a substituted compliance determination be made on a class or jurisdictional basis and that a foreign jurisdiction's requirements be comparable to otherwise applicable U.S. requirements, is consistent with this goal.

<sup>1129</sup> See Section III.E, *supra* (discussing the process by which foreign security-based swap dealers would be required to notify the Commission of their reliance on substituted compliance determinations).

<sup>1130</sup> As part of the registration process, nonresident security-based swap dealers must (i) appoint an agent for service of process in the United States, (ii) furnish the Commission with the identity and address of its agent for services of process, (iii) certify that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission, and (iv) provide the Commission with an opinion of counsel concurring that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission. See proposed Rule 15Fb2–4 under the Exchange Act, as discussed in the Registration Proposing Release, 77 FR 65799–801

<sup>1121</sup> Proposed Rule 3a71–5(a)(4) under the Exchange Act.

<sup>1122</sup> Proposed Rule 3a71–5(b) under the Exchange Act.

<sup>1123</sup> Proposed Rule 3a71–5(b)(2) under the Exchange Act.

<sup>1124</sup> Proposed Rule 3a71–5(c)(1) under the Exchange Act.

<sup>1125</sup> Proposed Rule 3a71–5(c)(2)(i) under the Exchange Act.

<sup>1126</sup> Proposed Rule 3a71–5(c)(2)(ii) under the Exchange Act. Proposed Rule 15Fb2–4 under the Exchange Act, as discussed in the Registration Proposing Release, 76 FR 65799–801, would require that a nonresident security-based swap dealer provide the Commission with an opinion of counsel concurring that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission. See Section III.C.3(b)ix, *supra*. The Commission preliminarily believes that, before a foreign security-based swap dealer should be permitted to make a substituted compliance request, it should assure the Commission that it can provide the Commission with prompt access to books and records and submit to onsite inspection and examination because we expect that access to books and records and the ability to inspect and examine a foreign security-based swap dealer will be essential conditions of any substituted compliance determination.

<sup>1127</sup> Proposed Rule 3a71–5(a) under the Exchange Act. Because, under the proposed approach, all requests for substituted compliance determinations must come directly from a foreign security-based swap dealer, foreign financial regulatory authorities may not themselves request such a determination.

<sup>1128</sup> Proposed Rule 3a71–5(a)(3) under the Exchange Act.

In addition, the Commission preliminarily believes that such an approach is consistent with the global nature of the security-based swap market and may be less disruptive of entity business arrangements than not permitting substituted compliance. At the same time, the Commission recognizes that U.S. security-based swap dealers may be put at a competitive disadvantage with their foreign counterparts if they are subject to, for example, more stringent capital or margin requirements than foreign security-based swap dealers. For instance, all other things being equal, a foreign security-based swap dealer that is subject to lower capital requirements would be able to enter into a security-based swap with a customer at a more competitive price than a U.S. security-based swap dealer that is subject to a higher capital requirement. Of course, more stringent capital or margin requirements could equally be viewed as a source of competitive advantage, with counterparties having greater confidence in the financial stability of U.S. counterparties.

One alternative to the proposed approach would be to impose uniform compliance on all registered security-based swap dealers rather than permitting substituted compliance for registered foreign security-based swap dealers. If the Commission were to adopt a uniform approach to the application of Section 15F requirements to registered U.S. and foreign security-based swap dealers without allowing for substituted compliance, foreign security-based swap dealers may find that complying with the Commission's capital, margin, and other entity-level rules would subject them to duplicative or conflicting requirements and may put them at a competitive disadvantage as a result.

As discussed above, the Dodd-Frank Act divides the entity-level regulatory oversight of security-based swap dealers between the Commission and prudential regulators.<sup>1131</sup> This statutory division of authority means that the Commission is not responsible for the capital and margin regulation of bank security-based swap dealers and, therefore, does not have the authority to make substituted compliance determinations in those areas for dealers that are banks. As a result, the Commission's provision of substituted compliance for capital and margin requirements only would extend to nonbank security-based swap dealers, whereas the Commission's substituted compliance determinations for all other entity-level requirements

would apply to both bank and nonbank security-based swap dealers.

In addition to this statutory limitation on the Commission's ability to provide for substituted compliance in certain areas, the Commission also may consider the rationale for different capital treatment of banks and nonbanks in the United States. As discussed above, the Commission's proposed capital rules for nonbank security-based swap dealers differ from those that would be applicable to bank dealers as proposed by the prudential regulators in that the Commission's proposed capital standards are principally focused on the retention of highly liquid assets that can be distributed to customers.<sup>1132</sup> Assuming that the Commission adopts capital standards for nonbank security-based swap dealers as proposed, the Commission's comparability determinations regarding entity-level requirements would likely analyze separately the capital treatment of nonbank entities in jurisdictions that do not impose a comparable net liquid assets test. In performing such an analysis, the Commission would take into account the other principles, rules, and regulations of the foreign jurisdiction that may be relevant to the analysis. It also would consider whether nonbank dealers in that jurisdiction are permitted to hold more illiquid assets as regulatory capital compared to the assets permitted to be held under the capital rules adopted by the Commission and, if so, whether nonbank dealers in that jurisdiction have access to sufficient liquidity at the entity level to support the liabilities they incur out of their business activity.<sup>1133</sup> Similarly, the Commission would need to consider the impact of any reduced liquidity associated with the application of foreign capital standards on the ability of nonbank dealers in such jurisdiction to wind down operations quickly and distribute assets to customers.<sup>1134</sup> As this example illustrates, however, even when separately analyzing capital requirements, the Commission's focus would remain on ensuring not that the foreign jurisdiction has identical rules but on ensuring that a foreign jurisdiction that applies capital rules that do not impose a comparable net liquid assets test to nonbank security-based swap dealers can achieve the regulatory outcomes comparable to

those intended under the Dodd-Frank Act.

Similarly, consistent with our category-based approach, the Commission's comparability determination with respect to the requirements set forth in Section 15F of the Exchange Act generally would not depend on the comparability of the goals achieved by foreign jurisdiction's capital and margin requirements taken alone but also would, in light of the interconnectedness of capital and margin with related entity-level requirements, take into account regulatory outcomes of other aspects of the jurisdiction's requirements. Although we believe that capital and margin requirements are at the core of a robust internal risk controls system at a firm, equally foundational to the financial integrity of a firm are effective internal risk management procedures and the effectiveness of other relevant foreign regulatory requirements that are connected to an entity's financial integrity. As noted above, the Commission is proposing to permit substituted compliance, not only with capital and margin requirements, but also with such other related entity-level requirements as the Commission finds appropriate.<sup>1135</sup> The Commission preliminarily believes that this approach to substituted compliance in the context of entity-level requirements will benefit foreign security-based swap dealers by allowing them to comply, where possible, with a single set of entity-level requirements where a substituted compliance determination is deemed appropriate, while ensuring that all registered security-based swap dealers are subject to robust entity-level oversight.

#### Request for Comment

The Commission requests comment on all aspects of the proposed rule establishing a policy and procedural framework for making substituted compliance determinations for registered foreign security-based swap dealers, including the following:

- What, if any, are the likely competitive effects, within the U.S. security-based swap market and among U.S. security-based swap dealers, of the proposed approach for application of substituted compliance for foreign security-based swap dealers? Please describe the specific nature of any such effects.
- The Commission generally solicits comments on the appropriateness and clarity of the proposed rule. Should

<sup>1132</sup> See Section III.C.3(b)(1), *supra*.

<sup>1133</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70304.

<sup>1134</sup> See *id.*

<sup>1135</sup> See Section XII.B.1, *supra*.

<sup>1131</sup> See Section III.C.3(b), *supra*.



additional details be included regarding any aspects of the proposed rule?

- As discussed above, in making a substituted compliance determination, the Commission would ultimately focus on the comparability of regulatory outcomes rather than a rule-by-rule comparison. Is this holistic approach to making a substituted compliance determination appropriate? If not, why not?

- Is the comparability standard appropriate and sufficiently clear? Should additional detail be provided as to what would and would not satisfy this standard? If so, what additional detail should be provided? Should a different standard be used? If so, what should be the standard and why?

- As discussed above, in making a substituted compliance determination, the Commission would consider factors such as the scope and objectives of the relevant foreign regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised. Are these factors appropriate? Are the enumerated factors too broad or too narrow? What other factors should the Commission consider?

- When assessing the effectiveness of a foreign jurisdiction's supervisory compliance program should the Commission consider factors such as the existence of a dedicated examination program, the expertise of examiners, the existence of a risk monitoring framework and an examination plan, and the existence of a disciplinary program to enforce compliance with laws? Similarly, when assessing the effectiveness of a foreign jurisdiction's enforcement program, should the Commission consider factors such as whether the program is actively administered, resourced, and transparent?

- As discussed above, the Commission could condition a substituted compliance determination by limiting it to a particular class or classes of registrants in the foreign jurisdiction, in which case the Commission would determine what conditions are appropriate on a case-by-case basis. What, if any, are the competitive effects of the proposed approach with respect to conditional substituted compliance determinations?

- As discussed above, the proposed rule permits the Commission, on our own initiative, to modify or withdraw a substituted compliance determination for a particular foreign jurisdiction, after appropriate notice and opportunity for comment. In the event that the Commission determines that a previous

substituted compliance determination needs to be further conditioned or even withdrawn, how much advance notice would be sufficient to permit market participants to adjust their activities to reflect the modification or withdrawal? For example, would 60 days be appropriate? Should the opportunity for comment be made public? Why or why not?

- Should a review period or "sunset provision" to revisit a previous substituted compliance determination be required? If so, what should be the appropriate time period be for such review period or sunset provision?

- Should the ability of a foreign security-based swap dealer to take advantage of substituted compliance be conditioned on it not transacting with certain classes of U.S. counterparties, such as persons that do not meet the definition of qualified institutional buyer, as defined in Securities Act Rule 144A (17 CFR 230.144A(a)(1)) ("QIB"), or some other threshold, such as qualified investor, as defined in Section 3(a)(54) of the Exchange Act? Would such counterparties be less able to appreciate the differences between engaging in security-based swap transactions with a security-based dealer subject to relevant provisions of Title VII versus a security-based swap dealer complying with comparable foreign regulations than a QIB or qualified investor? Would such an approach result in meaningful safeguards that would justify adopting such an approach? Is the use of such a substituted compliance regime likely to have a disparate impact on any particular class of counterparties? What are the potential advantages or disadvantages (including in terms of risk, competition, and counterparty protection) to counterparties, foreign security-based swap dealers, and U.S. security-based swap dealers in restricting the use of substituted compliance to transactions involving certain classes of U.S. counterparties?

- As discussed above, the proposed rule permits a foreign security-based swap dealer or group of foreign security-based swap dealers to submit a request that the Commission make a substituted compliance determination for the foreign jurisdiction with respect to specified requirements in Section 15F of the Exchange Act. Is the proposed procedure for submitting such requests sufficiently clear? Should additional details be included regarding any aspects of the proposed procedure?

- Do the proposed substituted compliance rules appropriately reflect the goal to increase the efficiency of the security-based swap market and

promote competition by avoiding (as appropriate) subjecting foreign security-based swap dealers to potentially conflicting or duplicative compliance obligations? Would it be more appropriate to make substituted compliance determinations on a firm-by-firm basis rather than a class or jurisdictional basis? If so, why?

- Should entity-level requirements be treated separately for purposes of substituted compliance determinations, or should they be considered as a package of regulations?

- Should the Commission permit substituted compliance with respect to external business conduct standards in Section 15F(h) of the Exchange Act and the rules and regulations thereunder? Would allowing substituted compliance impair the Commission's ability to enforce the business conduct standards that the Dodd-Frank Act added to the Exchange Act?

- Should the Commission permit substituted compliance in transactions between registered non-U.S. dealers and U.S. persons?

- Should the Commission permit substituted compliance in transactions by registered non-U.S. dealers within the United States?

- Would allowing substituted compliance impair the Commission's ability to enforce the business conduct standards that the Dodd-Frank Act added to the Exchange Act relating to counterparty protection, particularly with respect to "special entities"?

- Should the Commission not permit substituted compliance with respect to the conflicts of interest duties described in Section 15F(j)(5) of the Exchange Act and the rules and regulations thereunder? Why or why not? In particular, would allowing substituted compliance with respect to these requirements impair the Commission's ability to enforce these counterparty protections that the Dodd-Frank added to the Exchange Act? Why or why not? Should the foreign dealing subsidiaries of U.S. parents be allowed to take advantage of substituted compliance for entity-level requirements if they engage in U.S. Business?

- Should there be a threshold requirement that foreign security-based swap dealers engage in a predominately foreign business in order to rely on substituted compliance? If so, how should the "predominantly foreign business" threshold be measured? Should it be based on the relative notional amount of the security-based swap business of foreign security-based swap dealers with U.S. persons compared to the notional amount of their security-based swap business with

non-U.S. persons? If so, what should the threshold be (e.g., 80% Foreign Business by notional amount? More than 50%?)?

- Should the Commission consider providing substituted compliance determinations related to capital regulation in jurisdictions that apply Basel-based capital standards to nonbank security-based swap dealers? Why or why not?

- In what ways are Basel-based capital standards as applied to nonbank security-based swap dealers consistent with the Commission's own capital standards for nonbank security-based swap dealers? In what ways are they inconsistent?

- While the Commission is determining whether to make an initial set of substituted compliance determinations, should the Commission delay compliance with the requirements of the Exchange Act, and the rules and regulations thereunder, relating to security-based swap dealers for foreign security-based swap dealers? Are there some requirements that would be appropriate for delayed compliance? If so, please specify which ones and explain why. Are there other regulatory or market interests that the Commission should consider in determining the scope of the delayed compliance provision? If so, please describe those interests and how the proposed rule should address them.

- What would be the market impact of the proposed policy and procedural framework for making substituted compliance determinations for registered foreign security-based swap dealers? How would the application of the proposed policy and procedural framework affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed policy and procedural framework? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

- Should the Commission permit substituted compliance in transactions between registered non-U.S. dealers and U.S. persons?

- Should the Commission permit substituted compliance in transactions by registered non-U.S. dealers within the United States?

#### *D. Regulatory Reporting and Public Dissemination*

As initially proposed, Regulation SBSR did not contemplate that the reporting and public dissemination requirements associated with cross-border security-based swaps could be satisfied by complying with the rules of a foreign jurisdiction instead of U.S. rules. Thus, counterparties to a security-based swap would be required to comply with proposed Regulation SBSR even if the security-based swap also was, for example, reported to a foreign data repository or a foreign regulatory authority.

In response to this proposed approach, several commenters stated that requiring counterparties to report cross-border security-based swaps in more than one jurisdiction could result in duplicative or inconsistent reporting, unnecessary expense and administrative burden, and potential conflicts with another jurisdiction's confidentiality requirements.<sup>1136</sup> Commenters suggested various ways to address these issues. Some recommended generally that the Commission coordinate our trade reporting regime with those of other jurisdictions.<sup>1137</sup> Two commenters urged regulators to encourage the development of a single, global trade repository for each asset class.<sup>1138</sup> One of these commenters also stated that, in the absence of a global trade repository, regulators should implement internationally compatible reporting systems so that cross-border security-based swaps would not have to be reported twice.<sup>1139</sup> Another commenter suggested that the Commission define the term "security-based swap" to exclude a transaction that is reported to a non-U.S. trade repository, which would have the effect of eliminating any U.S. reporting requirement because the transaction would not be a security-based swap.<sup>1140</sup> Several commenters

<sup>1136</sup> See, e.g., AIMA Letter at 6; DTCC Letter II at 21; ISDA/SIFMA Letter I at 18. While not specifically addressing reporting requirements, another commenter believed generally that the U.S. branches of Japanese banks should not be subject to Title VII requirements, because such banks will be subject to comprehensive regulation under Japanese law. See Japanese Banks Letter at 4 (arguing that application of Title VII would be "superfluous at best" and could subject foreign banks to potentially inconsistent requirements).

<sup>1137</sup> See AIMA Letter at 6; ISDA/SIFMA Letter I at 18 (urging the Commission to "consult with foreign regulators before establishing the extra-territorial scope of the rules promulgated under Title VII"); Markit Letter III at 2 (arguing that the SEC and CFTC should "harmonize their regulations with those of international regulators to the extent possible").

<sup>1138</sup> See AIMA Letter at 6; ISDA Letter at 14.

<sup>1139</sup> See ISDA Letter at 13.

<sup>1140</sup> See Davis Polk Letter II at 21.

recommended that the Commission refrain from imposing any reporting requirements on security-based swaps that are reported pursuant to comparable rules of another jurisdiction.<sup>1141</sup>

The Commission is sympathetic to the desire to avoid redundant or conflicting reporting requirements, to the extent consistent with applicable statutory requirements. The Commission participates in a number of international organizations and initiatives that seek to coordinate regulation of the global OTC derivatives market, and the Commission staff has engaged in ongoing bilateral discussions with a number of foreign regulators on the subject of cross-border security-based swap activity. The Commission preliminarily believes that regulatory reporting of security-based swap transaction data is crucial to allow it and other regulators more effectively to carry out their statutorily assigned functions, which include the assessment of systemic risks.<sup>1142</sup> In addition, the Commission preliminarily believes that public dissemination generally would increase efficiency and price competition in the security-based swap market.<sup>1143</sup> The Commission preliminarily believes, therefore, that our own efforts to promote these goals should be implemented as quickly as practicable.

It is possible that other jurisdictions will implement reporting and dissemination regimes for security-based swap transactions that are comparable to the one set forth in Title VII and Regulation SBSR. In anticipation of that possibility, the Commission is now proposing rules regarding substituted compliance relating to regulatory reporting and public dissemination of security-based swaps, which are described below.

#### 1. General

Proposed Rule 908(c)(2)(i) would provide that the Commission could, conditionally or unconditionally, by

<sup>1141</sup> See, e.g., Cleary Letter II at 17; Davis Polk Letter I at 2 (urging the Commission to implement Title VII in a way that relies on home country supervision), 7 (arguing that a transaction required to be reported to a foreign trade repository should not also be required to be reported to an SDR); Davis Polk Letter II at 21–22; ISDA Letter at 14 (stating that, in the absence of a single international trade repository, regulators should recognize trade repositories in other jurisdictions); Société Générale Letter I at 11 (recommending deference to foreign regulators that have a comparable regulatory scheme).

<sup>1142</sup> See Regulation SBSR Proposing Release, 75 FR 75262–64.

<sup>1143</sup> See Regulation SBSR Proposing Release, 75 FR 75280–82 (discussing anticipated impact of proposed Regulation SBSR on efficiency, competition, and capital formation).

order, make a substituted compliance determination with respect to regulatory reporting and public dissemination in a foreign jurisdiction if such foreign jurisdiction imposes a comparable system for the regulatory reporting and public dissemination of all security-based swaps.

Section 13A(a)(1) of the Exchange Act<sup>1144</sup> provides that all security-based swaps that are not accepted for clearing shall be subject to regulatory reporting. Section 13(m)(1)(G) of the Exchange Act<sup>1145</sup> provides that each security-based swap (whether cleared or uncleared) shall be reported to a registered SDR, and Section 13(m)(1)(C) of the Exchange Act<sup>1146</sup> generally provides that transaction, volume, and pricing data of all security-based swaps shall be publicly disseminated. However, these statutory provisions do not address whether, or the extent to which, these requirements should apply to cross-border security-based swaps. Reporting security-based swap transactions pursuant to the regimes of both the United States and a foreign jurisdiction could be duplicative and potentially burdensome. Re-proposed Rule 908(c)(2)(i) would provide generally that compliance with a comparable system of a foreign jurisdiction for the regulatory reporting and public dissemination of all security-based swaps could, if certain conditions are met, be substituted for compliance with U.S. rules to satisfy the goals and objectives of these Title VII requirements.

## 2. Security-Based Swaps Eligible and Not Eligible for Substituted Compliance

The Commission preliminarily believes that, if a foreign jurisdiction applies a comparable system for the regulatory reporting and public dissemination of an entity's security-based swaps, it would be appropriate not to apply the U.S. requirements in addition to the requirements of that foreign jurisdiction. Where the Commission has found that a foreign jurisdiction's reporting and public dissemination requirements are comparable to those implemented by the Commission, we expect to make a substituted compliance determination with respect to such jurisdiction for these requirements. The Commission is re-proposing Rule 908(c)(1) to provide that compliance with the regulatory reporting and public dissemination requirements in Sections 13(m) and 13A of the Exchange Act, and the rules and

regulations thereunder, may be satisfied by compliance with the rules of a foreign jurisdiction that is the subject of a substituted compliance order issued by the Commission, provided that, with respect to at least one of the direct counterparties to the security-based swap:

(i) Such counterparty is either a non-U.S. person or a foreign branch; and

(ii) No person within the United States is directly involved in executing, soliciting, or negotiating the terms of the security-based swap on behalf of such counterparty.

The Commission preliminarily believes that, if at least one direct counterparty to a security-based swap is a non-U.S. person (even if the non-U.S. person is a security-based swap dealer or major security-based swap participant, or is guaranteed by a U.S. person) and no person within the United States is directly involved in executing, soliciting, or negotiating the terms of the security-based swap on behalf of that counterparty, the security-based swap should be eligible for substituted compliance with respect to regulatory reporting and public dissemination. Thus, substituted compliance with respect to regulatory reporting and public dissemination could apply even in the instance of a security-based swap with a direct counterparty that is operating from within the United States, so long as the other direct counterparty is a non-U.S. person and no person within the United States is directly involved in executing, soliciting, or negotiating the terms of the security-based swap on behalf of that non-U.S. person. This approach is designed to limit disincentives for non-U.S. persons to transact security-based swaps with U.S. persons by allowing compliance with the rules of a foreign jurisdiction to be substituted for compliance with U.S. rules when the non-U.S. person transacts with a U.S. person.

The Commission also preliminarily believes that the approach proposed above with respect to non-U.S. persons should be extended to the foreign branches of U.S. banks. As a result, we are proposing to allow the possibility of substituted compliance with respect to regulatory reporting and public dissemination if at least one counterparty of a security-based swap is the foreign branch of a U.S. bank, as long as no person within the United States is directly involved in executing, soliciting, or negotiating the terms of the security-based swap on behalf of such

foreign branch.<sup>1147</sup> This approach is designed to promote access of foreign branches of U.S. banks to the local markets in which those branches are located. Assume, for example, that a substituted compliance determination with respect to regulatory reporting and public dissemination applied to a foreign jurisdiction and a transaction involved, on one side, a local, non-U.S. person market participant, and the security-based swap is required to be reported and publicly disseminated under the rules of that foreign jurisdiction regardless of whether the counterparty on the other side is a local dealer or a foreign branch of a U.S. bank. If substituted compliance with respect to regulatory reporting and public dissemination were in effect, the fact that the foreign branch is a counterparty would not cause the transaction to have to be reported pursuant to U.S. rules in addition to the foreign jurisdiction's rules.

Consistent with the factors described above, the Commission preliminarily believes that certain kinds of security-based swaps should *not* be eligible for substituted compliance with respect to regulatory reporting and public dissemination, even if they might be subject to reporting and public dissemination requirements in a foreign jurisdiction.<sup>1148</sup> As noted above, re-proposed Rule 908(c)(1) would provide that a security-based swap would be eligible for substituted compliance with respect to regulatory reporting and public dissemination where both of the following conditions apply to at least one direct counterparty to the transaction: (i) such counterparty is either a non-U.S. person or a foreign branch; and (ii) the security-based swap transaction is not solicited, negotiated, or executed by a person within the United States on behalf of such counterparty. Thus, a security-based swap between *two U.S. persons* would *not* be eligible for substituted compliance with respect to regulatory reporting and public dissemination, even if the security-based swap were solicited, negotiated, and executed outside the United States.<sup>1149</sup>

<sup>1147</sup> See Section III.B.6, *supra* (discussing the definition of "foreign branch" in proposed Rule 3a71-3(a)(1) under the Exchange Act).

<sup>1148</sup> If the rules of a foreign jurisdiction would not apply to the security-based swap, there would be no need to consider the possibility of substituted compliance, because there would be no foreign rules that could substitute for the applicable U.S. rules.

<sup>1149</sup> This assumes that neither U.S. person is acting through a foreign branch. If either U.S. person were acting through a foreign branch, the

<sup>1144</sup> 15 U.S.C. 78m-1(a)(1).

<sup>1145</sup> 15 U.S.C. 78m(m)(1)(G).

<sup>1146</sup> 15 U.S.C. 78m(m)(1)(C).

Furthermore, re-proposed Rule 908(c)(1) would not allow for the possibility of substituted compliance with respect to regulatory reporting and public dissemination if both direct counterparties (or their agents)—regardless of place of domicile—solicit, negotiate, or execute a security-based swap from within the United States. The Commission preliminarily believes that U.S. rules for regulatory reporting and public dissemination should apply to transactions where all or the major part of actions associated with the security-based swap, on both sides of the transaction, are performed within the United States.

The following examples explain the operation of re-proposed Rule 908(c)(1). In all examples, assume that the Commission has issued a substituted compliance order with respect to regulatory reporting and public dissemination that applies to the foreign jurisdiction:

- *Example 1.* A bank in country X—solely through personnel located in country X—executes a security-based swap over the phone with a U.S. person located in New York, and no person within the United States is directly involved in soliciting, negotiating, or executing the terms of the security-based swap on behalf of the foreign bank. The security-based swap is not cleared. The security-based swap would be eligible for substituted compliance, regardless of whether the foreign bank is registered in any capacity with the Commission.

- *Example 2.* A foreign branch of a U.S. bank located in country X executes a security-based swap over the phone with a U.S. person located in New York. The foreign branch uses staff located solely in country X to solicit, negotiate, and execute the security-based swap. The security-based swap is not cleared. The security-based swap would be eligible for substituted compliance.

- *Example 3.* Two foreign branches of U.S. banks, both located in country X, execute a security-based swap in country X. The security-based swap transaction is not solicited, negotiated, or executed by a person within the United States on behalf of either counterparty. The security-based swap would be eligible for substituted compliance.

- *Example 4.* Two New York branches of foreign banks execute a security-based swap. Persons acting on behalf of each bank are located within the United States and are involved in soliciting, negotiating, and executing the

security-based swap between those U.S. persons would be eligible for substituted compliance.

terms of the security-based swap. The security-based swap would not be eligible for substituted compliance.

- *Example 5.* Same facts as Example 4, except that one foreign bank, instead of soliciting, negotiating, or executing the security-based swap using persons associated with its New York branch, uses only persons located in its home office to perform such functions. The security-based swap would be eligible for substituted compliance.

- *Example 6.* A foreign subsidiary (C1) of a U.S. person executes a security-based swap with a U.S. person (C2). No person within the United States solicits, negotiates, or executes the security-based swap on behalf of the foreign subsidiary C1. The security-based swap would be eligible for substituted compliance, regardless of the location of persons who executed, solicited, or negotiated the security-based swap on behalf of the U.S. person C2, and regardless of whether the foreign subsidiary C1 is guaranteed by a U.S. person.

### 3. Requests for Substituted Compliance

Proposed Rule 908(c)(2)(ii) would provide that any person that executes a security-based swap that would, in the absence of a substituted compliance order, be required to be reported pursuant to Regulation SBSR may file an application, pursuant to the procedures set forth in proposed Rule 0–13,<sup>1150</sup> requesting that the Commission make a substituted compliance determination regarding regulatory reporting and public dissemination with respect to a foreign jurisdiction the rules of which also would require reporting and public dissemination of the security-based swap. Proposed Rule 908(c)(2)(ii) would further provide that such application shall include the reasons therefor and such other information as the Commission may request. The Commission would consider those reasons as well as information derived from other sources in considering whether to grant a substituted compliance order with respect to regulatory reporting and public dissemination.

### 4. Findings Necessary for Substituted Compliance

Re-proposed Rule 908(c)(2)(iii) would provide that, in making a substituted compliance determination with respect to a foreign jurisdiction, the Commission shall take into account such factors as the Commission determines are appropriate, such as the

scope and objectives of the relevant foreign regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by the foreign financial regulatory authority to support oversight of its regulatory reporting and public dissemination system for security-based swaps. Furthermore, the Commission would not make a substituted compliance determination with respect to regulatory reporting and public dissemination unless the Commission found that:

(A) The data elements that are required to be reported pursuant to the rules of the foreign jurisdiction are comparable to those required to be reported pursuant to § 242.901;

(B) The rules of the foreign jurisdiction require the security-based swap to be reported and publicly disseminated in a manner and a timeframe comparable to those required by §§ 242.900–911;

(C) The Commission has direct electronic access<sup>1151</sup> to the security-based swap data held by a trade repository or foreign regulatory authority to which security-based swaps are reported pursuant to the rules of that foreign jurisdiction; and

(D) Any trade repository or foreign regulatory authority in the foreign jurisdiction that receives and maintains required transaction reports of security-based swaps pursuant to the laws of that foreign jurisdiction is subject to requirements regarding data collection and maintenance; systems capacity, resiliency, and security; and recordkeeping that are comparable to the requirements imposed on SDRs by sections 240.13n–5 to 240.13n–7 of the Exchange Act.

As noted above, the Commission preliminarily believes that compliance with a foreign jurisdiction's rules for reporting and public dissemination of security-based swaps should be a substitute for compliance with the U.S. rules only when the foreign jurisdiction has a reporting and public dissemination regime comparable to that of the United States. Thus, re-proposed Rule 908(c)(2)(iii)(A) would provide that the data elements required to be reported pursuant to the rules of the foreign jurisdiction must be comparable to those required to be reported pursuant to Rule 901 of Regulation SBSR. If the data elements required by the foreign jurisdiction were

<sup>1151</sup> New paragraph (k) of re-proposed Rule 900 would define the term “direct electronic access” to have the same meaning as in proposed Rule 13n–4(a)(5) under the Exchange Act, as proposed in the SDR Proposing Release, 75 FR 77318.

<sup>1150</sup> See Section XI.B, *supra*.

not comparable, certain important data elements about a security-based swap might not be captured by the foreign trade repository or foreign regulatory authority.

Furthermore, re-proposed Rule 908(c)(2)(iii)(B) would provide that the rules of the foreign jurisdiction must require security-based swaps to be reported and publicly disseminated in a manner and a timeframe comparable to those required by Regulation SBSR. The Commission preliminarily believes that, given the Title VII requirements that all security-based swaps be reported to an SDR and that all security-based swaps be publicly disseminated in real time (except for block trades), allowing substituted compliance with the rules of a foreign jurisdiction that has standards significantly different from those in the United States would run counter to the objectives and requirements of Title VII. Thus, for example, the Commission would not, under re-proposed Rule 908(c), permit substituted compliance with respect to regulatory reporting and public dissemination if the foreign jurisdiction did not (among other things) impose public dissemination requirements on a trade-by-trade basis; dissemination of trade information on an aggregate basis would not be sufficient. Furthermore, the Commission would not permit substituted compliance under re-proposed Rule 908(c) with respect to regulatory reporting and public dissemination if security-based swaps of non-block size were publicly disseminated in other than real time, as required under Section 763 of the Dodd-Frank Act.

Re-proposed Rule 908(c)(2)(iii)(C) would also provide that, to grant a substituted compliance order with respect to regulatory reporting and public dissemination, the Commission must have direct electronic access to the security-based swap data held by a trade repository or foreign regulatory authority to which security-based swaps are reported pursuant to the rules of that foreign jurisdiction. This requirement stems from the fact that the regulatory reporting provisions of Title VII are premised on the idea that the Commission will have direct electronic access to all the reported data. Not having direct electronic access could reduce the Commission's ability to effectively and efficiently monitor the U.S. security-based swap market and provide timely and complete data to other U.S. financial regulatory agencies. Thus, the Commission preliminarily believes that direct electronic access to the foreign trade repository or foreign regulatory authority to which security-based swap transactions are reported in

the foreign jurisdiction should be a prerequisite to issuing a substituted compliance order with respect to regulatory reporting and public dissemination applying to that jurisdiction.

An alternative to this proposed requirement would be to permit substituted compliance with respect to regulatory reporting and public dissemination if, instead, there existed an information-sharing agreement between the Commission and an appropriate body in the foreign jurisdiction that would permit the Commission to request and obtain transaction information from the foreign trade repository or foreign regulatory authority that otherwise would be reported to a registered SDR pursuant to Regulation SBSR. The Commission preliminarily believes, however, that it would be more appropriate to require direct electronic access to such data before allowing substituted compliance with respect to regulatory reporting and public dissemination. Without direct electronic access, the Commission could face substantial delays before a foreign entity, even acting expeditiously, could compile a substantial volume of data relating to a substantial volume of transactions. Delays in obtaining such data could compromise the ability of the Commission to supervise security-based swap market participants, and to share information with other U.S. financial regulators, in a timely fashion.

Re-proposed Rule 908(c)(2)(iii)(D) would provide that, to grant a substituted compliance order regarding regulatory reporting and public dissemination, the Commission must be able to find that any trade repository or foreign regulatory authority in the foreign jurisdiction that receives and maintains transaction reports of security-based swaps pursuant to the laws of that foreign jurisdiction is subject to requirements regarding data collection and maintenance; systems capacity, resiliency, and security; and recordkeeping that are comparable to the requirements that the Commission would impose on SDRs. The Commission has proposed certain requirements for SDRs relating to data collection and maintenance;<sup>1152</sup> systems capacity, resiliency, and security;<sup>1153</sup> and recordkeeping.<sup>1154</sup> These requirements are designed, among other things, to enhance the ability of SDRs to effectively receive and

maintain security-based swap transaction data that are reported to them. Without appropriate system security, for example, the data held by an SDR could be destroyed or rendered unusable by a hacker attack or computer virus. Therefore, the Commission preliminarily believes that, to allow substituted compliance for regulatory reporting and public dissemination with respect to a foreign jurisdiction, any entity in that foreign jurisdiction that is required to receive and maintain security-based swap transaction data should be required to have comparable protections.

Re-proposed Rule 908(c)(2)(iv) would specify that, before issuing a substituted compliance order pursuant to this section, the Commission shall have entered into a supervisory and enforcement MOU or other arrangement with the relevant foreign financial regulatory authority or authorities under such foreign financial regulatory system addressing oversight and supervision of the applicable security-based swap market under the substitute compliance determination.

#### 5. Modification or Withdrawal of Substituted Compliance Order

Re-proposed Rule 908(c)(2)(v) would provide that the Commission may, on our own initiative, modify or withdraw a substituted compliance order with respect to regulatory reporting and public dissemination in a foreign jurisdiction, at any time, after appropriate notice and opportunity for comment. Such a modification or withdrawal could result from a situation where, after the Commission issues an order recognizing the reporting and public dissemination regime of a foreign jurisdiction as eligible for substituted compliance, the basis for that order ceases to be true. For example, if the foreign jurisdiction did not sufficiently enforce its reporting and public dissemination rules, compliance with the foreign rules might no longer be deemed an effective substitute for compliance with the U.S. rules. Therefore, the Commission preliminarily believes that it would be appropriate to establish a mechanism whereby it could, at any time and on our own initiative, modify or withdraw a previously issued substituted compliance order with respect to regulatory reporting and public dissemination, after appropriate notice and opportunity for comment.

<sup>1152</sup> See proposed Rule 13n-5 under the Exchange Act.

<sup>1153</sup> See proposed Rule 13n-6 under the Exchange Act.

<sup>1154</sup> See proposed Rule 13n-7 under the Exchange Act.

## 6. Regulatory Reporting and Public Dissemination Considered Together in the Commission's Analysis of Substituted Compliance

The Commission has considered, but has determined not to propose, treating regulatory reporting and public dissemination separately for purposes of allowing substituted compliance. Under such an approach, for example, the Commission could allow substituted compliance for regulatory reporting with respect to a particular foreign jurisdiction without permitting substituted compliance for public dissemination. The Commission preliminarily believes that this approach would not implement Title VII's regulatory reporting and public dissemination requirements as effectively as considering these requirements together for purposes of analyzing requests for substituted compliance determinations.

One example of a potential problem with viewing these two requirements separately relates to the public dissemination of security-based swap transaction information. If the Commission were to permit substituted compliance for regulatory reporting but not for public dissemination, certain transactions could be reported to a foreign trade repository in lieu of an SDR that is registered with the Commission. However, the Commission has proposed that registered SDRs would be the entities charged with publicly disseminating information about security-based swap transactions. A registered SDR could carry out that function only if data about individual transactions are reported to it. If data about certain transactions were reported instead to a foreign trade repository, it would be impractical if not impossible for the SDR to publicly disseminate data about those transactions. The Commission also preliminarily believes that it would be impractical and unduly complicated to devise an alternate method for public dissemination of such transactions that did not involve registered SDRs.<sup>1155</sup> The Commission preliminarily concludes, therefore, that transactions should be required to be reported to a registered SDR even if there are comparable foreign rules that

would provide for reporting of such transactions to a foreign trade repository, unless the foreign rules also provide for public dissemination of such transactions in a manner comparable to Regulation SBSR. In such case, the Commission could, under re-proposed Rule 908(c), issue a substituted compliance order for both regulatory reporting and public dissemination with respect to that foreign jurisdiction.

The Commission notes that, under re-proposed Rules 908(a) and 908(b), certain security-based swap transactions would be subject to regulatory reporting but not public dissemination. The Commission also has considered, but has determined not to propose, treating regulatory reporting and public dissemination separately for purposes of allowing substituted compliance with respect to such transactions, even though Regulation SBSR would not require public dissemination of such transactions in any case. The Commission preliminarily believes that this approach could introduce unnecessary operational complexity for cross-border market participants and might yield few if any efficiency gains. Assume that a foreign branch of a U.S. bank is operating in a jurisdiction where a substituted compliance order were in effect for transactions that otherwise would be required to be reported but not publicly disseminated. With each transaction, the foreign branch would be required to determine whether the transaction was such that regulatory reporting but not public dissemination would be required under Regulation SBSR, in which case substituted compliance could apply and the transaction could instead be reported to the foreign trade repository, or whether both regulatory reporting and public dissemination would be required under Regulation SBSR, in which case substituted compliance would not apply and the transaction would be required to be reported to a registered SDR. The determination of the appropriate place to send the trade report would depend on the nature of the counterparty.<sup>1156</sup> While market participants could be

expected to develop the appropriate compliance systems to report through the appropriate channel depending on the circumstances, the Commission preliminarily sees only limited benefit to requiring market participants to do so. The Commission preliminarily believes instead that it would be simpler to permit substituted compliance for a foreign jurisdiction only when that foreign jurisdiction has rules for regulatory reporting *and* public dissemination that are comparable to Regulation SBSR. This approach is designed to minimize the necessity of determining, on a transaction-by-transaction basis, which jurisdiction's rules would apply.

### Request for Comment

The Commission is re-proposing Regulation SBSR in a manner that would set forth when a security-based swap generally would be required to be reported and publicly disseminated, and when reporting and dissemination requirements could be satisfied by substituting compliance with the rules of a foreign jurisdiction for compliance with U.S. rules. The public is invited to comment on all aspects of these proposed rules. In particular, the Commission invites responses to the following questions about our proposed rules relating to substituted compliance:

- Should the Commission make determinations of substituted compliance for regulatory reporting separately from public dissemination? Why or why not? If so, how could a security-based swap transaction be publicly disseminated if substituted compliance were in effect for regulatory reporting but not for public dissemination?
- Do you believe the Commission, as proposed in Rule 908(c)(2)(i), should have the ability to conditionally or unconditionally, by order, make a substituted compliance determination with respect to regulatory reporting and public dissemination in a foreign jurisdiction if such foreign jurisdiction imposes a comparable system for the regulatory reporting and public dissemination of all security-based swaps? Why or why not? Should the Commission allow for substituted compliance determinations under more limited circumstances? Why or why not? Under what other circumstances should the Commission consider substituted compliance? Please be specific.
- How should the Commission evaluate whether a foreign system is "comparable" for purposes of regulatory reporting and public dissemination? Please be specific.

<sup>1155</sup> A reporting side could be required to report to a registered SDR the data elements required by re-proposed Rule 901(c), which are those that would be publicly disseminated, but not be required to report the elements required by re-proposed Rule 901(d), which are the additional elements required for regulatory reporting. However, reporting the transaction to both a registered SDR and to a foreign trade repository (which it would be required to do by the rules of the foreign jurisdiction) would negate the effect of the substituted compliance order.

<sup>1156</sup> For example, if the foreign branch transacted with another foreign branch of a U.S. bank or with a non-U.S. person that was guaranteed by a U.S. person, the transaction would be subject to public dissemination (see re-proposed Rule 908(b)(2)(ii)) and substituted compliance would not apply. Thus, the transaction would have to be reported to an SDR registered with the Commission. However, if the foreign branch transacted outside the United States with a non-U.S. person that was not guaranteed by a U.S. person, public dissemination would not be required under Regulation SBSR. See re-proposed Rule 908(b)(2). Therefore, the transaction could be reported instead to the foreign trade repository.

• The Commission stated that our approach is designed to put the foreign branches of U.S. banks on a level playing field with non-U.S. persons in foreign jurisdictions where those branches are located. Do you believe that the proposed formulation would accomplish this goal? Why or why not? How should the Commission restructure re-proposed Rule 908(c)(1) to accomplish this goal? Please be specific.

• Do you believe that the examples provided adequately describe the situations under which security-based swap transactions should and should not be eligible for substituted compliance? Why or why not? What additional situations should the Commission consider? Please be specific.

• Do you agree with the Commission proposal, in re-proposed Rule 908(c)(2)(ii), that any person that executes security-based swaps that would be required to be reported to Regulation SBSR be eligible to file an application requesting substituted compliance? Why or why not? Should any other entities (*i.e.*, foreign regulators or industry associations) be eligible to file such an application? Why or why not?

• Do you agree with the factors the Commission would take into account when making a substituted compliance determination? Why or why not? What additional factors should the Commission take into account? Should a trade repository be subject to requirements that are comparable to all of Section 13(n) of the Exchange Act and the rules and regulations thereunder as a condition to a substituted compliance determination?

• Do you agree with the proposed findings that the Commission would be required to make pursuant to re-proposed Rule 908(c)(2)(iii)? Why or why not? Are there any other findings the Commission should be required to make? Please be specific.

• Do you agree, as detailed in re-proposed Rule 908(c)(2)(iv), that the Commission should have the ability, on our own initiative, to modify or withdraw a substituted compliance order at any time, after appropriate notice and opportunity for comment? Why or why not?

• The Commission is not at this time proposing that a duty to report and publicly disseminate a security-based swap would depend on the domicile of the issuer of the loan or security underlying the security-based swap. Should the Commission's rules for reporting and public dissemination take this factor into consideration? Why or why not?

• If a foreign jurisdiction has some form of public dissemination but the Commission does not believe that the foreign jurisdiction's rules are comparable to those of the United States to allow substituted compliance with respect to regulatory reporting and public dissemination, what would be the effect of having transaction reports of security-based swaps publicly disseminated in multiple jurisdictions? Do you believe that situation would impact price discovery or the market for such security-based swaps generally? If so, how, to what extent, and why? If not, why not? How practical would it be, and what would be the cost, for private actors to consolidate transaction reports of those security-based swaps emanating from potentially multiple feeds across multiple jurisdictions?

• Should the Commission permit substituted compliance with respect to regulatory reporting and public dissemination even if it does not have direct electronic access to the security-based swaps transactions reported to the foreign trade repository or foreign regulatory authority? If yes, how could the Commission ensure that it has timely access to the security-based swap transaction data held by the foreign entity that otherwise would have been reported pursuant to Regulation SBSR? If there were delays associated with obtaining data from the foreign entity, how long could those delays be for substituted compliance to still be appropriate? In addition to delays, do you foresee any other potential obstacles to the Commission obtaining this information from foreign entities?

• The Commission's re-proposed rules relating to substituted compliance for regulatory reporting and public dissemination requirements differ in certain respects from the CFTC's cross-border guidance. For example, the CFTC guidance provides that a swap between a U.S. person swap dealer and a non-U.S. person guaranteed by a U.S. person would be subject to public dissemination requirements, and that these requirements *could not* be satisfied through substituted compliance.<sup>1157</sup> The Commission, on the other hand, is proposing that public dissemination of a security-based swap between two such direct counterparties *could* be satisfied by substituted compliance (assuming that no person is soliciting, negotiating, or executing the security-based swap within the United States on behalf of the non-U.S. person that is guaranteed by a U.S. person).<sup>1158</sup>

<sup>1157</sup> See 77 FR 41237.

<sup>1158</sup> See re-proposed Rule 908(c)(1) of Regulation SBSR.

Please describe any other differences that you believe might exist and what would be the impact of any such differences.

• When making a comparability determination, the Commission would look not just at the rules of a foreign jurisdiction, but also at the comprehensiveness of the supervision and regulation by the appropriate governmental authorities of that jurisdiction. When assessing the effectiveness of a foreign jurisdiction's supervisory compliance program, should the Commission consider factors such as the existence of a dedicated examination program, the expertise of examiners, the existence of a risk monitoring framework and an examination plan; and the existence of a disciplinary program to enforce compliance with laws? Similarly, when assessing the effectiveness of a foreign jurisdiction's enforcement program, should the Commission consider factors such as whether the program is actively administered, resourced, and transparent?

• Is the Commission's holistic approach to making a comparability determination appropriate? Why or why not? Are there specific procedures or comparability considerations that would be useful for the Commission to incorporate in our proposed substituted compliance approach? If so, please describe. What would be the advantages of adopting such measures now? What would be the disadvantages of adopting such measures now?

• What would be the market impact of proposed approach to substituted compliance for regulatory reporting and public dissemination? How would the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

• In making substituted compliance determinations for reporting, should the Commission require direct electronic access to data maintained at foreign SDRs or should we only require an information sharing arrangement? Why or why not?



### E. Clearing Requirement

Section 3C(a)(1) of the Exchange Act requires a security-based swap that is subject to the mandatory clearing requirement to be cleared at a clearing agency that is either registered with the Commission or exempt from registration.<sup>1159</sup> The Commission recognizes, however, that in some circumstances counterparties may seek to clear security-based swaps subject to mandatory clearing at a clearing agency that is neither registered with the Commission nor exempt from registration, which would fail to satisfy the Title VII mandatory clearing requirement. This scenario may occur where counterparties seek either due to their own preference or regulatory requirements in a foreign jurisdiction to clear a transaction through a clearing agency that does not have any U.S. members and does not clear transactions conducted within the United States, because this type of clearing agency would not be required to register with the Commission or obtain an exemption from registration under the Commission's proposed interpretation of the clearing agency registration requirement in Section 17A(g), discussed in Section V above.

In recognition of this situation and the potential for duplicative or conflicting clearing requirements, the Commission preliminarily believes that it would be appropriate in certain circumstances to permit substituted compliance in this area. Specifically, the Commission is proposing to use our authority, under Section 36 of the Exchange Act,<sup>1160</sup> to exempt persons from the clearing mandate in Section 3C of the Exchange Act if a relevant transaction is submitted to a foreign clearing agency that is the subject of a substituted compliance determination by the Commission. Because such clearing agencies would not be engaged in activities that trigger the registration requirement, such substituted compliance determination

<sup>1159</sup> If a counterparty qualifies for the end-user clearing exception, then the security-based swap would not be required to be cleared unless the end user elects that it be cleared. See 15 U.S.C. 78c-3(g)(2) (providing that application of the exception is solely at the discretion of the counterparty to security-based swaps that meets the conditions of the exception in Section 3C(g)(1) of the Exchange Act).

<sup>1160</sup> See 15 U.S.C. 78mm. Section 36 of the Exchange Act provides that, subject to certain exceptions, the Commission "by rule, regulation, or order may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of person, securities, or transactions from any provision or provisions of [the Exchange Act] or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors."

would not be subject to the procedure outlined in Section 17A(k) to obtain an exemption from clearing agency registration, but would instead be considered in the context of an exemption from the clearing mandate. We preliminarily believe that providing substituted compliance in this area could help to facilitate the clearance and settlement of cross-border security-based swaps, while also promoting compliance with clearing mandates.

Under the proposed approach, upon the Commission's issuance of an order making a substituted compliance determination with respect to a particular foreign clearing agency, a counterparty to a security-based swap transaction that is subject to the mandatory clearing requirement would be able to rely on the Commission's substituted compliance determination to satisfy the mandatory clearing requirement by clearing such transaction on the specified foreign clearing agency.

The Commission's proposed approach to substituted compliance for clearing would be limited to foreign clearing agencies that have no U.S. person members or activities in the United States. A foreign clearing agency that meets these two threshold requirements could initiate the process of making a substituted compliance determination by filing an application, pursuant to the procedures set forth in proposed Rule 0-13,<sup>1161</sup> requesting that the Commission make a substituted compliance determination. Such application would need to include the reasons therefor and such other documentation as the Commission may request. To provide the Commission with enough information to make a substituted compliance determination, the application would have to include sufficiently comprehensive information regarding the clearing agency and the foreign regime such that the Commission has an adequate basis to make the substituted compliance determination.

In making a substituted compliance determination, the Commission expects that our review in such cases would include seeking appropriate assurances from the foreign clearing agency regarding the absence of U.S. person members and relevant activity in the United States, including the volume of clearing activity originating in the United States. In addition, the review would look at the scope and objectives of the applicable foreign jurisdiction's regulatory requirements, as well as the effectiveness of the supervisory

<sup>1161</sup> See Section XI.B, *supra*.

compliance program administered, and the enforcement authority exercised, by the relevant foreign financial regulatory authority or authorities to support the oversight of such clearing agency. Thus, the Commission's determination would take into account a foreign jurisdiction's overall regulatory framework, and would focus on the similarity of regulatory objectives in addition to the presence or absence of similar rules. We expect that our review of substituted compliance applications in this area would be aided by the resources available to the Commission as a result of cooperative relationships with other authorities that we expect would allow us to assess the risk characteristics of such foreign clearing agencies on an ongoing basis.<sup>1162</sup>

Subsequent to making a substituted compliance determination, the Commission would be able to modify or withdraw, at any time, an order containing such determination, after appropriate notice and opportunity for comment. This would allow the Commission to take action in the event that a foreign clearing agency, for any reason, is no longer suitable for substituted compliance.

The Commission's proposed approach to substituted compliance with respect to the mandatory clearing requirement differs from other Title VII categories where substituted compliance would be permitted in that we are not proposing a specific rule related to substituted compliance. We preliminarily do not believe that a rule is necessary in the clearing space, although we are soliciting comment on the issue in the request for comments below. This belief

<sup>1162</sup> See, e.g., FMI Principles, note 687, *supra*. Systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories ("Financial Market Infrastructures") are expected to observe the standards as soon as possible, and CPSS and IOSCO members are seeking to adopt the standards in their respective jurisdictions by the end of 2012. CPSS and IOSCO have also proposed assessment methodologies to oversee implementation of the FMI Principles, including self-assessments and external assessments, such as those conducted by the International Monetary Fund and the World Bank under the Financial Sector Assessment Program. See CPSS and Technical Committee of IOSCO, Assessment Methodology for the Principles for FMIs and the Responsibilities of Authorities (April 2012), available at: <http://www.bis.org/publ/cpss101b.pdf>. In addition, CPSS and the Technical Committee of IOSCO proposed a disclosure framework to ensure that disclosures made by FMIs are clear and comprehensive. See CPSS and Technical Committee of IOSCO, Disclosure Framework for Financial Market Infrastructures (April 2012), available at: <http://www.bis.org/publ/cpss101c.pdf>. Finally, see Basel III for a discussion of the preferential capital treatment that exposures to a central counterparty will receive if such central counterparty is supervised in a manner consistent with the FMI Principles.

stems in part from the fact that we do not expect a large number of requests for substituted compliance in this area due to the small number of security-based swap clearing agencies in the market. In addition, the Title VII clearing agency registration regime already contains a category of exempt security-based swap clearing agencies, and clearing security-based swaps through these entities satisfies the mandatory clearing requirement. As a result, we preliminarily believe that the proposed approach to substituted compliance in this area, whereby we are proposing a policy and procedural framework for the use of our exemptive authority in Section 36 of the Exchange Act, is sufficient to promote Title VII's clearing mandate while addressing the regulatory complexities that stem from the global scope of the security-based swaps market.

#### Request for comment

The Commission requests comment on all aspects of the proposed interpretation, including the following:

- Is substituted compliance related to the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act needed to prevent conflict with mandatory clearing requirements under foreign law? If so, is the proposed approach to substituted compliance sufficient to address the potential conflicts?

- Should the Commission apply Section 17A(k) of the Exchange Act under such circumstances to exempt particular foreign security-based swap clearing agencies to permit such clearing agencies to be used by counterparties subject to the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act? Are investor protection considerations sufficiently addressed if transactions are permitted to be cleared on a CCP that is not registered or exempt from registration? What conditions would need to be included to ensure the policy goals in the Dodd-Frank Act regarding central clearing are fulfilled? Should the conditions identified in Section 17A(k) that the clearing agency be available for inspection by the Commission and make available information requested by the Commission apply? Why or why not?

- Should the Commission codify the proposed approach to substituted compliance in the mandatory clearing space? Or is the proposed approach's reliance on the Commission's exemptive authority in Section 36 of the Exchange Act, and the procedures set forth in proposed Rule 0-13, sufficient? Why or why not?

- Are the conditions limiting the potential availability of substituted compliance to foreign clearing agencies that have no U.S. persons as members or activities in the United States appropriate? Are there other approaches that the Commission should consider? Should the Commission only consider a foreign clearing agency's CCP activities with regard to securities based swaps, or all type securities, in making a substituted compliance determination?

- What would be the market impact of the proposed approach to substituted compliance for the mandatory clearing requirement? How would the proposed approach affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed approach place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed approach be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

#### F. Trade Execution Requirement

Under the Commission's proposal, substituted compliance would be permitted for certain cross-border security-based swap transactions that would be subject to the mandatory trade execution requirement of Section 3C(h) of the Exchange Act. Specifically, under proposed Rule 3Ch-2(b)(1), the Commission could, conditionally or unconditionally, by order, make a substituted compliance determination with respect to a foreign jurisdiction to permit a person subject to the mandatory trade execution requirement to execute such transaction, or have such transaction executed on their behalf, on a security-based swap market (or class of markets) that is neither registered under the Exchange Act nor exempt from registration under the Exchange Act if the Commission determines that such security-based swap market (or class of markets) is subject to comparable, comprehensive supervision and regulation by a foreign financial regulatory authority or authorities in such foreign jurisdiction. Upon the Commission's issuance of an order making a substituted compliance determination with respect to a particular foreign jurisdiction under proposed Rule 3Ch-2(b), a counterparty to a security-based swap transaction that is subject to the mandatory trade execution requirement would be able to

rely on the substituted compliance determination by the Commission to satisfy the mandatory trade execution requirement by executing such transaction on a security-based swap market in such foreign jurisdiction, if such security-based swap market is covered by, or is in a class of markets that is covered by, the Commission's order.<sup>1163</sup>

Only transactions that meet the requirements of proposed Rule 3Ch-2(a), however, would be eligible for substituted compliance with respect to the mandatory trade execution requirement. Specifically, with respect to a foreign security-based swap market (or class of markets) for which the Commission has made a substituted compliance determination pursuant to proposed Rule 3Ch-2(b)(1), substituted compliance would only be available for security-based swap transactions where both of the following conditions apply to at least one counterparty to the transaction: (i) the counterparty is either a non-U.S. person or foreign branch of a U.S. bank;<sup>1164</sup> and (ii) the security-based swap transaction is not solicited, negotiated, or executed by a person within the United States on behalf of such counterparty.

Proposed Rule 3Ch-2(a) is designed to extend the availability of substituted compliance only to security-based transactions where one counterparty to the transaction is not acting directly or through an agent within the United States. The Commission preliminarily believes that transactions in which both counterparties utilize a U.S. person to act on their behalf to execute, solicit, or negotiate the transaction should not be eligible for substituted compliance and that it is appropriate to apply the mandatory trade execution requirement of Section 3C(h) of the Exchange Act to these transactions, and not foreign law. This approach should help mitigate any potential competitive advantage that non-U.S. intermediaries operating within the United States may have over U.S. intermediaries when facilitating security-based swap transactions on behalf of non-U.S. persons. It also should promote regulatory parity for U.S. and non-U.S. counterparties when they enter into security-based swap transactions within the United States. The Commission, however, solicits comments on this approach.

<sup>1163</sup> Proposed Rule 3Ch-2(a) under the Exchange Act.

<sup>1164</sup> Under proposed Rule 3Ch-1(c) under the Exchange Act, the term "foreign branch" would have the same meaning as set forth in proposed Rule 3a71-3(a)(1) under the Exchange Act. See Section III.B.7, *supra*.

By contrast, for transactions involving at least one counterparty that is a foreign branch or a non-U.S. person and for which no person within the United States is directly involved in executing, soliciting or negotiating the transaction on behalf of such non-U.S. person or foreign branch, the Commission preliminarily believes that such transactions should be eligible for substituted compliance in the foreign jurisdiction. The Commission believes that limiting eligibility for substituted compliance to such cross-border security-based swap transactions would promote the Title VII goals of transparency, access, competition, and anti-manipulation with respect to transactions that impact U.S. markets and market participants, and address the regulatory complexities that stem from the global scope of the security-based swaps market.

Under proposed Rule 3Ch-2(b)(2), in making a substituted compliance determination, the Commission would take into account such factors as the Commission determines are appropriate, such as the scope and objectives of the applicable foreign jurisdiction's regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by the relevant foreign financial regulatory authority or authorities to support the oversight of such security-based swap market (or class of markets). Thus, the Commission's determination would take into account a foreign jurisdiction's overall regulatory framework, and would focus on the similarity of regulatory objectives in addition to the presence or absence of similar rules. In addition, in making a substituted compliance determination with respect to a foreign jurisdiction, the Commission's determination could be with respect to a single security-based swap market within such jurisdiction, or a class of security-based swap markets within the jurisdiction. For instance, if a foreign jurisdiction imposes different levels of supervisory oversight with respect to different classes or categories of security-based swap markets, the Commission could apply a substituted compliance determination to an entire class of security-based swap markets in the foreign jurisdiction, enabling each security-based swap market of that class within such jurisdiction to rely on the substituted compliance determination.

Furthermore, under proposed Rule 3Ch-2(b)(3) under the Exchange Act, before issuing a substituted compliance order pursuant to proposed Rule 3Ch-2(b)(1) under the Exchange Act, the

Commission would be required to have entered into a supervisory and enforcement MOU or other arrangement with the relevant foreign financial regulatory authority or authorities addressing oversight and supervision of the security-based swap market (or class of markets) under the substituted compliance determination.

Under proposed Rule 3Ch-2(b)(4) under the Exchange Act, the Commission also would be able to modify or withdraw, at any time, an order containing a substituted compliance determination, after appropriate notice and opportunity for comment. This would allow the Commission to take action in the event that a security-based swap market (or class of markets), for any reason, is no longer suitable for substituted compliance.

The Commission notes that the factors the Commission would consider in making a substituted compliance determination with respect to mandatory trade execution would not necessarily be the same factors that the Commission would find relevant to a comparability determination for purposes of an exemption from registration as a SB SEF.<sup>1165</sup> The Commission preliminarily believes that possible factors, among others, it could consider when assessing the effectiveness of a foreign jurisdiction's supervisory compliance program may include the existence of a dedicated examination program; examiners with proper expertise; the existence of a risk monitoring framework and an examination plan; and a disciplinary program to enforce compliance with laws. The Commission, for example, could find the presence or absence of certain regulatory requirements in a particular foreign jurisdiction to be more relevant to a determination of whether a security-based swap market in that foreign jurisdiction should be exempt from registration as a SB SEF than to a substituted compliance determination with respect to mandatory trade execution. Accordingly, the Commission preliminarily believes that allowing substituted compliance with respect to mandatory trade execution for a foreign security-based swap market (or class of markets) would not necessarily result in a determination to exempt that foreign market (or class of markets) from registration as a SB SEF. However, the Commission generally solicits comments on the appropriateness or feasibility of this approach.

<sup>1165</sup> See Section VII.C, *supra*.

Proposed Rule 3Ch-2(c) under the Exchange Act provides that one or more security-based swap markets could initiate the process of making a substituted compliance determination by filing an application, pursuant to the procedures set forth in proposed Rule 0-13,<sup>1166</sup> requesting that the Commission make a substituted compliance determination. Such application would need to include the reasons therefor and such other documentation as the Commission may request. To provide the Commission with enough information to make a substituted compliance determination, the application would have to include sufficiently comprehensive information regarding the security-based swap market and the foreign regime such that the Commission has an adequate basis to make the substituted compliance determination set forth in proposed Rule 3Ch-2(b) under the Exchange Act.

#### Request for Comment

The Commission seeks comment on all aspects of proposed Rule 3Ch-2, including the following:

- The Commission generally solicits comments on the appropriateness and clarity of the proposed rule. Should additional details be included as to any aspect of this proposed rule? If so, for what aspects of the proposed rule would additional details be useful and why?
- As discussed above, under proposed Rule 3Ch-2(a) under the Exchange Act, substituted compliance would be permitted only for security-based swap transactions that have at least one counterparty that is a non-U.S. person or a foreign branch and the security-based swap transaction is not solicited, negotiated, or executed by a person within the United States on behalf of such counterparty. The Commission generally solicits comments on the appropriateness of permitting substituted compliance for the transactions described in proposed Rule 3Ch-2(a). Is the Commission's approach to defining the transactions that qualify for substituted compliance appropriate? If not, why not? Should some or all of the transactions described by the proposed rule not be eligible for substituted compliance? Should additional transactions not covered by the proposed rule be eligible for substituted compliance? In either case, please describe the transactions that should be eligible or ineligible for substituted compliance and provide the rationale for each.
- Does the proposed substituted compliance rule appropriately promote

<sup>1166</sup> See Section XI.B, *supra*.

the statutory objectives of the mandatory trade execution requirement, as well as the goal of international coordination? If not, how could this be better achieved? Would the objectives of Title VII be hindered by permitting persons to seek substituted compliance for the eligible transactions? If so, how?

- What is the likelihood that cross-border transactions would be subject to the mandatory trade execution requirements of foreign jurisdictions that conflict with the mandatory trade execution requirement of Section 3C(h) of the Exchange Act? For such transactions, would the complications stemming from such conflicting mandatory trade execution requirements be adequately addressed by permitting substituted compliance for the transactions described in the proposed rule? If not, why not? Please describe the complications, if any, that might still ensue even with substituted compliance. Would any conflicts likely arise for security-based swap transactions not covered by the proposed substituted compliance rule? If so, please describe those conflicts and how they would arise.

- Under proposed Rule 3Ch-2(b)(1), under the Exchange Act, the Commission may permit substituted compliance with respect to the mandatory trade execution requirement if a security-based swap market (or class of markets) is subject to comparable, comprehensive supervision and regulation by the relevant foreign financial regulatory authority or authorities. Is this comparability standard appropriate and sufficiently clear? Should additional detail be provided as to what would and would not satisfy this standard? If so, what additional detail should be provided? Should a different standard be used? If so, what should be the standard and why?

- In making a substituted compliance determination, under proposed Rule 3Ch-2(b)(2) under the Exchange Act, the Commission would consider such factors it determines are appropriate, such as the factors enumerated in proposed Rule 3Ch-2(b)(2) under the Exchange Act. Are these factors appropriate to such a determination? Are the enumerated factors too broad? Too narrow? Please explain. Should certain of these factors not be considered or should certain additional factors be enumerated in the proposed rule?

- As discussed above, in making a substituted compliance determination, the Commission would focus on the similarity of regulatory objectives in addition to the presence or absence of

similar rules. Is this holistic approach to making a substituted compliance determination appropriate? Why or why not? If not, what approach should the Commission take and why?

- As discussed above, the Commission preliminarily believes that the factors relevant to the Commission's substituted compliance determination for mandatory trade execution purposes would not necessarily be the same as the factors that the Commission would find relevant to a comparability determination for purposes of an exemption from registration as a security-based swap execution facility. The Commission generally solicits comments on the appropriateness of distinguishing the two determinations. Should the Commission consider the same factors in making a substituted compliance determination for mandatory trade execution and a comparability determination with respect to an exemption from registration as a security-based swap execution facility? If not, what factors would be relevant and appropriate to both determinations? Please describe. What factors would only be relevant or appropriate to a substituted compliance determination for mandatory trade execution or a comparability determination for an exemption from registration as a security-based swap execution facility, respectively? Please describe.

- Under proposed Rule 3Ch-2(c) under the Exchange Act, one or more security-based swap markets may file an application with the Commission to request that the Commission make a substituted compliance determination with respect to the mandatory trade execution requirement. Should persons other than security-based swap markets be permitted to file such substituted compliance applications? Why or why not? If so, what other types of persons should be permitted to file such applications? Please explain.

- What would be the market impact of proposed Rule 3Ch-2? How would the application of the proposed rule affect the competitiveness of U.S. entities in the global marketplace (both in the United States as well as in foreign jurisdictions)? Would the proposed rule place any market participants at a competitive disadvantage or advantage? If so, please explain. Would the proposed rule be a more general burden on competition? If so, please explain. What other measures should the Commission consider to implement the proposed approach? What would be the market impacts and competitiveness effects of alternatives to the proposed approach discussed in this release?

## Antifraud Authority

The provisions of the proposed rules and interpretive guidance, discussed above, relate solely to the applicability of the registration and mandatory reporting, clearing, and trade execution requirements under Title VII. The proposed rules and interpretive guidance do not limit the cross-border reach of the antifraud or other provisions of the federal securities laws to these entities.

In Section 929P(b) of the Dodd-Frank Act, Congress added provisions to the federal securities laws confirming the Commission's broad cross-border antifraud authority. Congress enacted Section 929P(b) in response to the Supreme Court's decision in *Morrison v. National Australia Bank*,<sup>1167</sup> which created uncertainty about the Commission's cross-border enforcement authority under the antifraud provisions of the federal securities laws. Prior to *Morrison*, the federal courts of appeals for nearly four decades had construed the antifraud provisions to reach cross-border securities frauds when the fraud either involved significant conduct within the United States causing injury to overseas investors, or had substantial foreseeable effects on investors or markets within the United States.<sup>1168</sup> With respect to the Commission's enforcement authority, Section 929P(b) codified the court of appeals' prior interpretation both as to the scope of the antifraud provisions' cross-border reach and the nature of the inquiry as one of subject-matter jurisdiction.<sup>1169</sup>

<sup>1167</sup> See 130 S. Ct. 2869, 2888 (2010) (holding in a Section 10(b) class action that "it is . . . only transactions in securities listed on domestic exchanges, and domestic transactions in other securities, to which § 10(b) applies").

<sup>1168</sup> See, e.g., *Schoenbaum v. Firstbrook*, 405 F.2d 200, 206 (2d Cir. 1968), modified on other grounds, 405 F.2d 215 (1968) (*en banc*).

<sup>1169</sup> See 156 Cong. Rec. H5237 (daily ed. June 30, 2010) (statement of Rep. Kanjorski, author of Section 929P(b)) ("In the case of *Morrison v. National Australia Bank*, the Supreme Court last week held that section 10(b) of the Exchange Act applies only to transactions in securities listed on United States exchanges and transactions in other securities that occur in the United States. In this case, the Court also said that it was applying a presumption against extraterritoriality. This bill's provisions concerning extraterritoriality, however, are intended to rebut that presumption by clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or the Justice Department. Thus, the purpose of the language of section 929P(b) of the bill is to make clear that in actions and proceedings brought by the SEC or the Justice Department, the specified provisions of the Securities Act, the Exchange Act and the Investment Advisers Act may have extraterritorial application, and that extraterritorial application is appropriate, irrespective of whether the securities are traded on a domestic exchange or the transactions occur in the United States, when the conduct within the United States is significant

Specifically, the Commission's antifraud enforcement authority under Section 17(a) of the Securities Act and the antifraud provisions of the Exchange Act—including Sections 9(j) and 10(b)—extends to “(1) conduct within the United States that constitutes significant steps in furtherance of [the antifraud violation], even if the securities transaction occurs outside the United States and involves only foreign investors,” and “(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”<sup>1170</sup> Similarly, the Commission's enforcement authority under Section 206 of the Investment Advisers Act applies broadly to reach “(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the violation is committed by a foreign adviser and involves only foreign investors,” and “(2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.”<sup>1171</sup>

The Commission's broad antifraud enforcement authority reflects the strong interest of the United States in applying the antifraud provisions to cross-border frauds that implicate U.S. territory, U.S. markets, U.S. investors or other U.S. market participants, or other U.S. interests.<sup>1172</sup> Doing so is necessary to ensure honest securities markets and high ethical standards in the U.S. securities industry, and thereby to promote confidence in our securities markets among both domestic and foreign investors. Cross-border application of the antifraud provisions is also critical for the protection of U.S. investors from securities frauds executed outside of the United States, but that threaten to produce, foreseeably do produce, or were otherwise intended to produce effects upon U.S. markets, U.S. investors or other U.S. market participants, or other U.S. interests.

or when conduct outside the United States has a foreseeable substantial effect within the United States.”). See also 156 Cong. Rec. S5915–16 (daily ed. July 15, 2010) (statement of Senator Reed).

<sup>1170</sup> Section 22 of the Securities Act, 15 U.S.C. 77v(a); Section 27 of the Exchange Act, 15 U.S.C. 78aa.

<sup>1171</sup> Section 214 of the Investment Advisers Act, 15 U.S.C. 80b–14.

<sup>1172</sup> See generally Restatement (Third) of Foreign Relations Law of the United States section 402 (1987), stating that “the United States has authority to prescribe law with respect to . . . conduct that, wholly or in substantial part, takes place within its territory; the status of persons, or interests in things, present within its territory” and “conduct outside its territory that has or is intended to have substantial effect within its territory”).

### XIII. General Request for Comment

#### A. General Comments

In responding to the specific requests for comment above, interested persons are encouraged to provide supporting data and analysis and, when appropriate, suggest modifications to proposed rule text. Responses that are supported by data and analysis provide great assistance to the Commission in considering the practicality and effectiveness of proposed new requirements as well as assessing the benefits and costs of proposed requirements. In addition, commenters are encouraged to identify in their responses a specific request for comment by indicating the section number of the release.

The Commission also seeks comment on the proposals as a whole. In particular, the Commission seeks comment on the following questions:

- How would the proposals integrate with provisions in other Titles and Subtitles of the Dodd-Frank Act and any domestic or global regulations or proposed regulations under those other Titles and Subtitles of the Dodd-Frank Act? For example, the Commission invites comment on how certain aspects of the proposals, such as registration and regulation of foreign security-based swap dealers and major security-based swap participants, and application of the transaction-level requirements, would integrate with regulation of systemically important financial institutions in Title I of the Dodd-Frank Act, regulation of registered broker-dealers and investment advisers, regulation of bank holding companies in the Bank Holding Company Act, and regulation of global systemically important financial institutions in other jurisdictions.

- For what aspects of the proposal should the Commission consider invoking our authority under Section 30(c) of the Exchange Act to prevent evasion? Please explain.

#### B. Consistency with CFTC's Cross-Border Approach

The CFTC has proposed interpretative guidance and a policy statement describing the cross-border application of certain swaps provisions of the CEA that were enacted by Title VII, and the CFTC's regulations promulgated thereunder.<sup>1173</sup> Specifically, the

<sup>1173</sup> The CFTC's guidance interprets Section 2(i) of the Commodity Exchange Act (“CEA”), as revised by Section 722(d) of the Dodd-Frank Act. Section 2(i) provides that Title VII's provisions relating to swaps, “(including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States unless

proposal addresses the registration requirement for swap dealers and major swap participants that are not U.S. persons, the application of Title VII requirements appurtenant to such registered entities, and the application of the clearing, trade execution, and certain reporting provisions under the CEA to cross-border swap transactions involving counterparties that are not swap dealers or major swap participants.

Understanding that the Commission and the CFTC regulate different products, participants, and markets, and have different statutory authority, and thus, appropriately may take different approaches to various issues, we nevertheless are guided by the objective of establishing consistent and comparable requirements to U.S. market participants. Accordingly, we request comments generally on (i) the impact of any differences between the Commission and CFTC approaches to the application of Title VII to cross-border activities, including the application of registration requirements and the substantive requirements of Title VII, (ii) whether the Commission's proposed application of Title VII in the cross-border context should be modified to conform to the proposals made by the CFTC, and (iii) whether any cross-border interpretations proposed by the CFTC, but not proposed by the Commission (whether as interpretations or rules), should be adopted by the Commission.

### XIV. Paperwork Reduction Act

#### A. Introduction

The Paperwork Reduction Act of 1995 (“PRA”) <sup>1174</sup> imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any “collection of information.”<sup>1175</sup> An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. In addition, 44 U.S.C. 3507(a)(1)(D) provides that before adopting (or revising) a collection of information requirement, an agency must, among other things, publish a notice in the **Federal Register** stating that the agency has submitted the proposed collection

those activities—(1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this Act that was enacted by the [Dodd-Frank Act].”

<sup>1174</sup> 44 U.S.C. 3501 *et seq.*

<sup>1175</sup> 44 U.S.C. 3502(3).

of information to the Office of Management and Budget (“OMB”) and setting forth certain required information, including: (1) A title for the collection of information; (2) a summary of the collection of information; (3) a brief description of the need for the information and the proposed use of the information; (4) a description of the likely respondents and proposed frequency of response to the collection of information; (5) an estimate of the paperwork burden that shall result from the collection of information; and (6) notice that comments may be submitted to the agency and director of OMB.<sup>1176</sup>

Certain provisions of proposed Rule 3a71–3, proposed Rule 3a71–5, proposed Rule 3Ch–2, re-proposed Forms SBSE, SBSE–A, and SBSE–BD, proposed Rule 18a–4, and re-proposed Rules 242.900 through 242.911 of Regulation SBSR contain “collection of information requirements” within the meaning of the PRA. Accordingly, the Commission is submitting these requirements to OMB for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title of these collections are [“Registration Rules for Security-Based Swap Entities,” “Disclosures by Certain Foreign Security-Based Swap Dealers and Major Security-Based Swap Participants,” “Reliance on Counterparty Representations Regarding Activity Within the United States,” “Requests for Cross-Border Substituted Compliance Determinations,” and “Reporting and Dissemination of Security-Based Swap Information.”] We are applying for OMB Control Numbers for the collections listed above in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13.

### B. Re-proposal of Form SBSE, Form SBSE–A, and Form SBSE–BD

#### 1. Summary of Collection of Information

On October 24, 2011, the Commission proposed Rules 15Fb1–1 through 15Fb6–1 and Forms SBSE, SBSE–A, SBSE–BD, SBSE–C, and SBSE–W to facilitate registration of, certification by, and withdrawal of SBS Entities, as required by Section 15F of the Exchange Act.<sup>1177</sup> In light of the Commission’s proposed rules regarding substituted compliance, the Commission is re-proposing Forms SBSE, SBSE–A, and SBSE–BD to add three questions to Form SBSE and Form SBSE–A, one question to Form SBSE–BD, and to amend Schedule F to those Forms as

described in more detail below.<sup>1178</sup> The Commission is not proposing to amend any of the other Forms, or any of the rules, proposed in the Registration Proposing Release. The burden estimates described below are designed to update our burden estimates for proposed Forms SBSE and SBSE–A to account for the revisions we are proposing to those two re-proposed forms. For information regarding the other burdens associated with proposed Rules 15Fb1–1 through 15Fb6–1 and Forms SBSE, SBSE–A, SBSE–BD, SBSE–C, and SBSE–W, please refer to the Registration Proposing Release.<sup>1179</sup>

Pursuant to paragraph (a) of proposed Rule 15Fb2–1, each SBS Entity would be required to file an application to register with the Commission.<sup>1180</sup> The Commission sought to reduce burdens and costs associated with the application process by providing alternate registration forms for certain types of SBS Entities (including Forms SBSE–A and SBSE–BD). Each SBS Entity would only need to research, complete, and file one of the proposed Forms.

Proposed Rule 15Fb2–3 would require that SBS Entities promptly amend their applications if they find that the information contained therein has become inaccurate.<sup>1181</sup> While SBS Entities may need to update their Forms periodically, each firm would only need to amend that aspect of the Form that has become inaccurate.

Proposed Rules 15Fb1–1 through 15Fb6–1 and re-proposed Forms SBSE, SBSE–A, and SBSE–BD would require that each respondent retain certain records and information for three years.<sup>1182</sup>

#### 2. Proposed Use of Information

Re-proposed Forms SBSE, SBSE–A, and SBSE–BD, as applicable, are applications through which SBS Entities would register with the Commission. Information collected through these re-proposed Forms SBSE, SBSE–A, and SBSE–BD would allow the Commission to determine whether applicants meet the standards for registration, including provisions regarding substituted compliance, and would help the Commission to fulfill our oversight responsibilities.

<sup>1178</sup> See Proposed Rule 3a71–5(c) under the Exchange Act; see also Section III.C, *supra*. The Commission is not proposing any changes to Form SBSE–BD, Form SBSE–C, or Form SBSE–W.

<sup>1179</sup> See Registration Proposing Release, 76 FR 65807.

<sup>1180</sup> *Id.* at 65820–21.

<sup>1181</sup> *Id.* at 65822.

<sup>1182</sup> See *id.* at 65821.

The Commission intends to make the information collected pursuant to proposed Rule 15Fb1–1 through 15Fb6–1 and re-proposed Forms SBSE, SBSE–A, and SBSE–BD public.

Any collections of information required pursuant to proposed Rules 15Fb1–1 through 15Fb6–1 and re-proposed Forms SBSE, SBSE–A, and SBSE–BD would be mandatory to permit the Commission to determine whether applicants meet the standards for registration, and to fulfill our oversight responsibilities.

#### 3. Respondents

In the Intermediary Definitions Adopting Release and Registration Proposing Release the Commission staff estimated, based on data obtained from DTCC and conversations with market participants, that approximately 50 entities would fit within the definition of a security-based swap dealer.<sup>1183</sup> The Commission staff also estimated in the Registration Proposing Release that up to five entities fit within the definition of major security-based swap participant.<sup>1184</sup> The Commission sought comment on the reasonableness and accuracy of our estimates, but received no comments regarding these estimates.

Of the 55 entities likely to be either security-based swap dealers or major security-based swap participants, the Commission staff estimates that 18 entities will be registered foreign security-based swap dealers, as defined in proposed Rule 3a71–3(a)(3) or foreign major security-based swap participants, as defined in proposed Rule 3a67–10(a)(1) (collectively, “Nonresident SBS Entities”).<sup>1185</sup> The Commission staff expects that most registered Nonresident SBS Entities will be based in one of a small number of non-U.S. jurisdictions; however, the Commission understands that approximately 19 jurisdictions are in the process of developing regulations and/or infrastructure for swaps, security-based

<sup>1183</sup> See Intermediary Definitions Adopting Release, 77 FR 30725; Registration Proposing Release, 76 FR 65808; see also Trade Acknowledgment Proposing Release, 76 FR 3868; External Business Conduct Standards Proposing Release, 76 FR 46668.

<sup>1184</sup> See Registration Proposing Release, 76 FR 65821; see also Intermediary Definitions Proposing Release, 75 FR 80209 n.188; Trade Acknowledgment Proposing Release, 76 FR 3868; External Business Conduct Standards Proposing Release, 76 FR 46668.

<sup>1185</sup> While the Commission estimated in the Registration Proposing Release that 22 non-resident entities would likely register with the Commission as SBS Entities (see Registration Proposing Release, 76 FR 65807–12), our estimates have changed based on the staff’s further analysis of the cross-border issues and likely respondents.

<sup>1176</sup> 44 U.S.C. 3507(a)(1)(D) (internal formatting omitted); see also 5 CFR 1320.5(a)(1)(iv).

<sup>1177</sup> See Registration Proposing Release, 76 FR 65784.

swaps, and other OTC derivatives.<sup>1186</sup> In addition, the Commission anticipates that a small number of security-based swap market participants could be based in other jurisdictions. As a result, the Commission staff estimate that cross-border issues may arise in connection with security-based swap market participants and transactions in and between up to 30 discrete jurisdictions.<sup>1187</sup>

In the Registration Proposing Release, Commission staff further estimated, based on its experience and understanding of the swap and security-based swap markets that of the firms that may register as SBS Entities, approximately 35 also will register with the CFTC as swap dealers or major swap participants, approximately 16 would also be registered with the Commission as broker-dealers, and approximately 4 firms not otherwise registered with the CFTC or the Commission will seek to become an SBS Entity.<sup>1188</sup> The Commission sought comment on the reasonableness and accuracy of our estimates, but has received no comments regarding these estimates to date.

The Commission again seeks comment on the reasonableness and accuracy of our estimates as to the number of participants in the security-based swap market that will be required to register with the Commission through the use of re-proposed Forms SBSE, SBSE-A, and SBSE-BD, including the number of registered foreign security-based swap dealers. The Commission also seeks comment on our estimate of the number of jurisdictions with security-based swap participants or infrastructure that may transact with or be used by U.S.-regulated entities.

<sup>1186</sup> See FSB Progress Report April 2013. These 19 jurisdictions are: Argentina, Australia, Brazil, Canada, China, the European Union, Hong Kong, India, Indonesia, Japan, Mexico, the Republic of Korea, Russia, Saudi Arabia, Singapore, South Africa, Switzerland, Turkey, and the United States. See also notes 35 and 36, *supra*.

<sup>1187</sup> The European Union is regulating OTC derivatives reporting, clearing, and bilateral risk management on a pan-European basis. Accordingly, the Commission may treat the European Union as a single jurisdiction for purposes of certain cross-border issues. However, the Commission notes that there may be variation between individual European countries even within this consolidated approach (e.g., privacy laws or supervisory oversight or enforcement may differ in various European countries).

<sup>1188</sup> See External Business Conduct Standards Proposing Release, 76 FR 46668.

#### 4. Total Initial and Annual Reporting and Recordkeeping Burdens

##### (a) Paperwork Burden Associated With Filing Application Forms

As indicated in the Registration Proposing Release, proposed Rule 15Fb2-1 would require that each SBS Entity register with the Commission by filing an application on Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate. Each SBS Entity would only need to research, complete, and file one form.<sup>1189</sup> The Commission is not proposing to amend this rule, but is re-proposing the Forms that would be filed to facilitate registration. The modifications to re-proposed Forms SBSE, SBSE-A, and SBSE-BD would add two questions to Form SBSE and Form SBSE-A, add one question to all three Forms, and would modify Schedule F to all the Forms.

The Commission staff does not believe that the addition of these questions will significantly increase the burdens associated with the filing of these forms. In the Registration Proposing Release, the Commission staff estimated that approximately four firms would need to register using proposed Form SBSE and that the total paperwork burden associated with filing each proposed Form SBSE (including the Schedules<sup>1190</sup> and disclosure reporting pages ("DRPs")) would be approximately 40 hours for each firm that would use this Form.<sup>1191</sup> The Commission staff acknowledged that it is likely that the time necessary to complete these forms would vary depending on the nature and complexity of an entity's business.<sup>1192</sup> The Commission staff believes, based on its experience with Form BD, that the addition of three new questions to Form SBSE included in the re-proposed Form SBSE could increase the amount of time it would take for an SBS Entity to complete this form by about two hours. Thus, the Commission staff estimates that it would take all 4 SBS Entities who may use Form SBSE to register with the Commission a total of approximately 168 hours to register using re-proposed Form SBSE.<sup>1193</sup> As each SBS Entity would only be required to file 1 complete form once, this would be a one-time burden associated with registration<sup>1194</sup> (the burden associated

<sup>1189</sup> *Id.* at 65820-21.

<sup>1190</sup> Except Schedule G (which we are not proposing to amend) and Schedule F (which is dealt with separately below).

<sup>1191</sup> Registration Proposing Release, 76 FR 65808.

<sup>1192</sup> *Id.*

<sup>1193</sup> 42 hours \* 4 firms = 168 hours.

<sup>1194</sup> While it is possible that another firm may choose to register as an SBS Entity at some future

with amendments to the form are discussed below).

As proposed, Form SBSE-A contains fewer questions than the proposed Form SBSE and is available only to firms that are (or will be) familiar with the registration process because they are registered (or will be registering) with the CFTC as a swap dealer or major swap participant. As a result, the Commission staff estimated in the Registration Proposing Release that it would take SBS Entities filing proposed Form SBSE-A approximately 80% of the time that it would take for an unregistered entity to research, complete, and file proposed Form SBSE (including the Schedules and DRPs).<sup>1195</sup> Accordingly, the Commission staff estimated that the total paperwork burden associated with filing each proposed Form SBSE-A across 35 firms would be approximately 32 hours for each firm who would use this Form.<sup>1196</sup> The Commission staff believes, based on its experience with Form BD, that the addition of 3 new questions to Form SBSE-A included in the re-proposed Form SBSE-A could increase the amount of time it would take for an SBS Entity to complete this form by about two hours. Thus, the Commission staff estimates that it would take all 35 SBS Entities who may use Form SBSE-A to register with the Commission a total of approximately 1,190 hours to register using re-proposed Form SBSE-A.<sup>1197</sup> As each SBS Entity would only be required to file 1 complete form once, this would be a one-time burden associated with registration<sup>1198</sup> (the burden associated with amendments to the form are discussed below).

As proposed, Form SBSE-BD contains fewer questions than both the proposed Form SBSE and Form SBSE-A and is available only to firms that are (or will

time, we presently estimate for purposes of this PRA that no additional firms will register in the next three years. This is because the Dodd-Frank Act imposed regulation on an existing industry and we expect those industry participants presently engaged in this business to either register when the rules become effective or decide to withdraw from this business. In addition, the costs to start-up an SBS Entity will likely be high, which may discourage new entrants. Finally, as the Commission has not yet promulgated rules to register or regulate these entities and we have no experience with the registration trends of SBS Entities over time, any estimate regarding the number of possible new entrants over time would be speculative.

<sup>1195</sup> Registration Proposing Release, 76 FR 65808. This estimate assumes that an entity that is familiar with an analogous registration process would require approximately 20% less time to complete Form SBSE-A compared to an unregistered entity completing Form SBSE.

<sup>1196</sup> *Id.*

<sup>1197</sup> 34 hours \* 35 firms = 1,190 hours.

<sup>1198</sup> See note 1194, *supra*.



be) familiar with the registration process because they are registered (or will be registering) with the Commission as a broker-dealer. As a result, the Commission staff estimated in the Registration Proposing Release that it would take SBS Entities filing proposed Form SBSE-BD approximately 25% of the time that it would take for an unregistered entity to research, complete, and file proposed Form SBSE (including the Schedules and DRPs).<sup>1199</sup> Accordingly, the Commission staff estimated that the total paperwork burden associated with filing each proposed Form SBSE-BD across sixteen firms would be approximately ten hours for each firm that would use this Form.<sup>1200</sup> The Commission staff believes, based on its experience with Form BD, that the addition of one new question to Form SBSE-BD included in the re-proposed Form SBSE-BD could increase the amount of time it would take for an SBS Entity to complete this form by about one half hour. Thus, the Commission staff estimates that it would take all sixteen SBS Entities that may use Form SBSE-BD to register with the Commission a total of approximately 168 hours to register using re-proposed Form SBSE-BD.<sup>1201</sup> As each SBS Entity would only be required to file one complete form once, this would be a one-time burden associated with registration<sup>1202</sup> (the burden associated with amendments to the form are discussed below).

(b) Paperwork Burden Associated With Amending Schedule F

As indicated in the Registration Proposing Release, proposed Rule 15Fb2-4 would require that each nonresident SBS Entity file an additional schedule (Schedule F) with its Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, to identify its U.S. agent for service of process and to certify that the firm can, as a matter of law, provide the Commission with access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission.<sup>1203</sup> The Commission is not proposing to amend this rule, but is re-proposing Schedule F. The modifications to re-proposed Schedule F would divide Schedule F into two sections. Section I would include the full text of the originally proposed Schedule F. Section II would elicit additional information regarding foreign

regulators with which the applicant may be registered or that otherwise have jurisdiction over the applicant.

The Commission staff does not believe that the addition of this new Section would significantly increase the burdens associated with the filing of Schedule F because information regarding the foreign regulators with jurisdiction over the entity should be known and readily available. In the Registration Proposing Release, the Commission staff estimated, based on its experience relative to the securities industry and Form BD, that the average time necessary for each Nonresident SBS Entity to complete and file Schedule F would be approximately one hour.<sup>1204</sup> The Commission staff believes, based on its experience with Form BD, that adding the new section to Schedule F could increase the amount of time it would take for an SBS Entity to complete this form by about one-half hour. Thus, the Commission staff estimates that it would take all 18 Non-resident SBS Entities who may use Schedule F to register with the Commission a total of approximately 27 hours complete Schedule F.<sup>1205</sup> As each SBS Entity would only be required to file Schedule F once, this would be a one-time burden associated with registration<sup>1206</sup> (the burden associated with amendments to the form—including the schedules—are discussed below).

(c) Paperwork Burden Associated With Amending Application Forms

As discussed in the Registration Proposing Release, proposed Rule 15Fb2-3 would require that SBS Entities amend their applications if they find that information contained in a prior filing has become inaccurate.<sup>1207</sup> The Commission is not proposing to amend this rule; however, the addition of three questions to proposed Forms SBSE and SBSE-A, the addition of one question to Form SBSE-BD, and the revisions to Schedule F would provide additional information that could change over time and require amendment of these Forms. As indicated in the Registration Proposing Release, the staff does not expect that the requirement to amend these Forms would impose a significant burden because each SBS Entity would have already completed proposed Forms SBSE, SBSE-A, or SBSE-BD, as applicable, and would only need to

amend those aspects of the Forms that may become inaccurate. In the Registration Proposing Release, the staff estimated, based on the number of amendments the Commission receives annually on Form BD, that each SBS Entity would file approximately three amendments annually.<sup>1208</sup> The staff also estimated in the Registration Proposing Release that, although the time necessary to file an amendment to proposed Forms SBSE, SBSE-A, or SBSE-BD, as applicable, would vary depending on the nature and complexity of the amendment, the Commission staff estimates the average total annual burden associated with amending proposed Forms SBSE, SBSE-A, and SBSE-BD would be approximately one hour for each amendment.<sup>1209</sup> The staff does not believe the addition of 3 questions included in each of re-proposed Forms SBSE and SBSE-A, the addition of one new question to re-proposed Form SBSE-BD, and the revision of Schedule F would increase either the number of amendments each firm may be required to file or the amount of time it would take for a firm to file an amendment.<sup>1210</sup> Thus we continue to believe the annual burden for associated with Rule 15Fb2-3 would be approximately 165 hours.<sup>1211</sup>

As indicated in the Registration Proposing Release, the collection of information relating to Forms SBSE, SBSE-A, SBSE-BD and Schedule F would be mandatory, and the Commission intends to make the information provided through these forms and Schedule F public.

5. Request for Comment on Paperwork Burden Estimates

The Commission seeks comment on the paperwork burdens associated with proposed Rules 15Fb1-1 through 15Fb6-1 and re-proposed Forms SBSE, SBSE-A, and SBSE-BD, as applicable.

- What burdens, if any, would respondents incur with respect to system design, programming, expanding systems capacity, and establishing compliance programs to comply with re-proposed Forms SBSE, SBSE-A, and SBSE-BD, as applicable?

<sup>1208</sup> *Id.*

<sup>1209</sup> *Id.*

<sup>1210</sup> The estimated number of amendments filed by each SBS Entity in the Registration Proposing Release was based on the number of amendments to Form BD filed annually by broker-dealers. See Registration Proposing Release, 76 FR 65809. We did not base our estimate on a comparison of the number or content of the questions, because we have no data upon which to base that type of estimate and we believe it would be too speculative.

<sup>1211</sup> 1 hour \* 3 amendments per year \* 55 SBS Entities = 165 hours.

<sup>1199</sup> Registration Proposing Release, 76 FR 65808.

<sup>1200</sup> *Id.*

<sup>1201</sup> 10½; hours \* 16 firms = 168 hours.

<sup>1202</sup> See note 1194, *supra*.

<sup>1203</sup> Registration Proposing Release, 76 FR 65822.

<sup>1204</sup> *Id.* at 65811.

<sup>1205</sup> 1½; hours \* 18 Non-resident SBS Entities = 27 hours.

<sup>1206</sup> See note 1194, *supra*.

<sup>1207</sup> Registration Proposing Release, 76 FR 65809.

• Is it likely that SBS Entities would complete re-proposed Forms SBSE, SBSE-A, and SBSE-BD, as applicable, themselves or is it more likely that they would obtain assistance in completing these forms from some outside entity (e.g., outside counsel)? If an SBS Entity obtains assistance in completing the forms from an outside entity, what type of entity may be utilized and what may the relative costs to employ such an entity for this purpose be?

• The Commission estimates that no new SBS Entities will register after year 1 because the security-based swap market is already well-developed and because of potentially significant barriers to entry for prospective market participants. Is this estimate accurate? If not, how many SBS Entities will register after year 1?

• Would there be different or additional paperwork burdens associated with the collection of information under re-proposed Forms SBSE, SBSE-A, and SBSE-BD, as applicable, that a respondent does not currently undertake in the ordinary course of business that the Commission has failed to identify? If so, please both describe and quantify any additional burden(s).

### C. Disclosures by Certain Foreign Security-Based Dealers and Major Security-Based Swap Participants

#### 1. Summary of Collection of Information

A registered foreign security-based swap dealer must disclose to any counterparty that is a U.S. person, prior to accepting any assets from, for, or on behalf of such counterparty to margin, guarantee, or secure a security-based swap, the potential treatment of any assets segregated by the registered foreign security-based swap dealer pursuant to Exchange Act Section 3E in an insolvency proceeding under U.S. bankruptcy law and any applicable foreign insolvency laws.<sup>1212</sup>

#### 2. Proposed Use of Information

The required disclosures would give U.S. counterparties important information regarding the treatment of their collateral and the role of U.S. and foreign law in any insolvency proceedings. The Commission preliminarily believes that this information would promote transparency and help counterparties in fully assessing the risks associated with their transactions. Moreover, without these disclosures, the Commission preliminarily believes that there is a risk that some U.S. counterparties could

assume, incorrectly, that any security-based swap transaction with a registered foreign security-based swap dealer or major security-based swap participant is automatically and fully subject to Title VII and other potentially applicable U.S. laws (e.g., U.S. bankruptcy law). These disclosures would make such confusion less likely and, as a result, help to ensure that U.S. counterparties conduct appropriate due diligence when transacting with foreign security-based swap dealers.

The disclosures required pursuant to proposed Rule 18a-4(e) under the Exchange Act would be mandatory for all registered foreign security-based swap dealers that enter into security-based swaps with counterparties that are not U.S. persons.

Registered foreign security-based swap dealers are required to disclose information pursuant to proposed Rule 18a-4(e) to their U.S. counterparties. Therefore, the Commission would not typically receive confidential information as a result of this collection of information. However, to the extent that the Commission receives confidential information pursuant to proposed Rule 18a-4(e) through our examination and oversight program, an investigation, or some other means, such information would be kept confidential, subject to the provisions of applicable law.<sup>1213</sup>

#### 3. Respondents

As discussed in Section B.3 above, the Commission staff estimates that there will be 18 Nonresident SBS Entities and that most of these firms will be based in one of a small number of non-U.S. jurisdictions.<sup>1214</sup> In addition, the Commission staff anticipates that a small number of security-based swap market participants could be based in other jurisdictions.<sup>1215</sup> As a result, the Commission staff estimates that cross-border issues may arise in connection with security-based swap market participants and transactions in and between up to 30 discrete jurisdictions.<sup>1216</sup>

<sup>1213</sup> See, e.g., 5 U.S.C. 552 (Exemption 4 of the Freedom of Information Act provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared by, or on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." 5 U.S.C. 552(b)(8)).

<sup>1214</sup> See Section XIV.B.3, *supra*.

<sup>1215</sup> *Id.*

<sup>1216</sup> *Id.*

#### 4. Total Initial and Annual Reporting Burdens

The estimates in this section reflect the Commission's experience with burden estimates for similar disclosure requirements and our staff's discussions with market participants.<sup>1217</sup> Pursuant to proposed Rule 18a-4(e)(3), registered foreign security-based swap dealers would be required to provide disclosures to their U.S. counterparties. The Commission believes that, in most cases, these disclosures would be made through amendments to the registered foreign security-based swap dealer's existing trading documentation. Because these disclosures relate to new regulatory requirements, the Commission anticipates that all registered foreign security-based swap dealers would need to incorporate new language into their existing trading documentation with U.S. counterparties. Disclosure of the potential treatment of segregated assets in insolvency proceedings under U.S. bankruptcy law and foreign insolvency laws pursuant to proposed Rule 18a-4(e)(3) would likely vary depending on the counterparty's jurisdiction. Accordingly, the Commission expects that these disclosures often may need to be tailored to address the particular circumstances of each trading relationship. However, in some cases, trade associations or industry working groups may be able to develop standard disclosure forms that can be adopted by foreign security-based swap dealers with little or no modification. In either case, the paperwork burden associated with developing new disclosure language and incorporating this language into a registered foreign security-based swap dealer's trading documentation will vary depending on: (1) the number of non-U.S. counterparties with whom the registered foreign security-based swap dealer trades; (2) the number of jurisdictions represented by the registered foreign security-based swap dealer's counterparties; and (3) the availability of standardized disclosure language. To the extent standardized disclosures become available, the paperwork burden on registered foreign security-based swap dealers would be limited to amending existing trading

<sup>1217</sup> See External Business Conduct Standards Proposing Release, 76 FR 42396; see also Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments, Securities Act Release No. 7386 (Jan. 31, 1997), 62 FR 6044 (Feb. 10, 1997).

<sup>1212</sup> Proposed Rule 18a-4(e)(3) under the Exchange Act.

documentation to incorporate the standardized disclosures. Conversely, more time will be necessary where a greater degree of customization is required to develop the required disclosures and incorporate this language into existing documentation.

The Commission estimates the maximum total paperwork burden associated with developing new disclosure language would be approximately 2,700 hours, plus \$2.1 million for all 18 foreign security-based swap dealers and 30 jurisdictions.<sup>1218</sup> This estimate assumes little or no reliance on standardized disclosure language. In addition, the Commission estimates the total paperwork burden associated with incorporating new disclosure language into each foreign security-based swap dealer's trading documentation would be approximately 9,000 hours for all 18 foreign security-based swap dealers.<sup>1219</sup>

The Commission expects that the majority of the paperwork burden associated with the new disclosure requirements will be experienced during the first year as language is developed, whether by individual foreign security-based swap dealers or through collaborative efforts, and trading documentation is amended. After the new disclosure language is developed and incorporated into trading documentation, the Commission believes that the ongoing burden associated with proposed Rule 18a-4(e) would be limited to periodically updating the disclosures to reflect changes in the applicable law or to incorporate new jurisdictions with security-based swap counterparties. The Commission estimates that this ongoing paperwork burden would not exceed 100 hours per year for all 18 foreign security-based swap dealers (approximately 5 hours per foreign security-based swap dealer per year).

<sup>1218</sup> The Commission staff estimates the total paperwork burden associated with developing new disclosure language for each foreign security-based swap dealer would be 150 hours of in-house counsel time (5 hours of in-house counsel time \* up to 30 potential jurisdictions), plus \$120,000 (based on 10 hours of outside counsel time \* \$400 \* up to 30 potential jurisdictions).

<sup>1219</sup> The Commission staff estimate that the average Nonresident SBS Entity will have 50 active non-U.S. counterparties. Accordingly, the Commission staff estimates the cost of incorporating new disclosure language into the trading documentation of an average foreign security-based swap participant would be 500 hours per foreign security-based swap participant (based on 10 hours of in-house counsel time \* 50 active non-U.S. counterparties).

## 5. Request for Comment on Paperwork Burden Estimates

The Commission seeks comment on the paperwork burdens associated with proposed Rule 18a-4(e).

- Is it likely that foreign security-based swap participants will have more than 50 active non-U.S. counterparties?
- In how many discrete jurisdictions do most foreign security-based swap participants have counterparties?
- In general, is the proposed collection of information necessary for the proper performance of the Commission's functions? Will the proposed collection of information have practical utility to the Commission and Commission staff?
- Are the Commission's estimates of the paperwork burden of the proposed collection accurate?
- Is the Commission's estimate of the expected ongoing burden associated with updating and maintaining the disclosures in proposed Rule 18a-4(e) reasonable? If not, why?
- Are there ways for the Commission to enhance the quality, utility, and clarity of the information collected? Are there ways for the Commission to minimize the paperwork burden of the proposed collection of information (e.g., through the use of automated collection techniques or other forms of information technology)? If so, please describe.

### D. Reliance on Counterparty Representations Regarding Activity Within the United States

#### 1. Summary of Collection of Information

When determining whether a security-based swap is a "transaction conducted through a foreign branch," as defined in proposed Rule 3a71-3(a)(4)(i) under the Exchange Act, a party may rely on a representation from its counterparty indicating that "no person within the United States is directly involved in soliciting, negotiating, or executing" the transaction on behalf of the counterparty, unless the party receiving the representation knows that it is not accurate.<sup>1220</sup> Similarly, when determining whether a security-based swap is a "transaction conducted within the United States," as defined in proposed Rule 3a71-3(a)(5)(i), a party may rely on a representation from its counterparty indicating that the transaction "is not solicited, negotiated, executed, or booked within the United States by or on behalf of such counterparty," unless the party

<sup>1220</sup> Proposed Rule 3a71-3(a)(4)(ii) under the Exchange Act.

receiving the representation knows that it is not accurate.<sup>1221</sup>

#### 2. Proposed Use of Information

Under the proposed rules, certain Title VII requirements would not apply to cross-border transactions conducted through a foreign branch of a U.S. bank where the foreign branch is the named counterparty to the transaction and no person within the United States is directly involved in soliciting, negotiating, or executing the security-based swap on behalf of the foreign branch or its counterparty. For example, under the proposed rules, a non-U.S. person would not be required to count toward the *de minimis* threshold in the security-based swap dealer definition its transactions with the foreign branch of a U.S. bank. Conversely, certain Title VII requirements would apply to transactions conducted within the United States, even if both counterparties are non-U.S. persons.

The Commission acknowledges that verifying whether a security-based swap falls within the definition of a "transaction conducted through a foreign branch" or a "transaction conducted within the United States" could require significant due diligence. The Commission preliminarily believes that the representations described in proposed Rule 3a71-3(a)(4)(ii) and proposed Rule 3a71-3(a)(5)(ii) would mitigate the operational difficulties that could arise in connection with investigating the activities of a counterparty to ensure compliance with the corresponding rules.

The representations described in proposed Rule 3a71-3(a)(4)(ii) and proposed Rule 3a71-3(a)(5)(ii) would be provided voluntarily by the counterparties to certain security-based swap transactions; therefore, the Commission would not typically receive confidential information as a result of this collection of information. However, to the extent that the Commission receives confidential information described in proposed Rule 3a71-3(a)(4)(ii) or proposed Rule 3a71-3(a)(5)(iii) through our examination and oversight program, an investigation, or some other means, such information would be kept confidential, subject to the provisions of applicable law.<sup>1222</sup>

<sup>1221</sup> Proposed Rule 3a71-3(a)(5)(ii) under the Exchange Act.

<sup>1222</sup> See, e.g., 5 U.S.C. 552 (Exemption 4 of the Freedom of Information Act provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are "contained in or related to examination, operating, or condition

### 3. Respondents

Based on our understanding of the OTC derivatives markets, including the size of the market, the number of counterparties that are active in the market, and how market participants currently structure security-based swap transactions, the Commission preliminarily estimates that 50 entities may include a representation that a security-based swap is a “transaction conducted through a foreign branch” in their trading relationship documentation (e.g., the schedule to a master agreement). Similarly, the Commission preliminarily estimates that 250 entities may include a representation that a security-based swap is not a “transaction conducted within the United States.”<sup>1223</sup>

### 4. Total Initial and Annual Reporting and Recordkeeping Burdens

The estimates in this section reflect the Commission’s experience with burden estimates for similar requirements and our discussions with market participants.<sup>1224</sup> Pursuant to proposed Rules 3a71–3(a)(4)(ii) and 3a71–3(a)(5)(iii), parties to security-based swaps would be permitted to rely on certain representations from their counterparties when determining whether a transaction falls within the definition of a “transaction conducted through a foreign branch” or a “transaction conducted within the United States.” The Commission preliminarily believes that, in most cases, these representations would be made through amendments to the parties’ existing trading documentation (e.g., the schedule to a master agreement).<sup>1225</sup> Because these representations relate to new regulatory requirements, the Commission anticipates that counterparties may elect to develop and incorporate these representations in trading documentation soon after the effective

reports prepare by, or on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.” 5 U.S.C. 552(b)(8)).

<sup>1223</sup> For a more detailed discussion, see discussion of the number of market participants that may be reporting counterparties in Section XIV.F.2.d.ii, *infra*.

<sup>1224</sup> See External Business Conduct Standards Proposing Release, 76 FR 42396.

<sup>1225</sup> The Commission preliminarily believes that because trading relationship documentation is established between two counterparties, whether one or both counterparties is able to represent that it is entering into a “transaction conducted through a foreign branch” or a “transaction conducted within the United States” would not change on a transaction-by-transaction basis and, therefore, such representations would generally be made in the schedule to a master agreement, rather than in individual confirmations.

date of the Commission’s security-based swap regulations, rather than incorporating specific language on a transactional basis. The Commission believes that parties would be able to adopt, where appropriate, standardized language across all of their security-based swap trading relationships. This language may be developed by individual firms or through a combination of trade associations and industry working groups.

The Commission estimates the maximum total paperwork burden associated with developing new representations would be, for each entity, no more than approximately three to five hours, plus between \$1,200 and \$2,000 for the services of outside professionals, for a maximum of approximately 1,500 hours and \$600,000 across all security-based swap counterparties.<sup>1226</sup> This estimate assumes little or no reliance on standardized disclosure language. In addition, the Commission estimates the total paperwork burden associated with incorporating new disclosure language would be no more than approximately three to five hours per counterparty, for a maximum of approximately 15,000 hours across all applicable security-based swap counterparties.<sup>1227</sup>

The Commission expects that the majority of the burden associated with the new disclosure requirements will be experienced during the first year as language is developed and trading documentation is amended. After the new representations are developed and incorporated into trading documentation, the Commission believes that the annual paperwork burden associated with this requirement would be no more than approximately 10 hours per counterparty for verifying representations with existing

<sup>1226</sup> Because the representations will be short and based on facts that should be known and readily available to the entity making the representation, the Commission staff estimates the paperwork burden associated with developing new representations would range from three to five hours of in-house counsel time, plus \$1,200 to 2,000 for the services of outside professionals (based on three to five hours of outside counsel time \* \$400). The Commission staff estimates that the burden for counterparties that only require one of the two representations would be at the lower end of this range.

<sup>1227</sup> The Commission staff estimates that the average security-based swap counterparty (including security-based swap dealers and buy-side counterparties) will have no more than 10 active counterparties able to represent that a transaction is conducted through a foreign branch, not conducted within the United States, or both. Accordingly, the Commission staff estimates the total burden associated with incorporating new disclosure language into the relevant trading documentation would be 15,000 hours (based on five hours per counterparty \* 300 respondents \* 10 applicable security-based swap counterparties).

counterparties and onboarding new counterparties, for a maximum of approximately 3,000 hours across all applicable security-based swap counterparties.<sup>1228</sup>

### 5. Request for Comment on Paperwork Burden Estimates

The Commission seeks comment on the paperwork burdens associated with proposed Rules 3a71–3(a)(4)(ii) and 3a71–3(a)(5)(ii).

- Are the Commission’s estimates of the numbers of market participants that will include a representation that a security-based swap is a “transaction conducted through a foreign branch” or not a “transaction conducted within the United States” reasonable? Are these estimates likely to become incorrect as a result of changes in the OTC derivatives markets? If so, how?

- Is the Commission’s estimate that a representation that a security-based swap is a “transaction conducted through a foreign branch” or not a “transaction conducted within the United States” will be made in a schedule to a master agreement rather than in individual confirmations reasonable? If not, where will these representations be made?

- In general, is the proposed collection of information necessary for the proper performance of the Commission’s functions? Will the proposed collection of information have practical utility to the Commission and Commission staff?

- Are the Commission’s estimates of the paperwork burden of the proposed collection accurate?

- Is the Commission’s estimate of the cost of outside counsel reasonable?

- Are there ways for the Commission to enhance the quality, utility, and clarity of the information collected? Are there ways for the Commission to minimize the paperwork burden of the proposed collection of information (e.g., through the use of automated collection techniques or other forms of information technology)? If so, please describe.

### E. Requests for Cross-Border Substituted Compliance Determinations

#### 1. Summary of Collection of Information

The Commission is proposing to apply various Title VII provisions to SBS Entities and related market infrastructures on a cross-border basis. However, as noted above, the Commission would permit, in appropriate circumstances, compliance

<sup>1228</sup> The Commission staff estimates that this burden would consist of 10 hours of in-house counsel time for each security-based swap market participant.

with comparable regulatory requirements in a foreign jurisdiction to substitute for compliance with certain requirements of the Exchange Act, and rules and regulations thereunder, relating to security-based swaps. As proposed, the Commission would consider making substituted compliance determinations with respect to four distinct categories of rules: (1) requirements applicable to registered foreign security-based swap dealers under Section 15F of the Exchange Act and the rules and regulations thereunder pursuant to proposed Rule 3a71-5(c) under the Exchange Act; (2) requirements relating to regulatory reporting and public dissemination of security-based swaps pursuant to re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR; (3) requirements relating to clearing for security-based swaps;<sup>1229</sup> and (4) requirements relating to trade execution for security-based swaps pursuant to proposed Rule 3Ch-2(c) under the Exchange Act.

Requests for a substituted compliance determination would come from registered foreign security-based swap dealers or other persons.<sup>1230</sup> However, under the proposed rules noted above, the Commission would make any determinations with respect to particular requirements on a class or jurisdiction basis, depending on the specific characteristics of the foreign regulatory regime, rather than on a firm-by-firm basis.<sup>1231</sup> Once the Commission has made a substituted compliance determination, other similarly situated market participants would be able to rely on that determination to the extent applicable and subject to any corresponding conditions. Accordingly, the Commission expects that requests for a substituted compliance determination would be made only where an entity seeks to rely on particular requirements of a foreign jurisdiction that have not previously been the subject of a substituted compliance request. The Commission believes that this approach would substantially reduce the burden associated with requesting substituted

compliance determinations for an entity that relies on a previously issued determination, and, therefore, complying with the Commission's rules and regulations more generally.<sup>1232</sup>

When applying for a substituted compliance determination under one of the proposed rules, an entity would be required to provide the Commission with any supporting documentation as the Commission may request, in addition to information that the entity believes is necessary for the Commission to make a determination, such as information demonstrating that the requirements applied in the foreign jurisdiction are comparable to the Commission's and describing the methods used by relevant foreign financial regulatory authorities to monitor compliance with those requirements. A foreign security-based swap dealer (or a group of foreign security-based swap dealers of the same class) seeking a substituted compliance determination with respect to one or more requirements in Section 15F of the Exchange Act and the rules and regulations thereunder also must demonstrate that it is directly supervised by the foreign financial regulatory authority (with respect to requirements relating to the applicable requirements in Section 15F of the Exchange Act) and provide the certification and opinion of counsel, as described in Rule 15Fb2-4(c).<sup>1233</sup>

The Commission is proposing that applicants follow the procedures set forth in proposed Rule 0-13 under the Exchange Act for an application requesting a substituted compliance determination.<sup>1234</sup>

## 2. Proposed Use of Information

The Commission would use the information collected pursuant to proposed Rule 3a71-5(c) under the Exchange Act to evaluate requests for substituted compliance with respect to requirements applicable to registered security-based swap dealers (or classes thereof) under Section 15F of the Exchange Act and the rules and regulations thereunder. The Commission would use the information collected pursuant to re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR to evaluate requests for substituted compliance with regard to requirements applicable to regulatory reporting and public dissemination of security-based

swaps. Finally, the Commission would use the information collected pursuant to proposed Rule 3Ch-2(c) under the Exchange Act to evaluate requests for substituted compliance with regard to requirements relating to trade execution for security-based swaps.

The requests for substituted compliance determinations in proposed Rule 3a71-5, re-proposed Rule 242.908(c)(2)(ii), and proposed Rule 3Ch-2(c) under the Exchange Act are required when a person seeks a substituted compliance determination.

The Commission intends to make public the information submitted to it pursuant to any request for a substituted compliance determination under proposed Rules 3a71-5, re-proposed Rule 242.908(c)(2)(ii), and proposed Rule 3Ch-2(c) under the Exchange Act, including supporting documentation provided by the requesting party.

## 3. Respondents

As discussed in Section XIV.B.3 above, the Commission preliminarily estimates that there will be 22 Nonresident SBS Entities and that most of these firms will be based in one of a small number of non-U.S. jurisdictions.<sup>1235</sup> In addition, the Commission staff anticipates that a small number of security-based swap market participants could be based in other jurisdictions.<sup>1236</sup> As a result, the Commission staff estimates that requests for substituted compliance determinations may arise in connection with security-based swap market participants and transactions in and between up to 30 discrete jurisdictions.<sup>1237</sup>

## 4. Total Initial and Annual Reporting and Recordkeeping Burdens

Proposed Rule 3a71-5 under the Exchange Act, proposed Rule 3Ch-2(c) under the Exchange Act, and re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR would require submission of certain information to the Commission to the extent entities elect to request a substituted compliance determination with respect to one or more areas where the Commission has issued rules under the Dodd-Frank Act.

### (a) Proposed Rule 3a71-5

Proposed Rule 3a71-5(c) under the Exchange Act would apply only to registered foreign security-based swap dealers (or classes thereof) that request a substituted compliance determination with regard to one or more requirements

<sup>1229</sup> The Commission is not proposing a rule regarding the substituted compliance process for the mandatory clearing requirement. See Section XI.E, *supra*.

<sup>1230</sup> As discussed above, the Commission is not proposing to permit substituted compliance for registered foreign major security-based swap participants.

<sup>1231</sup> Requests for substituted compliance determinations under proposed Rule 3a71-5(c) under the Exchange Act must come directly from a foreign security-based swap dealer (or a group of such dealers); foreign financial regulatory authorities may not request such a determination. Proposed Rule 3a71-5(c) under the Exchange Act.

<sup>1232</sup> The paperwork burden associated with requesting substituted compliance determinations is discussed in detail in Section XIV.E.4 below.

<sup>1233</sup> Proposed Rule 3a71-5(c); see also Section XIV.B, *supra*.

<sup>1234</sup> See Section XI.B, *supra* (discussing proposed Rule 0-13 under the Exchange Act).

<sup>1235</sup> See Section XIV.B.3, *supra*.

<sup>1236</sup> *Id.*

<sup>1237</sup> *Id.*

in Section 15F of the Exchange Act and the rules and regulations thereunder. As discussed above, in connection with each request, a registered foreign security-based swap dealer would be required to provide the Commission with any supporting documentation it believes necessary for the Commission to make a determination that its foreign financial regulatory authority or authorities have established requirements that are comparable to requirements otherwise applicable to a U.S. security-based swap dealer. Among other things, a foreign security-based swap dealer would be required to provide the Commission with information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor compliance with these rules. All such supporting documentation would be made public.<sup>1238</sup>

A registered foreign security-based swap dealer would not be required to make a request with respect to rules and regulations of a foreign jurisdiction that have previously been the subject of a substituted compliance determination. Given that only a relatively small number of jurisdictions have substantial OTC derivatives markets and are implementing OTC derivatives reforms, the Commission estimates that it will receive no more than 50 requests for substituted compliance determinations pursuant to proposed Rule 3a71-5.<sup>1239</sup> This estimate accounts for the fact that the Commission may receive multiple requests from each jurisdiction (e.g., separate requests from bank and nonbank entities).<sup>1240</sup> Because the Commission preliminarily expects that registered foreign security-based swap dealers will seek to rely on substituted compliance upon registration, the Commission believes that these requests will be made during the first year following the effective date.<sup>1241</sup>

The Commission staff estimates that the total paperwork burden associated with preparing and submitting a request for a substituted compliance determination pursuant to proposed Rule 3a71-5(c) would be approximately 4,000 hours, plus \$4 million for the services of outside professionals for all 50 requests.<sup>1242</sup> These total costs include all collection burdens associated with the proposed rule, including burdens associated with analyzing and comparing the regulatory requirements of the foreign jurisdiction with the requirements in Section 15F of the Exchange Act and the rules and regulations thereunder.

(b) Re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR

Re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR would apply to any person that requests a substituted compliance determination with respect to a foreign jurisdiction's rules regarding regulatory reporting and public dissemination of security-based swaps. In connection with each request, the requesting party would be required to provide the Commission with any supporting documentation that the entity believes is necessary for the Commission to make a determination, including information demonstrating that the requirements applied in the foreign jurisdiction are comparable to the Commission's and describing the methods used by relevant foreign financial regulatory authorities to monitor compliance with those requirements.<sup>1243</sup> The Commission preliminarily estimates that the total paperwork burden associated with submitting a request for a substituted compliance determination with respect to regulatory reporting and public dissemination would be approximately 1,120 hours, plus \$1,120,000 for 14 requests.<sup>1244</sup> This estimate includes all collection burdens associated with the request, including burdens associated

with analyzing whether the regulatory requirements of the foreign jurisdiction impose a comparable, comprehensive system for the regulatory reporting and public dissemination of all security-based swaps. Furthermore, this estimate assumes that each request would be prepared *de novo*, without any benefit of prior work on related subjects. The Commission notes, however, that as such requests are developed with respect to certain jurisdictions, the cost of preparing such requests with respect to other foreign jurisdictions could decrease.

Because only a small number of jurisdictions have substantial OTC derivatives markets and are implementing OTC derivatives reforms, the Commission preliminarily estimates that it would receive approximately 10 requests in the first year for substituted compliance determinations with respect to regulatory reporting and public dissemination pursuant to re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR. Assuming 10 requests in the first year, the Commission staff estimates an aggregated burden for the first year would be 800 hours, plus \$800,000 for the services of outside professionals.<sup>1245</sup> The Commission preliminarily estimates that it would receive 2 requests for substituted compliance determinations pursuant to re-proposed Rule 242.908(c)(2)(ii) in each subsequent year. Assuming the same approximate time and costs, the aggregate burden for each year following the first year would be up to 160 hours of company time and \$160,000 for the services of outside professionals.<sup>1246</sup>

(c) Proposed Rule 3Ch-2(c)

Finally, proposed Rule 3Ch-2(c) under the Exchange Act would apply to any person who requests a substituted compliance determination with respect to the rules of a foreign jurisdiction relating to trade execution for security-based swaps. In connection with each request, the requesting party would be required to provide the Commission

<sup>1242</sup> The Commission staff estimates that the paperwork burden associated with making each substituted compliance request pursuant to proposed Rule 3a71-5 would be approximately 80 hours of in-house counsel time, plus \$80,000 for the services of outside professionals (based on 200 hours of outside counsel time \* \$400). The paperwork burden associated with the opinion of counsel referenced in proposed Rule 3a71-5 is discussed in the Registration Proposing Release in connection with proposed Rule 15Fb2-4(c). See Registration Proposing Release, 76 FR 65811.

<sup>1243</sup> See Section VIII.C, *supra*.

<sup>1244</sup> The Commission staff estimates that the paperwork burden associated with making a substituted compliance request pursuant to re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR would be approximately 80 of in-house counsel time, plus \$80,000 for the services of outside professionals (based on 200 hours of outside counsel time \* \$400).

<sup>1245</sup> The Commission staff estimates that the paperwork burden associated with making a substituted compliance request pursuant to re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR would be up to approximately 800 hours (80 hours of in-house counsel time \* 10 respondents), plus \$800,000 for the services of outside professionals (based on 200 hours of outside counsel time \* \$400 \* 10 respondents).

<sup>1246</sup> The Commission staff estimates that the paperwork burden associated with making a substituted compliance request pursuant to re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR would be up to approximately 160 hours (80 hours of in-house counsel time \* two respondents) + plus \$160,000 for the services of outside professionals (based on 200 hours of outside counsel time \* \$400 \* two respondents).

<sup>1238</sup> See Section XIV.B, *supra*.

<sup>1239</sup> See Section XIV.B.3, *supra*.

<sup>1240</sup> The Commission preliminarily estimates that it may receive requests for substituted compliance determinations for up to 30 different jurisdictions. In approximately two-thirds of those jurisdictions, the Commission preliminarily estimates that it may receive requests from more than one type of market participant (e.g., a bank and a non-bank security-based swap dealer).

<sup>1241</sup> For purposes of this estimate, the Commission has assumed that proposed Rules 3a71-3 and 3a71-5 will be implemented contemporaneously. If the Commission requires registration before certain substituted compliance determinations are finalized, the Commission staff may receive requests for substituted compliance determinations pursuant to proposed Rule 3a71-5 after the first year following the effective date.

with certain supporting information.<sup>1247</sup> However, a person would not be required to make a request with respect to rules and regulations of a foreign jurisdiction related to trade execution that have previously been the subject of a substituted compliance determination. As discussed above, because only a relatively small number of jurisdictions have substantial OTC derivatives markets and are implementing OTC derivatives reforms, the Commission estimates that it will receive no more than 25 requests for substituted compliance determinations pursuant to proposed Rule 3Ch-2(c).<sup>1248</sup> Moreover, because market participants will likely seek to rely on substituted compliance upon registration, the Commission believes that many of these requests will be made during the first year following the effective date. However, because some jurisdictions may not fully implement their trade execution requirements in the immediate future, the Commission staff estimates that it may receive requests for substituted compliance determinations pursuant to proposed Rule 3Ch-2(c) for several years following the effective date.<sup>1249</sup>

The Commission preliminarily believes that the total paperwork burden associated with preparing and submitting a request for a substituted compliance determination pursuant to proposed Rule 3Ch-2(c) will be 2,000 hours and associated costs of \$2 million for the services of outside professionals, including attorneys.<sup>1250</sup> These total costs include all collection burdens associated with the proposed rule, including burdens associated with analyzing whether the regulatory requirements of the foreign jurisdiction impose a comparable, comprehensive system for the regulatory reporting and

public dissemination of all security-based swaps.

Assuming 17 requests in the first year, the Commission staff estimates an aggregated burden for the first year would be 1,360 hours, plus approximately \$1,360,000 for the services of outside professionals.<sup>1251</sup> The Commission preliminarily estimates that it would receive 4 requests for substituted compliance determinations pursuant to re-proposed Rule 3Ch-2(c) in each subsequent year. Assuming the same approximate time and costs, the aggregate burden for each year following the first year would be up to 320 hours of company time and \$320,000 for the services of outside professionals.<sup>1252</sup>

#### Request for Comment

The Commission seeks comment on the paperwork burdens associated with proposed Rules 3a71-5(c) under the Exchange Act, re-proposed Rule 242.908(c)(2)(ii) of Regulation SBSR, and proposed Rule 3Ch-2(c) under the Exchange Act.

- Are the Commission's estimates of the numbers of substituted compliance determinations reasonable? Are these estimates likely to become incorrect as a result of changes in the OTC derivatives markets? If so, how?

- In general, is the proposed collection of information necessary for the proper performance of the Commission's functions? Will the proposed collection of information have practical utility to the Commission and Commission staff?

- Are the Commission's estimates of the paperwork burden of the proposed collection accurate? Is the Commission's estimate of the cost of outside counsel reasonable?

- Are there ways for the Commission to enhance the quality, utility, and clarity of the information collected? Are there ways for the Commission to minimize the paperwork burden of the proposed collection of information (e.g., through the use of automated collection

techniques or other forms of information technology)? If so, please describe.

#### F. Reporting and Dissemination of Security-Based Swap Information

##### 1. Background on the Re-proposed Rules

The Commission is re-proposing Regulation SBSR to address a number of cross-border issues, many of which were discussed in comments to the cross-border provisions of the initial proposal. The changes made between the proposed and re-proposed versions of Regulation SBSR, and the Commission's preliminary estimates of the paperwork burdens that would result from re-proposed Regulation SBSR, are described below.

##### 2. Modifications to "Reporting Party" Rules

Proposed Rule 901 of Regulation SBSR, as amended herein, contains "collection of information requirements" within the meaning of the PRA. The title of this collection is "Rule 901—Reporting Obligations."

##### (a) Summary of Collection of Information

Under Rule 901(a), as initially proposed, a non-U.S. person security-based swap dealer or major security-based swap participant might incur the duty to report only if the security-based swap was executed in the United States or through any means of interstate commerce, or was cleared through a clearing agency having its principal place of business in the United States. If a non-U.S. person security-based swap dealer or major security-based swap participant entered into a swap with an unregistered U.S. person, the unregistered U.S. person would have incurred the duty to report. As set forth in more detail above, the Commission is re-proposing Rule 901(a) to provide that a security-based swap dealer or major security-based swap participant that is not a U.S. person could incur the duty to report a security-based swap in various cases. Re-proposed Rule 901(a) now provides as follows:

- If both sides of the security-based swap include a security-based swap dealer, the sides would be required to select the reporting side.

- If only one side of the security-based swap includes a security-based swap dealer, that side would be the reporting side.

- If both sides of the security-based swap include a major security-based swap participant, the sides would be required to select the reporting side.

- If one side of the security-based swap includes a major security-based

<sup>1247</sup> See Section XIV.E.1, *supra*.

<sup>1248</sup> See Section XIV.B.3, *supra*. The Commission notes that it may not receive requests for substituted compliance determinations pursuant to proposed Rule 3Ch-2(c) from every jurisdiction will have a security-based swap market that is potentially eligible for such a determination.

<sup>1249</sup> The Commission notes that certain jurisdictions may implement OTC derivatives reforms incrementally. Accordingly, the Commission's estimates in this section are based on the assumption that certain jurisdictions may implement trade execution requirements later in time than other OTC derivatives reforms (e.g., dealer regulation, reporting, and mandatory clearing requirements).

<sup>1250</sup> The Commission staff estimates that the paperwork burden associated with making each substituted compliance request pursuant to proposed Rule 3Ch-2(c) would be approximately 2,000 hours of in-house counsel time (80 hours \* 25 respondents), plus \$2,000,000 for the services of outside professionals (based on 200 hours of outside counsel time \* \$400 \* 25 respondents).

<sup>1251</sup> The Commission staff estimates that the paperwork burden associated with making a substituted compliance request pursuant to proposed Rule 3Ch-2(c) would be up to approximately 1,360 hours (80 hours of in-house counsel time \* 17 respondents), plus approximately \$1,360,000 for the services of outside professionals (based on 200 hours of outside counsel time \* \$400 \* 17 respondents).

<sup>1252</sup> The Commission staff estimates that the paperwork burden associated with making a substituted compliance request pursuant to proposed Rule 3Ch-2(c) would be up to approximately 320 hours (80 hours of in-house counsel time \* four respondents), plus \$320,000 for the services of outside professionals (based on 200 hours of outside counsel time \* \$400 \* four respondents).



swap participant and the other side includes neither a security-based swap dealer nor a major security-based swap participant, the side including the major security-based swap participant would be reporting side.

- If neither side of the security-based swap includes a security-based swap dealer or major security-based swap participant: (i) If both sides include a U.S. person or neither side includes a U.S. person, the sides would be required to select the reporting side; and (ii) If only one side includes a U.S. person, that side would be the reporting side.

In addition, in re-proposed Rule 901, the Commission is proposing certain technical or conforming changes. Specifically, the Commission is proposing certain changes to proposed Rules 901(c) and 901(d), which address the data elements to be reported to a registered SDR, to reflect that, under the re-proposal, certain security-based swaps might be subject to regulatory reporting but not public dissemination. Rule 901(c), as initially proposed, was titled “Information to be reported in real time.” Under Rule 902(a), as originally proposed, the registered SDR to which such information was reported would be required to promptly disseminate to the public such information (except in the case of a block trade). However, the Commission preliminarily believes that, if a security-based swap were subject to regulatory reporting but not public dissemination, there is no need to require that information about the security-based swap be reported in real time. Therefore, the introductory language to Rule 901(c) is being re-proposed as follows: “For any security-based swap that must be publicly disseminated pursuant to §§ 242.902 and 242.908 and for which it is the reporting side, the reporting side shall report the following information in real time. If a security-based swap is required by §§ 242.901 and 242.908 to be reported but not publicly disseminated, the reporting side shall report the following information no later than the time that the reporting side is required to comply with paragraph (d) of this section.” In addition, re-proposed Rule 901(c) would be retitled “Primary trade information,” thus eliminating the reference to real-time reporting—since the information required to be reported under Rule 901(c) would no longer in all cases be required to be reported in real time. Furthermore, re-proposed Rule 901(d) would be retitled “Secondary trade information.”

Rule 901(c)(10), as initially proposed, provided that the following data element would be required to be

reported: “If both counterparties to a security-based swap are security-based swap dealers, an indication to that effect.” As the Commission stated in the Regulation SBSR Proposing Release: “Prices of transactions involving a dealer and a non-dealer are typically ‘all-in’ prices that include a mark-up or mark-down, while interdealer transaction prices typically do not. Thus, the Commission believes that requiring an indication of whether a [security-based swap] was an interdealer transaction or a transaction between a dealer and a non-dealer counterparty would enhance transparency by allowing market participants to more accurately assess the reported price for a [security-based swap].”<sup>1253</sup> The Commission is now re-proposing Rule 901(c)(10) as follows: “If both sides of the security-based swap include a security-based swap dealer, an indication to that effect.” The re-proposed rule clarifies that a security-based swap dealer might be a direct or indirect counterparty to a security-based swap. The Commission continues to believe that, in either case, a security-based swap having a security-based swap dealer on each side could, all other things being equal, be priced differently than a security-based swap having a security-based swap dealer on only one side. Therefore, the Commission continues to believe that the existence of a security-based swap dealer on each side should be reported to the registered SDR and made known to the public.

The Commission is re-proposing Rule 901(d)(1)(ii) to require reporting of the broker ID, desk ID, and trader ID, as applicable, only of the *direct* counterparty on the reporting side. The Commission preliminarily believes that it would be impractical and unnecessary to report such data elements with respect to an indirect counterparty, as such elements might not be applicable to an indirect counterparty. Similarly, Rule 901(d)(1)(iii) is being re-proposed to require reporting of a description of the terms and contingencies of the payment streams only of each *direct* counterparty to the other. The Commission is including the word “direct” to avoid extending Rule 901(d)(1)(iii) to indirect counterparty relationships, where payments might not (except in unusual circumstances) flow to or from an indirect counterparty.

Proposed Rule 901(e) set forth provisions for reporting life cycle events of a security-based swap. The basic approach set forth in proposed Rule

901(e) was that, generally, the original reporting party of the initial transaction would have the responsibility to report any subsequent life cycle event; this approach remains unchanged in the re-proposal. However, if the life cycle event were an assignment or novation that removed the original reporting party, either the new counterparty or the original counterparty would have to be the reporting party. Further, Rule 901(e), as initially proposed, would provide that the new counterparty would be the reporting party if it were a U.S. person, whereas the other counterparty would be the new reporting party if the new counterparty were not a U.S. person.

However, as discussed above, the Commission is now proposing the concept of a “reporting side,” which would include the direct and any indirect counterparty. Further, as discussed above, the Commission is proposing that non-U.S. person security-based swap dealers or major security-based swap participants would, in certain instances, incur a duty to report. Thus, the Commission is re-proposing Rule 901(e) to provide that the duty to report would switch to the other side only if the new side did not include a U.S. person (as in the originally proposed rule) or a security-based swap dealer or major security-based swap participant (references to which are being added to Rule 901(e)). The Commission preliminarily believes that, if the new side includes a registered person such as a security-based swap dealer or major security-based swap participant, the new side should retain the duty to report. This approach is designed to align reporting duties with the market participants that the Commission preliminarily believes are better suited to carrying them out because non-U.S. security-based swap dealers and major security-based swap participants likely have already taken significant steps to establish and maintain the systems, processes and procedures, and staff resources necessary to report security-based swaps currently.<sup>1254</sup>

Aside from some technical changes to the titles of Rules 901(c) and (d) and to the introductory language to Rule 901(c) noted above, the Commission is not proposing to add or delete any data elements from Rules 901(c) and 901(d). Therefore, no revisions to the Commission’s paperwork estimates are being made to increase or decrease paperwork burdens because of more or fewer required data elements to be reported. However, other changes to the

<sup>1253</sup> See Regulation SBSR Proposing Release, 75 FR 75214.

<sup>1254</sup> See note 913 and accompanying text, *supra*; see also 15 U.S.C. 78m-1(a)(3).

paperwork burdens initially proposed for Rule 901 are necessitated by the other changes to the proposed rule noted above.

#### (b) Proposed Use of Information

As described by the Commission in the Regulation SBSR Proposing Release, the security-based swap transaction information required to be reported pursuant to re-proposed Rule 901 would be used by SDRs, market participants, the Commission, and other regulators. The information reported by reporting parties pursuant to re-proposed Rule 901 would be used by SDRs to publicly disseminate real-time reports of security-based swap transactions, as well as to offer a resource for regulators to obtain detailed information about the security-based swap market. Market participants would use the public market data feed, among other things, to assess the current market for security-based swaps and to mark their own positions. The Commission and other regulators would use information about security-based swap transactions reported to and held by SDRs to monitor and assess prudential and systemic risks, as well as to examine for improper behavior and to take enforcement actions, as appropriate.

#### (c) Respondents

Re-proposed Rule 901(a) would designate which side of a security-based swap transaction would be the reporting side.<sup>1255</sup> In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that up to 1,000 entities could incur duties to report transactions under proposed Rule 901(a), and that it was reasonable to use the figure of 1,000 respondents for estimating collection of information burdens under the PRA.<sup>1256</sup> As discussed in more detail below, the Commission now preliminarily estimates there would be 300 respondents to re-proposed Rule 901.

In the Regulation SBSR Proposing Release, the Commission noted that proposed Rule 901 would impose certain duties on SDRs. The Commission preliminarily estimated that the number of SDRs would not exceed 10. The Commission continues to believe that it is reasonable to use 10 as an estimate of the number of SDRs for the purpose of estimating collection of information burdens for re-proposed Regulation SBSR.

<sup>1255</sup> See Section VIII.D, *supra* (discussing the use of the term “reporting side”).

<sup>1256</sup> See Regulation SBSR Proposing Release, 75 FR 75247.

#### (d) Total Initial and Annual Reporting and Recordkeeping Burdens

##### i. Baseline Burdens

In the Regulation SBSR Proposing Release, the Commission estimated that respondents would face 3 categories of burdens to comply with proposed Rule 901. First, each entity that would incur a duty to report security-based swap transactions pursuant to Regulation SBSR would have to develop an internal order and trade management system (“OMS”) capable of capturing the relevant transaction information. Second, each reporting party would have to implement a reporting mechanism. Third, each reporting party would have to establish an appropriate compliance program and support for the operation of the OMS and reporting mechanism. In the Regulation SBSR Proposing Release, the Commission preliminarily estimated that the initial, aggregate annualized burden associated with proposed Rule 901 would be 1,438 hours per reporting party—for a total of 1,438,300 hours for all reporting parties—in order to develop an OMS, implement a reporting mechanism, and establish an appropriate compliance program and support system.<sup>1257</sup> The Commission preliminarily estimated that the ongoing aggregate annualized burden associated with proposed Rule 901 would be 731 hours per reporting party, for a total of 731,300 hours for all reporting parties.<sup>1258</sup> The Commission further estimated that the initial aggregate annualized dollar cost burden on reporting parties associated with Rule 901 would be \$201,000 per reporting party, for a total of \$201,000,000 for all reporting parties.<sup>1259</sup>

##### ii. Re-Proposed Burdens

For the reasons discussed above, the Commission now believes that it is appropriate to re-propose those aspects of Regulation SBSR that would set out who must report security-based swaps. First, the Commission is proposing to redefine the counterparties to a security-based swap. Specifically, “counterparty” would be defined as “a direct or indirect counterparty of a security-based swap.” Re-proposed Rule 900 would define “direct counterparty” as “a person that enters directly with another person into a contract that constitutes a security-based swap” and

<sup>1257</sup> See *id.* at 75250.

<sup>1258</sup> See *id.*

<sup>1259</sup> See *id.* The Commission notes that the Regulation SBSR Proposing Release incorrectly stated this total as \$301,000 per reporting party. The correct number is \$201,000 per reporting party (\$200,000 + \$1,000).

“indirect counterparty” as “a person that guarantees the performance of a direct counterparty to a security-based swap or that otherwise provides recourse to the other side for the failure of the direct counterparty to perform any obligation under the security-based swap.” Second, proposed Rule 900 would revise the term “reporting party” to “reporting side” and would further define “reporting side” as “the side of a security-based swap having the duty to report information in accordance with re-proposed rules 242.900–911 of Regulation SBSR to a registered security-based swap data repository, or if there is no registered security-based swap data repository that would receive the information, to the Commission.” “Side” would be defined as “a direct counterparty and any indirect counterparty that guarantees the direct counterparty’s performance of any obligation under a security-based swap.”

As re-proposed, Rule 901(a) would provide that a security-based swap dealer or major security-based swap participant that is not a U.S. person could incur the duty to report a security-based swap in various cases, as detailed above. The Commission preliminarily believes that no aspect of the re-proposal would significantly affect the burdens that an entity with a duty to report would incur to establish the systems, policies and procedures, and staff resources necessary to comply with Regulation SBSR. Therefore, the Commission is not revising these initial infrastructure-related burdens on a per-entity basis.

However, the Commission is revising our initial estimate of the total infrastructure-related burdens of re-proposed Rule 901(a) due to a reduction in the estimate of the number of reporting counterparties. In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that up to 1,000 respondents could be reporting parties under proposed Rule 901(a), and that it was reasonable to use the figure of 1,000 respondents for estimating collection of information burdens under the PRA.<sup>1260</sup> Since issuing the Regulation SBSR Proposing Release, the Commission has obtained additional and more granular data regarding participation in the security-based swap market from DTCC–TIW. These historical data suggest that approximately 30 counterparties—which are likely to be

<sup>1260</sup> See Regulation SBSR Proposing Release, 75 FR 75247. The Commission did not receive any comments related to its preliminary belief that up to 1,000 respondents could be reporting parties under proposed Rule 901(a) of Regulations SBSR.

required to register with the Commission as security-based swap dealers—account for the vast majority of recent security-based swap transactions and transaction reports. These data further suggest that there are only a limited number of security-based swap transactions that do not include at least one of these larger counterparties on either side. In other words, the vast majority of recent transactions have included a larger counterparty that reports the transaction currently, and that would likely be required to report a similar transaction in the future.

In addition, the Commission is attempting in re-proposed Regulation SBSR to further align reporting obligations to larger market participants that are better able to bear them. As a result of all of these factors, and to the extent that recent security-based swap market activity may be indicative of future activity, the Commission preliminarily believes that the more appropriate estimate of reporting counterparties is 300, 700 fewer than in the original proposal.<sup>1261</sup> This revised estimate continues to include some smaller counterparties to security-based swaps that would incur a reporting duty, but many fewer than estimated in the PRA of the initial Regulation SBSR proposal.

As a result of the revision to the number of reporting counterparties, the Commission preliminarily believes that the one-time burdens of Regulation SBSR could decrease by 1,006,600 aggregated hours and \$140,700,000.<sup>1262</sup> In addition, the Commission preliminarily believes that the annual ongoing burden of Regulation SBSR

<sup>1261</sup> The Commission is basing this new estimate on CDS data from the DTCC–TIW, but not from data from data repositories for other security-based swap asset classes, which are not currently available to the Commission. The Commission preliminarily believes that entities that are likely to incur obligations to report security-based swaps in other asset classes are already likely to be reporting CDS transactions to DTCC–TIW. The Commission also preliminarily believes that, to avoid duplicative compliance costs, such entities are likely to leverage their existing infrastructure for reporting CDS transactions to carry out reporting obligations for other asset classes, even though these other asset classes might be booked in different affiliated entities. The Commission preliminarily estimates that these other security-based swap asset classes consist of less than one-fifth of the overall security-based swap market. Therefore, the Commission preliminarily believes that reporting counterparties across all security-based swap asset classes should not exceed the estimate of 300 derived from the DTCC–TIW CDS data. See note 1301, *infra*.

<sup>1262</sup> The Commission estimates: ((1,000 reporting parties – 300 reporting sides) \* 1,438 hours) = 1,006,600 burden reduction for all reporting counterparties. The Commission estimates: ((1,000 reporting parties – 300 reporting sides) \* \$201,000) = \$140,700,000 burden reduction for all reporting counterparties.

could decrease by 511,700 aggregated hours and \$140,700,000.<sup>1263</sup> The Commission seeks comment on and data to quantify these potential cost reductions.

Although re-proposed Rule 901(a) could result in a significant reduction in aggregate costs due to reduction in the number of reporting counterparties that would be required to establish the systems, policies and procedures, and staff resources to carry out the reporting function, the Commission preliminarily believes that there may be a slight increase in burden for certain individual reporting counterparties due to a re-allocation of reportable security-based swap transactions among those reporting counterparties that continue to be covered. Specifically, small unregistered counterparties that may have been required to report a small number of security-based swaps under the original proposal would be less likely to incur the reporting duty under re-proposed Rule 901(a). Thus, the counterparties that would continue to have the reporting duty under re-proposed Rule 901(a), primarily security-based swap dealers and major security-based swap participants, would likely incur the reporting duty for most of these transactions. Consequently, re-proposed Rule 901(a) could result in each reporting counterparty being required to report, on average, a larger percentage of the total security-based swap transactions than envisioned under the original proposal. In the Regulation SBSR Proposing Release, the Commission estimated that, collectively, the reporting parties would spend 77,300 hours reporting specific security-based swap transactions to a registered SDR, as required by proposed Rule 901.<sup>1264</sup> Nonetheless, as explained below, the Commission's estimate of the anticipated number of security-based swap transactions to be reported pursuant to Regulation SBSR is being revised significantly downward.

In the Regulation SBSR Proposing Release, the Commission preliminarily

<sup>1263</sup> The Commission estimates: ((1,000 reporting parties – 300 reporting sides) \* 731 hours) = 511,700 burden reduction for all reporting counterparties. The Commission estimates: ((1,000 reporting parties – 300 reporting sides) \* \$201,000) = \$140,700,000 burden reduction for all reporting counterparties.

<sup>1264</sup> See Regulation SBSR Proposing Release, 75 FR 75248–49. In arriving at this figure, the Commission preliminarily estimated that 1,000 reporting parties would be responsible for reporting 15,458,824 security-based swap transactions. The Commission further estimated that each transaction would take 0.005 hours to report for a total burden of 77,300 hours, or 77.3 burden hours per reporting party. The Commission preliminarily believes that the hourly burden of reporting individual security-based swap transactions would not change.

estimated that 15.5 million security-based swap transactions per year would be required to be reported.<sup>1265</sup> In addition to revising our estimate of the number of reporting sides from 1,000 to 300, as discussed above, the Commission is now also revising our estimate of the number of reportable security-based swap transactions covered by re-proposed Regulation SBSR, for the following reasons. First, the Commission notes that the Regulation SBSR Proposing Release inadvertently overstated the number of historical security-based swap transactions such that the number of security-based swap transactions based on data available at the time of the Regulation SBSR Proposing Release should have been stated as approximately 2,200,000.<sup>1266</sup> Second, since issuing the Regulation SBSR Proposing Release, the Commission has obtained additional and more granular data regarding participation in the credit default swap market from DTCC–TIW. These more recent data further suggest that the Commission initially overestimated both the number of reporting counterparties and the number of security-based swap transactions that would be reportable to DTCC–TIW. As a result, the Commission now estimates that 300 reporting sides would be required to report approximately 5 million new security-based swaps and life cycle events (collectively, “reportable events”) under re-proposed Regulation SBSR per year.<sup>1267</sup>

<sup>1265</sup> See Regulation SBSR Proposing Release, 75 FR 75248.

<sup>1266</sup> See *id.* at 75248 nn. 182–85 and accompanying text. Specifically, in the SBSR Proposing Release, the Commission misinterpreted weekly CDS volume data as daily volume data. Based on the weekly data available at the time, a more accurate estimate for the number of CDS transactions per year would have been 1,872,000. This number is based on the following: (36,000 (estimated CDS transactions per week) \* 52 (weeks/year)) = 1,872,000 CDS transactions/year. Based on the Commission's preliminary assumption in the SBSR Proposing Release that CDS transactions represent approximately eight- to nine-tenths of all security-based swap transactions, a more accurate estimate for the number of security-based swap transactions per year would have been 2,202,353. This number was based on the following: (1,872,000 (number of CDS transactions per year)/0.85) = 2,202,353 security-based swap transactions/year.

<sup>1267</sup> The Commission now estimates that single-name CDS transactions for 2012 were approximately 4 million transactions. The data studied by the Commission cover CDS transactions, which the Commission continues to preliminarily believe account for approximately eight- to nine-tenths of the security-based swap market. As a result, and to the extent that recent security-based swap market activity may be indicative of future activity, the Commission preliminarily estimates that 300 reporting sides will have the duty to report 5 million security-based swap transactions (*i.e.*, 4,000,000/0.82 = 4,878,049 reportable events). See also note 1641, *infra*.

The Commission notes that the change in the estimate of the number of reportable events per year since the initial proposal of Regulation SBSR from more than 2,000,000 to approximately 5 million may be due to better and more precise data available from the industry on the scope, size, and composition of the security-based swap market. As a result, and to the extent that the available data regarding recent security-based swap market activity may be indicative of future activity, the Commission now preliminarily believes that a more appropriate estimate of the number of reportable events would be approximately 5 million per year.

The Commission preliminarily believes that, once a respondent's reporting infrastructure and compliance systems are in place, the burden of reporting a single reportable event would be *de minimis* when compared to the burdens of establishing the reporting infrastructure and compliance systems.<sup>1268</sup> The Commission now preliminarily estimates that re-proposed Regulation SBSR would result in total burden hours of 5,080 attributable to the reporting to security-based swap data repositories all reportable events over the course of a year.<sup>1269</sup> The Commission preliminarily believes that many reportable events would be reported through electronic means and that the ratio of electronic reporting to manual reporting is likely to increase over time. The Commission further preliminarily believes that the bulk of the burden hours estimated above would be attributable to manually reported transactions. Thus, reporting counterparties that capture and report transactions electronically would likely incur bear fewer burden hours than those reporting counterparties that capture and report transactions manually.

### iii. Summary of Re-Proposed Burdens

Based on the foregoing, the Commission preliminarily estimates

<sup>1268</sup> In the Regulation SBSR Proposing Release, the Commission preliminarily estimated that reporting specific security-based swap transactions to a registered SDR would impose an annual aggregate cost of approximately \$5,400,000. See Regulation SBSR Proposing Release, 75 FR 75265. The Commission further estimated that Regulation SBSR would impose an aggregate total first-year cost of approximately \$1,039,000,000 and an ongoing annualized aggregate cost of approximately \$703,000,000. See *id.* at 75280.

<sup>1269</sup> The Commission estimates: ((5 million \* 0.005)/(300 reporting sides)) = 83.3 burden hours per reporting side or 25,000 total burden hours. Since the number of respondents would decline from 1,000 reporting parties to 300 reporting sides, the transaction based reporting burden would be concentrated among fewer respondents.

that re-proposed Regulation SBSR would impose an estimated total first-year burden of approximately 1,444 hours<sup>1270</sup> per reporting counterparty for a total first-year burden of 433,200 hours for all reporting counterparties.<sup>1271</sup> The Commission preliminarily estimates that re-proposed Regulation SBSR would impose ongoing annualized aggregate burdens of approximately 737 hours<sup>1272</sup> per reporting counterparty for a total aggregate annualized cost of 221,100 hours for all reporting counterparties.<sup>1273</sup> The Commission further estimates that re-proposed Regulation SBSR would impose initial and ongoing annualized dollar cost burdens of \$201,000 per reporting counterparty, for total aggregate initial and ongoing annualized dollar cost burdens of \$60,300,000.<sup>1274</sup>

The Commission does not preliminarily believe that the proposed changes to Regulation SBSR would have any material impact on SDRs not discussed in Regulation SBSR, as originally proposed. The changes discussed herein do not impact the previously estimated burdens for SDRs. The Commission preliminarily believes that re-proposed Rule SBSR would not result in the registration of additional SDRs, and would not require existing SDRs to bear the burden of connecting to additional reporting counterparties. SDRs would already be required under proposed Regulation SBSR to have established mechanisms to receive and process security-based swap transaction reports, and none of the costs identified in the Regulation SBSR Proposing Release relating to SDRs were dependent upon the number of security-based swap transactions or the number of reporting counterparties.

<sup>1270</sup> The Commission derived its estimate from the following: (1,438 (Regulation SBSR Proposing Release estimated total burden) – 77.3 (Regulation SBSR Proposing Release estimated transaction reporting burden) + 83.3 (revised estimated transaction reporting burden)) = 1,444 hours. See Section XIV.F.2(d)ii.

<sup>1271</sup> The Commission derived its estimate from the following: (1,444 \* 300 reporting counterparties) = 433,200 hours.

<sup>1272</sup> The Commission derived its estimate from the following: (731 (Regulation SBSR Proposing Release estimated total burden) – 77.3 (Regulation SBSR Proposing Release estimated transaction reporting burden) + 83.3 (revised estimated transaction reporting burden)) = 737 hours. See Section XIV.F.2(d)ii, *infra*.

<sup>1273</sup> The Commission derived its estimate from the following: (737 \* 300 reporting counterparties) = 221,100 hours.

<sup>1274</sup> The Commission derived its estimate from the following: (\$201,000 \* 300 reporting counterparties) = \$60,300,000.

### iv. Recordkeeping Requirements

Concurrently with proposed Regulation SBSR, the Commission issued the SDR Proposing Release, which includes (among other things) recordkeeping requirements for security-based swap transaction data received by a registered SDR pursuant to proposed Regulation SBSR. Specifically, proposed Rule 13n–5(b)(4) under the Exchange Act would require a registered SDR to maintain the transaction data that it collects for not less than five years after the applicable security-based swap expires, and historical positions and historical market values for not less than five years.<sup>1275</sup> Accordingly, security-based swap transaction reports received by a registered SDR pursuant to proposed Rule 901 would be required to be retained by the registered SDR for not less than five years.

#### (e) Collection of Information Is Mandatory

Each collection of information discussed above would be a mandatory collection of information.

#### (f) Confidentiality

Re-proposed Rule 901(a) would not affect the confidentiality of responses to the collection of information provided under Rule 901 of Regulation SBSR as originally proposed. As described in the Regulation SBSR Proposing Release, information collected pursuant to proposed Rule 901(c) would be widely available to the public to the extent it is incorporated into security-based swap transaction reports that are publicly disseminated by a registered SDR pursuant to proposed Rule 902. A registered SDR, pursuant to Sections 13(n)(5) of the Exchange Act and proposed Rule 13n–9 thereunder, would be under an obligation to maintain the confidentiality of any information reported pursuant to proposed Rule 901(d) of Regulation SBSR. To the extent that the Commission receives confidential information pursuant to this collection of information, such information would be kept confidential, subject to the provisions of applicable law.

#### Request for Comment

The Commission requests public comment on our analysis of burdens associated with re-proposed Rule 901(a) and proposed Rule 901 generally. The Commission also seeks comment on the following:

- Would re-proposed Rule 901(a) impose burdens on parties additional to those imposed by Rule 901, as originally

<sup>1275</sup> See SDR Proposing Release, 75 FR 77369.

proposed? If so, what are these additional burdens? Please describe fully and quantify to the extent possible.

- Would re-proposed Rule 901(a) reduce overall burdens by aligning the security-based swap transaction reporting obligation with those market participants better able to carry out the reporting function? Why or why not?

- Are there any methods to enhance Rule 901 while minimizing the overall burdens associated with that rule?

- Would re-proposed Rule 901(a) reduce the total number of entities potentially subject to the reporting requirements? Is the Commission's revised estimate of 300 reporting sides reasonable?

- Would re-proposed Rule 901(a) have any impact on the burden imposed on SDRs? Are those costs dependent upon the number of reporting counterparties or the number of transactions submitted to SDRs?

### 3. Rules 902, 905, 906, 907, and 909

Regulation SBSR, as originally proposed, contained certain proposed rules, each of which was considered a "collection of information" within the meaning of the PRA, but that now either remains unchanged—or contains only technical, or conforming changes—as a result of re-proposed SBSR.

#### (a) Rule 902

In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that certain provisions of proposed Rule 902 contained "collection of information requirements" within the meaning of the PRA.<sup>1276</sup> As such, the Commission preliminarily estimated certain burdens resulting from the proposed rule.<sup>1277</sup>

As set forth in more detail above, the Commission is now proposing technical or conforming revisions to proposed Rule 902.

Rule 902(a), as initially proposed, would require a registered SDR to publicly disseminate a transaction report of any security-based swap immediately upon receipt of information about the security-based swap, except in the case of a block trade. Re-proposed Rule 908, however, contemplates situations where a security-based swap would be required to be reported to a registered SDR but not publicly disseminated.<sup>1278</sup> Therefore, the Commission is re-proposing Rule 902(a) to provide that a registered SDR would not have an

obligation to publicly disseminate a transaction report for any such security-based swap.

#### (b) Rule 905

In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that certain provisions of proposed Rule 905 contained "collection of information requirements" within the meaning of the PRA.<sup>1279</sup> As such, the Commission preliminarily estimated certain burdens resulting from the proposed rule.<sup>1280</sup>

As set forth in more detail in Section VIII above, in re-proposed Regulation SBSR, the Commission has proposed technical or conforming revisions to proposed Rule 905. Rule 905(b)(2) is being re-proposed to clarify that, if a registered SDR receives corrected information relating to a previously submitted transaction report, it would be required to publicly disseminate a corrected transaction report only if the initial security-based swap were subject to public dissemination.<sup>1281</sup> In addition, re-proposed Rule 905 conforms the rule language to incorporate the use of the term "side."

#### (c) Rule 906

In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that certain provisions of proposed Rule 906 contained "collection of information requirements" within the meaning of the PRA.<sup>1282</sup> As such, the Commission preliminarily estimated certain burdens on reporting parties and SDRs resulting from the proposed rule.<sup>1283</sup>

As set forth in more detail above, the Commission is now proposing technical revisions to proposed Rule 906. Re-proposed Rule 906 conforms the rule language to incorporate the use of the term "side."

#### (d) Rule 907

In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that certain provisions of proposed Rule 907 contained "collection of information requirements" within the meaning of the PRA.<sup>1284</sup> As such, the Commission

preliminarily estimated certain burdens on reporting parties and SDRs resulting from the proposed rule.<sup>1285</sup>

As set forth in more detail above, the Commission is now proposing technical or conforming revisions to proposed Rule 907. Re-proposed Rule 907(a)(6) would require a registered SDR to establish and maintain written policies and procedures "[f]or periodically obtaining from each participant information that identifies the participant's ultimate parent(s) and any other participant(s) which the *counterparty* is affiliated, using ultimate parent IDs and participant IDs" (emphasis added). The Commission now is re-proposing Rule 907(a)(6) with the word "participant" in place of the word "counterparty." Re-proposed Rule 907 also conforms the rule language to incorporate the use of the term "side."

#### (e) Rule 909

In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that certain provisions of proposed Rule 909 contained "collection of information requirements" within the meaning of the PRA.<sup>1286</sup> As such, the Commission preliminarily estimated certain burdens SDRs resulting from the proposed rule.<sup>1287</sup>

#### i. Impact of Re-Proposed Rules 902, 905, 906, 907, and 909 on the Commission's PRA Analysis

Since re-proposed Rules 902, 905, 906, 907, and 909 of Regulations SBSR either remain unchanged from the Regulation SBSR Proposing Release or contain only technical or conforming changes, the Commission preliminarily believes that our original PRA analysis, as set forth in the Regulation SBSR Proposing Release, continues to apply. The Commission preliminarily believes that our original analysis does not require revision, in part, because the burdens described in the Regulation SBSR Proposing Release are not dependent upon the number of respondents or the number of security-based swap transactions that would be reported to a registered SDR. In addition, the Commission preliminarily believes that the burdens described in relation to Rule 906 would not change because the number of reports required under and the universe of respondents subject to Rule 906 would not change. Furthermore, the Commission preliminarily believes that these re-proposed rules would not result in a

<sup>1279</sup> See Regulation SBSR Proposing Release, 75 FR 75254.

<sup>1280</sup> See *id.* at 75254–56.

<sup>1281</sup> Re-proposed Rule 905(b)(2) of Regulation SBSR also substitutes the word "counterparties"—which is a formally defined term in the regulation—for the word "parties," which was used in the initial proposal but was not a formally defined term.

<sup>1282</sup> See Regulation SBSR Proposing Release, 75 FR 75256.

<sup>1283</sup> See *id.* at 75256–58.

<sup>1284</sup> See *id.* at 75258.

<sup>1276</sup> See Regulation SBSR Proposing Release, 75 FR 75251.

<sup>1277</sup> See *id.* at 75251–52.

<sup>1278</sup> See Section VIII.C, *supra*.

<sup>1285</sup> See *id.* at 75258–60.

<sup>1286</sup> See *id.* at 75260.

<sup>1287</sup> See *id.* at 75260–61.

change in the Commission's original estimate of SDRs.

The Commission requests public comment on our analysis of burdens associated with these re-proposed rules, and whether re-proposed Rule 902, 905, 906, 907, or 909 would impose any collection of information requirements that the Commission has not considered. If so, please describe them.

#### 4. Rules 900, 903, 908, 910, and 911

Regulation SBSR, as originally proposed, contained certain proposed rules that were not considered a "collection of information" within the meaning of the PRA.

##### (a) Modification of the Definition of "U.S. Person"

In the Regulation SBSR Proposing Release, the Commission stated our belief that proposed Rule 900, since it contains only definitions of relevant terms, would not be a "collection of information" within the meaning of the PRA.<sup>1288</sup> Rule 900 of re-proposed Regulation SBSR contains a revised definition of "U.S. person" that cross-references proposed Rule 3a71-3(a)(7) under the Exchange Act. Re-proposed Rule 900 also contains definitions for new terms such as "side," "reporting side," and "direct electronic access." The Commission continues to believe that, because Rule 900 contains only definitions of relevant terms, it would not be a "collection of information" within the meaning of the PRA.

##### (b) Rule 903

In the Regulation SBSR Proposing Release, the Commission stated our belief that proposed Rule 903 would not be a "collection of information" within the meaning of the PRA because the rule would merely permit reporting parties and SDRs to use codes in place of certain data elements, subject to certain conditions.<sup>1289</sup> Re-proposed Rule 903 conforms the rule language to incorporate the use of the term "side." Because these are only technical changes to the proposed rule, the Commission continues to believe that re-proposed Rule 903 would not be a "collection of information" within the meaning of the PRA.

##### (c) Re-proposed Rules 908(a) and 908(b)

Rule 908(a), as initially proposed, provided that a security-based swap would be subject to regulatory reporting and public dissemination under Regulation SBSR if the security-based swap: (1) has at least one counterparty

that is a U.S. person; (2) is executed in the United States or through any means of interstate commerce; or (3) is cleared through a registered clearing agency having its principal place of business in the United States. Thus, original Rule 908(a) would not impose reporting requirements in connection with a security-based swap solely because one of the counterparties were guaranteed by a U.S. person or were a non-U.S. person security-based swap dealer or major security-based swap participant.

The Commission stated our preliminary belief that proposed Rule 908 would not be a "collection of information" within the meaning of the PRA, as the rule merely described the jurisdictional reach of proposed Regulation SBSR.

As set forth in more detail above, the Commission now believes that, where a security-based swap is executed outside the United States by a non-U.S. person direct counterparty but performance of any duties under that security-based swap is guaranteed by a U.S. person, the security-based swap should be subject to Title VII regulatory reporting requirements.<sup>1290</sup> In addition, a security-based swap dealer or major security-based swap participant that is a non-U.S. person would, under Rule 908(a) of re-proposed Regulation SBSR, be required to report a security-based swap executed outside the United States with a non-U.S. person counterparty (assuming no guarantee extended by a U.S. person).

Re-proposed Rule 908(a) is now divided into subparagraphs (1) and (2), which address regulatory reporting and public dissemination, respectively. The Commission also is re-proposing Rule 908(a) to require reporting and public dissemination in certain cases not required by the original proposal, and to make certain other changes described above (such as eliminating the "interstate commerce clause"). Because re-proposed Rule 908(a) continues merely to describe the situations to which proposed Regulation SBSR would apply, the Commission continues to believe that re-proposed Rule 908(a) would not be a "collection of information" within the meaning of the PRA. However, to the extent that additional types of security-based swaps would be subject to regulatory reporting and public dissemination under re-proposed Regulation than under the initial proposal, the additional burdens

on respondents are considered under re-proposed Rule 901 above.

Rule 908(b), as initially proposed, described when duties would be imposed on foreign counterparties of security-based swaps when some connections to the United States might be present. Rule 908(b), as initially proposed, provided that no duties would be imposed on a counterparty unless one of the following conditions were true: (1) the counterparty is a U.S. person; (2) the security-based swap is executed in the United States or through any means of interstate commerce; or (3) the security-based swap is cleared through a clearing agency having its principal place of business in the United States.

The Commission stated our preliminary belief that proposed Rule 908 would not be a "collection of information" within the meaning of the PRA, as the rule merely described the jurisdictional reach of proposed Regulation SBSR.

As set forth in more detail above, the Commission is proposing several technical revisions to proposed Rule 908(b). Specifically, Rule 908(b) is being revised to account for the possibility that a non-U.S. person registered with the Commission as a security-based swap dealer or major security-based swap participant could incur a duty to report. Moreover, the "interstate commerce clause" is being replaced with the new concept of a "transaction conducted within the United States."

Since re-proposed Rule 908(b) continues merely to describe the jurisdictional reach of Regulation SBSR, the Commission continues to believe that re-proposed Rule 908(b) would not be a "collection of information" within the meaning of the PRA. However, the Commission notes that re-proposed Rule 908(b) could result in a non-U.S. person security-based swap dealer or major security-based swap participant incurring a duty to report. To the extent that this could result in a change in the number of reporting counterparties, such burdens are considered in connection with re-proposed Rule 901 above.

The Commission requests public comment on our analysis of burdens associated with re-proposed Rules 908(a) and 908(b) generally. In particular:

- Would re-proposed Rules 908(a) and 908(b) impose any collection of information requirements that the Commission has not considered? If so, please describe.

Re-proposed Rule 908 contains a new subparagraph (c), dealing with substituted compliance, a subject that

<sup>1288</sup> See *id.* at 75246.

<sup>1289</sup> See *id.* at 75252-53.

<sup>1290</sup> However, as discussed above, the Commission preliminarily believes that certain of these cross-border security-based swaps need not be subject to Title VII's public dissemination requirements. See Section VIII.C.1, *supra*.

was not addressed in the original proposal. The PRA analysis for re-proposed Rule 908(c) is provided elsewhere, together with the PRA analysis of the substituted compliance provisions of the other Title VII proposed rules described in this release.<sup>1291</sup>

#### (d) Rule 910

As originally proposed, the Commission stated our belief that proposed Rule 910 would not be a “collection of information” within the meaning of the PRA, as it merely describes when a registered SDR and its participants would be required to comply with the various parts of proposed Regulation SBSR, and would not create any additional collection of information requirements.

As set forth in more detail above, the Commission is now proposing technical, or conforming revisions to proposed Rule 910. Rule 910(b)(4), as originally proposed, would provide that, in Phase 4 of the Regulation SBSR compliance schedule, “[a]ll security-based swaps reported to the registered security-based swap data repository shall be subject to real-time public dissemination as specified in § 242.902.” As noted above, under re-proposed Rule 908, certain security-based swaps would be subject to regulatory reporting but not public dissemination requirements. Therefore, the Commission is re-proposing Rule 910(b)(4) to provide that, “All security-based swaps received by the registered security-based swap data repository shall be treated in a manner consistent with §§ 242.902, 242.905, and 242.908.” Re-proposed Rule 910 also conforms the rule language to incorporate the use of the term “side.”

The Commission continues to believe that re-proposed Rule 910 would not be a “collection of information” within the meaning of the PRA.

#### (e) Rule 911

Rule 911, as originally proposed, would restrict the ability of a reporting party to report a security-based swap to one registered SDR rather than another, but would not otherwise create any duties or impose any collection of information requirements beyond those already required by proposed Rule 901. Therefore, the Commission stated our belief that proposed Rule 911 would not be a “collection of information” within the meaning of the PRA.<sup>1292</sup> As set forth in more detail above, the Commission is

now proposing technical revisions to proposed Rule 911. Re-proposed Rule 911 conforms the rule language to incorporate the use of the term “side.” The Commission continues to believe that re-proposed Rule 911 would not be a “collection of information” within the meaning of the PRA.

#### G. Request for Comments by the Commission and Director of OMB

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the proper performance of our functions, including whether the information shall have practical utility;
2. Evaluate the accuracy of our estimate of the burden of the proposed collection of information;
3. Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
4. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090, with reference to File Number S7–02–13, and File Numbers S7–34–10 (Regulation SBSR) and/or S7–40–11 (registration of security-based swap dealers and major security-based swap participants), as applicable. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7–02–13, and File Numbers S7–34–10 (Regulation SBSR) and/or S7–40–11 (registration of security-based swap dealers and major security-based swap participants), as applicable, and be submitted to the Securities and Exchange Commission, Office of FOIA/PA Operations, 100 F Street NE., Washington, DC 20549–2736. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

## XV. Economic Analysis

### A. Introduction

The Commission is sensitive to the economic consequences and effects, including costs and benefits, of our rules. In proposing the rules and interpretations in this release, the Commission has been mindful of the economic consequences of the decisions it makes regarding the scope of application of the Title VII requirements to cross-border activities pursuant to the proposed rules. The Commission has taken into account the costs and benefits associated with applying the Title VII regulatory requirements to cross-border transactions and market participants who would be required to register pursuant to these proposed rules and interpretations, as well as the costs associated with determining whether Title VII applies to a specific person or transaction, which we refer to as direct assessment costs these rules and interpretations would impose on market participants, if adopted as proposed. Some of these economic consequences and effects stem from statutory mandates, while others are affected by the discretion we exercise in implementing the mandates. Further, Section 3(f) of the Exchange Act requires the Commission, whenever we engage in rulemaking pursuant to the Exchange Act and are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>1293</sup> In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition. Section 23(a)(2) also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>1294</sup> The Commission requests comment on all aspects of the economic analysis of the proposed rules, including their costs and benefits, as well as any effect these rules may have on competition, efficiency, and capital formation.

As stated above, the Commission is proposing rules and interpretations regarding the application of Title VII to cross-border activities holistically in a single proposing release to provide market participants, foreign regulators, and other interested parties with an opportunity to consider, as an integrated

<sup>1293</sup> 15 U.S.C. 78c(f).

<sup>1294</sup> 15 U.S.C. 78w(a)(2).

<sup>1291</sup> See Section XIV.E.4, *supra*.

<sup>1292</sup> See Regulation SBSR Proposing Release, 75 FR 75261.



whole, the Commission's proposed approach to the application of various Title VII requirements to cross-border security-based swap transactions and to persons whose cross-border security-based swap activity is regulated under Title VII.<sup>1295</sup>

In analyzing the economic consequences and effects of the rules and interpretations proposed in this release, the Commission has been guided by the objectives of the Dodd-Frank Act to mitigate risks to the U.S. financial system, promote counterparty protection, increase swap market transparency, and facilitate financial stability. We have also taken into account the importance of maintaining a well-functioning security-based swap market. In evaluating these rules the Commission has considered the importance of avoiding unnecessary market disruption, and preserving market participants' access to liquidity irrespective of geography. This analysis also reflects the importance of regulatory harmonization and maintaining consistent international standards. In this regard, we recognize that regulators in other jurisdictions are currently engaged in implementing their own regulatory reforms of the OTC derivatives markets and that our proposed application of Title VII to cross-border activities may affect the policy decisions of these other regulators as they seek to address potential conflicts or duplication in the regulatory requirements that apply to market participants under their authority.

In addition, the Commission is aware of the development of OTC derivatives regulatory reform in other jurisdictions. In particular, the EU and certain other G20 members have taken various steps to develop and implement new regulations with respect to OTC derivatives.<sup>1296</sup> Moreover, market participants, foreign regulators, and other interested parties have provided views on the application of Title VII requirements to cross-border activities through both written comment letters to the Commission and/or the CFTC and meetings with Commissioners and Commission staff.<sup>1297</sup> These developments, comments, and discussions have been informative in the Commission's consideration of our proposed approach to the application of Title VII in the cross-border context and the economic consequences of the proposed rules and interpretations.

<sup>1295</sup> See Section I, *supra*.

<sup>1296</sup> See Section I and notes 35–35, *supra*.

<sup>1297</sup> See Section I and notes 24–25, *supra*.

## B. Economic Baseline

### 1. Overview

To assess the economic impact of the proposed rules described in this release, the Commission is using as our baseline the security-based swap market as it exists at the time of this proposal, including applicable rules adopted by the Commission but excluding the rules and interpretations proposed here. The analysis incorporates the statutory and regulatory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act. Many of the resulting costs and benefits are difficult to quantify with any degree of certainty, especially as the practices of market participants are expected to evolve and adapt to changes in technology and market developments.

In assessing the economic impact of the rules, we refer to the broader costs and benefits associated with the application of the proposed rules and interpretations as “programmatic” costs and benefits. These include the costs and benefits of applying the substantive Title VII requirements to transactions by market participants active in the cross-border context, as well as to the functions performed by infrastructure participants (clearing agencies, SDRs, and SB SEFs) in the global security-based swap market. In several places we also consider how the programmatic costs and benefits might change when comparing the proposed approach to the other alternatives suggested by industry comment letters and the other regulators. Our analysis also considers “assessment costs.”

Our analysis also recognizes that certain market participants may be subject to Title VII requirements under the proposed rules and interpretations while potentially also being subject to another set of foreign regulatory requirements. Concurrent, and potentially duplicative or conflicting, regulatory requirements could be imposed on persons because of their resident or domicile status or because of the place their security-based swap transactions are conducted. In certain circumstances, the Commission is proposing to consider permitting substituted compliance subject to certain conditions. In determining whether to propose rules that would permit market participants to seek substituted compliance determinations for particular requirements in certain circumstances, the Commission has considered the programmatic benefits intended by the specific Title VII requirements with respect to which substituted compliance may be permitted, the programmatic costs

associated with such Title VII requirements when they become fully effective, and the relevant assessment costs.<sup>1298</sup>

The proposed rules and interpretations reflect the Commission's preliminary determination regarding which participants and transactions in the security-based swap market warrant regulation under Title VII, and in making this determination, we have focused on whether a market participant is incorporated or resident, or has its principal place of business, within the United States and whether a transaction occurs within the United States. The economic impact of these proposed rules and interpretations will occur predominantly through the application in a cross-border context of the substantive requirements outlined in other releases, without, as a general matter, altering the nature of those substantive requirements.<sup>1299</sup> We have already analyzed many of the costs and benefits of the proposed substantive requirements in separate proposing and adopting releases. As a result, the following analysis focuses on the economic impacts and trade-offs of application of these substantive requirements in a cross-border context, that is, the economic implications of the decisions to include certain persons that reside or are organized (or have their principal place of business), or transactions that occur, within the United States within the scope of Title VII and the economic effects arising from that inclusion.

To the extent that future adopting releases implementing the substantive requirements under Title VII reflect substantive changes to the proposals, those releases will incorporate the

<sup>1298</sup> The Commission is proposing to permit market participants to seek a substituted compliance determination in connection with certain requirements—it has not yet made any such specific determinations. The Commission does not believe it is possible at this point to estimate the number of such determinations that it is likely to make for any given set of requirements, as such estimate would depend on information that is generally not yet available. However, the maximum programmatic benefits and costs associated with substituted compliance could occur in circumstances where the Commission grants every substituted compliance request. This does not in any way indicate that the Commission will make any number of substituted compliance determinations. Accordingly, the following analysis does not assume that such substituted compliance will be allowed. Where appropriate, however, we do discuss the economic implications if such substituted compliance were ultimately to be allowed.

<sup>1299</sup> We recognize that we are re-proposing Regulation SBSR in this release, which would have an impact on the security-based swap reporting obligations beyond the cross-border context, and we discuss these effects in our economic analysis of the re-proposal below.

relevant economic analysis. We also expect that our respective adopting releases for each of these substantive areas will discuss the economic consequences of the final substantive rules together with our final rules on the application of those rules in the cross-border context.

2. Current Security-Based Swap Market

Our analysis of the state of the current security-based swap market is based on data obtained from DTCC-TIW, especially data regarding the activity of market participants in the single-name credit default swap (or CDS) market during the years of 2008 to 2011. Because of the lack of market data in the context of total return swaps on equity and debt, we do not have the same amount of information regarding those products (or other products that are security-based swaps) as we have in connection with the present market for single-name CDS. With the exception of the analysis regarding the level of security-based swap clearing, we did not consider data regarding index credit default swaps for purposes of the analysis below. The data for index CDS encompasses both broad-based security indices and narrow-based security indices, and “security-based swap” in relevant part encompasses swaps based on single securities or on narrow-based security indices.<sup>1300</sup> We previously noted that the definition of security-based swaps is not limited to single-name CDS but we believed that the single-name CDS data are sufficiently

representative of the market to help inform the analysis of the state of the current security-based swap market.<sup>1301</sup>

We believe that the data underlying our analysis here provide reasonably comprehensive information regarding the single-name CDS transactions and composition of the single-name CDS market participants. In our analysis of market participants and their domiciles in subsections (a) and (c) below, we base our analysis on firms and accounts that have engaged in one or more trades with a U.S.-person counterparty or involving a U.S. reference entity according to data obtained from DTCC-TIW. Our analysis of trading activity in the security-based swap market in subsections (b) and (d) focuses on transactions involving a single-name CDS referencing a U.S. entity (“U.S. single-name CDS”). We note that the data available to us from DTCC-TIW do not encompass those CDS transactions that both: (i) do not involve U.S. counterparties; and (ii) are based on non-U.S. reference entities. Notwithstanding this limitation, we preliminarily believe that the DTCC-TIW data provides sufficient information to identify the types of market participants active in the security-based swap market and the general pattern of deal flow within that market.

(a) Security-Based Swap Market Participants

Although most security-based swap activity is concentrated among a relatively small number of dealer

entities,<sup>1302</sup> there are thousands of security-based swap market participants, including, but not limited to, investment companies, pension funds, private (hedge) funds, sovereign entities, and industrial companies.<sup>1303</sup> In the analysis below, we observe that most end users of security-based swaps do not engage directly in the trading of swaps, but use dealers, banks, or investment advisers as agents to establish their positions. Based on an analysis of the counterparties to trades reported to the DTCC-TIW, there were 1,489 entities<sup>1304</sup> engaged in trading of single-name CDS shortly after the enactment of the Dodd-Frank Act. Table 1, below, highlights that nearly three-quarters of these entities (DTCC-defined “firms” shown in DTCC-TIW, which we refer to here as “transacting agents”) were identified as investment advisers, of which 40% (30% of all transacting agents) were registered investment advisers under the Investment Advisers Act.<sup>1305</sup> Although investment advisers comprise the vast majority of transacting agents, the transactions they executed account for only 10.2% of all single-name CDS trading activity reported to the DTCC-TIW, measured by number of transaction-sides (each transaction has two transaction sides, *i.e.*, two transaction counterparties). The vast majority of transactions (83.7%) measured by number of transaction-sides were executed by ISDA-recognized dealers.<sup>1306</sup>

TABLE 1—NUMBER OF TRANSACTING AGENTS BY COUNTERPARTY TYPE AND THE FRACTION OF TOTAL TRADING ACTIVITY, FROM NOVEMBER, 2006 THROUGH OCTOBER, 2010, REPRESENTED BY EACH COUNTERPARTY TYPE

Transacting agents	Number	Percent	Transaction share (percent)
Investment advisers .....	1,099	73.8	10.2
—SEC registered .....	446	30.0	5.3
Banks .....	239	16.1	4.9

<sup>1300</sup> See Section 3(a)(68)(A) of the Exchange Act, 15 U.S.C. 78c(a)(68)(A).

<sup>1301</sup> According to data published by BIS, the global notional amount outstanding in equity forwards and swaps as of June 2012 was \$1.88 trillion. The notional amount outstanding in single-name CDS was approximately \$15.57 trillion, in multi-name index CDS was approximately \$9.73 trillion, and in multi-name, non-index CDS was approximately \$1.63 trillion. See Semi-annual OTC derivatives statistics at end-June 2012 (Nov. 2012), Table 19, available at: <http://www.bis.org/statistics/otcder/dt1920a.pdf>. For the purposes of this analysis, we assume that multi-name index CDS are not narrow-based index CDS and therefore, do not fall within the security-based swap definition. See Section 3(a)(68)(A) of the Exchange Act; see also the Product Definitions Adopting Release, 77 FR 48208. We also assume that all instruments reported as equity forwards and swaps are security-based swaps, potentially resulting in underestimation of the proportion of the security-based swap market

represented by single-name CDS. Therefore, single-name CDS appear to constitute roughly 82% of the security-based swap market. Although the BIS data reflects the global OTC derivatives market, and not just the U.S. market, we have no reason to believe that these ratios differ significantly in the U.S. market.

<sup>1302</sup> See Intermediary Definitions Adopting Release, 77 FR 30636–37, 30740, and the accompanying notes 485 and 1573.

<sup>1303</sup> Staff of the Division of Risk, Strategy, and Financial Innovation review of DTCC-defined “firms” shown in DTCC-TIW as transaction counterparties.

<sup>1304</sup> The 1,489 entities included all DTCC-defined “firms” shown in DTCC-TIW as transaction counterparties that report at least one transaction to DTCC-TIW as of October, 2010. The staff in the Division of Risk, Strategy, and Financial Innovation classified these firms that are shown as transaction counterparties by machine matching names to

known third-party databases and by manual classification. Manual classification included searching the EDGAR and Bloomberg databases, the SEC’s Investment Adviser Public Disclosure database, and the firm’s public Web site or the public Web site of the account represented by the firm. The staff also referred to ISDA protocol adherence letters available on the ISDA Web site. All but 52 of the 1,489 DTCC-defined “firms” were identified and classified.

<sup>1305</sup> As identified through matches to Form ADV.

<sup>1306</sup> For the purpose of this analysis, the ISDA-recognized dealers are those defined as G14 by ISDA. See [http://www.isda.org/c\\_and\\_a/pdf/ISDA-Operations-Survey-2010.pdf](http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf). G14 refers to JP Morgan Chase NA (and Bear Stearns), Morgan Stanley, Bank of America NA (and Merrill Lynch), Goldman Sachs, Deutsche Bank AG, Barclays Capital, Citigroup, UBS, Credit Suisse AG, RBS Group, BNP Paribas, HSBC Bank, Lehman Brothers, and Société Générale.

TABLE 1—NUMBER OF TRANSACTING AGENTS BY COUNTERPARTY TYPE AND THE FRACTION OF TOTAL TRADING ACTIVITY, FROM NOVEMBER, 2006 THROUGH OCTOBER, 2010, REPRESENTED BY EACH COUNTERPARTY TYPE—Continued

Transacting agents	Number	Percent	Transaction share (percent)
Pension Funds .....	23	1.5	0.0
Insurance Companies .....	22	1.5	0.3
ISDA-Recognized Dealers .....	16	1.1	83.7
Other .....	90	6.0	0.8
Total .....	1,489	100.0	100.0

The staff's further analysis of the "accounts" in DTCC-TIW shows that transaction agents classified in Table 1 represent over 8,500 accounts and funds who are the principal risk holders of the transactions. Table 2, below, classifies these "accounts" or principal risk holders by their counterparty type and whether they are represented by a registered or unregistered investment adviser.<sup>1307</sup> For instance, 239 banks in Table 1 allocated transactions to 353

accounts, of which 29 were represented by investment advisers and 324 were represented directly by banks, while 16 ISDA-recognized dealers in Table 1 allocated transactions to 69 accounts.

Among the accounts, there are over 1,400 Dodd-Frank Act-defined special entities and 482 investment companies registered under the Investment Company Act of 1940.<sup>1308</sup> Private funds comprise the largest type of account holders that we were able to classify,

and although not verified through a recognized database, most of the funds we were not able to classify appear to be private funds. The data analyzed here largely predate the effectiveness of our rules implementing the Dodd-Frank Act's requirement that previously exempt advisers to hedge funds and certain other private investment funds register with the Commission.<sup>1309</sup>

TABLE 2—THE NUMBER AND PERCENTAGE OF ACCOUNT HOLDERS—BY TYPE—WHO PARTICIPATE IN THE SECURITY-BASED SWAP MARKET THROUGH A REGISTERED INVESTMENT ADVISER, AN UNREGISTERED INVESTMENT ADVISER, OR DIRECTLY AS A TRANSACTING AGENT, FROM NOVEMBER 2006 THROUGH OCTOBER 2010

Account holders by type	Number	Represented by a registered investment adviser	Represented by an unregistered investment adviser	Participant is transacting agent <sup>1310</sup>
Private Funds .....	2,154	952 44%	1,202 56%	0 0%
DFA Special Entities .....	1,474	1,359 92%	46 3%	69 5%
Registered Investment Companies .....	482	477 99%	5 1%	0 0%
Banks (non G14) .....	353	25 7%	4 1%	324 92%
Insurance Companies .....	192	145 76%	19 10%	28 15%
ISDA-recognized Dealers .....	69	0 0%	0 0%	69 100%
Foreign Sovereigns .....	53	35 66%	6 11%	12 23%
Non-financial Corporations .....	37	26 70%	1 3%	10 27%
Finance Companies .....	7	1 14%	0 0%	6 86%
Other/unclassified .....	3,746	2,522 67%	1,158 31%	66 2%
All .....	8,567	5,542 65%	2,441 28%	584 7%

### (b) Levels of Security-Based Swap Trading Activity

CDS contracts make up the vast majority of security-based swap products and most are written on corporate issuers, corporate securities,

sovereign countries, or sovereign debt (reference entities and reference securities).<sup>1311</sup> Figure 1 below describes the percentage of global, notional transaction volume<sup>1312</sup> in U.S. single-name CDS reported to the DTCC-TIW

between January 2008 and December 2011, separated by whether transactions are between two ISDA-recognized dealers (interdealer transactions) or whether a transaction has at least one non-dealer counterparty.

<sup>1307</sup> Unregistered investment advisers include all investment advisers not registered under the Investment Advisers Act, and may include investment advisers registered with a state or a foreign authority.

<sup>1308</sup> There remain 3,746 DTCC "accounts" unclassified by type. Although unclassified, each was manually reviewed to verify that it was not likely to be a special entity within the meaning of the Dodd-Frank Act and instead was likely to be an entity such as a corporation, an insurance company, or a bank.

<sup>1309</sup> See Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment

Advisers Act Release No. 3221 (June 22, 2011), 76 FR 42950 (July 19, 2011).

<sup>1310</sup> This column reflects the number of participants who are also trading on their own accounts.

<sup>1311</sup> See Intermediaries Adopting Release, 77 FR 30636 n.476. See also Chen, Kathryn, Michael Flemming, John Jackson, Ada Li, and Asani Sarkar, "An Analysis of CDS Transactions: Implications for Public Reporting," Federal Reserve Bank of New York Staff Report, No. 517 (Sep. 2011) (decomposing single-name CDS contracts into corporate, sovereign, and other).

<sup>1312</sup> This volume includes all price-forming CDS transactions (trades, assignments, and terminations)

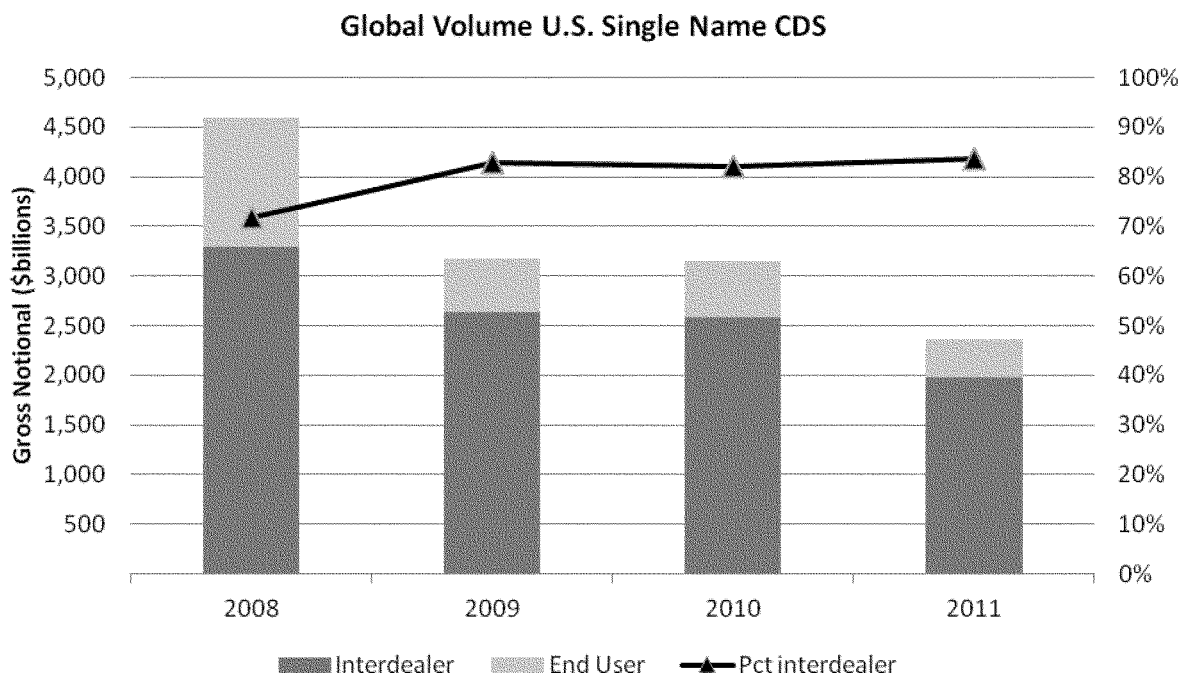
on U.S.-based reference entities reported to the DTCC-TIW during calendar years 2008 through 2011, including those executed between two foreign counterparties. "Price-forming transactions" include all new transactions, assignments, modifications to increase the notional amounts of previously executed transactions, and terminations of previously executed transactions. Transactions terminated, transactions entered into in connection with a compression exercise, and expiration of contracts at maturity are not considered price-forming and are therefore excluded, as are replacement trades and all bookkeeping-related trades.

The level of trading activity with respect to U.S. single-name CDS in terms of notional volume has declined from more than \$5 trillion in 2008 to less than \$2.5 trillion in 2011. The start of this decline predates the enactment of the Dodd-Frank Act and the rules proposed thereunder. For the purpose of establishing an economic baseline, this seems to indicate that CDS market demand shrank prior to the enactment of the Dodd-Frank Act, and therefore the causes of trading volume declines may

be independent of those related to the development of security-based swap market regulation. If the security-based swap market experiences further declines in trading activity, it would be difficult to isolate the effects of the newly-developed security-based swap market regulation and to identify whether the changes in trading activity are due to natural market forces or the anticipation of (or reaction to) proposed (or adopted) Title VII requirements.

Although notional volume had declined over the past four years, the percentage of interdealer transactions has remained fairly constant, at a little more than 80% of the total notional volume. This is consistent with the 83.7% of transactions involving ISDA-recognized dealers on one side of the transactions executed from November 2006 through October 2010 as shown in Table 1.

**Figure 1.** Global, notional trading volume in U.S. single-name CDS by calendar year and the fraction of volume that is interdealer.



(c) Market Participant Domiciles

In analyzing data to identify an economic baseline of trading activity for purposes of this proposal, we found that there has been a distinct shift in country of domicile since the enactment of the Dodd-Frank Act. Prior to the enactment of the Dodd-Frank Act, the majority of the funds and accounts<sup>1313</sup> that were allocated CDS transactions reported to the DTCC-TIW were domiciled within the United States, according to self-reported registered office location

recorded by the DTCC-TIW.<sup>1314</sup> Since the enactment of Dodd-Frank Act, there has been a significant shift in reported domiciles, with far fewer funds and accounts reporting a U.S. domicile. Figure 2, left, shows that more than two-thirds of funds and accounts in existence as of October of 2010 reported a U.S. domicile.<sup>1315</sup> Figure 2, right, reports the domicile of the more than

2,600 new funds and accounts that were allocated trades reported to the DTCC-TIW for the first time since October 2010. For these funds and accounts, only 43% report a registered office location in the United States, a decline of 25 percentage points. While the fraction of foreign domiciled funds increases by nine percentage points, most of the shift in domicile is a result of funds and accounts reporting a foreign registered office location while being managed by an adviser in the United States, or a result of accounts of foreign branches of U.S. banks or subsidiaries of U.S. entities, an increase from 3% prior to the enactment of the Dodd-Frank Act to 19% after the enactment of the Dodd-Frank Act.<sup>1316</sup>

<sup>1313</sup> The DTCC accounts are not the same as entities. One entity may have multiple accounts and, depending on where accounts are located, may report multiple domicile locations. For example, a bank may have one DTCC account for its U.S. headquarters and one DTCC account for one of its foreign branches. The self-reported registered office location for the U.S. headquarters account is different from that for the foreign branch account.

<sup>1314</sup> Following the Warehouse Trust Guidance on CDS data access (see text accompanying notes 83–85, *supra*), the DTCC-TIW surveyed market participants, asking for the physical address associated with each of their accounts (*i.e.*, where the account is incorporated as a legal entity). This is designated the registered office location. For purposes of this discussion, we have assumed that the registered office location reflects the place of domicile for the fund or account.

<sup>1315</sup> When the fund does not report a registered office location, we assume that the settlement country reported by the investment adviser or parent entity to the fund or account is the place of domicile.

<sup>1316</sup> In these instances, the fund or account lists a non-U.S. registered office location while the investment adviser, U.S. bank, or U.S. parent lists the United States as its settlement country.

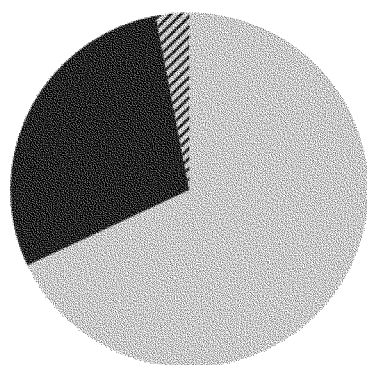
While it is likely that some of the shift in domicile is in reaction to development of the new Title VII regulatory regime, with many funds shifting their registered office locations offshore in anticipation of potential future compliance costs and burdens, some of the activity could be attributed to more precise reporting of domicile by funds and accounts relative to

information that was on record for older funds and accounts. In particular, prior to the enactment of the Dodd-Frank Act, funds and accounts did not formally report their domicile because there was no systematic requirement to do so. Since Dodd-Frank Act enactment, the DTCC-TIW has collected the account or fund registered office location, which is self-reported and voluntary.<sup>1317</sup> Among

funds and accounts that signed up for DTCC-TIW services for the first time after October 2010, most have self-reported domiciles that are outside the United States (57% of first-time DTCC-TIW users), but a sizeable proportion of these are managed from within the United States (19% of all first-time DTCC-TIW users).

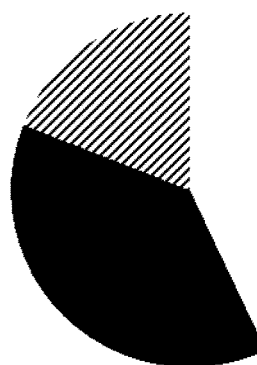
**Figure 2.** The fraction of (1) accounts and funds with domicile in the United States (referred to as “US”), (2) accounts and funds with domicile outside the United States (referred to below as “Foreign”), and (3) funds outside the United States but managed by a U.S. entity, account of a foreign branch of a U.S. bank, and account of a foreign subsidiary of a U.S. entity (collectively referred to below as “Foreign managed by US”). Left chart represents all funds as of October 2010; Right chart represents all new funds created between October 2010 and December 2011.

**Domicile of DTCC-TIW funds  
in October 2010**



US ■ Foreign ▨ Foreign managed by US

**Domicile of new DTCC-TIW  
funds since October 2010**



US ■ Foreign ▨ Foreign managed by US

#### (d) Level of Current Cross-Border Activity in Single-Name CDS

About half of the trading activity in U.S. single-name CDS reflected in the set of data we analyzed was between counterparties domiciled in the United States and counterparties domiciled abroad. When counterparty domicile is based on the registered office location<sup>1318</sup> of the DTCC-TIW accounts,

only 7% of the global transaction volume by notional volume in 2011 was between two U.S.-domiciled counterparties, compared to 49% entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 44% entered into between two foreign-domiciled counterparties (see figure 3). When the domicile locations of DTCC-TIW accounts are defined according to

the domicile of their ultimate parent, headquarters or home office (e.g., classifying a foreign bank branch or foreign subsidiary of a U.S. entity as domiciled in the United States), the fraction of transactions entered into between two U.S.-domiciled counterparties increases to 25%, and to 57% for transactions entered into between a U.S.-domiciled counterparty and a foreign-domiciled counterparty.

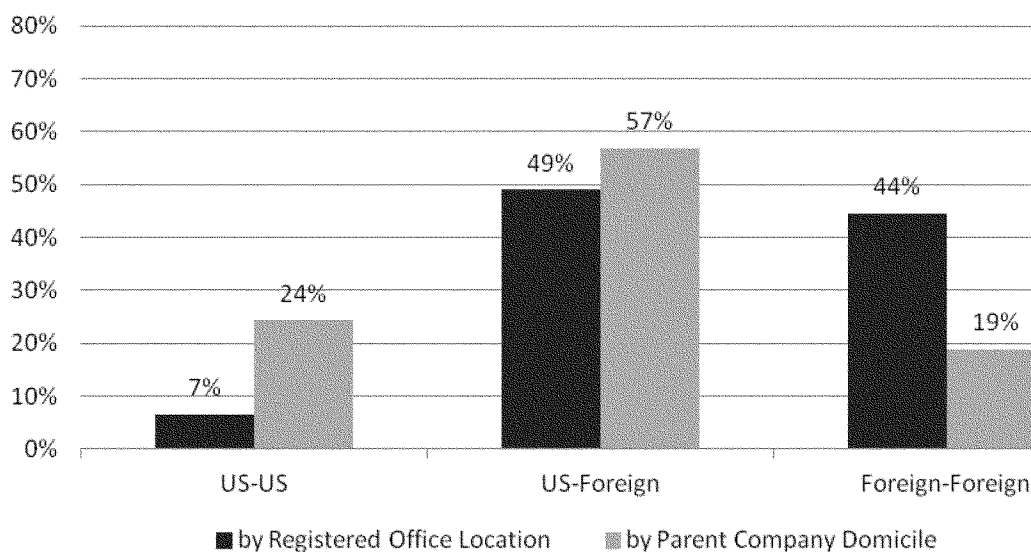
<sup>1317</sup> SEC Staff discussions with DTCC.

<sup>1318</sup> DTCC-TIW collects certain information from its users, including registered office location, which

is defined as the “place of organization of the legal entity.” DTCC, “Multifund User Agreement Form & Key Contacts,” at 5, available at: [http://](http://www.dtcc.com/customer/membership/derivserv/derivserv.php)

[www.dtcc.com/customer/membership/derivserv/derivserv.php](http://www.dtcc.com/customer/membership/derivserv/derivserv.php).

**Figure 3. 2011 U.S. Single Name CDS Transactions by Domicile  
(% of notional volume)**



By either definition of domicile, the data indicate that a large fraction of U.S. single-name CDS transaction volume is entered into between counterparties domiciled in two different jurisdictions or between counterparties domiciled outside the United States. For the purpose of establishing an economic baseline, this observation indicates that a large fraction of security-based swap activity would be affected by the scope of any cross-border approach we could propose to take in applying the Title VII requirements. The large fraction of U.S. single-name CDS transactions between U.S.-domiciled and foreign-domiciled counterparties also highlights the extent to which security-based swap activity transfers risk across geographical boundaries. Moreover, the legal domicile of a counterparty may not represent the only location of risk.

#### (e) Levels of Security-Based Swap Clearing

Although no mandatory clearing regime yet exists, a substantial

proportion of single name CDS and index CDS are cleared on a voluntary basis. Voluntary clearing of security-based swaps in the United States is currently limited to CDS products, including single-name CDS and index CDS. At present, there is no central clearing in the United States for security-based swaps that are not CDS products.

The analysis below is based on information reported by ICE Clear Credit on its public Web site and is based on price-forming transactions,<sup>1319</sup> which includes the clearing of transactions on the same day as the transaction was executed as well as the clearing of transactions submitted for clearing on a retroactive basis. The data presented here do not include transactions that result from the compression<sup>1320</sup> of transactions previously submitted for clearing.

Figure 4 shows that index CDS in U.S. names account for the bulk of current voluntary clearing activity. The proportion of transactions in names

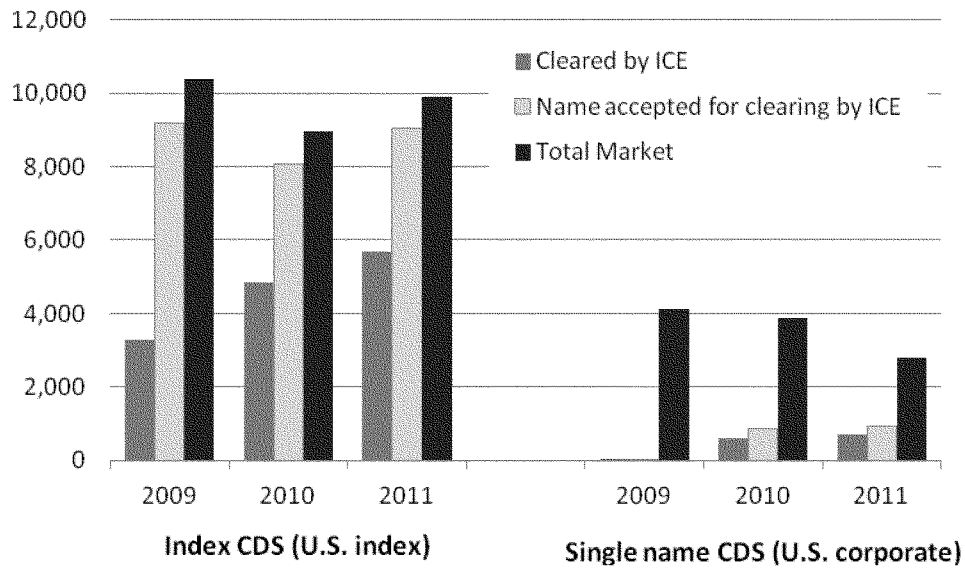
accepted for clearing that are ultimately cleared also appears to be higher in index CDS in U.S. names than in single-name CDS referencing U.S. corporate issuers or securities. In calendar years 2010 and 2011, Figure 4 indicates that 90% of the total notional volume of transactions is in index names that are accepted for clearing as of the end of each calendar year and that cleared index transactions correspond to more than 50% of the total notional volume during the same period. By contrast, the figure suggests that the proportion of transactions in single-name corporate CDS referencing names that were accepted for clearing was only 33% of the total single-name CDS during 2011, with cleared transactions during the same year totaling only 25% of all the single-name CDS executed during the same period.

<sup>1319</sup> See note 1312, *supra*. Transactions reported to the DTCC-TIW used for this analysis reflect all global activity, including transactions between two foreign counterparties. See Clearing Procedures Adopting Release, 77 FR 41636-37.

<sup>1320</sup> In compression, counterparties agree to terminate or change the notional amount of some or all of their outstanding contracts and replace any terminated contracts with new contracts. Compression reduces counterparties' gross notional amount, while leaving their net notional amount

unchanged. Transactions entered into in connection with a compression exercise are not considered price-forming and are therefore excluded from the analysis here.

**Figure 4. Gross notional transaction volume (\$billions)**



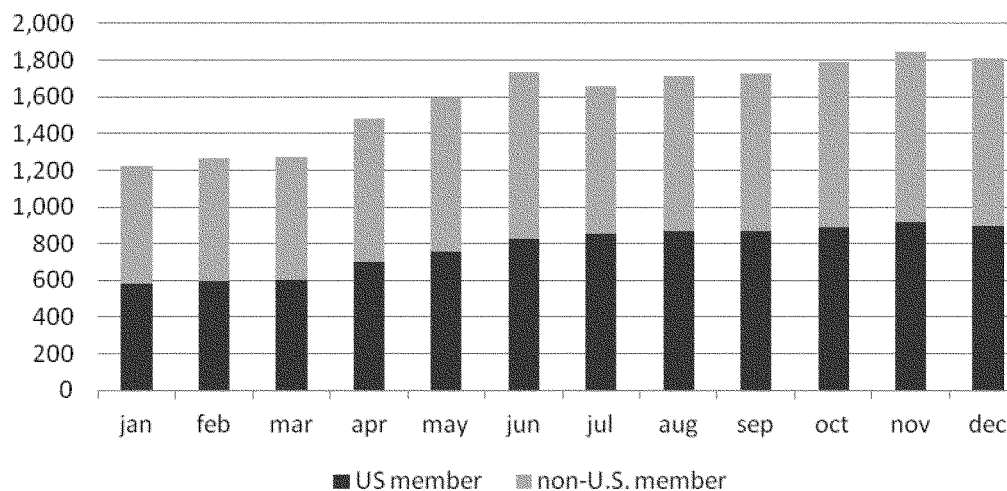
\*Source: DTCC-TIW

While a large fraction of CDS trading activity continues to settle bilaterally, particularly in light of limited eligibility to clear among market participants, clearing activity has steadily increased alongside the Title VII rulemaking

process, and in advance of mandatory clearing requirements.<sup>1321</sup> Figure 5 shows that member positions at ICE Clear Credit in the United States are roughly half held by foreign-domiciled dealing members.<sup>1322</sup> Hence, there is

considerable credit exposure between ICE Clear Credit and these foreign-domiciled clearing members, in both directions.

**Figure 5. 2011 monthly notional positions at ICE Clear Credit (\$ billions)**



<sup>1321</sup> See Clearing Procedures Adopting Release, 77 FR 41636-38.

<sup>1322</sup> Positions represent each side of an original swap contract such that the aggregated numbers

reported here are twice the amount of the notional exposure from the original contract.



### C. Analysis of Potential Effects on Efficiency, Competition, and Capital Formation

#### 1. Introduction

In developing our approach to the application of Title VII to cross-border activities, we have focused on meeting the goals of Title VII, including the promotion of the financial stability of the United States by improving accountability and transparency in the U.S. financial system, the reduction of systemic risk, and the protection of counterparties to security-based swaps.<sup>1323</sup> We also have sought to take into account a range of principles relevant to regulation of this market, as described above.<sup>1324</sup> As reflected in our discussion of the various policy choices we are proposing above<sup>1325</sup> and of the potential costs and benefits associated with our proposed approach in the economic analyses below,<sup>1326</sup> we also have considered effects on competition, efficiency, and capital formation.<sup>1327</sup>

In this section, we focus particularly on these effects. Given the complexity and inter-relatedness of the potential effects of the proposed rules—both on a rule-by-rule basis and taken together as a whole—on the market for security-based swaps, we provide a framework for a general analysis of the effects of the proposed rules on competition, efficiency, and capital formation. We then use this framework to engage in an analysis of the possible effects of our proposed approach.

In developing the general analytical framework for considering the effects of our proposed cross-border approach on competition, efficiency, and capital formation, we have noted certain distinct analytical issues. First, various proposed rules may give rise to similar or overlapping effects. Second, each proposed rule or interpretation is a component of the Title VII regulatory framework and operates in tandem with

the other Title VII components to form a comprehensive regulatory regime. To the extent that the proposed rules interact with each other, it is appropriate to broaden the analysis beyond a single rule. For example, although each of the rules and interpretations regarding registration of security-based swap dealers and the application of the public dissemination, regulatory reporting, mandatory clearing, and mandatory trade execution requirements in the cross-border context serve distinct regulatory purposes,<sup>1328</sup> together they may have combined effects on dealer participation in the U.S. security-based swap market and on the ability of certain market participants to access other parts of the global security-based swap market.

The analytical framework we establish here for considering the effects of our proposed approach to analyzing effects related to competition, efficiency, and capital formation is premised upon our understanding of the existing state of the security-based swap market. Two important features of the security-based swap market inform our analysis.

First, the security-based swap market is global in nature, and dealers and other market participants are highly interconnected within this global market. While most end users have only a few counterparties, dealers can have hundreds of counterparties, consisting of both end users and other dealers.<sup>1329</sup> This interconnectedness provides a myriad of paths for liquidity and risk to move throughout the financial system. As a result, it can be difficult to attribute liquidity and risk to a particular entity. The interconnected nature of the global security-based swap market contributes to an increased potential for sequential counterparty failures, liquidity shocks, and market dislocation during times of financial market stress.<sup>1330</sup>

<sup>1328</sup> For example, registration of security-based swap dealers is intended, among other things, to increase the safety and soundness of security-based swap dealers and improve the stability of the U.S. financial system, while application of the public dissemination and mandatory trade execution requirements in the cross-border context are intended, among other things, to increase the transparency of the U.S. security-based swap market.

<sup>1329</sup> See Section XV.B.2(a), *supra* (discussing current security-based swap market participants). In addition, based on an analysis of 2011 transaction data by staff in the Division of Risk, Strategy, and Financial Innovation, the entities recognized by ISDA as dealers had on average 292 counterparties, with a minimum of 17 and a maximum of 695. All other entities (*i.e.*, those more likely to be end users), averaged 4 counterparties, with a minimum of 1 and a maximum of 52.

<sup>1330</sup> “Rethinking the financial network,” speech by Andrew G. Haldane, Executive Director for Financial Stability at the Bank of England,

In other words, the failure of one firm can have consequences beyond the firm itself, and the loss of trading confidence and willingness to trade in one market can have consequences beyond the firm’s home jurisdiction or market. If firms consider the implications of security-based swap activity only on their own operations, without considering aggregate financial sector risk, including lack of liquidity and market disruption or the possibility of spillover effects, the financial system may end up bearing more risk than the aggregate capital of the intermediaries in the system can support and may cease to function normally.<sup>1331</sup>

Second, the security-based swap market developed as an over-the-counter market, without transparent pricing or volume information.<sup>1332</sup> In markets without transparent pricing, access to information confers a competitive advantage. Within the security-based swap market, large dealers and other large market participants with a large share of order flow have an informational advantage over smaller dealers and end users who observe a smaller subset of the market. Greater private order flow enables better assessment of current market values that dealers may use to extract rents from counterparties who are less informed.<sup>1333</sup> End users are aware of this information asymmetry, and certain end users—particularly larger entities who transact with many dealers—may be able to obtain access to competitive pricing. Typically, however, the value of private information will be captured by those who have the information—in this case, predominantly dealers who observe the greatest order flow.

In sum, the security-based swap market is a global market characterized

delivered to Financial Student Association, Amsterdam (Apr. 28, 2009), available at: <http://www.bis.org/review/r090505e.pdf?frames=0>.

<sup>1331</sup> See Viral V. Acharya, Lasse H. Pedersen, Thomas Philippon, and Matthew Richardson, “Measuring Systemic Risk” (May 2010), available at: <http://vlab.stern.nyu.edu/public/static/SR-v3.pdf>. The authors use a theoretical model of the banking sector to show that, unless the external costs of their trades are considered, financial institutions will have an incentive to take risks that are borne by the aggregate financial sector). Under this theory, in the context of Title VII, the relevant external cost is systemic risk (*i.e.*, the potential for risk spillovers and sequential counterparty failure), leading to an aggregate systemic capital shortfall and breakdown of financial intermediation in the financial sector.

<sup>1332</sup> See SB SEF Proposing Release, 76 FR 10949.

<sup>1333</sup> Martin D. D. Evans and Richard K. Lyons, “Exchange Rate Fundamentals and Order Flow,” NBER Working Paper No. 13151 (June 2007), available at: [http://128.97.165.17/media/files/evans\\_lyons.pdf](http://128.97.165.17/media/files/evans_lyons.pdf). Using data on end-user currency trades, the authors find evidence that transaction flows forecast future macro variables such as output growth, money growth, and inflation.

<sup>1323</sup> See note 4, *supra*.

<sup>1324</sup> See Section II.C, *supra*.

<sup>1325</sup> See Sections III–XI, *supra*.

<sup>1326</sup> See Sections XV.D–I, *infra*.

<sup>1327</sup> As noted above, Section 3(f) of the Exchange Act requires that whenever pursuant to the Exchange Act the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. 15 U.S.C. 78c(f). In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. 15 U.S.C. 78w(a)(2).

by a high level of interconnectedness and spillover risk and by significant information asymmetries that result from the opacity of the OTC market. The global nature of this market, combined with the interconnectedness of market participants, means that it is difficult to isolate risk and liquidity problems to one geographical segment of the market, or to one asset class. Because U.S. market participants and transactions regulated under Title VII are a subset of the overall global security-based swap market, concerns surrounding these types of spillovers are part of the framework in which we analyze the competitive effects of our proposed rules and interpretations.

The interconnectedness of this market also highlights the need for coordination among international regulators.<sup>1334</sup> Because liquidity and risk spillovers, even from entities that engage in security-based swap activity entirely outside the United States, have the potential to put the U.S. market at risk, consistent regulation of the security-based swap market across jurisdictions may be necessary to effectively reduce those risks. However, the regulatory developments in various jurisdictions are not necessarily consistent in pace and scope, which may result in certain types of risks being addressed in different ways.

In our assessment of the economic effects of the proposed rules and interpretations, we also are mindful that these differences in scope and timing may affect the behavior of some market participants. In particular, the United States being first-mover in many areas of security-based swap market regulation presents unique challenges to maintaining high regulatory standards and avoiding disruptions in the global security-based swap market.

We also recognize that regulations designed to mitigate systemic risk and improve transparency can impose a barrier to entry and access for foreign participants, which could have an effect on liquidity in the security-based swap market. For example, regulatory requirements in the U.S. that conflict with foreign laws may preclude foreign entities from participating in U.S. markets. We also recognize that regulators in other jurisdictions are currently engaged in implementing their own regulatory reforms of the OTC derivatives markets and are faced with a similar tradeoff between preserving market access and reducing risks to

their financial systems. Our proposed application of Title VII to cross-border activities may affect the policy decisions of these other regulators as they seek to address this tradeoff under their authority.

Regulatory differences among jurisdictions in the global security-based swap markets driven by lack of coordination could create incentives for business restructuring solely for the purposes of operating outside of Title VII regulation. Furthermore, barriers to market access may produce competitive distortions and lead to fragmented markets.<sup>1335</sup> We also note that the potential effects of our proposed application of Title VII in the cross-border context on competitive frictions and market fragmentation would be moderated or amplified by the substantive requirements ultimately adopted by the Commission. The Commission is reopening the comment periods for our outstanding rulemaking releases that concern security-based swaps and security-based swap market participants and were proposed pursuant to certain provisions of the Exchange Act, as amended by Title VII of the Dodd-Frank Act.<sup>1336</sup>

## 2. Competition

The proposed rules and interpretations discussed in this release will likely affect competition in the U.S. security-based swap market and potentially change the set of available counterparties that would compete for business and provide liquidity to U.S. market participants. Some of these proposed rules and interpretations will likely enhance competition and participation in the U.S. market, as application of Title VII requirements to entities that are engaged in security-based swap activity conducted with U.S. persons or otherwise conducted within the United States will likely promote safety and soundness, transparency, and competition within the U.S. security-based swap market and the U.S. financial system as a whole. At the same time, these proposed rules and interpretations may impose certain costs

or other burdens that may reduce the level of competition in this market.

Assessing the net effect of these proposed rules and interpretations on competition is particularly complicated in the cross-border context. As already noted, cross-border activity involving market participants domiciled in different jurisdictions accounts for the vast majority of transactions in the security-based swap market. U.S. persons routinely enter into security-based swap transactions with market participants located in other jurisdictions or have operations outside the United States that engage in security-based swap activity; similarly, non-U.S. persons routinely enter into transactions with U.S. persons and maintain operations within the United States. The global nature of the market and of market participants' operations may lead to differences in the application of Title VII to firms active in the global security-based swap market and may create incentives for firms to restructure their operations to minimize contact with the United States that would be less likely in a less global market.

In our preliminary view, there are three key factors that will contribute to the effects our proposed cross-border rules and interpretations will have on competition in the security-based swap market: (1) how Title VII requirements apply to U.S. persons and non-U.S. persons when they transact security-based swaps within the United States; (2) how these requirements apply to U.S. persons and non-U.S. persons when they transact security-based swaps outside the United States; and (3) whether the regulatory requirements that foreign jurisdictions impose on U.S. persons and non-U.S. persons are comparable to those that we are proposing in this release. In addition, as noted above, the magnitude of any competitive effects flowing from our proposed application of the Title VII requirements described in this release will also be determined by the substantive rules we ultimately adopt to implement Title VII.

For example, in response to our proposal to impose Title VII requirements on non-U.S. persons that engage in security-based swap activity with U.S. persons or within the United States, some non-U.S. persons may seek to restructure their operations to minimize their contact with the United States in an effort to avoid having to comply with Title VII; some non-U.S. persons may determine to exit the U.S. market entirely. Similarly, to the extent that our proposed rules treat the foreign business of U.S. persons and non-U.S.

<sup>1335</sup> See, e.g., Arnold W.A. Boot, Silva Dezellan, and Todd T. Milbourn, "Regulatory Distortions in a Competitive Financial Services Industry," J. of Fin. Serv. Res., Vol. 17, No. 1 (2000) (showing that, in a simple industrial organization model of bank lending, a change in the cost of capital resulting from regulation results in a greater loss of profits when regulated banks face competition from non-regulated banks than when regulations apply equally to all competitors). See also Victor Fleischer, "Regulatory Arbitrage," 89 Tex. L. Rev. 227 (Mar. 4, 2010) (discussing how, when certain firms are able to choose their regulatory structure, regulatory burdens are shifted onto those entities that cannot engage in regulatory arbitrage).

<sup>1336</sup> See note 29, *supra*.

<sup>1334</sup> The Commission has entered into bilateral and multilateral discussions with foreign regulatory authorities concerning the regulation of OTC derivatives. See Section I and notes 34 and 35, *supra*.

persons differently from their U.S. business, these entities may have incentives to restructure their business to separate their foreign and U.S. operations. Both of these potential responses to our proposal may result in lessened competition in the security-based swap market within the United States. The decision to restructure and move operations outside the United States does not necessarily indicate reduction of the exposures of the U.S. financial system to systemic risk if, for example, the foreign operations are supported by a guarantee provided by a U.S. person, which provides a path for the transmission of risk to transmit to the United States.

The competitive effects of our proposal will also be affected by whether entities potentially subject to Title VII are also subject to similar regulations in foreign jurisdictions when they transact security-based swaps or perform infrastructure functions in the security-based swap market, and, if so, whether those regulations are inconsistent with, or duplicative of applicable Title VII regulations. Many other jurisdictions are implementing reforms of the OTC derivatives market (including those products defined as security-based swaps within the United States), but this regulation can be expected to develop along different timelines and impose different substantive requirements.

To the extent that these timelines or requirements are different, market participants may have the opportunity to take advantage of these differences by making strategic choices, at least in the short term, with respect to their transaction counterparties and operating business models. For example, at a larger scale, firms may choose whether to withdraw from, or participate in the U.S. security-based swap market. This may change the number of participants in the U.S. market and could have a direct impact on competition in the U.S. market. In addition, differences in regulatory requirements may make it difficult for U.S. dealers to provide competitive spreads relative to foreign dealers. While we do not anticipate that this disadvantage would cause U.S. dealers to exit foreign markets, it could have a direct effect on competition in foreign markets unless U.S. dealers restructure their business to conduct foreign transactions through subsidiaries that satisfy the requirements to be considered non-U.S. persons.

In developing the approach we are proposing in this release, we have considered the potential for competitive

distortions as a result of these inconsistencies. At the same time, the Commission believes that, while the potential of regulatory arbitrage is real, the effects of these strategic choices may be mitigated to some extent as regulators in other jurisdictions implement the G20 commitments.<sup>1337</sup> Efforts are underway to achieve robust derivatives market regulation, including regulations of the security-based swap markets, in various jurisdictions.<sup>1338</sup> As jurisdictions progress toward full implementation of the G20 commitments, competitive distortions should decline to some extent, blunting the incentives for this type of strategic behavior.

#### (a) Security-Based Swap Dealers

Our proposed approach would generally apply dealer registration and other Title VII requirements to entities that conduct dealing activity with U.S. persons<sup>1339</sup> or in the United States.<sup>1340</sup> Because the full range of Title VII requirements are applied generally to activity in the United States regardless of the counterparty's U.S.-person status,<sup>1341</sup> persons choosing to transact a security-based swap in the United States may have no incentive to favor a non-U.S. counterparty over a U.S. counterparty.<sup>1342</sup>

At the same time, some entities may determine that the compliance costs arising from the requirements of Title VII warrant exiting the security-based swap market in the United States. Non-U.S. persons may find this option more

<sup>1337</sup> See note 32 and accompanying text, *supra*.

<sup>1338</sup> See, e.g., Joint Press Statement of Leaders on Operating Principles and Areas of Exploration in the Regulation of the Cross-Border OTC Derivatives Market, available at: <http://www.sec.gov/news/press/2012/2012-251.htm>.

<sup>1339</sup> See the proposed definition of "U.S. person" in proposed Rule 3a71-3(a)(7) under the Exchange Act.

<sup>1340</sup> See the proposed definition of "transaction conducted within the United States" in proposed Rule 3a71-3(a)(5) under the Exchange Act.

<sup>1341</sup> See the proposed *de minimis* rule in proposed Rule 3a71-3(b) under the Exchange Act, the proposed application of the mandatory clearing requirement to cross-border security-based swap transactions in proposed Rule 3Ca-3, as discussed in Section IX above; the proposed application of the mandatory trade execution requirement to cross-border security-based swap transactions in proposed Rule 3Ch-1, as discussed in Section X above; and the proposed application of the regulatory reporting and public dissemination requirements in proposed Rule 908 of Regulation SBSR, as discussed in Section VIII above.

<sup>1342</sup> This is in general the case, however, proposed Rules 3Ca-3(b) and 3Ch-1(b) would not apply the mandatory clearing and mandatory trade execution requirements to transactions between two non-U.S. persons who are not security-based swap dealers and whose performances under security-based swaps are not guaranteed by a U.S. person, even though such transactions are conducted in the United States.

attractive than U.S. persons because they may find it easier to structure their foreign business so as to prevent it from falling within the scope of Title VII. To the extent that entities engaged in dealing activity exit the U.S. security-based swap market, the level of competition in the market may decline. These exits could result in higher spreads and affect the ability and willingness of end users to engage in security-based swaps.<sup>1343</sup>

We noted in the Intermediary Definitions Adopting Release that the registration requirement would impose dealer registration costs on entities that engage in the bulk of dealing activity in the market, while the *de minimis* threshold would allow persons who account for a small portion of dealing activity to avoid incurring these costs to obtain what would likely be comparatively modest benefits, given the small size of these dealers.<sup>1344</sup> We noted in that release that the *de minimis* threshold may mitigate some of the potential competitive burdens that could fall on entities engaged in a smaller amount of dealing activity without leaving an undue amount of dealing activity outside of the ambit of dealer regulation.<sup>1345</sup>

In the cross-border context, the proposed *de minimis* exception<sup>1346</sup> could reduce the number of entities likely to exit the U.S. market because it would enable an established foreign entity to transact a *de minimis* amount of security-based swap dealing activity in the U.S. market before it determines whether to expand its U.S. business<sup>1347</sup> and become a registered security-based swap dealer. However, since the ability of smaller entities to access the U.S. security-based swap market without registration would be limited to conducting dealing activity below the *de minimis* threshold, these entities

<sup>1343</sup> Barclay, Michael, William G. Christie, Jeffrey H. Harris, Eugene Kandel and Paul H. Schultz, "Effects of Market Reform on the Trading Costs and Depths of Nasdaq Stocks," *Journal of Finance*, Vol. 54, No. 1 (Feb. 1999) (measuring the impact of rules designed to enhance public competition with Nasdaq dealers, and observing evidence of lower quoted and effective spreads without adverse effects on market quality).

<sup>1344</sup> See Intermediary Definitions Adopting Release, 77 FR 30741.

<sup>1345</sup> See *id.*

<sup>1346</sup> The proposed application of the *de minimis* exception would allow a U.S. and foreign dealing entity to conduct dealing activity in the U.S. security-based swap market without registering as a security-based swap dealer so long as their trailing 12-month notional volume of transactions with U.S. persons and transactions conducted within the United States in its dealing capacity is below the *de minimis* threshold. See proposed Rule 3a71-3(b) under the Exchange Act.

<sup>1347</sup> See proposed Rule 3a71-3(a)(6) under the Exchange Act.

would have an incentive to curtail their security-based swap dealing activity with U.S. persons as they approach the *de minimis* threshold to avoid having to register as a dealer. To the extent that such entities choose to operate in the U.S. market at levels below the *de minimis* threshold, the net effect on competition of their decision to remain in the U.S. market is likely to be small and unlikely to deter the accumulation of market power by a relatively smaller number of large dealing entities than are currently active in the U.S. market.

On the other hand, Title VII regulatory requirements may allow registered dealers to credibly signal high quality, better risk management, and better counterparty protection relative to unregistered dealers that compete for the same order flow. End users in the U.S. market may be willing to pay higher prices for higher-quality services from registered entities.<sup>1348</sup> These regulatory benefits could mitigate the competitive burdens imposed by the proposed cross-border rules and substantive Title VII requirements applicable to registered security-based swap dealers by, for example reducing incentives for firms to exit the market.

The proposed approach to application of Title VII requirements to dealing activities outside the United States may also have distinct competitive effects that interact with the effects just described. Because we are proposing to take a different approach to the application of Title VII to dealing activity outside the United States from the application of Title VII to dealing activity in the United States, certain dealing entities may have incentives to restructure their existing dealing business<sup>1349</sup> in order to prevent all or part of their security-based swap business from becoming subject to Title

VII. For example, a foreign dealing entity conducting its U.S. Business<sup>1350</sup> in excess of the *de minimis* threshold may be motivated to separate its U.S. Business from its Foreign Business into two or more distinct entities.<sup>1351</sup> Such a firm may conduct U.S. Business and Foreign Business through two separate entities and confine its U.S. Business in an entity registered as security-based swap dealer, potentially allowing the firm to insulate its Foreign Business from Title VII requirements. Alternatively, some foreign dealing entities may choose to exit the U.S. market entirely.

Similarly, application of the transaction-level requirements for public dissemination, mandatory clearing, and mandatory trade execution may generally be triggered, in part, by the choice of non-U.S. persons to conduct security-based swap transactions within the United States.<sup>1352</sup> This may give foreign security-based swap dealers and other market participants an incentive to restructure their operations or otherwise avoid using an agent in the United States to conduct security-based swap transactions in order to avoid the transaction-level requirements.<sup>1353</sup>

For example, a foreign security-based swap dealer operating within the United States whose performance under security-based swaps are not guaranteed by a U.S. person (“foreign non-guaranteed security-based swap dealer”) would be required to comply with the mandatory clearing requirement with respect to a security-based swap with a non-U.S. person counterparty whose security-based swap transaction is not guaranteed by a U.S. person (“non-U.S. non-guaranteed counterparty”). However, the same security-based swap between a foreign non-guaranteed security-based swap dealer and a non-

U.S. non-guaranteed counterparty would not be subject to mandatory clearing if the transaction were conducted outside the United States. Therefore, foreign non-guaranteed security-based swap dealers and non-U.S. non-guaranteed counterparties may be motivated to avoid using their U.S. operations, such as a sales and trading desk in the United States, to conduct security-based swaps with non-guaranteed non-U.S. counterparties in order to avoid application of the mandatory clearing, public dissemination, and trade execution requirements under Title VII. They may be further motivated to move part of their operations, such as the sales and trading desk in the United States that currently conducts security-based swaps with non-guaranteed non-U.S. counterparties to a location outside the United States.

These potential restructurings may impact competition in the U.S. market. On one hand, the ability to restructure one’s business rather than exit the U.S. market entirely to avoid application of Title VII to an entity’s non-U.S. operations may reduce the number of entities that exit the market, thus mitigating the negative effects on competition described above. On the other hand, U.S. end users may find that the only foreign security-based swap dealers that are willing to deal with them are those whose security-based swap business is sufficiently large to afford the costs of restructuring and of registration as well as the ensuing compliance costs associated with applicable Title VII requirements. To the extent that smaller dealers continue to have an incentive to exit the market, the overall level of competition in the market may decline.

Moreover, regardless of the response of dealers to our proposed approach, we cannot preclude the possibility that large end users in the United States who have the resources to restructure their business also may pursue restructuring and move part of their business offshore in order to transact with dealers outside the reach of Title VII. This may reduce liquidity within the U.S. market and provide additional incentives for U.S. persons and non-U.S. persons to shift a higher proportion of their security-based swap business off-shore, further reducing the level of competition within the United States. In this scenario, the competitive frictions caused by the application, in the cross-border context, of a *de minimis* threshold for dealing activity may affect the ability of small end users of security-based swaps to access the security-based swap market more than large ones, as smaller end

<sup>1348</sup> Cf. Carl Shapiro, “Investment, Moral Hazard, and Occupational Licensing,” *The Review of Economic Studies*, Vol. 53, No. 5 (1986) (using a theoretical model to show “that licensing and certification tend to benefit consumers who value quality highly at the expense of those who do not”). Oren Fuerst, “A Theoretical Analysis of the Investor Protection Regulations Argument for Global Listing of Stocks,” Working Paper (1998) (using a theoretical model of the listing decision to show how managers of high quality firms signal their quality more effectively in a strict regulatory regime). Craig Doidge, G. Andrew Karolyi and Rene M. Stulz, “Why are Foreign Firms Listed in the U.S. Worth More?” *Journal of Financial Economics*, Vol. 71, Issue 2 (2004) (hypothesizing that firms cross-listed in the United States are better able to take advantage of growth opportunities, and finding that “expected sales growth is valued more highly for firms listed in the U.S. and that this effect is greater for firms from countries with poorer investor rights”).

<sup>1349</sup> See Section II.A.2, *supra* (describing the dealing structures used by dealing entities to conduct global security-based swap business).

<sup>1350</sup> See proposed Rule 3a71–3(a)(6) under the Exchange Act.

<sup>1351</sup> See proposed Rule 3a71–3(a)(2) under the Exchange Act.

<sup>1352</sup> This is in general the case, however, proposed Rules 3Ca-3(b) and 3Ch-1(b) would not apply the mandatory clearing and mandatory trade execution requirements to transactions between two non-U.S. persons who are not security-based swap dealers and whose performances under security-based swaps are not guaranteed by a U.S. person, even though such transactions are conducted in the United States.

<sup>1353</sup> This is especially the case with respect to the public dissemination requirement; however, with respect to mandatory clearing and mandatory trade execution requirements, this incentive would not exist with respect to a non-U.S. person who is not a security-based swap dealer and whose performance under security-based swaps is not guaranteed by a U.S. person, if such non-U.S. person transacts with another non-U.S. person that is not a security-based swap dealer and is not guaranteed by a U.S. person. See note 1352, *supra*.

users are less likely to have the resources that would enable or justify a restructuring of their business.

To reduce the likelihood of market fragmentation and increase U.S. persons' access to foreign markets, we are proposing not to require non-U.S. persons to count transactions with foreign branches of U.S. banks toward their *de minimis* threshold if the transactions are conducted outside the United States.<sup>1354</sup> We preliminarily believe that this would reduce the incentives of non-U.S. person dealers to avoid engaging in security-based swap dealing activity with foreign branches of U.S. banks. In addition, we are proposing not to apply certain market-wide transaction-level requirements (*i.e.*, mandatory clearing, public dissemination, and mandatory trade execution requirements) to foreign branches and non-U.S. persons whose performance under security-based swap transactions is guaranteed by a U.S. person, when foreign branches and guaranteed non-U.S. persons transact with non-U.S. persons whose performance under security-based swap transactions is not guaranteed by a U.S. person and who are not registered security-based swap dealers. This approach to transaction-level requirements reduces the likelihood of conflicting regulations for foreign branches of U.S. banks and guaranteed non-U.S. persons operating in foreign jurisdictions as these jurisdictions adopt regulatory requirements for security-based swap participants.

Finally, our proposed cross-border approach includes a substituted compliance policy framework that allows market participants to request substituted compliance. Substituted compliance, if granted, would allow certain security-based swap transactions or participants to satisfy their compliance obligations with respect to the applicable Title VII requirements by complying with the rules of a foreign jurisdiction. This should reduce market participants' compliance costs by reducing the effects of duplicative regulation. Substituted compliance could encourage foreign firms' participation in the U.S. market and U.S. firms' access to the global market. This might result in increased competition between both U.S. and foreign intermediaries without compromising the regulatory benefits intended by the applicable Title VII requirements.

Conflicting regulations may impose a legal barrier to entry that goes beyond

<sup>1354</sup> See proposed Rule 3a71-3(b) under the Exchange Act.

firms' willingness to participate in U.S. markets as a result of duplicative compliance costs. In these cases, substituted compliance determinations may remove this legal barrier, even if offered conditionally, and allow market participants to more easily access U.S. markets. This may also facilitate U.S. participants' access to foreign liquidity. Access to more liquidity providers and infrastructure services, as well as the general benefits of increased market participation, should promote competition in the security-based swap market.

The overall effects of the proposed approach described in this release on competition among dealing entities in the U.S. security-based swap market will depend on the way market participants respond to these different elements of our proposal. For example, suppose the proposed application of the security-based swap dealer registration requirement increases concentration among security-based swap dealers providing services to U.S. end users. Application of market-wide transaction-level requirements that facilitate competition (as discussed further below) may offset any competitive effects caused by increased concentration. Fewer dealing entities may lead to decreased competition and wider spreads in the security-based swap market; however, implementation of the public dissemination and mandatory trade execution requirements would increase pre-trade and post-trade transparency, making it more difficult for dealing entities to post wider spreads.<sup>1355</sup>

#### (b) Security-Based Swap Market Infrastructure Requirements

##### i. Registration of Clearing Agencies, SDRs and SB SEFs

The Commission has considered the effects of the proposed application in the cross-border context, of the registration requirements with respect to clearing agencies, SDRs, and SB SEFs on competition in the U.S. security-based swap market.

The proposed approach to applying the registration requirements with respect to security-based swap market infrastructures is based on whether a CCP, a data repository, or a security-based swap trading facility has performed the type of activity in the

<sup>1355</sup> Michael A. Goldstein, Edith S. Hotchkiss, and Erik R. Sirri, "Transparency and Liquidity: A Controlled Experiment on Corporate Bonds," *Review of Financial Studies*, Vol. 20, No. 2 (2007) (using a controlled experiment in the BBB bond market to show how, in some cases, spreads on newly post-trade transparent bonds decline relative to bonds that remain opaque).

United States or with respect to U.S. persons that constitutes clearing services, data repository services, or trading facility services within the meaning of the Exchange Act that would trigger the registration requirement. One of the indicators of performing security-based swap infrastructure services in the United States is to provide such services to a U.S. person. In the case of clearing services, this would include accepting a U.S. person as a member of a CCP. Similar to our analysis of the effects of the proposed application of the security-based swap dealer registration requirement on competition in the cross-border context, we are mindful that the proposed approach would directly affect the total number of clearing agencies, SDRs, and SB SEFs that would be required to register with the Commission. Registration would trigger certain Title VII requirements, which would entail compliance costs. Certain CCPs, data repositories, or security-based swap trading facilities may choose to withdraw from the U.S. market to avoid registration.

However, the burden on competition imposed by the proposed approach to infrastructure registration requirements would likely be less acute than the security-based swap dealer registration requirement. Clearing, trade reporting, and execution on trading platforms are relatively recent services for the security-based swap market, and only a limited number of CCPs, trade repositories, and execution facilities currently perform these services<sup>1356</sup> and may therefore be required to register under the Dodd-Frank Act. In addition, the proposed interpretation with respect to availability of an exemption from registration for foreign SB SEFs should reduce or eliminate the duplicative regulatory costs for foreign SB SEFs subject to comparable regulatory requirements and increase the likelihood that foreign SB SEFs will enter the United States, which, in turn, would increase competition.

Nonetheless, the proposed application of Title VII regulation in the cross-border context generates competitive frictions similar to those discussed above in the context of dealers. Broadly, providers of security-based swap infrastructure may seek to limit their exposure to the U.S. portion of the market in order to avoid Title VII

<sup>1356</sup> See Clearing Agency Standards Adopting Release, 77 FR 66258 (estimating that between seven and 10 entities would be likely to register as CCPs); SDR Proposing Release, 75 FR 77347 n.207 (estimating that 10 entities would be likely to register as SDRs); SB SEF Proposing Release, 76 FR 11023 (estimating that up to 20 entities could seek to register as SB SEFs).

regulation. For example, a foreign CCP that does not otherwise perform clearing services in the United States may refuse to accept U.S. persons as members to avoid registration and compliance costs, which would limit U.S. persons' access to foreign clearing services to correspondent arrangements. Similar arguments apply to U.S. persons' access to execution venues and data repositories.

The Commission also has considered the ways in which the structure of the market for infrastructure services may affect the benefits that flow from certain Title VII regulations. Providing incentives for entry of SDRs could result in fragmentation of regulatory data across multiple repositories, which would complicate oversight of the security-based swap market and require that regulators take additional steps to consolidate data sets.<sup>1357</sup> In this release, the Commission has proposed the availability of conditional exemptive relief for non-U.S. persons performing SDR functions that potentially reduces the number of SDRs that would receive regulatory data.<sup>1358</sup> Further, the proposed indemnification exemption may discourage the establishment of SDRs on jurisdictional lines.<sup>1359</sup>

Similarly, a single CCP serving the entire security-based swap market may result in more effective netting of offsetting positions among members, potentially reducing aggregate counterparty risk borne by the CCP and making risk management less costly.<sup>1360</sup> Indeed, high fixed costs and low variable costs associated with the provision of clearing services may contribute to a natural monopoly in this market. A second benefit of a single CCP is that it would preclude the possibility that risk management standards could erode as CCPs compete for clearing business. However, if the market evolves so that a single CCP emerges, it could require additional regulatory monitoring to address issues associated with natural monopolies.<sup>1361</sup>

These arguments are less clear in the case of SB SEFs. Evidence from equity

markets seems to indicate benefits from both consolidation and fragmentation.<sup>1362</sup> On the one hand, some research supports the conclusion that consolidation of order flow onto a small number of trading venues may facilitate efficient matching between supply and demand, reduce price volatility within the trading venue,<sup>1363</sup> and reduce spreads.<sup>1364</sup> On the other hand, other researchers have found that the competitive effects flowing from multiple trading venues can outweigh the effects of fragmentation, resulting in more efficient pricing and narrower spreads.<sup>1365</sup>

The Commission has considered the above effects and proposed a cross-border approach that would require a CCP or execution facility to register if it performs clearing agency function in the United States or operates a facility for the trading or processing of security-based swaps in the United States or with respect to U.S. persons. Similarly, the Commission has proposed an approach that would require a trade repository to register if it performs SDR functions within the United States. The Commission preliminarily believes that this approach would promote transparency, improve systemic risk management, and allow better regulatory oversight, which in turn, would encourage broader market participation in the U.S. security-based swap market.

#### ii. Application of Mandatory Clearing, Public Dissemination, Regulatory Reporting, and Trade Execution Requirements in the Cross-Border Context

The proposed application of the market-wide transaction-level requirements to cross-border activities may have significant effects on competition in the U.S. security-based swap market. As noted above, the Commission is proposing an approach that would generally apply Title VII

transaction-level requirements evenly to persons who conduct security-based swap activity with U.S. persons or within the United States.<sup>1366</sup> Because these requirements are generally applied evenly and expansively in the United States, a foreign person who wishes to avoid clearing, public dissemination, or pre-trade transparency requirements would have to avoid either transacting with U.S. persons or involving a U.S. person as agent in negotiating, soliciting, or executing security-based swap transactions on its behalf within the United States.<sup>1367</sup>

Notwithstanding a possible reduction in competition, the Commission believes that these market-wide transaction-level requirements should be applied to such transactions because they reduce systemic risk, promote transparency, and improve regulatory oversight. All of these contribute to the integrity and efficiency of the U.S. security-based swap market and should increase competition among those who choose to participate under Title VII.

The proposed cross-border approach would generally not apply the market-wide transaction-level requirements to foreign branches and non-U.S. persons whose performance under security-based swap transactions is guaranteed by a U.S. person, when foreign branches and guaranteed non-U.S. persons transact with non-U.S. persons whose performance under security-based swap transactions is not guaranteed by a U.S. person and who are not registered security-based swap dealers. As stated in the competition analysis with respect to security-based swap dealers,<sup>1368</sup> this proposed approach would facilitate U.S.-based dealing entities' access to foreign markets and help prevent market fragmentation. However, the guarantees provided by U.S. persons remain a conduit for systemic risk to be transmitted to the United States.

However, the Commission is mindful that, in the near term and until full implementation of transparency requirements in the other jurisdictions that are comparable to the U.S. market-wide transaction-level requirements, if

<sup>1362</sup> See Haim Mendelson, "Consolidation, Fragmentation and Market Performance," *Journal of Financial and Quantitative Analysis*, Vol. 22, Issue 2 (1987) (using a theoretical model to examine the tradeoffs between consolidation and fragmentation). See also James L. Hamilton, "Marketplace Fragmentation, Competition, and the Efficiency of the Stock Exchange," *Journal of Finance*, Vol. 34, Issue 1 (1979) (examining data from the NYSE and showing that off-board trading that competes with specialists tends to reduce spreads more than the fragmentation of trade tends to increase them).

<sup>1363</sup> See Mendelson, note 1362, *supra*.

<sup>1364</sup> See Pankaj Jain, "Institutional Design and Liquidity at Stock Exchanges around the World," Working Paper (2003). Using data on institutional features of stock exchanges around the world, the author observes that consolidated order flow is associated with lower spreads.

<sup>1365</sup> See Hamilton, note 1362, *supra*.

<sup>1366</sup> See the proposed definition of "transaction conducted within the United States" in proposed Rule 3a71-3(a)(5) under the Exchange Act and notes 1340 and 1341 above.

<sup>1367</sup> However, with respect to the mandatory clearing and mandatory trade execution requirements, transactions between two non-U.S. persons whose performance of obligations under security-based swaps is not guaranteed by U.S. persons and who are not security-based swap dealers would not be subject to mandatory clearing and mandatory trade execution even though these transactions are conducted within the United States. See proposed Rules 3Ca-3 and 3Ch-1 under the Exchange Act.

<sup>1368</sup> See Section XV.C.2(a), *supra*.

<sup>1357</sup> See Section VI.B, *supra*.

<sup>1358</sup> See Section XV.H.1(a)(ii), *infra*.

<sup>1359</sup> See Section XV.H.2, *infra*.

<sup>1360</sup> See Craig Pirrong, "The Economics of Central Clearing: Theory and Practice," ISDA Discussion Papers Series, No. 1 (2011). Concentration of risk in a CCP can itself also become a source of systemic risk. See Section II.A.6.(c), *supra*.

<sup>1361</sup> See, e.g., Section 17A(b)(3)(D) of the Exchange Act, 15 U.S.C. 78q-1(b)(3)(D) (requiring that the rules of a "clearing agency provide for the equitable allocation of reasonable dues, fees, and other charges among its participants"). See also Kenneth Train, "Optimal Regulation: The Economic Theory of Natural Monopoly," Cambridge: The MIT Press (1991) (discussing price regulation of natural monopolies).

any part of the global market is left opaque without either public dissemination or pre-trade transparency, there may be opportunities for market participants to restructure and move their transactions to the OTC part of the global market. The value of transparency in the U.S. market would be reduced to the extent that liquidity migrates to less-transparent jurisdictions.

### 3. Efficiency

As noted above, in proposing the rules and interpretations discussed in this release, we are required to consider whether these actions would promote efficiency. In significant part, the effects of our proposed cross-border approach on efficiency are linked to the effects on competition. Minimizing impediments to access to the security-based swaps not only promotes competition, but also encourages participants to express their true valuation for security-based swaps and, as a result, is expected to promote efficiency. Generally, rules and interpretations that delineate an appropriate scope of application of the Title VII requirements can be expected to promote the efficient allocation of risk, capital, and other resources by facilitating price discovery and reducing costs associated with dislocations in the market for security-based swaps.

The proposed application of Title VII rules to cross-border transactions potentially increases the volume of transactions that will take place on transparent venues. For example, while the proposed rules allow exceptions to the mandatory trade execution requirement for certain transactions involving a foreign branch of a U.S. bank or a guaranteed non-U.S. person as one counterparty, these exceptions do not apply when a foreign security-based swap dealer is the other counterparty to the transactions, and such transactions would be exposed to pre-trade transparency on SB SEFs or exchanges. As stated above, the OTC security-based swap market is characterized by search frictions and asymmetric information.<sup>1369</sup> Currently, in order to trade, market participants must contact intermediaries on a bilateral basis to locate counterparties. Intermediaries may capture these search costs by behaving less competitively. Search-based inefficiencies in the bilateral OTC market manifest explicitly in the costs of matching with counterparties and are implicit in the somewhat wider spreads that dealers might quote as a strategic

response to customer search costs.<sup>1370</sup> In addition, large intermediaries who observe vast volumes of order flows from the breadth of their customer base have an informational advantage over customers or small dealers who observe less order flow. This means that end users potentially face adverse selection in addition to search costs which may reduce their willingness to participate in the security-based swap market even when they might benefit from increased risk-sharing.

In markets with impartial access, such as those characterized by our proposed regime for SB SEFs, participants would face lower search costs when they decide to enter or exit a security-based swap position. Moreover, access to the security-based swap market would be available to more participants, increasing the likelihood of efficient reallocation of risks carried by security-based swap contracts.<sup>1371</sup> At the same time, pre- and post-trade transparency requirements under Title VII reduce dealers' ability to benefit from private information that comes from observing order flow.<sup>1372</sup> This change may increase the willingness of market participants to lay off risks they are relatively less-equipped to bear. Increased liquidity in a transparent security-based swap market should facilitate price discovery.<sup>1373</sup>

Increased price efficiency in the security-based swap market, in turn, produces important externalities.

<sup>1370</sup> See Darrell Duffie, Nicolae Garleanu, and Lasse Heje Pedersen, "Over-the-Counter Markets," *Econometrica*, Vol. 73, Issue 6 (2005) (using a theoretical model of an over-the-counter market to show a reduction in spreads when investors have easier access to multiple counterparties).

<sup>1371</sup> See John Cochrane, *Asset Pricing*, Princeton University Press, Princeton, NJ (2001). Chapter 3 discusses the role of securities markets, new securities, and financial innovation in allowing individuals to share and diversify risks.

<sup>1372</sup> We recognize that intermediaries' informational advantage may not be completely eliminated by the mandatory trade execution and public dissemination requirements. For example, intermediaries would have the advantage of seeing order flows or inquiries that are not ultimately executed and disseminated. In addition, the executing intermediary still has informational advantage from knowing the counterparty's identity, and intermediaries may know about an order or inquiry before anyone else in the market.

<sup>1373</sup> See Terrence Hendershott and Charles M. Jones, "Island Goes Dark: Transparency, Fragmentation, and Regulation," *Review of Financial Studies*, Vol. 18, No. 3 (2005) (showing that a decrease in limit order book transparency on Island was followed by substantial price discovery movement from the ETF market to the futures market). See also Bengt Holmstrom and Jean Tirole, "Market Liquidity and Performance Monitoring," *Journal of Political Economy*, Vol. 101, No. 4 (1993) (using a theoretical model to show how increased liquidity can increase the marginal value of information and the informativeness of stock prices).

Transparency in the security-based swap market could result in more accurate valuation of security-based swaps generally, as all market participants would have the benefit of knowing how counterparties to a security-based swap valued the security-based swap at a specific moment in time.<sup>1374</sup> Especially with complex instruments, investment decisions generally are predicated on a significant amount of due diligence to value the instrument properly. A post-trade transparency system permits other market participants to derive at least some informational benefit from obtaining the views of the two counterparties who traded that instrument. Finally, central clearing of security-based swaps could make it easier for market participants who observe prices to disentangle the default risk of counterparties from the fundamental risks priced into the underlying contract. This has the benefit of enhancing the incremental price discovery already associated with the transparency requirements.

Better valuations could have a significant impact on efficiency and capital allocation. In particular, under the pre-trade and post-trade transparency regimes contemplated by Title VII, persons outside the security-based swap market could use information produced and aggregated by the security-based swap market as an input to both real investment decisions as well as financial investments in related markets for equity and debt.<sup>1375</sup> By helping asset valuations move closer to their fundamental values, transparency encourages efficient capital allocation.<sup>1376</sup>

In the cross-border context, our proposed approach generally applies the full range of Title VII requirements (including mandatory clearing, regulatory reporting, public dissemination, and mandatory trade execution requirements) to transactions with U.S. persons and transactions conducted within the United States,<sup>1377</sup> with the objective of promoting

<sup>1374</sup> See Regulation SBSR Proposing Release, 75 FR 75281.

<sup>1375</sup> See Philip Bond, Alex Edmans, and Itay Goldstein, "The Real Effects of Financial Markets," *Annual Review of Financial Economics*, Vol. 4 (Oct. 2012) (reviewing the theoretical literature on the feedback between financial market price and the real economy). See also Sugato Chakravarty, Huseyin Gulen, and Stewart Mayhew, "Informed Trading in Stock and Option Markets," *Journal of Finance*, Vol. 59, No. 3 (2004) (estimating that the proportion of information about underlying stocks revealed first in option markets ranges from 10 to 20 percent).

<sup>1376</sup> See Regulation SBSR Proposing Release, 75 FR 75281.

<sup>1377</sup> See note 1367, *supra*.

<sup>1369</sup> See SB SEF Proposing Release, 76 FR 10949.



transparency and efficiency in the U.S. security-based swap market. For example, as noted above,<sup>1378</sup> the Commission is re-proposing certain provisions of Regulation SBSR to, among other things, extend the scope of security-based swaps that would be subject to regulatory reporting and public dissemination. As a result of the re-proposal, more transactions with a nexus to the United States would be reported to SDRs and thus would be made available to regulators.<sup>1379</sup> Furthermore, by possessing more comprehensive data on security-based swap transactions, regulators will be able to observe pockets of risk in the global marketplace that heretofore would not have been accessible to them. Early awareness of such risks provided by access to such data may enable regulators to respond by taking actions to mitigate the potential impact of such risks on the market, which could in turn prevent the deterioration of market conditions that could result if such risks remain hidden.

Besides impacts on price efficiency and the efficient allocation of capital, the Commission also has considered more generally the impact of the rules and interpretations in this release on the efficient use of resources. In our re-proposal of Regulation SBSR, the Commission is revising our approach to assigning the reporting duty to place less emphasis on the domicile of the counterparties, and to focus more on their status (*i.e.*, whether or not a counterparty is a security-based swap dealer or major security-based swap participant).<sup>1380</sup> We preliminarily believe that the revisions in the re-proposal reallocate the reporting burden to those entities that face a relatively lower cost of reporting, thus promoting efficiency. These revisions are designed to assign the responsibility to report a security-based swap transaction to persons that the Commission preliminarily believes are more easily able to fulfill that responsibility, and in a manner consistent with the reporting hierarchy set forth in Section 13A(a)(3) of the Exchange Act.<sup>1381</sup> In addition, the

Commission expects any transaction reporting systems implemented by security-based swap dealers and major security-based swap participants to be automated.

However, we recognize that certain aspects of our proposal may reduce efficiency in the U.S. security-based swap market. Increasing market transparency, in some instances, may cause certain market participants to abstain from trading that would otherwise be efficient. For example, market participants might be less willing to trade on centralized, transparent markets if it means exposing their trading strategies to their competitors.<sup>1382</sup>

Further, as we noted in our competition analysis, various jurisdictions are developing transparency rules at different paces. If stringent regulation under Title VII results in less access for U.S. persons to foreign segments of the security-based swap market, opportunities for efficient risk-sharing may correspondingly decline. Furthermore, to the extent that we have implemented the transparency requirements and the other jurisdictions have not (or to the extent that the scope of the transparency requirement among various jurisdictions is not comparable), market participants may have an incentive to restructure their business in order to move transactions to opaque corners of the global security-based swap market.

If such restructuring results in a large and opaque market outside the reach of Title VII at the expense of liquidity in a transparent market regulated under Title VII, the efficiency benefits of Title VII would be undermined, in terms of price efficiency, efficient risk-sharing, and the efficient allocation of capital across real and financial assets.

Commission. The Commission previously noted that it “understands that many reporting parties already have established linkages to entities that may register as [SDRs], which could significantly reduce the out-of-pocket costs associated with establishing the reporting function.” See Regulation SBSR Proposing Release, 75 FR 75249 n. 193. The Commission preliminarily believes that the additional cost for non-U.S. person security-based swap dealers and major security-based swap participants absorbing the costs of reporting these additional transactions should be *de minimis*, since these larger market participants have likely already taken significant steps to establish and maintain the systems, processes, and procedures, and have likely devoted staff resources to report security-based swaps currently to existing data repositories. See Section XV.H.3(a)(ii), *infra*.

<sup>1382</sup> See, e.g., Ananth Madhavan, *et al.*, “Should Securities Markets Be Transparent?” J. of Fin. Markets, Vol. 8 (2005) (finding that an increase in pre-trade price transparency leads to lower liquidity and higher execution costs, because limit-order traders are reluctant to submit orders given that their orders essentially represent free options to other traders).

Moreover, insofar as the types of restructuring contemplated above purely constitute attempts at regulatory arbitrage, they represent a use of resources that could potentially be put to more productive uses. In addition, the effect of the proposed application of the Title VII requirements described in this release on efficiency also would be affected by the substantive rules we ultimately adopted to implement the relevant Title VII requirements.

In the cross-border context, we try to strike a balance between promoting efficiency in the U.S. security-based swap market and mitigating potential disruptions to other parts of the global market by including certain carve-outs in our proposed application of market-wide transaction-level requirements.<sup>1383</sup> These exceptions are designed to enable foreign branches and foreign affiliates whose performance under security-based swaps is guaranteed by a U.S. person to maintain access to other parts of the global security-based swap markets when they transact with non-U.S. persons whose performance under security-based swaps is not guaranteed by a U.S. person. This should help ensure that U.S. banks operating through foreign branches and foreign affiliates of U.S. persons are able to continue to access global liquidity. However, as stated in our analysis of competition effects, the tradeoff is that the guarantees provided by U.S. persons represent a conduit for systemic risk to flow to the United States.

By seeking to minimize, where appropriate, interruption to existing relationships of U.S. banks and foreign affiliates of U.S. persons with foreign market participants, the Commission’s proposed cross-border approach could help preserve existing conduits for global risk-sharing. We considered this benefit and the efficiency costs that may result because these transactions are not occurring in the transparent market envisioned under Title VII.

Finally, recognizing that the U.S. security-based swap market is an integral part of the global security-based swap market, the Commission has proposed exemptive relief from registration for foreign SB SEFs and SDRs in certain cases. The Commission’s proposal to consider an exemption from SB SEF registration for foreign security-based swap markets may facilitate the consolidation of global order flow onto certain particular trading venues for security-based swap contracts written on certain reference

<sup>1383</sup> See proposed Rule 3Ca-3(b), proposed Rule 3Ch-1(b), and re-proposed Rule 908(a)(2) under the Exchange Act.

<sup>1378</sup> See Section VIII, *supra*.

<sup>1379</sup> Due to corresponding impacts on the market not realized under Rule 908(a) as originally proposed, under the re-proposal, security-based swap transactions executed outside the United States by a non-U.S. person direct counterparty but performance of which is guaranteed by a U.S. person would now be subject to regulatory reporting.

<sup>1380</sup> See Section VIII, *supra* (describing the Regulation SBSR re-proposal).

<sup>1381</sup> 15 U.S.C. 78m-1(a)(3). Section 13A(a)(3) of the Exchange Act assigns to specific kinds of counterparties the duty to report uncleared security-based swaps to an SDR or to the

entities. The Commission believes this may promote participation in the transparent market and, in turn, market efficiency, without sacrificing the benefits of requiring SB SEF registration.

The proposed exemptive relief for non-U.S. persons performing the functions of SDRs within the United States would allow non-U.S. persons to continue to receive data reported pursuant to the reporting requirements of a foreign jurisdiction without registering with the Commission as an SDR, subject to a condition that would help ensure that the confidentiality of the data and Commission access to data is maintained. The potential for exemptive relief from SDR registration requirements might reduce the incentive for market participants to restructure their operations to avoid triggering registration requirements.<sup>1384</sup> Further, the potential for an Indemnification Exception, proposed in this release, could reduce the potential for SDRs to be established along purely jurisdictional lines.<sup>1385</sup>

Similarly, the proposed cross-border approach permits substituted compliance in certain circumstances if the Commission determines that the applicable foreign regulatory requirements are comparable to the related Title VII requirements. By allowing certain security-based swap transactions or participants to satisfy their compliance obligations with respect to the applicable Title VII requirements by complying with the rules of a foreign jurisdiction, duplicative compliance costs could be reduced and compliance burdens minimized. This could allow security-based swap counterparties to operate more efficiently, as by allocating resources to other activities, such as improving operational efficiency or engaging in other investment activity. Therefore, the possibility of substituted compliance would encourage foreign firms' participation in the U.S. market and would help preserve U.S. firms' access to the other parts of the global market, while helping to ensure that substantially equivalent regulatory benefits are generated by meeting foreign regulatory standards comparable to Title VII.

#### (4) Capital Formation

The Commission preliminarily believes that many aspects of the proposed cross-border approach are likely to promote capital formation. As

mentioned above,<sup>1386</sup> a security-based swap market with pre-trade and post-trade price transparency, and enhanced regulatory oversight may facilitate entry by a wide range of market participants seeking to engage in a broad range of hedging and trading activities. However, we recognize that, to the extent that Title VII imposes barriers to entry and access, or results in market fragmentation, it may impair capital formation and result in a redistribution of capital across jurisdictional boundaries.

As stated above, pre- and post-trade transparency should result in more accurate valuation, which should promote efficient allocation of capital.<sup>1387</sup> In general, market participants benefit from knowing how counterparties to a security-based swap transaction value the security-based swap at a specific moment in time; information revealed through pre- and post-trade transparency allows market participants to derive more-informed assessments with respect to asset valuations, leading to more efficient capital allocation. This should be true for the underlying assets as well. That is, information learned from security-based swap quoting and trading provides signals not only about security-based swap valuation, but also about the value of the reference assets underlying the swap. Similarly, we expect pre- and post-trade transparency to benefit the real economy as well. Transparent prices provide better signals about the quality of a business investment, promoting capital formation in the real economy by helping managers to make more-informed decisions and making it easier for firms to obtain financing for new business opportunities.<sup>1388</sup>

Furthermore, as discussed above, our proposed cross-border approach strives to address the disruptions that implementation of Title VII may cause to the foreign branch of U.S. banks and foreign affiliates of U.S. persons by proposing certain exceptions to the application of the *de minimis* exception to security-based swap dealer registration<sup>1389</sup> and the market-wide transaction-level requirements.<sup>1390</sup> We preliminarily believe that by doing so, our proposed cross-border approach to

application of the Title VII requirements, as a whole, would address the disruptions to the global security-based swap market. Integrated markets provide more risk-sharing opportunities, which encourages efficient risk-sharing and capital allocation; the more integrated U.S. participants are into the global security-based swap market, the more access, liquidity, and participation we would expect to see in both the U.S. security-based swap market and the global security-based swap market as a whole.

Similarly, the proposed policy framework of substituted compliance should encourage foreign firms' participation in the U.S. security-based swap market and facilitate U.S. firms' access to the other parts of the global market while helping to ensure that the regulatory benefits of the applicable Title VII requirements are achieved by requiring the related foreign regulatory standards to be comparable to the requirements of Title VII. Substituted compliance is designed to accommodate the global nature of the security-based swap market and, therefore, should similarly help the security-based swap market continue to integrate various segments or subparts of the markets. As stated above, the integration of the U.S. market into the global market should encourage efficient global risk-sharing, which should, in turn, potentially free up more capital for investment in real assets.

#### Request for Comment

The Commission generally requests comment about our preliminary analysis of the effects of our proposal on efficiency, competition, and capital formation. In particular, the Commission requests comment on any effect the proposed rules, rule amendments, and interpretations may have on efficiency, competition, and capital formation, including the competitive or anticompetitive effects the proposed rule may have on market participants.

#### *D. Economic Analysis of Proposed Rules Regarding "Security-Based Swap Dealers" and "Major Security-Based Swap Participants"*

To promote the goals of reduced risk, increased transparency, and improved market integrity in the financial system, Title VII of the Dodd-Frank Act requires, among other things, registration and regulation of security-based swap dealers and major security-based swap participants. The Commission and the CFTC jointly adopted final rules in 2012 to further define "security-based swap dealer" and "major security-based swap

<sup>1386</sup> See Section XV.C.3, *supra* (discussing the effects of our proposed cross-border approach on efficiency).

<sup>1387</sup> See *id.*

<sup>1388</sup> See Bond, *et al.* and Chakravarty, *et al.*, note 1211, *supra*.

<sup>1389</sup> See proposed Rule 3a71-3(b), proposed Rule 3Ca-3(b), proposed Rule 3Ch-1(b), and re-proposed Rule 908(a)(2) under the Exchange Act. See also Section XV.C.3, *supra* (discussing the effects of our proposed cross-border approach on efficiency).

<sup>1390</sup> See Sections VIII.C, IX.C, and X.B.3, *supra*.

<sup>1384</sup> See Section XV.H.1(b)(i), *infra*.

<sup>1385</sup> See Section XV.H.2, *infra*.

participant.”<sup>1391</sup> Of particular importance is the *de minimis* exception to dealing activity, which excepts a dealer in security-based swaps from the definition and designation of “security-based swap dealer” if the notional amount of its dealing activity in the trailing 12-month period is below a particular threshold. As discussed in the Intermediary Definitions Adopting Release, the costs and benefits of the dealer and participant definitions fall into two categories. First, there are costs and benefits associated with identifying a subset of current and future market participants as either security-based swap dealers or major security-based swap participants (*i.e.*, the assessment costs). Second, there are costs and benefits associated with subjecting that subset to a complete, fully effective complement of Title VII statutory and regulatory requirements (*i.e.*, the programmatic costs and benefits).

In the Intermediary Definitions Adopting Release, the Commission estimated that, out of more than 1,000 entities engaged in CDS activity worldwide in 2011, 166 had worldwide CDS activity at a level high enough such that they would perform the dealer-trader analysis prescribed under the security-based swap dealer definition. Furthermore, based on an analysis of trading activity using DTCC-TIW data, the Commission estimated that, based on their global trading volumes, potentially 50 of these entities would exceed the *de minimis* threshold and thus ultimately have to register as security-based swap dealers. Similarly, based on position data from DTCC-TIW, the Commission estimated that, based on positions arising from their worldwide CDS activity, as many as 12 entities would perform substantial position and substantial counterparty exposure tests prescribed under the major security-based swap participant definition.

These estimates represent a baseline against which the Commission can analyze the costs and benefits of the proposed application of the intermediary definitions to cross-border activities. More specifically, because the proposed cross-border rules would allow non-U.S. persons to exclude from the *de minimis* and major participant thresholds certain transactions and positions with non-U.S. counterparties, the ultimate number of entities that would exceed the dealer *de minimis* or the major participant thresholds will likely be lower than estimated in the Intermediary Definitions Adopting

<sup>1391</sup> See Intermediary Definitions Adopting Release, 77 FR 30596.

Release, and this decline will have a corresponding impact on the programmatic costs and benefits associated with these definitions. On the other hand, the cross-border rules are likely to increase assessment costs, as certain non-U.S. persons may need to determine which transactions and positions may be excluded from the thresholds. These costs and benefits are discussed more fully below.

#### 1. Programmatic Costs and Benefits

##### (a) Registration of Security-based Swap Dealers and Major Security-Based Swap Participants

Title VII requires the registration of security-based swap dealers and major security-based swap participants in accordance with rules promulgated by the Commission.<sup>1392</sup> The Commission proposed rules and forms to facilitate registration of security-based swap dealers and major security-based swap participants in the Registration Proposing Release.<sup>1393</sup> In that release, the Commission provided an economic analysis relating to the proposed registration requirements and forms.<sup>1394</sup> As discussed in more detail therein, the Commission expects that dealers engaging in security-based swap activity exceeding the *de minimis* amount will incur costs associated with registration.<sup>1395</sup> In addition, persons who are not security-based swap dealers but hold substantial security-based swap positions that create an especially high level of risk that could have systemic impact on the U.S. financial system will incur costs associated with registration as a major securities-based swap participant.<sup>1396</sup> Registration will provide the Commission with information regarding security-based swap dealers and major security-based swap participants, which will enable the Commission to oversee these registered entities with respect to their security-based swap activity and oversee compliance with the substantive requirements applicable to them. The Commission believes that the revisions included in re-proposed Forms SBSE, SBSE-A, and SBSE-BD would not

<sup>1392</sup> See Section 15F(b)(5) of the Exchange Act, 15 U.S.C. 78o-10(b)(5).

<sup>1393</sup> See Registration Proposing Release, 76 FR 65784.

<sup>1394</sup> *Id.* at 65812-19.

<sup>1395</sup> In the Registration Proposing Release, the Commission described the costs we expect security-based swap dealers and major security-based swap participants to incur in connection with completing and filing forms, providing related certifications, addressing additional requirements in connection with associated persons, as well as certain additional costs. See Registration Proposing Release, 76 FR 65812-19.

<sup>1396</sup> *Id.*

significantly impact our analysis of the costs and benefits of the rules and forms to facilitate registration of security-based swap dealers and major security-based swap participants.

##### (b.) Security-Based Swap Dealers—*De Minimis* Exception

Title VII requires entities engaged in security-based swap dealing activity to register as security-based swap dealers unless such transactions constitute only “a *de minimis* quantity of security-based swap dealing” and the dealer, therefore, is sufficiently small not to warrant regulation as a security-based swap dealer.<sup>1397</sup> The statutory *de minimis* exception is silent on its application to the cross-border security-based swap dealing activity of U.S. persons and non-U.S. persons, and the Commission did not address this issue in the Intermediary Definitions Adopting Release. The Commission proposes Rule 3a71-3(b) under the Exchange Act in this release to address this issue.

Proposed Rule 3a71-3(b)(1) under the Exchange Act sets forth the application of the *de minimis* exception to the activities of U.S. persons and non-U.S. persons, describing which security-based swap transactions conducted in a dealing capacity should be counted for purposes of the *de minimis* exception. Because proposed Rule 3a71-3(b)(1) under the Exchange Act would exclude certain transactions from the *de minimis* calculation and thereby may allow certain entities to remain below the *de minimis* threshold, it affects the programmatic benefits and costs of security-based swap dealer regulation under Title VII,<sup>1398</sup> as these programmatic costs depend on the number of persons that will ultimately be required to register as security-based swap dealers as well as the substantive requirements that are to be adopted in connection with the security-based swap dealer regime.

This does not mean, however, that there would be a one-to-one relationship between the exclusion of any particular person as a security-based swap dealer as a result of the *de minimis* exception and any change in the programmatic benefits and costs that would be associated with the non-regulation of that person. In other words, although Proposed Rule 3a71-3(b)(1) may allow certain entities to remain below the *de minimis* threshold, it does not follow that the programmatic costs and benefits will change by an amount proportional

<sup>1397</sup> See Section III.C.3(b)(2), *supra*; see also Section 3(a)(71)(D) of the Exchange Act, 15 U.S.C. 78c(a)(71)(D), and 17 CFR 240.3a71-2.

<sup>1398</sup> See Intermediary Definitions Adopting Release, 77 FR 30596.

to the volume of those entities' dealing activity. As the Commission explained in the Intermediary Definitions Adopting Release, some of the costs and benefits of regulating an intermediary may be fixed, while other costs and benefits of regulation may be variable, depending on a particular person's security-based swap dealing activity.<sup>1399</sup> For example, the programmatic benefits associated with the registration and regulation of persons engaged in security-based swap dealing activity—in other words, the expected mitigation of risks to the stability and transparency of the U.S. financial system and to the protection of counterparties in the United States—will likely vary depending on the type and nature of those persons' dealing activity. Estimating the *de minimis* exception's effects on the programmatic costs and benefits (through including or excluding any particular person within the intermediary definition) will be further complicated by the other proposed rules regarding application of the entity-level and transaction-level requirements, as discussed more fully below.

Given the same limitations on our ability to conduct a quantitative assessment of the programmatic costs and benefits associated with intermediary definitions as stated in the Intermediary Definitions Adopting Release,<sup>1400</sup> we believe the methodology

<sup>1399</sup> See *id.* at 30724 (“Some of the costs of regulating a particular person as a dealer or major participants, such as costs of registration, may largely be fixed. At the same time, other costs associated with regulating that person as a dealer or major participant (e.g., costs associated with margin and capital requirements) may be variable, reflecting the level of the person's security-based swap activity. Similarly, the regulatory benefits that would arise from deeming that person to be a dealer or major participant (e.g., benefits associated with increased transparency and efficiency, and reduced risks faced by customers and counterparties), although not quantifiable, may be expected to be variable in a way that reflects the person's security-based swap activity.”).

<sup>1400</sup> The limitations stated in the Intermediary Definitions Adopting Release are those related to (i) the data available to us and (ii) the set of data we use to draw inferences from in order to estimate the number of dealers. See Section XV.B, *supra*.

With respect to the availability of data, we have taken into account data obtained from DTCC—TIW, especially data regarding the activity of participants in the single-name credit default swap market. See Intermediary Definitions Adopting Release, 77 FR 30635. We also have considered more limited publicly available data regarding equity swaps. *Id.* at 30636 n.476, and 30637 n.485. The lack of market data is significant in the context of total return swaps on equity and debt. We do not have the same amount of information regarding those products as we have in connection with the present market for single name CDS. *Id.* at 30724 n.1456. We did not consider data regarding index CDS for purposes of the economic analysis of the security-based swap dealer definition because the data for index CDS encompasses both broad-based security indices and narrow-based security indices, and “security-based

used in the Intermediary Definitions Adopting Release is appropriate and potentially most illustrative in demonstrating our consideration of programmatic costs and benefits associated with proposed Rule 3a71–3(b) under the Exchange Act regarding application of the *de minimis* exception in the definition of security-based swap dealer.

In the Intermediary Definitions Adopting Release, we sought to identify a subset of entities that appear to be the types of entities for which the statutory requirements of Title VII were created based on the volume of their dealing activity. We then sought to adopt definitions that would capture these entities, as Title VII required us to do, without imposing the costs of Title VII on those entities for which regulation currently may not be justified in light of those purposes. In developing Rule 3a71–2, which establishes the *de minimis* threshold for security-based swap dealers, we took into account data regarding the security-based swap market and especially data regarding the activity—including activity that may be

swap” in relevant part encompasses swaps based on single securities or on narrow-based security indices. See Section 3(a)(68)(A) of the Exchange Act, 15 U.S.C. 78c(a)(68)(A); see also Intermediary Definitions Adopting Release, 77 FR 30635 n.472. We noted that the definition of security-based swaps is not limited to single-name CDS but we believed that the single-name CDS data are sufficiently representative of the market to help inform the analysis. See Section XV.B.2 and note 1278, *supra*, and accompanying text.

With respect to the dataset we use, we have based, in part, our economic analysis of the security-based swap dealer definition on certain data addressed by an analysis regarding the market for single-name CDS performed by the SEC's Division of Risk, Strategy, and Financial Innovation made available to the public. See “Information regarding activities and positions of participants in the single-name credit default swap market” (Mar. 15, 2012), available at: <http://www.sec.gov/comments/s7-39-10/s73910-154.pdf> (“CDS Data Analysis”). As stated in the Intermediary Definitions Adopting Release, we believe that the data underlying the CDS Data Analysis provides reasonably comprehensive information regarding the CDS activities and positions of U.S. market participants, but we noted that the data does not encompass those CDS that both: (i) do not involve U.S. counterparties; and (ii) are based on non-U.S. reference entities. We also noted that the CDS Data Analysis contains transactions reflecting both dealing activity and non-dealing activity, including transactions by persons who may engage in no dealing activity whatsoever. *Id.* at 30635–36.

We also recognized in the Intermediary Definitions Adopting Release, and in our discussion of the limitations of this data above, that the CDS Data Analysis may be imperfect as a tool for identifying dealing activity, given that the presence or absence of dealing activity ultimately turns upon the relevant facts and circumstances of an entity's security-based swap transactions, as informed by the dealer-trader distinction. Nonetheless, various criteria used in the CDS Data Analysis appear to be useful for identifying apparent dealing activity in the absence of full analysis of the relevant facts and circumstances. *Id.* at 30636.

suggestive of dealing behavior—of participants in the single-name CDS market.<sup>1401</sup> Based on the CDS Data Analysis,<sup>1402</sup> we estimated in the economic analysis of the *de minimis* exception to the dealer definition in the Intermediary Definitions Adopting Release that 50 or fewer entities ultimately may have to register as security-based swap dealers.<sup>1403</sup>

In developing proposed Rule 3a71–3(b), we have applied a methodology and analytical framework similar to that employed in the Intermediary Definitions Adopting Release to ensure that our proposed cross-border approach captures only those entities that we believe are likely, because activity relevant to the statutory dealer definition as interpreted in the Intermediary Definitions Adopting Release occurs with U.S. persons or otherwise within the United States, to raise the types of concerns with respect to the U.S. financial system that Title VII was intended to address, including stability, transparency, and counterparty protection. We continue to believe that entities engaged in such activity at levels above the *de minimis* threshold may be expected to raise these concerns and, therefore, warrant regulation under Title VII as security-based swap dealers. Conversely, we do not believe that entities engaged in dealing activity wholly outside the United States directly raise these types of concerns with respect to the U.S. financial system, and our proposed approach would not require non-U.S. persons engaged in dealing activity wholly

<sup>1401</sup> See Intermediary Definitions Adopting Release, 77 FR 30635.

<sup>1402</sup> See CDS Data Analysis.

<sup>1403</sup> See Intermediary Definitions Adopting Release, 77 FR 30725 and n.1457. We stated that this estimate of 50 security-based swap dealers that would be required to register was a “conservative” estimate. See *id.* In establishing the *de minimis* threshold in that release, we analyzed the percentage of the market activity that would likely be attributable to registered security-based swap dealers under various thresholds and various screens designed to identify entities that are engaged in dealing activity. See Intermediary Definitions Adopting Release, 77 FR 30636; CDS Data Analysis at 8–21. Our analysis placed particular weight on the screen that identified entities that engaged in security-based swap transactions with three or more counterparties that themselves were not identified as dealers by ISDA. See Intermediary Definitions Adopting Release, 77 FR 30636. Twenty-eight firms and corporate groups satisfied this criterion, and 25 of these entities also engaged in trading activity over the \$3 billion threshold. See *id.* Based on this analysis, together with our expectation that some of the included corporate groups would register more than a single security-based swap dealer and that new entrants may be likely to enter the market, we estimated that as many as 50 entities would ultimately be required to register as a security-based swap dealer. See Intermediary Definitions Adopting Release, 77 FR 30725 n.1457.

outside the United States to register as security-based swap dealers.

We recognize that security-based swap activity outside the United States, including the activity of foreign persons that engage in security-based swap dealing activity wholly outside the United States, may affect the U.S. financial system either because the foreign person's positions are guaranteed by a U.S. person or through risk spillover effects that may arise from, for example, counterparty defaults, asset fire sales, capital shortfalls, and asymmetric information about the positions of unregistered persons active in the global network of security-based swap market participants. However, to the extent that the risks presented by an entity engaged in security-based swap dealing activity to the U.S. financial system arise solely from such guarantees or from these spillover effects, rather than from the entity engaging in relevant activity within the United States, we preliminarily do not believe that Title VII dealer registration provides the appropriate mechanism for addressing these risks.

As we have already discussed, we believe that Title VII's dealer registration requirements are intended to apply to those entities that pose risks to the U.S. financial system or to counterparties in the United States or to the transparency of the U.S. financial market by virtue of their dealing activity within the United States. To the extent that an entity engaged in dealing activity wholly outside the United States poses risks to the U.S. financial system, we preliminarily believe that subjecting it to dealer registration and the related requirements would not generate the types of programmatic benefits that Title VII dealer regulation is intended to produce, as the dealing activity of such entity poses risks to counterparties outside the United States.

Our proposed Rule 3a71-3 identifies the types of transactions that U.S. persons and non-U.S. persons engaged in dealing activity within the United States, and that may therefore be expected to raise Title VII concerns, must count toward their *de minimis* threshold. As described above,<sup>1404</sup> because dealing activity engaged in by U.S. persons generally involves activity within the United States and results in risks being borne by a person within the United States, proposed Rule 3a71-3(b)(1)(i) would require U.S. persons to count toward their *de minimis* threshold all transactions that they enter into in a

dealing capacity, regardless of the location or U.S.-person status of the counterparty, including any such transactions that the dealing entity conducts through a foreign branch. Similarly, as we discuss above, because security-based swap dealing activity conducted entirely outside the United States with non-U.S. persons will generally not give rise to the concerns addressed by security-based swap dealer regulation under Title VII within the United States, proposed Rule 3a71-3(b)(1)(ii) would require non-U.S. persons to include in their *de minimis* calculation only those transactions arising out of their dealing activity with U.S. persons or otherwise conducted within the United States.

As discussed above, our proposed rule allows non-U.S. persons to exclude transactions with foreign branches of U.S. banks from their *de minimis* threshold, if those transactions are conducted outside the United States.<sup>1405</sup> Although requiring non-U.S. persons to count these transactions toward the *de minimis* threshold would be consistent with the view that a foreign branch is part of a U.S. person, we are proposing not to require non-U.S. persons to count these transactions. As noted above, since U.S. banks are U.S. persons subject to certain exemptions, foreign branches that engage in security-based swap activity will generally be subject to applicable provisions of Title VII (e.g., mandatory clearing, mandatory trade execution, public dissemination, and SDR reporting requirements) regardless of whether their non-U.S. person counterparty is a registered security-based swap dealer. If a foreign branch engages in security-based swap activity in a dealing capacity with non-U.S. persons outside the United States exceeding the *de minimis* level, the bank (including the foreign branch) will be required to register as a security-based swap dealer and the entire bank will be subject to the entity-level and transaction-level requirements discussed above.<sup>1406</sup>

The security-based swap transactions excepted from the *de minimis* calculation of non-U.S. persons take place outside the United States. Requiring non-U.S. persons to count these transactions occurring in their foreign local markets could discourage non-U.S. persons from transacting with foreign branches, which could increase the likelihood of market disruption and fragmentation, including liquidity and order flow fragmentation, while decreasing the ability of U.S. banks to

access foreign markets and foreign liquidity. Therefore, we preliminarily believe that the proposed approach to excepting non-U.S. persons' transactions with foreign branches outside the U.S. from the *de minimis* calculation would have the benefit of minimizing disruption to U.S. banks' access to foreign markets without significantly diminishing the benefits that flow from Title VII dealer regulation and the proposed application of the *de minimis* exception in the cross-border context.

As stated above, the most significant programmatic effects of the *de minimis* exception result from how it changes the number of entities that are required to register as security-based swap dealers. We preliminarily believe that under our proposed Rule 3a71-3(b) under the Exchange Act, the number of entities that may have to register with the Commission may be somewhat smaller than the upper bound of 50 that we estimated in the Intermediary Definitions Adopting Release and in any case should not exceed that previous estimate of 50 or fewer entities.<sup>1407</sup> The

<sup>1407</sup> See note 1218, *supra*. After further experience with the data used in the CDS Data Analysis, we have estimated the trading activity and number of counterparties of firms within a corporate group, which allows us to conduct a more granular analysis of the potential number of entities that will be required to register as security-based swap dealers. In the CDS Data Analysis, we estimated that 28 entities and corporate groups had three or more counterparties that are not ISDA dealers and that 25 of these entities had trailing notional transactions exceeding \$3 billion. See CDS Data Analysis at 14. Under our refined approach, which identifies the number of entities within a corporate group that may have to register, we estimate that 46 individual firms have three or more non-ISDA-dealer counterparties; of these, we estimate that 31 firms also engaged in a total of \$3 billion in worldwide security-based swap dealing activity during 2011. Of these firms, we estimate that 27 also engaged in at least \$3 billion of security-based swap activity during 2011 that these entities would be required to count toward their *de minimis* threshold under proposed Rule 3a71-3(b). We further estimate that the aggregation requirement for unregistered dealers may result in an additional two firms being required to register, for a total of 29 security-based swap dealers based on the current structure of the security-based swap market.

We continue to believe that an estimate of 50 or fewer entities that would be required to register with the Commission as security-based swap dealers is reasonable in light of this analysis. As explained in note 1403 above, our estimate of as many as 50 potential registrants was consistent with our analysis showing 25 entities that had both three or more non-ISDA-dealer counterparties and \$3 billion or more in trailing notional security-based swap transactions and our recognition of the potential for growth in the security-based swap market, for new entrants into the dealing space, and the possibility that some corporate groups may register more than one entity. Because our current estimate of 29 firms that may be required to register as security-based swap dealers includes individual entities within corporate groups (rather than

Continued

<sup>1404</sup> See Section III.B.3, *supra*.

<sup>1405</sup> See Section III.B.7, *supra*.

<sup>1406</sup> See Sections III.C.3 and 4, *supra*.

entities that are not captured under our proposed approach would be those that engage in security-based swap dealing activity entirely (or almost entirely) with non-U.S. persons outside the United States.

We recognize that the U.S. market participants and transactions regulated under Title VII are a subset of the overall global security-based swap market and that there may be spillover risks arising from a foreign entity's dealing activity outside the United States. This spillover risk has the potential to affect the U.S. financial system either through that foreign entity's transactions with foreign entities, which, in turn, transact with U.S. persons (and may, as a result, be registered security-based swap dealers or major security-based swap participants) or through membership in a clearing agency which may be providing CCP services in the United States or have a U.S. person as a clearing member. We have considered these spillover risks in connection with discussing the effects of our proposed cross-border approach on efficiency, competition, and capital formation.<sup>1408</sup>

(c) Major Security-Based Swap Participants—"Substantial Position" and "Substantial Counterparty Exposure" Thresholds

Title VII requires a person with a "substantial position" or "substantial counterparty exposure" in security-based swaps to register as a major security-based swap participant. As described in the Intermediary Definitions Adopting Release, the substantial position and substantial counterparty exposure tests prescribed by Rules 3a67-3 and 3a67-5 under the Exchange Act seek to capture persons whose security-based swap positions pose sufficient risk to counterparties and the markets generally, thus, warranting regulation as a major security-based swap participant.<sup>1409</sup> Furthermore, based on a review of notional positions maintained in 2011 by entities with single-name CDS positions, the Commission estimated

treating corporate groups as a single entity), it accounts for the possibility that some corporate groups may register more than one security-based swap dealer. It also accounts for the likely results of our proposed aggregation requirement. Further allowing for the possibility of additional new entrants and growth in the security-based swap market, while also recognizing the possibility that our analysis overestimates the volume of dealing activity (and thus likely dealers), we think that our analysis in this release remains consistent with our earlier estimate of 50 or fewer entities.

<sup>1408</sup> See Section XV.C.1, *supra*.

<sup>1409</sup> See Intermediary Definitions Adopting Release, 77 FR 30727.

that approximately 12 entities may reasonably find it necessary to engage in the requisite calculations, and that the number of major security-based swap participants likely will be fewer than five.<sup>1410</sup>

As proposed, Rule 3a67-10(c) under the Exchange Act provides that when determining whether a non-U.S. person falls within the major security-based swap participant definition, only transactions entered into with a U.S. person<sup>1411</sup> as the counterparty would be considered.<sup>1412</sup> Under this proposed rule, a non-U.S. person would calculate its security-based swap positions under the major security-based swap definition based solely on its security-based swap transactions with U.S. persons as counterparties (including foreign branches of U.S. banks), and all security-based swap transactions with non-U.S. persons would be excluded from the analysis. We recognize that there may be indirect spillover risks to the U.S. financial system resulting from the security-based swap positions entered into by non-U.S. persons with other non-U.S. person counterparties, but we preliminarily believe that such indirect risk may be more appropriately regulated by the foreign regulatory authorities with responsibilities for such non-U.S. persons. Similar to the *de minimis* exception to dealer designation and registration, the most significant programmatic effects of the application in the cross-border context of the major participant thresholds flow from the number of entities that will fall within the definition of major security-based swap participant given a particular threshold. Because non-U.S. persons must count only transactions with U.S. counterparties toward the substantial position and substantial counterparty exposure thresholds, the final number of registered major participants may be lower than the preliminary upper bound of five estimated in the Intermediary Definitions Adopting Release.

We also are proposing interpretive guidance regarding the attribution of guaranteed positions for purposes of the major security-based swap participant calculation. In the Intermediary Definitions Adopting Release, we provided interpretive guidance that requires a person that guarantees or otherwise provides direct recourse to an affiliate or guaranteed entity's security-based swap counterparties to include

<sup>1410</sup> *Id.* at 30734.

<sup>1411</sup> The proposed rule uses the same definition of "U.S. person" as developed in the context of foreign security-based swap dealer registration. See Section III.B.5, *supra*.

<sup>1412</sup> Proposed Rule 3a67-10(c) under the Exchange Act.

those transactions in its own major participant calculations.<sup>1413</sup> We are proposing further guidance in this release regarding the application of this interpretation in the cross-border context. As proposed, this guidance would require U.S. persons that guarantee the obligations of a non-U.S. person's security-based swap transactions to count those transactions in their major participant calculations. Our proposed guidance also would require a non-U.S. person to include in its calculations transactions of a U.S. person that it guarantees and transactions entered into by a non-U.S. person with U.S. persons that it guarantees. A non-U.S. person would not include in its calculation transactions it guarantees that are entered into by a non-U.S. person with another non-U.S. person.

We preliminarily believe that this guidance identifies the guaranteed security-based swap positions that are likely to pose risks to the U.S. financial system. Title VII envisions the establishment of a comprehensive regulatory regime that will identify, monitor, and mitigate risks to the U.S. financial system and protect counterparties in security-based swap transactions. Our proposed application of the major securities-based swap participant calculation in the cross-border context, and related guidance, is designed to include only those market participants whose security-based swap activity may directly affect the U.S. financial system in a manner relevant to the concerns of Title VII.

With respect to U.S. persons that provide a guarantee, our proposed interpretive guidance confirms that they must include in their major security-based swap participant calculations all security-based swap transactions that they guarantee, regardless of the U.S.-person status of the guaranteed person or the status of the counterparty to the transaction. Such interpretation is consistent with the rules and interpretations adopted in the Intermediary Definitions Adopting Release. We recognize that attributing security-based swap positions to the person guaranteeing another person's security-based swap transactions may increase the number of major participants and therefore affect the programmatic benefits discussed above. As stated in the Intermediary Definition Adopting Release, we do not currently possess data relating to the existence of guarantees of the security-based swap positions of other parties and thus

<sup>1413</sup> See Intermediary Definitions Adopting Release, 77 FR 30689.

cannot reasonably estimate the number of additional entities that may be brought within the ambit of major security-based swap participant regulation by virtue of the interpretation related to guarantees.<sup>1414</sup> However, to the extent that a guarantee provided by a U.S. person of the security-based swap positions of another person, whether such other person is a U.S. person or a non-U.S. person, creates the level of exposure—and corresponding risk to the U.S. guarantor and the U.S. financial system—that warrants regulation under Title VII, it would appear inconsistent with the purposes of the statute not to attribute all of the security-based swap positions guaranteed by a U.S. person to such U.S. person and subject such U.S. person to major participant regulation.<sup>1415</sup>

Our proposed interpretive guidance regarding guarantees provided by non-U.S. persons also is likely to have no effect on the programmatic costs and benefits of major security-based swap participant regulation. The proposed guidance would allow non-U.S. persons to exclude security-based swap positions guaranteed by them from their major security-based swap participant calculations if the security-based swaps giving rise to the positions are entered into by a non-U.S. person with another non-U.S. person. By contract, non-U.S. persons would be required to include security-based swap positions guaranteed by them in their major security-based swap participant calculations if the security-based swaps are entered into by a non-U.S. person with a U.S. person. To the extent that any non-U.S. persons who guarantees security-based swap positions with U.S. persons that do not rise to the major security-based swap participant thresholds, they are unlikely to pose the types of risks addressed by the major security-based swap participant definition, and, as a result, not requiring them to register should not reduce the programmatic benefits that the major security-based swap participant definition was intended to achieve.

As stated above, we do not currently possess data relating to the existence of guarantees of the security-based swap positions of other parties and thus cannot reasonably estimate the number of additional entities that may be brought within the ambit of major security-based swap participant regulation by virtue of the interpretation related to guarantees. However, any non-U.S. person that is required to

register under our proposed approach because of guarantees extended to U.S. persons or to non-U.S. persons that have positions arising from transactions with U.S. persons would have security-based swap exposures of the nature and size that would raise concerns that the major security-based swap participant requirements established by Title VII were intended to address. We therefore preliminarily believe that the registration of such persons as major security-based swap participants would increase the programmatic benefits of our rule by ensuring that the risks presented by such entities to the U.S. financial system and U.S. counterparties to such transactions are regulated under the framework established by Title VII. Imposing Title VII on such entities would also increase programmatic costs, as such entities would be required to comply with the substantive requirements of Title VII.

Moreover, where a non-U.S. person's home country supervisor has adopted capital standards consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision (Basel Accord), to the extent that such non-U.S. person's security-based swap positions are guaranteed, we preliminarily believe that it is not necessary to attribute such guaranteed security-based swap positions to the guarantor, regardless of the guarantor's U.S.-person status. To the extent that this proposed interpretive guidance reduces the number of entities that would be required to register as major security-based swap participants as estimated in the Intermediary Definitions Adopting Release, we preliminarily believe that it would not significantly reduce the programmatic benefits expected under Title VII because the risk arising from the guaranteed security-based swap positions posed to the United States, and that Title VII was intended to address, would be addressed by the foreign regulation of the non-U.S. person's capital that is consistent with the Basel Accord. At the same time, excluding such entities from the definition of major security-based swap participant would further reduce the programmatic costs associated with the various requirements that apply to major security-based swap participants.

## 2. Assessment Costs

### (a) Security-Based Swap Dealers—*De Minimis* Exception

Because proposed Rule 3a71-3(b) explains how the dealer *de minimis* exception adopted in Rule 3a71-

2(a)(1)<sup>1416</sup> should be applied to cross-border dealing activity, the analysis of the assessment costs relating to the proposed Rule 3a71-3(b) is closely related to the analysis of the assessment costs relating to the dealer determination described in the Intermediary Definitions Adopting Release.<sup>1417</sup> Our proposed approach to the *de minimis* calculation in the cross-border context would require potential registrants that are non-U.S. persons, in assessing the applicability of Title VII's dealer registration and regulation requirements, to apply the new definitions of "U.S. person," "transactions conducted within the United States," and "transactions conducted through a foreign branch," which are used in Proposed Rule 3a71-3(b) of the Exchange Act to identify transactions that should be included in the *de minimis* calculation given the purposes of Title VII. Our proposed approach would also allow non-U.S. persons to exclude from this assessment and the *de minimis* calculation security-based swap transactions with a foreign branch of a U.S. bank, which would require them to make a separate determination that a particular counterparty satisfies the definition of "foreign branch."

As noted in the Intermediary Definitions Adopting Release, some market participants whose security-based swap activities exceed, or are not materially below, the *de minimis* threshold may be expected to incur assessment costs in connection with the dealer analysis.<sup>1418</sup> In the Intermediary Definitions Adopting Release, we estimated that 123 entities out of over 1,000 entities (U.S. and non-U.S.) that engaged in single-name CDS transactions in 2011 had more than \$3 billion in single-name CDS transactions over the previous 12 months.<sup>1419</sup> We also assumed that the 43 entities that engaged in security-based swap activity during the trailing 12-month period totaling between \$2 and \$3 billion notional may opt to engage in the dealer analysis out of an abundance of caution or to meet internal compliance requirements, leading to a total of 166 entities.<sup>1420</sup> We concluded that this

<sup>1416</sup> 17 CFR 240.3a71-2(a)(1).

<sup>1417</sup> See Intermediary Definitions Adopting Release, 77 FR 30731-32.

<sup>1418</sup> *Id.* at 30731. These assessment costs include costs associated with analyzing an entity's security-based swap activities to determine whether those activities constitute dealing activity and the costs of monitoring the volume of dealing activity against the *de minimis* threshold.

<sup>1419</sup> Intermediary Definitions Adopting Release, 77 FR 30731-32.

<sup>1420</sup> *Id.*

<sup>1414</sup> See Intermediary Definitions Adopting Release, 77 FR 30730.

<sup>1415</sup> *Id.*



estimate of 166 entities represented a potential upper bound for the total assessment costs arising from security-based swap dealer determinations.<sup>1421</sup> To the extent that all of these entities retain outside counsel to analyze their status under the security-based swap dealer definition, including the *de minimis* exception, we estimated that the assessment costs may approach \$4.2 million.<sup>1422</sup>

In considering the assessment costs associated with the proposed Rule 3a71-3(b), we hold the same expectation as we noted in the Intermediary Definitions Adopting Release that market participants generally would be aware of the notional amount of their activity involving security-based swaps as a matter of good business practice. However, as discussed below, proposed Rule 3a71-3(b) introduces a few variables that may result in higher overall assessment costs associated with the dealer registration analysis for certain non-U.S. persons that may result in different aggregate assessment costs for all entities performing this dealer analysis from the figure that we estimated in the Intermediary Definitions Adopting Release.

Because non-U.S. persons would be required to count toward the dealer *de minimis* threshold only those transactions they enter into, in a dealing capacity, with U.S. persons (other than foreign branches of U.S. banks) or otherwise conducted within the United States, we believe that such persons would likely implement systems to identify transactions that involve U.S. persons or that are conducted within the United States<sup>1423</sup> and monitor the notional amount of dealing activity reflected in such transactions.<sup>1424</sup> We

<sup>1421</sup> *Id.*

<sup>1422</sup> *Id.* We estimated that the per-entity cost of the dealer analysis would be approximately \$25,000. Our estimate of aggregate industry-wide costs of \$4.2 million reflects the costs that may be incurred by all 166 entities. *See id.*

<sup>1423</sup> *See* proposed Rule 3a71-3(a)(5) under the Exchange Act. "Transactions conducted within the United States" refers to security-based swap transactions that are solicited, negotiated, or executed within the United States.

<sup>1424</sup> Given the ability of non-U.S. persons under our proposed rule to exclude certain transactions from their *de minimis* calculation, we expect that potentially all 166 of the entities identified in our Intermediary Definitions Adopting Release as likely to perform the dealer analysis may engage in analysis to determine whether they are U.S. persons. Because our proposed definition of U.S. person is relatively straightforward to apply, we believe that any market participant should be able readily to identify its U.S.-person status by referring to its residence status, its principal place of business, or its organizational documents. To the extent that an entity seeks the assistance of outside counsel, we expect that the cost of this analysis will

preliminarily believe that the costs of establishing a system capable of identifying the volume of transactions with U.S. persons or within the United States should be similar to the costs estimated in the Intermediary Definitions Adopting Release for a system to monitor positions for purposes of the major security-based swap participant thresholds because such a system would involve monitoring the total volume of an entity's dealing transactions in a system capable of flagging those transactions that involve U.S. persons or otherwise occur within the United States. We preliminarily believe that this system would have similar functionality and requirements to the system that potential major security-based swap participants would be likely to adopt in order to track their exposures for purposes of the major security-based swap participant thresholds. In the Intermediary Definitions Adopting Release, we noted that entities establishing such a system would likely incur one-time programming costs of \$15,287 and ongoing annual systems costs of \$17,040.<sup>1425</sup>

be encompassed in the \$25,000 in assessment costs that we have estimated in the Intermediary Definitions Adopting Release. *See* Intermediary Definitions Adopting Release, 77 FR 30732.

<sup>1425</sup> In the Intermediary Definitions Adopting Release, we estimated that the one-time programming costs of \$13,692 per entity and annual ongoing assessment costs of \$15,268. *See* Intermediary Definitions Adopting Release, 77 FR 30734-35 and accompanying text (providing an explanation of the methodology used to estimate these costs). The hourly cost figures in the Intermediary Definitions Adopting Release for the positions of Compliance Attorney, Compliance Manager, Programmer Analyst, and Senior Internal Auditor were based on data from SIFMA's Management & Professional Earnings in the Securities Industry 2010. For purposes of the cost estimates in this release, we have updated these figures with more recent data as follows: the figure for a Compliance Attorney is \$310/hour, the figure for a Compliance Manager is \$269/hour, the figure for a Programmer Analyst is \$234/hour, and the figure for a Senior Internal Auditor is \$217/hour, each from SIFMA's Management & Professional Earnings in the Securities Industry 2011, modified by SEC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. We also have updated the Intermediary Definitions Adopting Release's \$464/hour figure for a Chief Financial Officer, which was based on 2011 data. Using the consumer price index to make an inflation adjustment to this figure, we have multiplied the 2011 estimate by 1.02 and arrived at a figure of \$473/hour for a Chief Financial Officer in 2012. Incorporating these new cost figures, the updated one-time programming costs based upon our assumptions regarding the number of hours required in the Intermediary Definitions Adopting Release would be \$15,287 per entity, *i.e.*, (Compliance Attorney at \$310 per hour for 2 hours) + (Compliance Manager at \$269 per hour for 8 hours) + (Programmer Analyst at \$234 per hour for 40 hours) + (Senior Internal Auditor at \$217 per hour for 8 hours) + (Chief Financial Officer at \$473 per hour for 3 hours) = \$15,287, and the annual

The Commission preliminarily believes that market participants would also incur costs arising from the need to identify and maintain records concerning the U.S.-person status of their counterparties and the location of their transactions. We anticipate that potential dealers are likely to request representations from their transaction counterparties to determine the counterparties' U.S.-person status and whether the transaction was conducted within the United States. Therefore, the Commission preliminarily believes that the assessment costs associated with determining the status of counterparties and the location of transactions should be primarily one-time costs of establishing a practice or compliance procedure of requesting and collecting representations from trading counterparties and maintaining the representations collected as part of the recordkeeping procedures and limited ongoing costs associated with requesting and collecting representations. The Commission preliminarily believes that such one-time costs would be approximately \$15,160.<sup>1426</sup> The Commission preliminarily believes that requesting and collecting representations would be part of the standardized transaction process reflected in the policies and procedures described above regarding security-based swap sales and trading practices and should not result in separate assessment costs.<sup>1427</sup>

The Commission also considers it likely that market participants will implement modifications to the system described above to monitor counterparty status for purposes of future trading of

ongoing costs would be \$17,040 per entity, *i.e.*, ((Senior Internal Auditor at \$217 per hour for 16 hours) + Compliance Attorney at \$310 per hour for 4 hours) + (Compliance Manager at \$269 per hour for 4 hours) + (Chief Financial Officer at \$473 per hour for 4 hours) + (Programmer Analyst at \$234 per hour for 40 hours) = \$17,040.

<sup>1426</sup> This estimate is based on estimated 40 hours of in-house legal or compliance staff's time to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be built into form of standardized trading documentation. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the Commission staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379.

<sup>1427</sup> There will be ongoing costs associated with processing representations received from counterparties, including additional due diligence and verification to the extent that a counterparty's representation is contrary to or inconsistent with the knowledge of the collecting party. The Commission believes that these would be compliance costs encompassed within programmatic costs associated with the security-based swap dealer definition.

security-based swaps. The Commission preliminarily believes that there would be one-time programming costs associated with the system implementation by market participants to maintain a record of counterparty status for purposes of performing the dealer *de minimis* calculation and estimates such programming costs to be \$12,870.<sup>1428</sup>

Based on the foregoing discussion, the Commission estimates the total one-time per-entity costs for non-U.S. persons engaged in dealing activity within the United States associated with the *de minimis* calculation would be \$43,317.<sup>1429</sup> Estimated annual ongoing costs would be \$17,040. Based on available data provided by the DTCC-TIW, we preliminarily believe that as many as 70 of the firms with over \$2 billion in total worldwide notional trading activity in single-name CDS during 2011 may be non-U.S. persons under our proposed rule and thus will likely incur these costs. Assuming that each of these 70 entities perceived the need to monitor the status of its counterparties and the location of its transactions to perform the dealer *de minimis* calculation, we preliminarily believe that the total annual one-time industry-wide costs associated with establishing such systems would amount to \$3,032,190. Total annual ongoing costs would amount to \$1,192,800.

In addition to assessment costs discussed above associated with determining the volume of U.S.-facing transactions, market participants would also incur assessment costs relating to performing the analysis as to whether

certain security-based swaps involve dealing activity. At the same time, some non-U.S. persons that establish such systems may be expected to forgo the costs of performing the dealing activity analysis. As noted above, we assumed in the Intermediary Definitions Adopting Release that only entities with more than \$2 billion in security-based swap transactions over the previous 12 months would be likely to engage in the full dealer analysis. We believe that it similarly is unlikely that non-U.S. persons with less than \$2 billion in U.S.-facing security-based swap transactions over the previous 12 months would engage in the dealer analysis. Available data from the Trade Information Warehouse shows that 39 of these 70 non-U.S. persons had total U.S.-facing security-based swap transactions under \$2 billion in 2011. We preliminarily believe that, under our proposed rule, these entities would not engage in the full dealer analysis and thus would not be likely to incur the \$25,000 in assessment costs described in the Intermediary Definitions Adopting Release, reducing the estimated assessment costs in that release by approximately \$975,000. The combined effect of our proposed rule on non-U.S. persons, therefore, should result in a net increase in assessment costs over those estimated in the Intermediary Definitions Adopting Release of approximately \$2,057,190.<sup>1430</sup>

<sup>1430</sup> As noted above, in the Intermediary Definitions Adopting Release, we estimated total annual one-time industry-wide costs associated with the dealer analysis to be \$4.2 million. See note 1422, *supra*. According to the analysis above, non-U.S. persons are likely to incur additional annual one-time industry-wide costs of \$3,032,190 associated with new systems to monitor the volume of dealing activity, while annual one-time industry-wide costs associated with the dealing activity analysis may decline by \$975,000. We therefore estimate the annual one-time industry-wide costs associated with the dealer analysis for both U.S. persons and non-U.S. persons to be \$6,257,190 (\$4,200,000 + \$3,032,190 – \$975,000 = \$6,257,190), or \$2,057,190 more than our initial estimate of \$4.2 million.

We have not separately estimated the assessment costs that market participants may incur associated with identifying the special entity status of their counterparties. The Intermediary Definitions Adopting Release noted that the *de minimis* threshold for dealing activity involving special entities would cause market participants to incur costs independent of those associated with the general *de minimis* threshold based on the CDS Data Analysis, which showed that all entities engaged in security-based swap transactions with special entities appeared to also engage in more than \$8 billion in security-based swap transactions in 2011. See CDS Data Analysis at 21 n.8 and Intermediary Definitions Adopting Release, 77 FR 30732 n.1510.

(b) Major Security-Based Swap Participants—“Substantial Position” and “Substantial Counterparty Exposure” Thresholds

Proposed Rule 3a67–10(c) and the proposed interpretive guidance regarding the attribution of guaranteed positions, which is discussed below, together identify the security-based swap positions that entities would be required to include in determining whether they exceed the major security-based swap participant thresholds that were established in the Intermediary Definitions Adopting Release. We preliminarily believe that entities that perceive the need to perform the threshold calculations associated with the major security-based swap definition will incur only relatively minor incremental costs to those described in the Intermediary Definitions Adopting Release as a result of our proposed rule and interpretive guidance applying these thresholds in the cross-border context.

In the Intermediary Definitions Adopting Release, we estimated that certain market participants could be expected to incur costs in connection with the determination of whether they have a “substantial position” in security-based swaps or pose “substantial counterparty exposure” in connection with security-based swaps in connection with their determination as to whether or not they are a major security-based swap participant.<sup>1431</sup>

Based on the data available at that time, we estimated that as many as 12 entities might perceive the need to perform these calculations, given the size of their security-based swap positions.<sup>1432</sup> We further estimated that each of these entities would likely incur annual one-time costs of \$15,287 and ongoing annual costs of \$17,040 in monitoring these positions and performing the necessary calculations.<sup>1433</sup>

Our proposal would require non-U.S. persons to include in these calculations only transactions they enter into directly with, or that they guarantee, that involve U.S.-person counterparties. As noted above, Proposed Rule 3a67–10(c) would require a non-U.S. person that performs the major security-based swap participant calculation to identify the U.S.-person status of its counterparties. Our proposed interpretive guidance would further clarify that a non-U.S. person must

<sup>1431</sup> See Intermediary Definitions Adopting Release, 77 FR 30734–36.

<sup>1432</sup> See Intermediary Definitions Adopting Release, 77 FR 30734.

<sup>1433</sup> See note 1425, *supra*.

<sup>1428</sup> This is based on an estimate of the time required for a programmer analyst to modify the software to track the U.S. person status of a counterparty and to record and classify whether a transaction is a transaction conducted within the United States, including consultation with internal personnel, and an estimate of the time such personnel would require to ensure that these modifications conformed to proposed definitions of U.S. person and transaction conducted within the United States. Using the estimated hourly costs described above, we estimate the costs as follows: (Compliance Attorney at \$310 per hour for 2 hours) + (Compliance Manager at \$269 per hour for 4 hours) + (Programmer Analyst at \$234 per hour for 40 hours) + (Senior Internal Auditor at \$217 per hour for 4 hours) + (Chief Financial Officer at \$473 per hour for 2 hours) = \$12,870. See note 1425, *supra* (for source of the estimated per hour costs).

<sup>1429</sup> The estimated one-time costs of \$43,317 represent the costs for programming a system to monitor the dealing activity of a non-U.S. person (\$15,287), the costs for programming a system to monitor the U.S.-person status of its counterparties and the location of its dealing activity (\$12,870), and the costs for establishing a practice or compliance procedure of requesting and collecting representations from trading counterparties and maintaining the representations collected as part of the recordkeeping procedures (\$15,160).

include in its calculation all transactions of other entities that it guarantees where a U.S. person has direct recourse to the non-U.S. person performing the major security-based swap participant calculation.<sup>1434</sup> A non-U.S. person performing this calculation would therefore be required to identify the U.S.-person status of its counterparties, and the counterparties of transactions it guarantees, and monitor the positions arising from transactions involving U.S. person as counterparties.

The Commission preliminarily believes that market participants would request representations from their transaction counterparties to determine the U.S. person status of their counterparties. Therefore, the Commission preliminarily believes that the one-time assessment costs associated with the counterparty status should be limited to the costs of establishing a practice or compliance procedure or requesting and collecting representations from trading counterparties and maintaining the representations collected as part of the recordkeeping procedures. The Commission preliminarily believes that such assessment costs would be approximately \$15,160.<sup>1435</sup>

The Commission also considers it likely that market participants will

<sup>1434</sup> Our proposed interpretive guidance also would clarify that U.S. persons performing the major security-based swap participant calculation must include all positions entered into by other parties where it guarantees the transaction. Because this interpretive guidance would not change the scope of the transactions that a U.S. person must consider in performing this calculation, we do not expect it to have any effect on the assessment costs incurred by such persons.

<sup>1435</sup> This estimate is based on estimated 40 hours of in-house legal or compliance staff's time to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be built into form of standardized trading documentation. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379.

Similar to our analysis of the assessment costs associated with the *de minimis* exception relating to the definition of the security-based swap dealer, we preliminarily believe that requesting and collecting representations would be part of the standardized transaction process reflected in the policies and procedures described above regarding security-based swap sales and trading practices. There would be ongoing costs associated with processing representations received from counterparties, including additional due diligence and verification to the extent that a counterparty's representation is contrary to or inconsistent with the knowledge of the collecting party. The Commission believes that these costs would be compliance costs encompassed within programmatic costs associated with the major security-based swap participant definition.

implement systems to keep track of counterparty status for purposes of future trading of security-based swaps. The Commission preliminarily believes that there would be one-time programming costs associated with the system implementation by market participants to maintain a record of counterparty status for purposes of assessing the major security-based swap participant status and estimates such programming costs to be \$12,870.<sup>1436</sup> Therefore, the Commission estimates the total one-time costs per entity associated with the proposed Rule 3a67-10(c) and the interpretive guidance regarding guarantee could be \$28,030.<sup>1437</sup> This is in addition to the estimate of ongoing annual costs of \$17,040 associated with performing the major security-based swap participant threshold calculations and the one-time programming costs of \$15,287 related to establishing an automated system or modifying the existing automated system to perform the major participant threshold calculations as described in the Intermediary Definitions Adopting Release.<sup>1438</sup>

#### Request for Comment

The Commission generally requests comment about our preliminary estimates of the number and composition of dealing entities and major participants that may be required to register as security-based swap dealers as a result of the proposed application of the *de minimis* exception in the cross-border context. The Commission also requests comments about our estimates of the effect of our proposed approach on programmatic costs and benefits and assessment costs. The Commission requests that

<sup>1436</sup> This is based on an estimate of the time required for a programmer analyst to modify the software to track the U.S. person status of a counterparty and to record and classify whether a transaction is a transaction conducted within the United States, including consultation with internal personnel, and an estimate of the time such personnel would require to ensure that these modifications conformed to proposed definitions of U.S. person and transaction conducted within the United States. Using the estimated hourly costs described above, we estimate the costs as follows: (Compliance Attorney at \$310 per hour for 2 hours) + (Compliance Manager at \$269 per hour for 4 hours) + (Programmer Analyst at \$234 per hour for 40 hours) + (Senior Internal Auditor at \$217 per hour for 4 hours) + (Chief Financial Officer at \$473 per hour for 2 hours) = \$12,870. For the source of the estimated per hour costs. See note 1263, *supra*.

<sup>1437</sup> The \$28,030 per entity cost is derived from \$15,160 cost of establishing a written compliance policy and procedures regarding obtaining counterparty representations and plus \$12,870 one-time programming cost relating to system implementation to maintain counterparties representations and track the U.S. person status of each counterparty in the system.

<sup>1438</sup> See note 1433, *supra*.

commenters provide data and sources of data to support any comments.

- Are the Commission's estimates regarding the number of U.S.-person and non-U.S. persons active as dealers in security-based swaps, both in the United States and worldwide, and the number of these that engage in security-based swap dealing transactions above the *de minimis* threshold reasonable in light of the proposed rule?

- Are the Commission's estimates of assessment costs associated with the dealer registration analysis, including the costs associated with the determination of the status of counterparties as U.S. persons, non-U.S. persons, foreign branches and the costs associated with the determination of transactions conducted within the United States reasonable?

- Are the Commission's estimates of the number of U.S. persons and non-U.S. persons whose security-based swap positions may rise to the major security-based swap participant level reasonable, both in the United States and worldwide?

- Are the Commission's estimates of the number of U.S. persons and non-U.S. persons whose security-based swap positions may be attributed to other persons because of guarantees and whether such attribution may result in such persons becoming major security-based swap participants reasonable?

- Is the Commission's estimate that the revisions included in re-proposed Form SBSE and re-proposed Form SBSE-A would not significantly impact the costs and benefits associated with the rules and forms to facilitate registration accurate?

- Has the Commission accurately explained the relationship between the proposed application of the dealer *de minimis* threshold (including the definition of U.S. person) and the programmatic effects and the programmatic costs and benefits of our dealer definition?

- Has the Commission appropriately accounted for the programmatic benefits and costs of subjecting (or not subjecting) certain entities to the security-based swap dealer or major security-based swap participant requirements under the proposed approach?

- Does the Commission's analysis of the proposed treatment of non-U.S. persons who are guaranteed by U.S. persons adequately reflect the expected programmatic costs and benefits associated with this treatment?

- Has the Commission properly analyzed the programmatic costs and benefits associated with requiring U.S. persons to include dealing activity

conducted through a foreign branch in their dealer *de minimis* calculations?

- Has the Commission properly analyzed the programmatic costs and benefits associated with permitting non-U.S. persons not to count dealing transactions with a foreign branch toward their *de minimis* threshold?

- Is the Commission's estimate of the assessment costs associated with determining whether one falls within the security-based swap dealer or major security-based swap participant definitions accurate? Do the Commission's estimates reflect reasonable assumptions about the types of systems that would be necessary to perform the required analyses?

- Does the Commission's estimate of assessment costs appropriately reflect the cost to an entity of determining its U.S.-person status? Does it appropriately reflect the cost of determining whether its counterparty is a U.S. person or is engaging in a transaction conducted within the United States?

- Has the Commission accurately estimated the costs associated with identifying and maintaining records concerning the U.S.-person status of counterparties and the location of transactions?

### 3. Alternatives Considered

#### (a) *De Minimis* Exception

As stated above, market participants, foreign regulators and other interested parties have provided views on the application of Title VII requirements in the cross-border context through written comment letters (on other proposed rulemakings by the Commission and on the cross-border interpretive guidance proposed by the CFTC) and meetings with the Commission and our staff.<sup>1439</sup> In particular, commenters have provided their views on how the term "U.S. person" should be defined and how the *de minimis* exception in the security-based swap dealer definition should be applied in the cross border context.<sup>1440</sup> These comments have been informative in the Commission's development of our proposed approach to the application of the *de minimis* exception in the cross-border context, and our understanding of the economic consequences of the proposed U.S. person definition and the proposed *de minimis* exception. In this section, we briefly describe our analysis of the economic impact of these alternative

approaches suggested by the commenters.

#### i. Alternatives to the Proposed Definition of U.S. Person

The proposed definition of U.S. person plays a central role in the application of Title VII in the cross-border context. It directly affects the number of entities that will have to register as security-based swap dealers: A potential security-based swap dealer performing its *de minimis* calculation must first determine its own U.S.-person status and then, if it is a non-U.S. person, identify the U.S.-person status of its counterparties in transactions arising out of its dealing activity.<sup>1441</sup> We also propose to use the U.S. person definition in determining the applicability of certain transaction-level requirements under Title VII.<sup>1442</sup> As a result, the U.S. person definition in the proposed rule directly affects the scope of the application of Title VII requirements to the cross-border security-based swap market and, in particular, the number of entities that will be required to register as security-based swap dealers.<sup>1443</sup>

As explained above, our proposed definition of U.S. person is designed to identify those market participants whose security-based swap activity may be particularly likely to affect the U.S. market in a manner relevant to the concerns of Title VII or that may warrant the protections of Title VII. In our view, the security-based swap activity of a person that has its place of residence, incorporation, or its principal place of business within the United States may be particularly likely to warrant the application of Title VII because its security-based swap activity is likely to result in risks being borne by the person within the United States or because its activity raises other concerns that Title VII is intended to address, such as the stability or transparency of the U.S. financial system or the protection of counterparties. Consistent with this view, we have proposed a definition of U.S. person that looks to the location of the person's residence,

incorporation, or principal place of business.

In developing our proposed definition of U.S. person, we have considered two alternative definitions: One suggested by commenters, and one proposed by the CFTC in its own cross-border guidance proposal.<sup>1444</sup> In the discussion that follows, we briefly describe these alternatives and the related benefits and costs. A more in-depth analysis of the programmatic costs and benefits of these alternatives will continue in the following sections, in which we analyze the role that these definitions play in the specific application of our proposed approach to the *de minimis* calculations to different types of entities.

Several commenters suggested that we consider the definition of U.S. person found in Regulation S of the Securities Act, noting that at least some market participants would find the definition familiar and easy to apply.<sup>1445</sup> As explained above, we declined to take this approach because we believe that the U.S. person definition in Regulation S addresses specific concerns associated with the offshore offering of unregistered securities that are different from the concerns of Title VII.<sup>1446</sup> Regulation S, among other things, provides safe harbors for offshore offerings of unregistered securities, and a central concern of Regulation S is ensuring that unregistered securities offered abroad do not come to rest within the United States.<sup>1447</sup> Given this concern, the definition of U.S. person used in the Regulation S safe harbors appropriately focuses on the location of the person making the decision to purchase unregistered securities.<sup>1448</sup>

On the other hand, as already noted, Title VII addresses the potential impact of swap and security-based swap transactions on the stability of the U.S. financial system, market transparency, and counterparty protection.<sup>1449</sup> In this

<sup>1444</sup> See, e.g., Cleary Letter IV at 2; SIFMA Letter at 5; see also CFTC Cross-Border Proposal, 77 FR 41218 (discussing the definition of U.S. person proposed by the CFTC).

<sup>1445</sup> See SIFMA Letter at 5. Regulation S provides, among other things, certain safe harbors regarding registration requirements as they relate to the offshore offering of securities. See *Offshore Offers and Sales*, Final Rules, 55 FR 18306 (May 2, 1990). Under Regulation S, an entity's U.S.-person status is a relevant factor in determining whether certain of the safe harbors are available to a specific offering or sale of securities. See 17 CFR 230.902(o) (defining "U.S. person").

<sup>1446</sup> See Section III.B.4, *supra*.

<sup>1447</sup> See Regulation S Adopting Release, 55 FR 18308. Whether securities come to rest in the United States or abroad is relevant to whether the interests served by the registration requirement are affected by the securities offering.

<sup>1448</sup> See 17 CFR 230.902(o).

<sup>1449</sup> See note 4, *supra*.

<sup>1441</sup> See proposed Rule 3a71-3(b) under the Exchange Act, as discussed in Section III.B.3, *supra*.

<sup>1442</sup> See Sections VIII-X, *supra* (discussing the application of the reporting and public dissemination of security-based swap information, mandatory clearing, and mandatory trade execution requirements). As further discussed in these sections, the U.S. person definition plays a significant role in determining whether a particular transaction is subject to transaction-level requirements.

<sup>1443</sup> See Section XV.C.1, *supra* (discussing economic analysis of the proposed *de minimis* exception).

<sup>1439</sup> See Section I, *supra*.

<sup>1440</sup> See, e.g., Cleary Letter IV at 2, 6-9; Davis Polk Letter I at 6 n.6.

context and in light of the nature of the risk arising from such transactions, the location of the person making the decision to enter into a security-based swap appears to us to be less relevant than the location of the person bearing the risk of the transaction. For example, as discussed further below, if the definition of U.S. person in Regulation S were used to determine whether a potential security-based swap dealer should be registered or whether a security-based swap should be subject to Title VII transaction-level requirements, a dealer may not be required to register as a security-based swap dealer based on its dealing activity conducted through its foreign branch, despite the fact that such transactions generally create the same risks for the dealing entity as any other security-based swap activity that it conducts directly from its headquarters. Excluding foreign branches from the definition of U.S. person could result in U.S. banks engaging in significant levels of security-based swap dealing activity, and bearing the risk of such activity, entirely outside the requirements of Title VII, including the registration requirements. This result would reduce the programmatic benefits that the Title VII security-based swap dealer definition or the security-based swap dealer registration requirement is intended to achieve, which are to subject to regulation those dealing entities that we believe are likely, by virtue of engaging in dealing activity within the United States, to pose risk to the U.S. financial system that Title VII was intended to regulate.<sup>1450</sup> Therefore, the definition of U.S. person in Regulation S, with its focus on the location of the person making the investment decision and not on the person bearing the risk of the transaction, is ill-suited to address these types of concerns.

We also considered the interpretation of U.S. person proposed by the CFTC in its cross-border interpretive guidance.<sup>1451</sup> The CFTC definition resembles our proposed definition in many respects, as it also focuses on the location of the person bearing the risk of the transaction. However, we have declined to include in our proposed definition certain categories of entities

<sup>1450</sup> Similarly, under the definition of U.S. person in Regulation S, certain dealers may not be required to register as a security-based swap dealer based on their dealing activity with an investment manager located outside the United States who manages a discretionary account on behalf of a U.S. person, even though the resulting transactions are with that U.S. person and that U.S. person bears the risk arising out of that transaction.

<sup>1451</sup> See CFTC Cross-Border Proposal, 77 FR 41218.

(or their equivalent in the security-based swap market) that the CFTC has defined as U.S. persons. Most significant of these are (i) entities “in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. person”; (ii) certain investment vehicles, wherever organized or incorporated, “of which a majority ownership is held, directly or indirectly, by a U.S. person;” and (iii) certain investment vehicles “the operator of which would be required to register as a commodity pool operator with the CFTC.”<sup>1452</sup> The Commission has preliminarily determined not to include within the definition of “U.S. person” any entity that is not resident, organized, or incorporated within the United States or does not have its principal place of business in the United States, regardless of any ownership interest by a U.S. person.

We are proposing this approach because we preliminarily believe that Title VII is primarily concerned about security-based swap activity that raises the types of concerns—including the stability of the U.S. financial system, swap market transparency, and counterparty protection—within the United States that Title VII was intended to address.<sup>1453</sup> If U.S. residents or U.S.-based entities suffer losses from their investments in investment vehicles or their investments in entities organized, incorporated, or having the principal place of business located outside the United States, such losses are generally limited to their investments in the form of equity or debt securities. Such investment risks are not related to security-based swaps, and the protection of U.S. investors with respect to investments in equity, debt securities, or investment vehicles, as well as investment management or investment advisory activity, is addressed by other provisions of U.S. securities law pertaining to issuances and offerings of equity or debt securities.

Therefore, the Commission does not believe that it would advance the programmatic benefits of Title VII to include foreign entities or foreign investment vehicles in the U.S. person definition because U.S.-based entities or U.S. residents own them or because a

<sup>1452</sup> *Id.*

<sup>1453</sup> See Section III.B.3, *supra*. As noted above, we do not believe that Title VII’s security-based swap dealer registration requirements are the appropriate mechanism for addressing the potential for spillover effects caused by non-U.S. persons that engage in security-based swap dealing activity or other security-based swap activity wholly outside the United States.

U.S.-based entity is responsible for the foreign entities’ liabilities (as proposed by the CFTC). Furthermore, given our focus on reducing risk to, and promoting transparency in, the U.S. security-based swap market, we do not think the U.S.-person status of a commodity pool operator or fund adviser (as opposed to the fund actually entering into the transaction) is in itself relevant in determining whether security-based swap activity occurs within the United States and should therefore be subject to the full range of Title VII requirements because those entities do not bear the risk of the transactions.<sup>1454</sup>

Finally, the Commission preliminarily believes that the alternative definition of U.S. person in Regulation S and the definition of U.S. person proposed by the CFTC would likely cause potential security-based swap dealers and end users to incur higher assessment costs. For example, Regulation S classifies accounts differently depending on whether they are discretionary or non-discretionary,<sup>1455</sup> while our proposed definition would focus on the status of the counterparty to a security-based swap transaction.<sup>1456</sup> The Regulation S definition specifies the U.S. person status of more types of entities than does our proposed definition and would introduce a level of complexity into the definition that is not relevant to the purposes of Title VII. Similarly, the CFTC’s proposed interpretation likely would increase assessment costs compared to our proposed definition by, for example, requiring investment funds or their counterparties to determine the U.S.-person status of the direct and indirect owners of such funds. It may be operationally costly and otherwise impracticable to identify the indirect ownership of an investment vehicle given the legal structure of the

<sup>1454</sup> We also note that, to the extent that the commodity pool operator or fund advisor enters into a security-based swap transaction that is conducted within the United States, Title VII would generally apply to that transaction. See proposed Rule 3a71–3(a)(5) under the Exchange Act (defining “transaction conducted within the United States”), as discussed in Section III.B.5, *supra*. However, proposed Rules 3Ca–3(b)(2) and 3Ch–1(b)(2) would not apply the mandatory clearing and mandatory trade execution requirements to transactions between two non-U.S. persons who are not security-based swap dealers and whose performances under security-based swaps are not guaranteed by a U.S. person, even though such transactions are conducted in the United States.

<sup>1455</sup> *Cf.* 17 CFR 230.902(o)(1)(vi), (vii) (defining certain types of accounts to be U.S. persons) with 17 CFR 230.902(o)(2) (defining certain types of accounts not to be U.S. persons).

<sup>1456</sup> Proposed Rule 3a71–3(a)(7)(iii) under the Exchange Act (defining an account as a U.S. person by looking at the status of the account holder or owner), as discussed in Section III.B.4, *supra*.

investment vehicle and the beneficial ownership in book-entry form, and it is unnecessary as those entities bear risks only to the amount of their investment (as opposed to the open-ended risks that can be associated with security-based swap positions). We expect that this complexity could significantly raise assessment costs for market participants.

Based on the above, we preliminarily believe that our proposed definition appropriately focuses on the types of entities that are likely to be actively engaged in the security-based swap market and on the specific categories of such entities whose security-based swap activity has the potential to impact the U.S. financial system. We do not believe that following either the Regulation S approach or the CFTC's proposed interpretation would achieve the benefits of Title VII. We also believe that either approach would result in higher assessment costs.<sup>1457</sup>

#### ii. Alternatives to the Proposed Rule Regarding Application of the De Minimis Exception

As described above, our proposal also includes a proposed rule regarding the application of the *de minimis* exception in the cross-border context.<sup>1458</sup> This rule prescribes how a person's transactions arising out of its dealing activity must be included in its *de minimis* calculation, depending on whether it is a U.S. person or non-U.S. person. The definition of U.S. person, described above, is central to this rule, as it is used to identify both the status of the person engaged in security-based swap dealing activity and, with respect to a non-U.S. person engaged in dealing activity, the status of its counterparties in transactions connected to dealing activity.

In this section, we will describe certain alternatives to our proposed application of the *de minimis* exception and explain how these alternatives would have affected the programmatic costs and benefits of Title VII. Some of these alternatives have been considered in our discussions of the U.S. person definition.

#### a. Calculation of U.S. Persons' Transactions for *De Minimis* Exception

Our proposed approach would require a U.S. person to count toward the *de*

*minimis* threshold all transactions it enters into in a dealing capacity, including those it conducts through a foreign branch, regardless of the location of the counterparty to the transaction.<sup>1459</sup> Some commenters suggested that the Commission lacks the authority to subject the dealing activity of a foreign branch of a U.S. bank to Title VII, including our registration requirements, to the extent that it does business only with counterparties that are not U.S. persons outside the United States.<sup>1460</sup> As noted above, commenters generally took the view that the Commission should consider using the Regulation S definition of U.S. person for purposes of applying the *de minimis* exception in the cross border context, as Regulation S specifically excludes from its definition of U.S. person foreign branches of U.S. banks.<sup>1461</sup> Presumably, under the approach suggested by some commenters, the headquarters of a U.S. bank would be designated a U.S. person, whereas each of its foreign branches would be classified as a separate non-U.S. person for purposes of Title VII.

For the reasons already noted above,<sup>1462</sup> we are not proposing to follow this approach. Because of the nature of the risks posed by security-based swaps, which are borne by the entire legal entity even if the transaction is entered into by a foreign branch of such entity, consistent with the Commission's approach to the meaning of "person" in the security-based swap dealer definition, as discussed above,<sup>1463</sup> we are proposing to define the term "U.S. person" to include the entire entity, including its foreign branches. In addition, such separation is inconsistent with the focus in Title VII on the effect of a person's dealing activity on the U.S. financial system, including the risks such person bears as a result of its dealing activity. Although we recognize that certain U.S.-based banks have chosen to conduct some or all of their foreign security-based swap business through foreign branches,<sup>1464</sup> we preliminarily believe that, given Title VII's goal of addressing potential dealing risk to the U.S. financial system caused by security-based swap dealing activity, the *de minimis* exception should apply to all security-based swap dealing activity of a person that has its principal place of business within, or is

incorporated or organized within, the United States, regardless of which part of such person carries out such dealing activity wherever its counterparties are located, even if elements of that activity occur outside the United States.

We preliminarily believe that the alternative approach suggested by commenters could reduce the programmatic benefits of security-based swap dealer registration under Title VII and the ensuing substantive requirements applicable to registered security-based swap dealers if the *de minimis* calculation for U.S. persons engaged in dealing activity does not include the entire volume of such persons' dealing activity. Drawing a distinction between the branches, desks, or offices of a U.S. person and the entity as a whole would be inconsistent with the fact that the U.S. person as a whole bears the risk of all security-based swap transactions that it enters into, including those transactions conducted through a foreign branch or office with non-U.S. person counterparties located outside the United States.<sup>1465</sup>

Even if the headquarters of a U.S. bank were already registered by virtue of its own security-based swap dealing activity in the United States, the commenters' suggested approach would presumably allow the same bank, through its foreign branches, to engage in unlimited dealing activity with non-U.S. persons outside the United States without registering those branches.<sup>1466</sup> We do not view such disparate regulatory treatment of two parts of the same legal entity to be consistent with the purposes of Title VII, particularly given that this approach would appear to place entirely outside the scope of regulation under Title VII transactions that pose risks to a U.S. bank that are indistinguishable from those arising from transactions done directly from the home office of that bank.<sup>1467</sup> We believe that excluding transactions conducted through foreign branches from the *de minimis* calculations would not achieve the programmatic benefits intended by

<sup>1465</sup> See Section II.A.3, *supra* (discussing the example of AIG FP).

<sup>1466</sup> For example, treating the branch differently may remove the branch entirely from Title VII's rules. This could prevent regulation of capital adequacy and other risk mitigating requirements, even though all of the risk from the transaction is residing within the entity as a whole, creating risk for the U.S. financial system.

<sup>1467</sup> Security-based swap activity conducted through a foreign branch poses risks to the entire entity to which the branch belongs that are generally indistinguishable from those posed by security-based swap activity conducted through an office. The experience of AIG FP demonstrates that the security-based swap activity of a foreign office can lead to the default of the entire entity. See Section II.A.3, *supra*.

<sup>1457</sup> We will discuss the relative costs and benefits of these alternatives in more detail in the context of our analysis of alternatives to proposed rules that use the U.S. person definition in the following sections.

<sup>1458</sup> See Proposed Rule 3a71-3(b) under the Exchange Act, as discussed in Section III.B.3, *supra*. See also 17 CFR 240.3a71-2.

<sup>1459</sup> See proposed Rule 3a71-3(b)(1)(i) under the Exchange Act, as discussed in Section III.B.3, *supra*.

<sup>1460</sup> See, e.g., Sullivan & Cromwell Letter at 2.

<sup>1461</sup> See notes 218 and 219, *supra*.

<sup>1462</sup> See Section III.B.3, *supra*.

<sup>1463</sup> See Section III.B.4, *supra*.

<sup>1464</sup> See Sections II.A.2 and III.B.6, *supra* (discussing the dealing structures used by U.S.-based entities).

the Title VII requirements because it would leave unaddressed risks associated with security-based swap dealing activity that occurs within the United States and therefore raises the types of concerns with respect to the U.S. market that Title VII's dealer requirements were intended to address.

b. Calculation of Non-U.S. Persons' Transactions for De Minimis Exception (including transactions conducted within the United States)

Our proposed application of the *de minimis* exception to non-U.S. persons engaged in security-based swap dealing activity would require them to include in their *de minimis* calculations any transactions with U.S. persons or any transactions otherwise conducted within the United States, to the extent they are entered into in a dealing capacity. Given the focus on Title VII on the stability and transparency of the U.S. financial system and the protection of counterparties,<sup>1468</sup> we preliminarily believe that it is appropriate to require non-U.S. persons that engage in dealing activity within the United States and therefore are likely to raise these types of concerns to count such dealing activity toward their *de minimis* thresholds. To the extent that the aggregate notional amount of transactions arising from a non-U.S. person's dealing activity involving U.S. persons or otherwise conducted within the United States exceeds the *de minimis* threshold in the trailing 12-month period, we would require a non-U.S. person to register as a security-based swap dealer.

In developing our proposed application of the *de minimis* threshold to non-U.S. persons, we have considered alternatives suggested by commenters or proposed by the CFTC. We declined to incorporate these alternatives into our approach.

Some commenters suggested that a non-U.S. person that engages in dealing activity with U.S.-person counterparties through an affiliated U.S. intermediary should be permitted to register in a limited capacity or should not be required to register as a security-based swap dealer.<sup>1469</sup> Specifically, some commenters suggested that the Commission adopt an approach that is modeled on the Commissions' existing regimes, permitting non-U.S. security-based swap dealers to transact with U.S. persons without registering in the United States if those transactions are

intermediated by a U.S.-registered security-based swap dealer.<sup>1470</sup>

We preliminarily believe that the above alternative suggested by commenters would potentially reduce the programmatic benefits intended by Title VII. To the extent that a non-U.S. person engages in security-based swap dealing entirely with U.S. persons or within the United States, that person's security-based swap activity raises the concerns that security-based swap dealer regulation under Title VII intends to address: First, the entity's dealing activity raises customer protection concerns, which the external business conduct standards and segregation requirements of Title VII are intended to address; second, the entity's dealing activity raises financial responsibility concerns, which Title VII's entity-level requirements applicable to registered security-based swap dealers are intended to address; finally, the entity's dealing activity raises transparency, regulatory oversight, counterparty risk and systemic risk concerns, which Title VII intends to address through its regulatory reporting, public reporting, mandatory clearing, and mandatory trade execution requirements. Although the Commission recognizes that some of these concerns might be addressed by regulating the intermediary, as in the broker-dealer context, we preliminarily believe that only if the non-U.S. person dealer itself is subject to Title VII would it be possible to address the entire range of concerns that Title VII dealer regulation is intended to address.<sup>1471</sup>

The CFTC has proposed that non-U.S. persons that are guaranteed by U.S. persons be required to include in their *de minimis* calculation all transactions carried out in a dealing capacity with any counterparty, wherever that counterparty is located, just as a U.S. person acting in a dealing capacity would be required to do.<sup>1472</sup> As discussed above, the Commission recognizes that such guarantees of the

security-based swap transactions of non-U.S. persons may pose risk to the U.S. financial system; however, the Commission does not believe that the security-based swap dealer regulation in Title VII is the appropriate vehicle for regulating the dealing activity of non-U.S. persons occurring outside the United States with other non-U.S. persons.<sup>1473</sup> As discussed above, the Commission preliminarily believes that the risk posed to the U.S. markets by the dealing activity of non-U.S. persons outside the United States whose performance under security-based swaps is guaranteed by a U.S. person does not necessarily raise the full range of concerns that Title VII dealer regulation is intended to address. Such activity may give rise to security-based swap positions that raise concerns within the United States that are relevant to the purposes of Title VII if those positions are large enough to affect the stability of the institution providing the guarantee and potentially the stability of the U.S. financial system more generally. This risk, however, arises from attribution of security-based swap positions to the guarantor due to the guarantee rather than the dealing activity per se. In these circumstances, we preliminarily believe that the risks relating to these positions warrant registration only to the extent that the positions exceed the thresholds established for major security-based swap participant registration.<sup>1474</sup>

In light of the foregoing, we do not believe that requiring a non-U.S. person that is guaranteed by a U.S. person to count every transaction entered into in a dealing capacity toward its *de minimis* threshold and to register as a security-based swap dealer even if it engaged in no dealing activity with U.S. persons or otherwise within the United States would materially increase the programmatic benefits of the dealer registration requirements. Although it is likely that such an approach would cause more entities to register as dealers than does our proposed approach, to the extent that these entities were required to register as security-based swap dealers even though they engaged in dealing activity only with non-U.S. persons outside the United States, we preliminarily believe that this alternative would impose programmatic costs on these entities without a corresponding increase of the programmatic benefits to the U.S. security-based swap markets that are intended by the security-based swap dealer requirements in Title VII, as we

<sup>1468</sup> Pub. L. No. 111-203 Preamble. See Section I and note 4, *supra*.

<sup>1469</sup> See, e.g., Société Générale Letter II; Cleary Letter IV.

<sup>1470</sup> See, e.g., Davis Polk Letter I at 11 n.17 ("This model is similar to the mode of operation permitted by Rule 15a-6 under the Securities Exchange Act of 1934, pursuant to which foreign broker-dealers interface with U.S. customers under arrangements with affiliated or non-affiliated broker-dealers without themselves registering as broker-dealers in the U.S."); Cleary Letter IV at 22 ("Accordingly, as one alternative, we suggest that the Commissions adopt an approach that is modeled on the Commissions' existing regimes, permitting non-U.S. swap dealers to transact with U.S. persons without registering in the U.S. if those transactions are intermediated by a U.S.-registered swap dealer. This would be consistent with the approach adopted by the SEC under Rule 15a-6 and prior interpretative precedents with respect to non-U.S. securities dealers.")

<sup>1471</sup> See Section III.B.4, *supra*.

<sup>1472</sup> See CFTC Cross-Border Proposal, 77 FR 41221.

<sup>1473</sup> See Section III.B.7, *supra*.

<sup>1474</sup> *Id.*



do not believe that the dealing activity of such persons (to the extent that it involves only non-U.S. counterparties outside the United States) raises the types of concerns within the United States that Title VII dealer registration was intended to address.

Another alternative to our proposed approach would be not to require non-U.S. persons that engage in dealing activity with other non-U.S. persons through transactions conducted within the United States to include such transactions in their *de minimis* calculations.<sup>1475</sup> As noted above, Title VII is intended to promote accountability and transparency in the U.S. financial system,<sup>1476</sup> and to do so, it is necessary to ensure that security-based swap dealing activity that occurs within the United States is subjected to the requirements of Title VII,<sup>1477</sup> including those related to external business conduct protections and other transaction-level requirements. Even if a non-U.S. person located outside the United States is engaging in dealing activity with non-U.S. persons located in the United States, it is, among other things, providing liquidity in the U.S. security-based swap market and thus engaging in dealing activity within the United States. Excluding such dealing activity from Title VII would reduce the programmatic benefits of security-based swap dealer regulation because it would reduce the transparency of the U.S. market and deprive counterparties within the United States of the protections of Title VII. We recognize that the ultimate programmatic benefits discussed here associated with the application of the security-based swap dealer regulation in the cross-border context would be affected by the substantive rules adopted by the Commission. The Commission is reopening the comment periods for our outstanding rulemaking releases that concern security-based swaps and security-based swap market participants and were proposed pursuant to certain provisions of the Exchange Act, as amended by Title VII of the Dodd-Frank Act.

### iii. Aggregation of Affiliate Dealing Activity

Our proposed rule regarding the application of the *de minimis* exception in the cross-border context also requires

a U.S. person who enters into security-based swap transactions in a dealing capacity, or non-U.S. person who enters into security-based swap transactions with U.S. persons or transactions conducted within the United States in a dealing capacity, to count toward such person's *de minimis* threshold certain transactions of its affiliates. Specifically, such persons would be required to include in the *de minimis* calculation the notional amount of (1) the transactions entered into in a dealing capacity by all of their commonly controlled affiliates who are U.S. persons and (2) the transactions with U.S. persons or transactions conducted within the United States entered into in a dealing capacity by all of its commonly controlled affiliates who are non-U.S. persons. However, such calculation would exclude any affiliate that is a registered security-based swap dealer if such person who relies on the *de minimis* exception maintains separate operations independent of any affiliate who is a registered security-based swap dealer and does not involve, or act in concert with, any affiliate that is a registered security-based swap dealer in any stage of a security-based swap transaction that arises out of its dealing activity.<sup>1478</sup>

In developing this rule, we considered the approach proposed by the CFTC, which we understand to permit non-U.S. persons to aggregate only the transactions carried out in a dealing capacity by their commonly controlled affiliates that are also non-U.S. persons, rather than including all such transactions by all commonly controlled affiliates, wherever located. As noted above,<sup>1479</sup> we declined to follow the CFTC's proposal in part out of concern that doing so could confer competitive advantages on affiliated corporate groups that engage in security-based swap dealing activity through both U.S. and foreign affiliates by allowing them to operate with an effective *de minimis* threshold twice higher than the threshold applicable to security-based swap dealers operating solely within the United States or solely in one or more foreign-based affiliates.

We recognize that our approach may require some persons to register that might not be required to register under the CFTC's approach and thus would

impose programmatic costs on those entities that they might not otherwise incur. It may also require more firms to engage in assessment, as even those with activity levels far below the threshold will probably perform these calculations, if they are part of a larger corporate family with a number of security-based swap dealers. However, we believe that those corporate groups operating a centralized booking model or centralized risk management should be able to have the central booking entity or central risk management location perform the *de minimis* aggregation calculation for the entire corporate group. For purposes of this analysis, we have assumed that corporate groups are likely to perform such assessments centrally.<sup>1480</sup>

We preliminarily conclude that our proposed application of the aggregation requirement to the *de minimis* calculation in the cross-border context is appropriate in light of the purposes of Title VII and of dealer regulation in particular. The aggregation requirement is designed to discourage evasion of the dealer registration requirement by a corporate group by engaging in large volumes of dealing activity through multiple affiliates, none of which engages in activity exceeding the *de minimis* threshold.<sup>1481</sup> Therefore, we have preliminarily determined that a corporate group's dealing activity should be considered as a whole.

Similarly, to be entitled to rely on the *de minimis* exception, an unregistered affiliate within a corporate group must have an independent operation separate from any affiliate who is a registered security-based swap dealer and must not act in concert with the registered affiliate in any stage of a security-based swap transaction. The Commission preliminarily believes that this requirement would have the benefit of preventing evasion.

### (b) Major Security-Based Swap Participants

Several commenters suggested that foreign government-related entities, such as sovereign wealth funds and multilateral development institutions,

<sup>1475</sup> The CFTC's proposed guidance does not trigger application of Title VII requirements based on the location of the security-based swap activity.

<sup>1476</sup> See Section II, *supra*.

<sup>1477</sup> See proposed Rule 3a71-3(a)(5) under the Exchange Act (defining "transaction conducted within the United States"), as discussed in Section III.B.5, *supra*.

<sup>1478</sup> See proposed Rule 3a71 under the Exchange Act. This approach is consistent with the aggregation requirement described in the Intermediary Definitions Release. See Intermediary Definitions Release, 77 FR 30631 (requiring aggregation of dealing activity by commonly controlled affiliates for purposes of *de minimis* calculation).

<sup>1479</sup> See Section III.B.4.(c), *supra*.

<sup>1480</sup> We understand, based on comment letters and our staff's discussion with market participants, that many market participants keep a global swap book and operate a central booking model. See, e.g., Cleary Letter I at 9. If this is not the case with respect to a particular market participant, then the number of entities that need to perform the *de minimis* calculation would increase. The Commission currently does not have available information with respect to the number of market participants active in the security-based swap market that utilize a central booking model.

<sup>1481</sup> See Intermediary Definitions Release, 77 FR 30631.

should be excluded from the major security-based swap participant definition.<sup>1482</sup> By potentially capturing fewer major security-based swap participants, this alternative approach would correspondingly decrease the programmatic costs and benefits associated with Title VII regulation of major security-based swap participants. We preliminarily believe that security-based swap transactions entered into by these types of foreign government-related entities with U.S. persons pose the same risks to the U.S. security-based swap markets as transactions entered into by entities that are not foreign-government related. Moreover, as noted above,<sup>1483</sup> based upon our conversations with market participants we understand that foreign government-related entities rarely enter into security-based swap transactions (as opposed to other types of swap transactions) in amounts that would trigger the obligation to register as a major security-based swap participant. Therefore, we preliminarily believe that the proposed approach considering only security-based swap transactions entered into with a U.S. person as counterparty in determining a non-U.S. person's status as a major security-based swap participant, regardless of whether such non-U.S. person is a foreign government-related entity, is more appropriately tailored to the objectives of Title VII.

#### Request for Comment

The Commission requests comments on all aspects of the economic analysis of the alternatives to the proposed definition of U.S. person, the proposed application of the *de minimis* exception and the proposed application of the major security-based swap participant definition in the cross-border context. The Commission requests that commenters provide data and sources of data to support any comments. In addition, the Commission requests commenters' views on the following:

- Has the Commission appropriately considered the costs and benefits associated with adopting the definition of U.S. person found in Regulation S? If not, please explain why and provide information on how such costs and benefits should be assessed.
- Has the Commission appropriately considered the costs and benefits associated with adopting the same definition of U.S. person as proposed by the CFTC? If not, please explain why and provide information on how such costs and benefits should be assessed.

- Has the Commission appropriately considered the costs and benefits associated with adopting a rule to permit foreign branches of U.S. banks to exclude transactions conducted through a foreign branch from their *de minimis* calculations? If not, please explain why and provide information on how such costs and benefits should be assessed.

- Has the Commission appropriately considered the costs and benefits associated with not requiring a non-U.S. person to count its transactions conducted within the United States with non-U.S. persons towards its *de minimis* threshold? If not, please explain why and provide information on how such costs and benefits should be assessed.

- Has the Commission appropriately considered the costs and benefits associated with requiring a non-U.S. person whose performance under security-based swaps is guaranteed by a U.S. person to count all transactions connected to its security-based swap dealing activity toward its *de minimis* threshold, even though such non-U.S. person only conducts dealing activity with non-U.S. persons outside the United States? If not, please explain why and provide information on how such costs and benefits should be assessed.

- Has the Commission appropriately considered the costs and benefits associated with the proposed rule regarding aggregation of security-based swap transactions entered into in a dealing capacity by a person and its affiliates under common control and requiring that such aggregated notional amount be included in such person's *de minimis* calculation? If not, please explain why and provide information on how such costs and benefits should be assessed. Should the Commission require operational independence, from the cost and benefit point of view, as a condition to excluding transactions of an affiliate that is a registered security-based swap dealer from a person's *de minimis* calculation?

- Has the Commission appropriately considered the costs and benefits associated with excluding foreign government-related entities, such as sovereign wealth funds and multilateral development institutions, from the definition of major security-based swap participant? If not, please explain why and provide information on how such costs and benefits should be assessed.

- Should the Commission take into account the potential impact of the Push-Out Rule and the Volcker Rule in considering the approach to application of the Title VII requirements to foreign branches of the U.S. banks? For

example, what would the costs and benefits be with respect to requiring foreign branches of U.S. banks to include transaction conducted through a foreign branch in its *de minimis* calculation, or requiring a non-U.S. person to include its transactions with foreign branches in its major security-based swap participant calculation, after taking into account the effects of the Push-Out Rule and the Volcker Rule on U.S. banks? Please explain how such costs and benefits should be assessed.

#### E. Economic Analysis of the Proposed Application of the Entity-Level and Transaction-Level Requirements to Security-Based Swap Dealers and Major Security-Based Swap Participants

As stated above, persons who fall within the statutory definitions of security-based swap dealer and major security-based swap participant, as further defined by the rules adopted in the Intermediary Definition Adopting Release, will be required to register with the Commission and comply with a host of ensuing substantive requirements.<sup>1484</sup> These requirements include entity-level requirements<sup>1485</sup> and transaction-level requirements<sup>1486</sup> set forth in Sections 15F and 3E of the Exchange Act and rules and regulations thereunder.<sup>1487</sup>

##### 1. Entity-Level Requirements

Section 764(a) of the Dodd Frank Act adds a new Section 15F(e) to the Exchange Act, which imposes capital and margin requirements on security-based swap dealers and major security-based swap participants.<sup>1488</sup> These requirements are designed to reduce the probability of these institutions' failure, mitigate the consequences of these institutions failures, protect customer assets, and contribute to the stability of the security-based swap market in particular and the U.S. financial system more generally.<sup>1489</sup> The benefits of the capital and margin requirements for security-based swap dealers are expected to include enhancing protection of customer assets and mitigation of the consequences of a firm failure, while allowing security-based swap dealers appropriate flexibility in how they conduct their security-based swaps business.<sup>1490</sup> Similarly, the

<sup>1484</sup> See Section XV.D.1, *supra*.

<sup>1485</sup> See Section III.C.3(a), *supra*.

<sup>1486</sup> See Section III.C.3(b), *supra*.

<sup>1487</sup> See Section 15F of the Exchange Act, 15 U.S.C. 78o-8, and Section 3E of the Exchange Act, 15 U.S.C. 78c-4.

<sup>1488</sup> See Section 15F(e) of the Exchange Act, 15 U.S.C. 78o-10(e).

<sup>1489</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70218 and 70303.

<sup>1490</sup> See *id.* at 70218.

<sup>1482</sup> See note 382, *supra*.

<sup>1483</sup> See Section IV.C.3, *supra*.

benefits of the capital and margin requirements for major security-based swap participants are expected to include neutralization of the credit risk between a major security-based swap participant and a counterparty, which would lessen the impact on the counterparty if the major security-based swap participant failed.<sup>1491</sup> We believe the capital and margin requirements strengthen the financial system by reducing the potential for defaults by entities engaging in security-based swap activity and mitigating the impact of such defaults, including the adverse spillover or contagion effect of a default by security-based swap dealers and major security-based swap participants.<sup>1492</sup>

In addition, registered security-based swap dealers and major security-based swap participants are required to establish robust risk management systems adequate for managing their day-to-day business,<sup>1493</sup> keep books and records and maintain daily trading records of the security-based swaps they enter into,<sup>1494</sup> establish internal systems and controls,<sup>1495</sup> diligently supervise the security-based swap business,<sup>1496</sup> designate a chief compliance officer,<sup>1497</sup> and keep books and records open to inspection and examination by the Commission.<sup>1498</sup>

The programmatic costs and benefits associated with the entity-level

requirements applicable to security-based dealers and major security-based swap participants under Title VII are (or will be) addressed in more detail in connection with the applicable rulemakings implementing Title VII.<sup>1499</sup>

With respect to the application of the entity-level requirements in the cross-border context, as stated above, the Commission preliminarily believes that it would be consistent with the objective of Title VII to ensure the safety and soundness of registered security-based swap dealers<sup>1500</sup> to require foreign security-based swap dealers to comply with the entity-level requirements.<sup>1501</sup> Similarly, the Commission preliminarily does not believe that foreign major security-based swap participants should be excluded from the application of any entity-level requirements.<sup>1502</sup> However, the Commission recognizes the concerns raised by commenters regarding the possibility that foreign security-based swap dealers may be subject to conflicting or duplicative regulatory requirements and proposes to mitigate the costs associated with the potential duplicative compliance obligations through the Commission's proposed approach to substituted compliance.<sup>1503</sup> We have considered the effect of the proposed rules regarding substituted compliance on its effect on efficiency, competition and capital formation above<sup>1504</sup> and will discuss the economic considerations of the proposed rules regarding substituted compliance more fully below.<sup>1505</sup>

#### Alternative

The CFTC proposed to treat Title VII margin requirements with respect to non-cleared swaps as transaction-level requirements and would not apply the margin requirements to foreign non-bank swap dealers (including foreign affiliates of U.S. persons regardless of whether such foreign affiliates' performance obligations under swaps are guaranteed by U.S. persons) when they transact swaps with non-U.S. person counterparties whose

performance obligations under the swaps are not guaranteed by U.S. persons.<sup>1506</sup> The prudential regulators' margin proposal does not apply Title VII margin requirements to a foreign covered swap entity<sup>1507</sup> with respect to foreign non-cleared swaps or foreign non-cleared security-based swaps.<sup>1508</sup> In practice, the Commission's proposed treatment of the margin requirements as an entity-level requirement differs from the CFTC's and the Prudential regulators' proposals in that non-bank foreign security-based swap dealers (regardless of whether their performance of obligations under security-based swaps are guaranteed by U.S. persons) would be subject to the margin requirements with respect to their transactions with non-U.S. person counterparties whose performance obligations under the security-based swaps are not guaranteed by U.S. persons.

The Commission could have taken the CFTC's approach to treat margin requirements as transaction-level requirements by proposing not to apply margin to non-bank foreign security-based swap dealers with respect to their transactions with non-U.S. person counterparties whose performance obligations under the security-based swaps are not guaranteed by U.S. persons. We also could have taken the prudential regulators' approach by proposing not to apply margin to foreign non-bank security-based swap dealers

<sup>1506</sup> See CFTC Cross-Border Proposal, 77 FR 41226, 41228, and 41237.

<sup>1507</sup> A "foreign covered swap entity" is defined as any entity prudentially regulated by the prudential regulators and required to register as a swap dealer, major swap participant, security-based swap dealer or major security-based swap participant under section 4s of the Commodity Exchange Act or section 15F of the Exchange Act that (i) is not a company organized under the laws of the United States or any State; (ii) is not a branch or office of a company organized under the laws of the United States or any State; (iii) is not a U.S. branch, agency or subsidiary of a foreign bank; and (iv) is not controlled, directly or indirectly, by a company that is organized under the laws of the United States or any State. See Prudential Regulator Margin and Capital Proposal, 76 FR 27581.

<sup>1508</sup> A "foreign non-cleared swap or foreign non-cleared security-based swap" is defined as a non-cleared swap or non-cleared security-based swap with respect to which: (i) The counterparty to the foreign covered swap entity is not a company organized under the laws of the United States or any State, not a branch or office of a company organized under the laws of the United States or any State, and not a person resident in the United States; and (ii) performance of the counterparty's obligations to the foreign covered swap entity under the swap or security-based swap has not been guaranteed by an affiliate of the counterparty that is a company organized under the laws of the United States or any State, a branch of a company organized under the laws of the United States or any State, or a person resident in the United States. See Prudential Regulator Margin and Capital Proposal, 76 FR 27581.

<sup>1491</sup> *Id.*

<sup>1492</sup> These spillover effects could create instability for the financial markets more generally, such as by limiting the willingness of market participants to extend credit to each other, and thus substantially reduce liquidity and valuations for particular types of financial instruments. See, e.g., Markus K. Brunnermeier and Lasse Heje Pedersen, "Market Liquidity and Funding Liquidity," *Review of Financial Studies* (2009); Denis Gromb and Dimitri Vayanos, "A Model of Financial Market Liquidity," *Journal of the European Economic Association* (2010).

<sup>1493</sup> See Section 15F(j)(2) of the Exchange Act, 15 U.S.C. 78o-10(j)(2); see also Section III.C.3(b)(3), *supra*.

<sup>1494</sup> See Sections 15F(f) and (g) of the Exchange Act, 15 U.S.C. 78o-10(f) and (g); see also Section III.C.3(b)(4), *supra*.

<sup>1495</sup> See Sections 15F(j)(3) and (4) of the Exchange Act, 15 U.S.C. 78o-10(j)(3) and (4); Section III.C.3(b)(5), *supra*. See also proposed Rule 15Fh-3(i)(2)(iv) under the Exchange Act.

<sup>1496</sup> See Section 15F(h)(1)(B) of the Exchange Act, 15 U.S.C. 78o-10(h)(1)(B). The Commission has proposed a rule that would establish supervisory obligations that incorporates principles from Section 15(b) of the Exchange Act and existing SRO rules. Proposed Rule 15Fh-3(i) under the Exchange Act, as discussed in the External Business Conduct Standards Proposing Release, 76 FR 42419-21. See also Section III.C.3(b)(6), *supra*.

<sup>1497</sup> See Section 15F(k) of the Exchange Act, 15 U.S.C. 78o-10(k); see also Section III.C.3(b)(7), *supra*.

<sup>1498</sup> See Section 15F(l)(C) of the Exchange Act, 15 U.S.C. 78o-10(l)(C); see also Section III.C.3(b)(8), *supra*.

<sup>1499</sup> See, e.g., Capital, Margin, and Segregation Proposing Release, 77 FR 70214.

<sup>1500</sup> See Section 15F(e)(3)(A) of the Exchange Act, 15 U.S.C. 78o-8(e)(3)(A) ("To offset the greater risk to the security-based swap dealer . . . and the financial system arising from the use of security-based swaps that are not cleared, the requirements imposed under paragraph (2) shall—(i) help ensure the safety and soundness of the security-based swap dealer . . .").

<sup>1501</sup> See Section III.C.5, *supra*.

<sup>1502</sup> *Id.*

<sup>1503</sup> See Section XI, *supra* (discussing the Commission's overall proposed approach to substituted compliance in the context of Title VII).

<sup>1504</sup> See Section XV.C, *supra*.

<sup>1505</sup> See Section XV.I, *infra*.

that are not controlled by a U.S. person with respect to their transactions with non-U.S. person counterparties whose performance obligations under the security-based swaps are not guaranteed by U.S. persons. Either approach would not treat margin as an entity-wide requirement.

The Dodd-Frank Act seeks to address the counterparty credit risk exposures arising from OTC derivatives by, among other things, imposing mandatory clearing and margin requirements for non-cleared security-based swaps.<sup>1509</sup> The margin requirements established by the Commission with respect to non-cleared security-based swaps will operate in tandem with mandatory clearing provisions in the Dodd-Frank Act.<sup>1510</sup> Registered clearing agencies that operate as CCPs manage credit and other risks through a range of controls and methods, including prescribed margin rules for their participants.<sup>1511</sup> Thus, the mandatory clearing requirements in effect will establish margin requirements for cleared security-based swaps and, thereby, complement the margin requirements for non-cleared security-based swaps established by the Commission and the prudential regulators.<sup>1512</sup>

In addition, margin requirements, along with the capital standards and segregation requirements, are an integral part of the proposed financial responsibility requirements for security-based swap dealers that are intended to enhance the financial integrity of these entities.<sup>1513</sup> The margin requirements proposed by the Commission are intended to work in tandem with the capital requirements to strengthen the financial system by reducing the potential for default to an acceptable

level and limiting the amount of leverage that can be employed by security-based swap dealers and other market participants.<sup>1514</sup> For example, with respect to cleared security-based swaps, for which margin requirements will not be established by the Commission, the Commission proposed a capital charge that would apply if a nonbank security-based swap dealer collects margin collateral from a counterparty in an amount that is less than the deduction that would apply to the security-based swap if it was a proprietary position of the non-bank security-based swap dealer.<sup>1515</sup> In addition, the Commission proposed capital charges to address exceptions from the margin collection requirements with respect to non-cleared security-based swaps, as an alternative to margin collateral by requiring a non-bank security-based swap dealer to hold sufficient net capital to enable it to withstand losses if a counterparty defaults.<sup>1516</sup>

In the context of the statutory framework and the Commission's proposed financial responsibility program for non-bank security-based swap dealers, if the Commission were to treat margin as a transaction-level requirement and apply margin to certain non-cleared transactions but not others, any credit risk of such other transactions that are not collateralized by mutually agreed contractual arrangement between a security-based swap dealer and its counterparty would need to be addressed by imposing capital charges, which would increase the amount of net capital a non-bank security-based swap dealer is required to set aside. While the increased liquid capital would provide an additional buffer for a non-bank security-based swap dealer to withstand losses resulting from a default of its counterparties, it also would increase business costs. Depending on the size of a foreign security-based swap dealers' foreign business that is not collateralized, the size of the increased amount of the capital charge may be very large. As discussed in the Capital, Margin, and Segregation Proposing Release, if security-based swap dealers are required to maintain an excessive amount of capital, that amount may result in certain costs for the markets and the financial system, including the potential for the reduced availability of security-based swaps for market participants who would otherwise use such transactions to hedge the risks of

their business, or engage in other activities that would promote capital formation.<sup>1517</sup> End users also may incur increased transaction costs in connection with the increased capital charges as security-based swap dealers are likely to pass on the financial burden of any increased capital requirements to customers.<sup>1518</sup> If the transaction costs are too high, end users may seek other cheaper alternatives, such as cleared security-based swaps or voluntary collateral posting to reduce transaction pricing, or they may decide not to transact security-based swaps at all.

In the cross-border context, the Commission is proposing not to apply the mandatory clearing requirement to transactions between a foreign security-based swap dealer and non-U.S. person counterparties whose performance obligations under security-based swaps are not guaranteed by U.S. persons. Therefore, a foreign security-based swap dealer's exposure to counterparty credit risk arising from its transactions with these non-U.S. person counterparties would not be addressed by the Title VII mandatory clearing requirement. If margin requirements do not apply to these transactions, the counterparty credit risk arising from such transactions may be left uncollateralized. In the event that non-U.S. counterparties experience financial difficulties, and the foreign security-based swap dealer's uncollateralized exposures to such counterparties have grown exponentially due to severe market movement, the uncollateralized foreign credit exposures may jeopardize the safety and soundness of the foreign security-based swap dealer, whose failure would have negative impact on the U.S. security-based swap market and present risk to the U.S. financial system. Such uncollateralized credit risk could be addressed by imposing capital charges under the Commission's proposed capital rule, but taking this approach would result in increased costs and higher barrier for new foreign entrants into the U.S. security-based swap market. To mitigate the cost of increased capital charges, a foreign security-based swap dealer may choose to enter into credit support arrangements and request some or all counterparties to post collateral. This would be particularly the case when a foreign security-based swap dealer is transacting in a foreign market where collateral posting is a common market practice to manage counterparty credit risk or in a foreign jurisdiction that

<sup>1509</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70258; see also Section 3C(a)(1) and Section 15F(e)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1) and 78o-10(e)(1).

<sup>1510</sup> See Section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1) (requiring that security-based swaps must be cleared through a registered clearing agency unless an exception to mandatory clearing exists).

<sup>1511</sup> See Clearing Agency Standards Adopting Release, 77 FR 66230-32.

<sup>1512</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70259; see also Prudential Regulator Margin and Capital Proposal, 76 FR 27567 ("In the derivatives clearing process, central counterparties (CCPs) manage the credit risk through a range of controls and methods, including a margining regime that imposes both initial margin and variation margin requirements on parties to cleared transactions. Thus, the mandatory clearing requirement established by the Dodd-Frank Act for swaps and security-based swaps will effectively require any party to any transaction subject to the clearing mandate to post initial and variation margin to the CCP in connection with that transaction.").

<sup>1513</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70303 and 70259.

<sup>1514</sup> See *id.* at 70304.

<sup>1515</sup> See *id.* at 70245-46.

<sup>1516</sup> See *id.* at 70246.

<sup>1517</sup> See *id.* at 70306.

<sup>1518</sup> *Id.*

imposes margin requirements because the foreign security-based swap dealer would encounter less resistance to posting margin from foreign counterparties. To the extent that the costs of capital charges drive foreign security-based swap dealers to voluntarily collateralize their exposures to counterparty credit risks, the differences in the economic consequences between treating margin as an entity-level requirement as opposed to a transaction-level requirement would narrow.

By contrast, under the proposed approach, the counterparty credit exposures arising from a foreign non-bank security-based swap dealers transactions with non-U.S. persons whose performance of obligations under non-cleared security-based swaps are not guaranteed by U.S. persons would be collateralized but the collateral would not be segregated.<sup>1519</sup> The collateral received would protect the foreign security-based swap dealer against the default risk of the foreign counterparty and reduce the probability of the failure of the foreign security-based swap dealer and the spillover and contagion risk of a foreign counterparty's default that may impact the U.S. financial system. In addition, such collateral could finance the business needs of the foreign security-based swap dealer and increase its liquidity. The Commission preliminarily believes that the proposed treatment of margin as an entity-level requirement would generate the benefit of offsetting the greater risk to the foreign security-based swap dealer and the U.S. financial system arising from the use of non-cleared security-based swaps and help ensure the safety and soundness of the security-based swap dealers<sup>1520</sup> without imposing excessive capital charges at the same time, which may raise the barrier for foreign dealers to enter the U.S. security-based swap market. The proposed treatment of margin also may increase funds available to finance a foreign security-based swap dealer's business activity, which would decrease the borrowing needs and lower the costs of business.

Commenters raised concerns about the potential costs and burdens of

<sup>1519</sup> A foreign security-based swap dealer that is not a registered broker-dealer would not be required to segregate assets held as collateral received from a non-U.S. person counterparty with respect to non-cleared security-based swap transactions. A foreign security-based swap dealer that is a registered broker-dealer would be required to segregate margin collateral received from all counterparties. See proposed Rule 18a-4(e)(1) under the Exchange Act and discussion in Section III.C.4(b).ii, *supra*.

<sup>1520</sup> See Section 15F(e)(3)(A) of the Exchange Act, 15 U.S.C. 78o-10(e)(3)(A).

applying duplicative margin collection requirements to foreign transactions.<sup>1521</sup> The Commission preliminarily believes that the costs of complying with duplicative margin requirements can be addressed by the proposed substituted compliance framework. As stated in our cost and benefit analysis with respect to substituted compliance below, the Commission preliminarily believes that substituted compliance would not substantially change the programmatic benefits intended by the entity-level requirements in Section 15F of the Exchange Act, including margin requirements; however, to the extent that substituted compliance eliminates duplicative compliance costs, registered foreign security-based swap dealers that are eligible for a substituted compliance determination may incur lower programmatic costs associated with implementation or compliance with the specified Title VII requirements (including margin requirements).<sup>1522</sup>

#### Request for Comment

The Commission requests comments on all aspects of the economic analysis of the alternatives to the proposed definition of U.S. person, the proposed application of the *de minimis* exception and the proposed application of the major security-based swap participant definition in the cross-border context. The Commission requests that commenters provide data and sources of data to support any comments. In addition, the Commission requests commenters' views on particular issues below. Responses that are supported by empirical data and analysis provide great assistance to the Commission in considering the economic consequences of the proposed treatment of certain requirements as entity-level and other requirements as transaction-level requirements.

- Has the Commission appropriately considered the costs and benefits associated with an approach that would treat all the requirements set forth in Section 15F of the Exchange Act, and rules and regulations thereunder, as entity-level requirements and apply them on an entity-wide basis, except for the external business conduct standards and segregation requirements? Has the Commission appropriately estimated the costs and benefits associated with requiring a foreign security-based swap dealer to conform its capital and risk management practices to the rules

<sup>1521</sup> See Cleary Letter IV at 18 ("If non-U.S. margin requirements are essentially the same, or are merely different, but not significantly different, it is not obvious how the Agencies could justify their proposal or *ex ante* cost-benefit analysis.")

<sup>1522</sup> See Section XV.I, *infra*.

proposed by the Commission? If not, please explain why and provide information on how such costs and benefits should be assessed.

- Are there any requirements that are treated as entity-level in the Commission's cross-border proposal that should be treated as transaction-level requirements from the cost and benefit point of view? If so, please explain how such treatment would affect the costs and benefits of the proposed approach.

- Has the Commission appropriately considered the costs and benefits associated with treating margin as an entity-level requirement, taking into account the interplay between the minimum capital requirement and margin requirement? If not, please explain why and provide information on how such costs and benefits should be assessed. What would be the economic impact of treating margin as an entity-level requirement? Should the Commission adopt the CFTC's approach by treating margin as a transaction-level requirement, given the costs and benefits of this alternative? Should the Commission adopt the prudential regulators' approach to exclude certain foreign security-based swaps from application of the margin requirement, given the costs and benefits of this alternative?

#### 2. Transaction-Level Requirements

With respect to the application of these transaction-level requirements to security-based swap dealers active in the cross-border context, the Commission proposes Rule 3a71-3(c) under the Exchange Act regarding application of customer protection requirements to security-based swap dealers,<sup>1523</sup> Rule 18a-4(e) regarding application of segregation requirements to foreign security-based swap dealers,<sup>1524</sup> Rule 3a67-10(b) regarding application of customer protection requirements to foreign major security-based swap participants,<sup>1525</sup> and Rule 18a-4(f) regarding application of segregation requirements to foreign major security-based swap participants.<sup>1526</sup> In the following sections, we discuss the economic considerations of these proposed rules regarding application of transaction-

<sup>1523</sup> See proposed Rule 3a71-3(c) under the Exchange Act, as discussed in Section III.C.4(b).i, *supra*.

<sup>1524</sup> See proposed Rule 18a-4(e) under the Exchange Act, as discussed in Section III.C.4(b).ii, *supra*.

<sup>1525</sup> See proposed Rule 3a67-10(b) under the Exchange Act, as discussed in Section IV.D.1(b), *supra*.

<sup>1526</sup> *Id.*

level requirements to security-based swap dealers or major security-based swap participants in the cross-border context.

(a) Proposed Rule 3a71-3(c)—  
Application of Customer Protection  
Requirements

Title VII imposes certain external business conduct requirements on registered security-based swap dealers that govern their interactions with counterparties to security-based swap transactions.<sup>1527</sup> These provisions are intended to protect the counterparties of registered dealers in such transactions by ensuring that security-based swap dealers, among other things, provide adequate disclosures to their counterparties about the risks of the transaction.<sup>1528</sup>

Proposed Rule 3a71-3(c) provides that registered security-based swap dealers, with respect to their Foreign Business, shall not be subject to the requirements relating to business conduct standards described in Section 15F(h) of the Exchange Act, and the rules and regulations thereunder, other than Section 15F(h)(1)(B) of the Exchange Act, and the rules and regulations thereunder. We are proposing to define “Foreign Business” as security-based swap transactions entered into, or offered to be entered into, by or on behalf of a foreign security-based swap dealer or a U.S. security-based swap dealer in a dealing capacity that are not its “U.S. Business.”<sup>1529</sup>

“U.S. Business” would be defined separately for foreign security-based swap dealers and U.S. security-based swap dealers. With respect to a foreign security-based swap dealer, “U.S. Business” would include any transaction entered into, or offered to be entered into, by or on behalf of such foreign security-based swap dealer, with a U.S. person (other than a foreign branch), or any transaction conducted within the United States.<sup>1530</sup> With respect to a U.S. security-based swap dealer, “U.S. Business” would include any transaction by or on behalf of the U.S. security-based swap dealer, wherever entered into or offered to be entered into, other than a transaction conducted through a foreign branch with a non-U.S. person or another

foreign branch.<sup>1531</sup> With the exception of the exclusion of transactions conducted through a foreign branch from the definition of a U.S. security-based swap dealer’s U.S. Business, these definitions closely track the application of the *de minimis* exception to the transactions of U.S. persons and non-U.S. persons under proposed Rule 3a71-3(b) under the Exchange Act. Moreover, whether a transaction occurs within the United States or with a U.S. person, which are key elements of the Foreign Business and U.S. Business definitions, would turn on the same factors that are used to determine whether the *de minimis* exception applies to the security-based swap activity of a non-U.S. person engaged in dealing activity.<sup>1532</sup>

In the External Business Conduct Standards Proposing Release, we have considered the expected benefits and costs of the proposed rules regarding external business conduct standards as they apply to dealers generally, and we expect to discuss the benefits and costs associated with the final rules in our adopting release. In the proposing release, we noted that these rules may be expected to benefit security-based swap dealers and other market participants in a number of ways. For example, the requirement for security-based swap dealers to provide a daily mark should enable counterparties to have a clearer picture of their relationship with security-based swap dealers, including by providing a meaningful reference point for calculating variation margin.<sup>1533</sup> Similarly, our proposed rules regarding security-based swap dealers’ obligations to know their counterparties may be expected to help ensure that security-based swap dealers recommend only transactions that are appropriate to the needs and resources of their counterparties.<sup>1534</sup> Proposed rules regarding the standards of conduct in transactions involving special entities should likewise help ensure that such business is awarded on the merits of the transaction.<sup>1535</sup>

We also noted that the proposed external business conduct rules would

be likely to impose certain costs on security-based swap dealers and other market participants. For example, they would require security-based swap dealers to make various disclosures and establish systems for monitoring compliance with these requirements.<sup>1536</sup>

Because this proposing release does not change the substantive external business conduct requirements but only potentially reduces the number of registered security-based swap dealers and the number of transactions involving registered security-based swap dealers that would be subject to the external business conduct requirements, our discussion below focuses on how proposed Rule 3a71-3(c) affects the scope of application of these rules. This change in scope will directly affect the resulting programmatic benefits and costs. We also discuss the assessment costs associated with distinguishing Foreign Business from U.S. Business.

i. Programmatic Benefits and Costs

Our proposed rules may affect the programmatic costs and benefits associated with requirements regarding external business conduct standards in two ways. First, we are proposing rules regarding application of the *de minimis* exception in the cross-border context that may be expected to reduce the number of non-U.S. persons that would otherwise be required to register as security-based swap dealers.<sup>1537</sup> Because the business conduct and conflict-of-interest rules apply only to registered dealers, reducing the number of registered dealers would reduce the number of entities required to comply with these dealer-specific rules. Second, we are proposing not to require foreign or U.S. security-based swap dealers to comply with requirements relating to external business conduct standards with respect to their Foreign Business, which would reduce the proportion of registered dealers’ transactions that are required to comply with these rules. We preliminarily believe that these proposed rules will not significantly affect the programmatic benefits of the rules but should reduce programmatic costs that they impose on market participants.

As already noted, Title VII is concerned directly with risk to the U.S. financial system, transparency, and the protection of investors,<sup>1538</sup> and we preliminarily believe that our proposed

<sup>1527</sup> See Sections 15F(h) and 15F(j)(5) of the Exchange Act.

<sup>1528</sup> See Section III.C.3(a)i, *supra*.

<sup>1529</sup> Proposed Rule 3a71-3(a)(2) under the Exchange Act, as discussed in Section III.C.4.(a), *supra*.

<sup>1530</sup> Proposed Rule 3a71-3(a)(6)(i) under the Exchange Act, as discussed in Section III.C.4.(a), *supra*.

<sup>1531</sup> Proposed Rule 3a71-3(a)(6)(ii) under the Exchange Act, as discussed in Section III.C.4.(a), *supra*.

<sup>1532</sup> See proposed Rule 3a71-3(b)(1)(i) under the Exchange Act (identifying transactions that U.S. persons and non-U.S. persons must include in their *de minimis* calculations); proposed Rule 3a71-3(a)(2) under the Exchange Act (defining “Foreign Business”); proposed Rule 3a71-3(a)(6) under the Exchange Act (defining “U.S. Business”).

<sup>1533</sup> External Business Conduct Standards Proposing Release, 76 FR 42449.

<sup>1534</sup> See *id.* at 42450.

<sup>1535</sup> See *id.* at 42450.

<sup>1536</sup> See *id.* at 42443–448.

<sup>1537</sup> See proposed Rule 3a71-3(b) under the Exchange Act, as discussed in Section III.B.3, *supra*.

<sup>1538</sup> See note 4, *supra*.

approach to applying requirements related to external business conduct standards is consistent with these goals. As noted above in our discussion of the programmatic costs and benefits associated with our application of the *de minimis* exception in the cross-border context, we believe that our proposed approach to the *de minimis* calculation appropriately identifies those entities whose dealing activity poses the type of stability, transparency, and counterparty-protection concerns that Title VII is intended to address.<sup>1539</sup> To the extent that the number of entities required to comply with these requirements relating to external business conduct standards decline because the number of registered foreign security-based swap dealers declines, we do not believe that there will be a significant change in programmatic benefits, as foreign security-based swap dealers whose transactions with U.S. persons and transaction conducted within the United States falls below the *de minimis* threshold raise concerns no different from those posed by U.S. security-based swap dealers whose security-based swap activity falls below the threshold. We see no reason, therefore, for treating these two types of entities differently.

We also preliminarily believe that our proposal not to require compliance with these requirements with respect to Foreign Business, even if a security-based swap dealer is registered, will have an insignificant effect, if any, on programmatic benefits and should reduce programmatic costs. We recognize that our proposed rule would not require foreign and U.S. security-based swap dealers to comply with these rules with respect to a significant proportion of their transactions. However, because Title VII is directed to the promoting the stability of the U.S. financial system and protecting counterparties, we do not believe that this proposed approach would reduce the programmatic benefits of our regulatory framework, given that such transactions, including any customer-facing activity, occur entirely or in significant part outside the United States where the parties typically do not expect U.S. customer-protection requirements to apply. At the same time, our definition of U.S. Business should ensure that registered dealers are required to comply with these requirements in their transactions with those counterparties that are entitled to protection in light of the purposes of Title VII or that reasonably expect to be

protected in their dealings with registered security-based swap dealers.

We preliminarily believe that our proposed approach will reduce programmatic costs for registered security-based swap dealers generally in proportion to their relative volume of Foreign Business, although certain of the costs associated with policies and procedures established to comply with these requirements are likely to remain fairly constant to the extent that a security-based swap dealer has any U.S. Business. Permitting security-based swap dealers to enter into transactions arising out of their Foreign Business without complying with these requirements should reduce the costs of compliance with Title VII for such registered security-based swap dealers and reduce the competitive effects of the Title VII dealer requirements by reducing unnecessary disparities between registered and unregistered security-based swap dealers in their foreign business.

#### ii. Assessment Costs

The assessment costs associated with the proposed rules regarding these requirements would primarily flow from the determination of whether a given transaction is part of a registered security-based swap dealer's U.S. Business or its Foreign Business. Both for U.S. and foreign security-based swap dealers, "U.S. Business" is defined to capture largely the same transactions that these entities are required to calculate in determining whether they are required to register as security-based swap dealers.<sup>1540</sup> Because of this overlap with the information needed to perform the *de minimis* calculation, the incremental costs of these determinations for registered security-based swap dealers should be minimal. We preliminarily believe that a registered foreign security-based swap dealer would not incur additional assessment costs above those already incurred in establishing and maintaining a system to identify and monitor the status of its counterparties and transactions for purposes of the *de minimis* calculation, as described above.<sup>1541</sup>

U.S. security-based swap dealers would likely not have incurred these types of systems costs in performing the *de minimis* calculation because our proposed approach would require U.S.

persons to count all of their dealing transactions toward their *de minimis* threshold. However, U.S. security-based swap dealers who conduct some or all of their security-based swap business through foreign branches and seek to rely on the Foreign Business exception to the external business conduct requirement would likely establish a similar system to identify such transactions. We believe that the costs of such a system would closely track the costs associated with the systems that non-U.S. persons are likely to establish to perform the dealer *de minimis* calculation and to determine whether a foreign security-based swap dealer must comply with Title VII external business conduct requirements, as described above, as U.S. security-based swap dealers conducting business through a foreign branch will also need to classify their counterparties and transactions in order to determine whether external business conduct requirements apply.<sup>1542</sup> Based on a review of DTCC-TIW data relating to single-name credit default swap activity in 2011, there were no more than five U.S. security-based swap dealers that conducted dealing activity through foreign branches. Assuming that all such entities elected to establish a system to identify their Foreign Business, the total assessment costs associated with our proposed rule would be approximately \$85,200 in one-time annual programming costs and \$76,435 in ongoing annual costs.<sup>1543</sup>

#### iii. Alternatives

The Commission's proposed approach to the application of the requirements relating to external business conduct standards is similar to the CFTC's proposed approach in certain aspects but differs from the CFTC's proposed approach in other aspects. With respect to U.S. security-based swap dealers, both the Commission's and the CFTC's proposed approaches would not apply the requirements relating to external business conduct standards to such U.S. security-based swap dealers' transactions conducted through a foreign branch outside the United States with non-U.S. person counterparties.<sup>1544</sup> On the other hand,

<sup>1542</sup> See Section XV.D.2(a), *supra*.

<sup>1543</sup> As noted above in connection with the calculation of the *de minimis* threshold by foreign security-based swap dealers, we estimate the per-entity one-time annual programming costs to total approximately \$17,040 and the per-entity ongoing annual costs to total \$15,287. See note 1425, *supra*.

<sup>1544</sup> See CFTC Cross-Border Proposal, 77 FR 41230 and the text accompanying note 116. However, the CFTC's cross-border proposal did not address whether external business conduct

<sup>1539</sup> See Section III.B.4, *supra*.

<sup>1541</sup> See Section XV.D.2, *supra*.



with respect to foreign security-based swap dealers, the Commission's proposed approach would apply the requirements relating to external business conduct standards to such foreign security-based swap dealers' transactions conducted within the United States with all counterparties and transactions conducted outside the United States with foreign branches while the CFTC's proposed approach would not apply external business conduct standards to non-U.S. swap dealers' swap transactions with non-U.S. person counterparties even though such transactions are conducted within the United States.<sup>1545</sup>

The Commission could have proposed an approach to the application of the external business conduct standards that is the same as the CFTC's but instead, is proposing a territorial approach with a focus on counterparty protection in the United States. The Commission preliminarily believes that imposing external business conduct standards on U.S. security-based swap dealers with respect to their transactions conducted outside the United States through foreign branches would cause U.S. security-based swap dealers to incur compliance costs with respect to their foreign business<sup>1546</sup> conducted through foreign branches, which would not be incurred by foreign security-based swap dealers when foreign security-based swap dealers conduct security-based swap transactions outside the United States in foreign markets.

The Commission recognizes that non-bank U.S. security-based swap dealers who do not conduct transactions through foreign branches would be subject to the external business conduct standards with respect to all transactions, including transactions with non-U.S. persons. The Commission preliminarily believes that, unlike U.S. security-based swap dealers who are banks and conduct foreign business through their foreign branches, a non-bank U.S. security-based swap dealer may conduct dealing activity with non-U.S. persons directly from its U.S. location or from its foreign offices that may not have separate operations that are subject to substantive local financial regulation and may not operate for valid business reasons. Therefore, transactions conducted by a non-bank

standards would apply to transactions conducted through a foreign branch or agency of a U.S. security-based swap dealer within the United States where the counterparty is a non-U.S. person.

<sup>1545</sup> See CFTC Cross-Border Proposal, 77 FR 41229 and 41237.

<sup>1546</sup> See proposed Rule 3a71-3(a)(2) and the discussion in Section III.C.4(a), *supra*.

U.S. security-based swap dealer with non-U.S. persons are an inseparable part of such non-bank dealer's security-based swap business. Consistent with our traditional entity approach to the regulation of broker-dealers, the Commission preliminarily believes that it is appropriate to apply the external business conduct standards to a non-bank U.S. security-based swap dealer with respect to all transactions. To the extent that non-bank U.S. security-based swap dealers conduct dealing activity with non-U.S. persons through foreign affiliates, the proposed approach to application of the external business conduct standards would not impose burdens on non-bank U.S. security-based swap dealers' activity in the foreign security-based swap markets and would achieve the benefits of protecting investors from abusive financial services practices in the United States. The Commission requests comments on the costs and benefits associated with the proposed application of external business conduct standards to U.S. security-based swap dealers and whether the proposed approach would burden bank and non-bank U.S. security-based swap dealers' foreign dealing business.

With respect to foreign security-based swap dealers, the Commission proposes to apply the external business conduct standards to their transactions with non-U.S. persons if such transactions are conducted within the United States. As stated above, the proposed approach to application of the external business conduct standards to transactions conducted within the United States would generate the benefit of protecting investors from abusive financial services practices. To permit registered foreign security-based swap dealers not to comply with the external business conduct standards when they conduct transactions in the United States with non-U.S. person may not adequately prevent abusive financial services practices in the U.S. security-based swap market and would permit double standards in security-based swap dealings in the United States. Therefore, the Commission preliminarily believes that the proposed territorial approach with a focus on counterparty protection in the United States is appropriate.

#### Request for Comment

- The Commission requests data to assess the costs and benefits of the proposed rule regarding application of external business conduct standards described above. Specifically, the Commission requests comment on (1) whether the proposed rule not to require a registered U.S. bank security-based

swap dealer and foreign security-based swap dealer to comply with the external business conduct standards with respect to its foreign business would compromise counterparty protection from abusive financial services practices in the United States; (2) whether the proposed rule to require a registered non-bank U.S. security-based swap dealer to comply with the external business conduct standards with respect to all transactions regardless of whether the counterparties are U.S. persons or non-U.S. persons would affect its foreign dealing business; and (3) the Commission's estimate of the assessment costs with respect to the proposed rule. Commenters should provide an assessment of these costs and benefits, as well as any costs and benefits not already defined, that may result from the adoption of the proposed rule. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposals.

#### (b) Proposed Rule 18a-4(e)— Application of Segregation Requirements

##### i. Programmatic Benefits and Costs

##### a. Pre-Dodd Frank Segregation Practice

Segregation is intended to protect customer assets by ensuring that cash and securities that a registered security-based swap dealer holds for security-based swap customers are isolated from the proprietary assets of the security-based swap dealer and identified as property of such customers.<sup>1547</sup> Customer assets related to OTC derivatives are currently not consistently segregated from dealer proprietary assets in today's OTC derivatives markets.<sup>1548</sup> With respect to non-cleared derivatives, available information suggests that there is no uniform segregation practice but that collateral for most accounts is not segregated.<sup>1549</sup> In the absence of a

<sup>1547</sup> See Section III.C.4.(b)(2), *supra*. See also Capital, Margin, and Segregation Proposing Release 77 FR 70274.

<sup>1548</sup> See ISDA Margin Survey 2012. See also Capital, Margin, and Segregation Proposing Release, 77 FR 70325.

<sup>1549</sup> See generally ISDA Margin Survey 2012. According to this survey, where an independent amount (initial margin) is collected, ISDA members reported that most (approximately 72.2%) was commingled with variation margin and not segregated, and only 4.8% of the amount received was segregated with a third party custodian. The survey also notes that while the holding of the independent amounts and variation margin together continues to be the industry standard both contractually and operationally, it is interesting to note that the ability to segregate has been made increasingly available to counterparties over the past three years on a voluntary basis, and has led to 26% of independent amount received and 27.8%

segregation requirement, the likelihood that security-based swap customers would suffer losses upon a security-based swap dealer's default may be substantially higher than may be expected if security-based swap dealers are subject to such a requirement.<sup>1550</sup>

#### b. Benefits of the Segregation Requirements

Segregation requirements would limit the potential losses for security-based swap customers if a registered security-based swap dealer fails.<sup>1551</sup> The extent to which assets are in fact protected by proposed Rule 18a-4(a)-(d) would depend on how effective they are in practice in allowing assets to be readily returned to customers.<sup>1552</sup> In the cross-border context, the effectiveness of the segregation requirement with respect to foreign security-based swap dealers in practice may depend on many factors, including the type and objective of the insolvency or liquidation proceeding and how the U.S. Bankruptcy Code, SIPA, banking regulations, and applicable foreign insolvency laws are interpreted by the U.S. bankruptcy court, SIPC, Federal Deposit Insurance Corporation, and relevant foreign authorities. In the Capital, Margin, and Segregation Proposing Release, we stated that it would be difficult to measure the benefits of the segregation requirements proposed by the Commission under Section 3E of the Exchange Act;<sup>1553</sup> however, we believe that Rule 15c3-3, the existing segregation rule for broker-dealers, would provide a reasonable template for crafting the segregation requirements for security-based swap dealers.<sup>1554</sup> The ensuing increased confidence of market participants when transacting in security-based swaps, as compared to the OTC derivatives market as it exists today, should increase the desire to trade security-based swaps and generally benefit market participants.<sup>1555</sup>

#### c. Costs of the Segregation Requirements

Segregation requirements also will impose certain costs on registered

of independent amount delivered being segregated in some respects. See ISDA Margin Survey 2012 at 10. See also Capital, Margin, and Segregation Proposing Release, 77 FR 70325.

<sup>1550</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70325.

<sup>1551</sup> *Id.*; see also CFTC and Commission, Statement on MF Global about the deficiencies in customer futures segregated accounts held at the firm (Oct. 31, 2011).

<sup>1552</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70325.

<sup>1553</sup> *Id.*

<sup>1554</sup> *Id.*

<sup>1555</sup> *Id.* at 70326.

security-based swap dealers as well as other market participants. The costs associated with individual account segregation include fees charged by custodians to monitor individual account assets and to account for potential legal risks and liabilities of custodians to account beneficiaries or dealers, as well as operational costs to account for collateral on an individual customer basis.<sup>1556</sup> The costs associated with omnibus segregation would include operational costs and increase in costs of funds to dealers due to inability to use customer funds,<sup>1557</sup> compared to the baseline today that dealers in general do not segregate customer collateral for security-based swaps, and to the extent collateral is segregated, it is not done so on the terms that would be required by the segregation rules proposed by the Commission in the Capital, Margin, and Segregation Proposing Release.<sup>1558</sup> The operational costs include costs to establish qualifying bank accounts and to perform the calculations required to determine the amount that is required at any one time to be maintained in the reserve account.<sup>1559</sup> The increase in costs of funds to the extent that collateral a dealer holds that could otherwise be rehypothecated to finance business activity would no longer be permitted for that purpose could equal the borrowing costs of the dealer. The extent of the increase of cost of funds to dealers would depend on how much collateral associated with security-based swaps and held by dealers today

<sup>1556</sup> In the Capital, Margin, and Segregation Proposing Release, we stated that a commenter to the CFTC raised concerns with the length of time and the costs to comply with an individual segregation mandate. Specifically, the commenter raised concerns regarding the number of collateral arrangements that would be required. The commenter estimated, based on discussion with its members, that "a rough estimate of the time it would take to establish the necessary collateral arrangements is 1 year and eleven months, with an associated cost of \$141.8 million, per covered swap entity." See Capital, Margin, and Segregation Proposing Release 77 FR 70326.

<sup>1557</sup> See Capital, Margin, and Segregation Proposing Release 77 FR 70326, citing SIFMA/ISDA Comment Letter to the Prudential Regulators ("First, because the collateral cannot be rehypothecated, and because the collateral amounts will be very large, CSEs will be limited to investing very large amounts of eligible collateral in assets that generate low returns.").

<sup>1558</sup> See proposed Rules 18a-4(a)-(d) under the Exchange Act and Capital, Margin, and Segregation Proposing Release 77 FR 70274-78.

<sup>1559</sup> See section V.C. of the Capital, Margin, and Segregation Proposing Release for a discussion of implementation costs. In cases where an SBSB is jointly registered as a broker-dealer, the costs of adapting existing systems to account for security-based swap transactions may not be material in light of the similarities between the systems and procedures required by Rule 15c3-3 and those that would be required by proposed Rules 18a-4(a)-(d).

consists of initial margin that they can rehypothecate, *i.e.*, that is not now segregated as would be required under the new Rules 18a-4(a)-(d) proposed by the Commission in the Capital, Margin and Segregation Proposing Release.<sup>1560</sup> The Commission currently does not have sufficient information to quantify the increase of costs of funds to dealers as a result of the proposed segregation requirement and seeks comment on the impact of the proposed application of segregation requirements on the increase of costs of funds.<sup>1561</sup>

#### d. Costs and Benefits of Proposed Rules 18a-4(e)(1) and (2) Regarding Application of Segregation Requirements to Foreign Security-Based Swap Dealers

Proposed Rules 18a-4(e)(1) and (2) would not apply segregation requirements to a foreign security-based swap dealer in certain circumstances. Specifically, with respect to non-cleared security-based swap transactions, a foreign security-based swap dealer that is not a broker-dealer would not be subject to the segregation requirements set forth in Section 3E of the Exchange Act and paragraphs (a)-(d) of the proposed Rule 18a-4 with respect to margin received from non-U.S. person counterparties.<sup>1562</sup> Therefore, under the proposed Rule 18a-4(e)(1)(ii), non-U.S. person counterparties to non-cleared security-based swaps with a registered foreign security-based swap dealer that is not a registered broker-dealer would not be "customers" of such registered foreign security-based swap dealer and would not be given the preferred priority status with respect to the segregated assets in the omnibus account maintained by such foreign security-based swap dealer in a stockbroker liquidation proceeding

<sup>1560</sup> See Capital, Margin, and Segregation Proposing Release, 77 FR 70326. See also Manmohan Singh, "Velocity of Pledged Collateral: Analysis and Implications," IMF Working Paper (Nov. 2011), available at: [http://nowandfutures.com/large/VelocityOfPledgedCollateral-wp11256\(imf\).pdf](http://nowandfutures.com/large/VelocityOfPledgedCollateral-wp11256(imf).pdf); Manmohan Singh and James Aitken, "The (sizable) Role of Rehypothecation in the Shadow Banking System," IMF Working Paper (July 2010), available at: <http://www.imf.org/external/pubs/ft/wp/2010/wp10172.pdf>.

<sup>1561</sup> The amount of initial margin collateral associated with security-based swaps posted to and held by dealers today that they can rehypothecate is unknown to the Commission.

<sup>1562</sup> See proposed Rule 18a-4(e)(1)(ii) under the Exchange Act. A foreign security-based swap dealer that is a broker-dealer shall be subject to the segregation requirements set forth in Section 3E of the Exchange Act and paragraphs (a)-(d) of the proposed Rule 18a-4 with respect to margin received from any counterparties. See proposed Rule 18a-4(e)(1)(i) under the Exchange Act.

under the U.S. Bankruptcy Code.<sup>1563</sup> With respect to a registered foreign security-based swap dealer that is not a foreign bank with a branch or agency in the United States and is not a registered broker-dealer, the proposed Rule 18a-4(e)(2)(ii) would subject such foreign security-based swap dealer to the segregation requirements with respect to any assets posted by a non-U.S. person counterparty to secure a cleared security-based swap transaction only if such foreign security-based swap dealer accepts any assets from, for, or on behalf of a U.S. person counterparty to secure a security-based swap.<sup>1564</sup> The proposed Rule 18a-4(e)(2)(iii) would not subject a registered foreign security-based swap dealer that is a foreign bank with a branch or agency in the United States to the segregation requirements with respect to any assets posted by a non-U.S. person counterparty to a security-based swap transaction.<sup>1565</sup>

As stated above, the proposed Rules 18a-4(e)(1) and (2) regarding application of the segregation requirements to foreign security-based swap dealers would focus on applying the segregation requirements to provide customer protection to U.S. person counterparties and would not extend the same customer protection to non-U.S. person counterparties unless not doing so would result in losses to U.S. person counterparties.<sup>1566</sup> To the extent that a foreign security-based swap dealer would not be subject to the segregation requirements, the programmatic benefits described above, such as prompt return of customer assets and limiting the potential losses for security-based swap customers in the event of a failure of a registered security-based swap dealer, would not be extended to non-U.S. person counterparties. In addition, the benefits of potential increased confidence of market participants when transacting in security-based swaps, as brought about by the segregation requirements, would not occur in the markets where such foreign security-based swap dealer transacts with non-U.S. person counterparties.

There also would be corresponding decrease in costs as a result of the

proposed Rule 18a-4(e)(1)(ii) not requiring a foreign security-based swap dealer that is not a registered broker-dealer to segregate assets collected from non-U.S. person counterparties as collateral to secure non-cleared security-based swaps. A foreign security-based swap dealer would not need to provide notice required pursuant to Section 3E(f)(1)(A) of the Exchange Act to a non-U.S. person counterparty with respect to the right to elect individual account segregation.<sup>1567</sup> This would save operational costs to account for collateral on an individual customer basis and save fees charged by custodians as described above.<sup>1568</sup> A foreign security-based swap dealer that is not a registered broker-dealer also would have cost-savings associated with omnibus segregation, including less operational cost (such as the cost to perform the calculations required to determine the amount that is required at any one time to be maintained in the reserve account) as described above, and may be able to rehypothecate non-U.S. person counterparty's assets to finance its business activity, which would result in borrowing cost savings. The extent of these cost savings would depend on how much collateral posted by non-U.S. person counterparties and held by dealers today to secure security-based swaps consisting of margin that is available for dealers to use (*i.e.*, that is not now segregated).

The Commission preliminarily believes that the above decreases in benefits and costs as a result of the proposed Rule 18a-4(e)(1) and (2) are not those programmatic benefits and costs intended by the segregation requirements set forth in Section 3E of the Exchange Act, and the rules and regulations thereunder. Such decreases reflect the exclusion of foreign security-based swap dealers (that are not registered broker-dealers) from the segregation requirements when they transact with non-U.S. persons in the foreign markets, which we believe is consistent with the objective of the

<sup>1567</sup> See Section 3E(f)(1)(A) of the Exchange Act, 15 U.S.C. 78c-5(f), and proposed Rule 18a-4(d)(1) under the Exchange Act.

<sup>1568</sup> Although the segregation requirements with respect to non-cleared security-based swaps described in Section 3E(f) and the proposed Rule 18a-4(a)-(d) would not apply to a foreign security-based swap dealer when such foreign security-based swap dealer transacts with a non-U.S. person counterparty, proposed Rule 18a-4(e)(1) does not prevent parties from making segregation arrangements by contractual agreement under applicable local law. If parties were to make segregation arrangements, certain benefits and costs would arise; however, these benefits and costs would be outside the Title VII regulatory regime and would not be attributable to the Title VII regulatory regime.

Dodd-Frank Act to protect the U.S. markets and participants in those markets.<sup>1569</sup>

#### e. Costs and Benefits of Proposed Rule 18a-4(e)(3) Regarding Disclosures

There would be new costs and benefits associated with compliance with the segregation requirements for foreign security-based swap dealers due to the disclosures requirements in the proposed Rule 18a-4(e)(3). Specifically, proposed Rule 18a-4(e)(3) would require a registered foreign security-based swap dealer to disclose to its counterparty that is a U.S. person the potential treatment of the assets segregated by such registered foreign security-based swap dealer pursuant to Section 3E of the Exchange Act, and the rules and regulations thereunder, in insolvency proceedings under U.S. bankruptcy law and any applicable foreign insolvency laws. Such disclosure shall include whether the foreign security-based swap dealer is subject to the segregation requirement set forth in Section 3E of the Exchange Act, and the rules and regulations thereunder, with respect to the assets collected from the U.S. person counterparty who will receive the disclosure, whether the foreign security-based swap dealer could be subject to the stockbroker liquidation provisions in the U.S. Bankruptcy Code, whether the segregated assets could be afforded customer property treatment under the U.S. bankruptcy law, and any other relevant considerations that may affect the treatment of the assets segregated under Section 3E of the Exchange Act in insolvency proceedings of the foreign security-based swap dealer. The Commission preliminarily believes that such disclosure would greatly benefit U.S. person counterparties and assist them in evaluating the legal risk in respect of posting collateral to a foreign security-based swap dealer and the likely treatment of their assets held as collateral in the event of insolvency or liquidation of the foreign security-based swap dealer whom they transact with and post collateral to.

With respect to costs, the Commission preliminarily believes that a foreign security-based swap dealer should be able to include such disclosure in the credit support agreement pursuant to which assets would be posted to margin, guarantee, or secure a security-based swap transaction. The costs associated with such disclosure may include legal costs related to consulting bankruptcy counsels, both U.S. counsel and relevant foreign counsel, in respect of the

<sup>1569</sup> See Section III.C.4.(b)(2), *supra*.

<sup>1563</sup> See Section III.C.4.(b)(2), *supra*.

<sup>1564</sup> See proposed Rule 18a-4(e)(2)(ii) under the Exchange Act. A registered foreign security-based swap dealer that is a registered broker-dealer shall be subject to the segregation requirements set forth in Section 3E of the Exchange Act and paragraphs (a)-(d) of the proposed Rule 18a-4 under the Exchange Act with respect to margin received from any counterparties. See proposed Rule 18a-4(e)(2)(i) under the Exchange Act.

<sup>1565</sup> See proposed Rule 18a-4(e)(2)(iii) under the Exchange Act.

<sup>1566</sup> See Section III.C.4.(b)(2), *supra*.

potential treatment of the segregated assets under U.S. bankruptcy law and applicable foreign insolvency laws, the costs of drafting such disclosure, and the costs of updating such disclosure whenever there is a material change of U.S. bankruptcy law or applicable foreign laws that may render the prior disclosure inaccurate or misleading. The Commission preliminarily estimates that the average costs associated with such disclosure would be less than \$2,000,000 and a narrow range could be between \$760,000 and \$920,000.<sup>1570</sup>

#### ii. Assessment Costs

The assessment cost associated with proposed Rule 18a-4(e)(1) and (2) should primarily be related to inquiries about a counterparty's U.S. person status, whether a security-based swap is a cleared or non-cleared transaction, whether the foreign security-based swap dealer is a registered broker-dealer, whether the foreign security-based swap dealer has a branch or agency in the United States, and whether the foreign security-based swap dealer accepts any assets from, or on behalf of, a U.S. person counterparty to security a security-based swap, in order to determine whether a transaction

<sup>1570</sup> This estimate is based on staff experience in undertaking legal analysis of U.S. bankruptcy law treatment of customer assets held by broker-dealers and assumes that foreign security-based swap dealers would seek outside legal counsel to prepare the disclosures described in proposed Rule 18a-4(e)(3) and that the legal analysis of the treatment of customer property under a complex foreign insolvency law regime may cost \$50,000 per entity and the same legal analysis under a less complex foreign insolvency law regime or the U.S. bankruptcy law regime may cost \$30,000 per entity. We recognize that the complexity of the insolvency laws relating to liquidation of a foreign security-based swap dealer may vary greatly, and that we do not have insight into various insolvency law regimes such that we could reasonably determine what insolvency law regime may be considered more or less complex for these purposes. Thus, based on our understanding of the U.S. bankruptcy law analysis relating to liquidation of a broker-dealer, taking into account the potential application of various foreign insolvency laws, we believe that an average of the costs associated with more complex and less complex insolvency law regimes equaling \$40,000 per entity could reasonably approximate the average costs for a foreign security-based swap dealer to prepare the disclosures required in proposed Rule 18a-4(e)(3). We have estimated that the total number of dealers that may be required to register under the proposed *de minimis* rule is 50 or fewer entities, and if the criterion of three or more non-ISDA dealer counterparties is applied to the analysis, we estimated that the total number of dealers that may be required to register is between 27 and 31. See Section XV.D.1(b), *supra*. Out of these dealers, we estimated that the number of non-U.S. domiciled dealers is between 19 and 23. Therefore, the aggregate costs of the disclosure requirement could be \$2,000,000 (\$40,000 \* 50) or less with a narrow range from \$760,000 (\$40,000 \* 19) to \$920,000 (\$40,000 \* 23).

would be subject to the segregation requirements. A security-based swap dealer should know whether it is a registered broker-dealer and whether a particular transaction is submitted for clearing and should not incur any assessment costs relating to determining whether a transaction is cleared or non-cleared security-based swap. A foreign security-based swap dealer may need to make an internal inquiry as to whether it has a branch or agency in the United States and whether it accepts collateral from, or on behalf of, a U.S. person counterparty. Such inquiry should be a factual inquiry involving consulting the corporate secretary, in-house attorney or compliance manager without the need for further research and, therefore, the cost of such inquiry should be minimal. The Commission preliminarily believes that the costs associated with inquiring about a counterparty's U.S. person status should be subsumed in the assessment costs of the *de minimis* rule and the requirements relating to the external business conduct standards since a security-based swap dealer only needs to inquire about a counterparty's U.S. person status and implement systems to record and track the counterparty status once in order to assess and comply with all the Title VII requirements that depend on such factual inquiry. Therefore, the Commission preliminarily believes that the assessment costs associated with proposed Rules 18a-4(e)(1) and (2) alone should be minimal.

The assessment cost associated with the disclosures in proposed Rule 18a-4(e)(3) would be related to inquiries about a counterparty's U.S. person status, which also would be subsumed in the assessment costs associated with proposed Rules relating to the *de minimis* exception and the requirements relating to the external business conduct standards.

#### Request for Comment

- Is it appropriate, from the cost and benefit point of view, not to require foreign security-based swap dealers to comply with the segregation requirements when they transact with non-U.S. person counterparties? Are there other costs and benefits not mentioned above? Specifically, the Commission requests comment on (1) whether the proposed approach to application of the segregation requirements to foreign security-based swap dealers based on their status as a broker-dealer, foreign security-based swap dealer that is a bank with a branch or agency in the United States, or foreign security-based swap dealer that is not a broker-dealer and is not a bank

with a branch or agency in the United States would generate the benefit of effectively administering the segregation requirement in practice and protecting U.S. counterparties, (2) the costs of custodian fees, the operation costs and the costs associated with increased costs of funds due to inability to use customer assets as a result of a foreign security-based swap dealer being required to comply with the segregation requirements, (3) the costs of preparing the disclosures required in proposed Rule 18a-4(e)(3) and (4) the assessment costs associated with the proposed Rule 18a-4(e).

- Is it appropriate, from the cost and benefit point of view, to require a foreign security-based swap dealer to disclose potential treatment of the assets segregated by such foreign security-based swap dealer in insolvency proceedings under U.S. bankruptcy law and any applicable foreign insolvency laws? Are there other costs and benefits not mentioned above?

- Is it appropriate, from the cost and benefit point of view, to require a foreign security-based swap dealer to disclose to its non-U.S. person counterparty that it is not subject to the segregation requirements and that funds or property provided by such non-U.S. person counterparty would not be treated as "customer property" as that term is defined in 11 U.S.C. 741?

#### F. Economic Analysis of Application of Rules Governing Security-Based Swap Clearing in Cross-Border Context

The Dodd-Frank Act amends the Exchange Act to require central clearing of security-based swaps that the Commission determines should be cleared,<sup>1571</sup> and it directs entities that perform clearing agency functions for security-based swaps to register with the Commission.<sup>1572</sup> In this section, we first discuss the costs and benefits resulting from clearing agency registration and then consider the costs and benefits associated with the proposed rule regarding application of the clearing agency registration requirement to foreign clearing agencies. Following this, we discuss the costs and benefits that result from requiring security-based swap market participants to centrally clear transactions and then examine the trade-offs associated with the proposed rule implementing the mandatory clearing requirement in the cross-border context.

<sup>1571</sup> See Section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1).

<sup>1572</sup> See Section 17A(g) of the Exchange Act, 15 U.S.C. 78q-1(g).

1. Programmatic Benefits and Costs Associated With the Clearing Agency Registration

(a) Proposed Interpretive Guidance Regarding Clearing Agency Registration

(i) Current State of Clearing Agency Registration

At present, voluntary clearing of security-based swaps in the United States is limited to CDS products.<sup>1573</sup> It began in December of 2008, when the Commission acted to facilitate the clearing of OTC security-based swaps by permitting five clearing agencies, including three foreign clearing agencies,<sup>1574</sup> to clear CDS on a temporary, conditional basis.<sup>1575</sup> In each instance, these clearing agencies wanted to perform clearing functions with respect to CDS in the United States by providing CCP services directly to U.S. persons.<sup>1576</sup> The temporary exemptive orders granted to four of these clearing agencies (including two foreign clearing agencies) were extended until July 16, 2011.<sup>1577</sup> Title VII of the Dodd-Frank Act provides that (1) a depository institution that cleared swaps as a multilateral clearing organization prior to the date of enactment of the Dodd-Frank Act or (2) a derivatives clearing organization registered with the CFTC that cleared swaps pursuant to an exemption from registration as a clearing agency prior to the date of enactment of the Dodd-Frank Act is deemed registered as a clearing agency for the purposes of clearing security-based swaps (“Deemed Registered Provision”).<sup>1578</sup> The Deemed

Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, became effective on July 16, 2011.<sup>1579</sup> As a result, three clearing agencies, *i.e.*, ICE Clear Europe, Limited, ICE Clear Credit LLC (formerly ICE Trust US LLC), and Chicago Mercantile Exchange Inc., which were performing CCP functions with respect to CDS in the United States, were deemed registered with the Commission on July 16, 2011.<sup>1580</sup>

(ii) Programmatic Effect of the Proposed Interpretive Guidance

As stated above,<sup>1581</sup> the Commission is proposing interpretive guidance that a clearing agency performing the functions of a CCP for security-based swaps within the United States would be required to register pursuant to Section 17A(g) of the Exchange Act.<sup>1582</sup> Under this proposed interpretive guidance, a registration requirement pursuant to Section 17A(g) of the Exchange Act would apply only to clearing agencies that provide CCP services directly to a U.S. person with respect to security-based swaps, since these entities would be performing the functions of a CCP within the United States. Three clearing agencies currently provide CCP services directly to U.S. persons with respect to swaps and security-based swaps.<sup>1583</sup> All of these three clearing agencies are registered with the Commission under the Deemed Registered Provision. Therefore, the proposed interpretation would not increase the number of domestic or foreign clearing agencies required to register with the Commission until new clearing agencies desire to enter the U.S. market to provide CCP services directly to U.S. persons with respect to security-based swaps.

(iii) Costs and Benefits of the Proposed Interpretive Guidance

The Commission has considered the costs and benefits associated with the clearing agency registration requirement in Section 17A(g) of the Exchange Act<sup>1584</sup> in the cross-border context through the lens of a key Title VII goal: systemic risk mitigation. We discuss below the costs and benefits of the proposed interpretive guidance by looking at the role of the clearing agency in the security-based swap market and how clearing agencies transfer financial risks.

The proposed interpretive guidance regarding clearing agency registration would generate significant programmatic benefits. These benefits are tied to mandatory clearing. As explained below, clearing agency registration promotes sound management of the counterparty risk concentrated in CCPs, the importance of which is magnified by the application of a mandatory clearing requirement. Registration would provide standards for CCPs’ management of financial risks, including counterparty credit risk, legal risk and liquidity risk. Mandatory clearing of security-based swaps is one means by which Title VII of the Dodd-Frank Act seeks to reduce systemic risk in the U.S. financial system. Under Title VII, security-based swaps, “whenever possible and appropriate,”<sup>1585</sup> shall be centrally cleared through a clearing agency that is registered or exempt from registration under the Exchange Act.<sup>1586</sup> In a world of bilateral transactions in which each counterparty bears the other counterparty’s credit risk, a large counterparty who transacts with many other counterparties and cumulates significant security-based swap positions may pose systemic risk when its failure would generate sequential counterparty defaults.<sup>1587</sup>

<sup>1573</sup> See Section XV.B.2(e), *supra*.

<sup>1574</sup> These three foreign clearing agencies are ICE Clear Europe Limited, Eurex Clearing AG, and LIFFE A&M and LCH Clearnet Ltd. See note 74, *supra*.

<sup>1575</sup> See note 74, *supra*.

<sup>1576</sup> *Id.*

<sup>1577</sup> See Exchange Act Release Nos. 63389 (Nov. 29, 2010), 75 FR 75520 (Dec. 3, 2010) (order extending temporary conditional exemptions in connection with request on behalf of ICE Clear Europe, Limited), 63390 (Nov. 29, 2010), 75 FR 75518 (Dec. 3, 2010), (order extending temporary conditional exemptions in connection with request on behalf of Eurex Clearing AG), 63388 (Nov. 29, 2010), 75 FR 75522 (Dec. 3, 2010) (order extending temporary conditional exemptions in connection with request on behalf of Chicago Mercantile Exchange, Inc.), and 63387 (Nov. 29, 2010) 75 FR 75502 (Dec. 3, 2010) (order extending and modifying temporary exemptions in connection with request of ICE Trust US LLC); LIFFE A&M and LCH Clearnet Ltd. allowed their order to lapse without seeking renewal.

<sup>1578</sup> See 15 U.S.C. 78q–1(j). Under this Deemed Registered Provision, a clearing agency will be required to comply with all requirements of the Exchange Act, and the rules thereunder, applicable to registered clearing agencies to the extent it clears security-based swaps after the effective date of the Deemed Registered Provision, including, for example, the obligation to file proposed rule changes under Section 19(b) of the Exchange Act.

<sup>1579</sup> See Section 774 of the Dodd-Frank Act (stating, “[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle.”).

<sup>1580</sup> Eurex Clearing AG did not meet the criteria in the Deemed Registered Provision and is not currently providing CCP services in the United States with respect to security-based swaps. See, *e.g.*, Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection with the Pending Revision of the Definition of “Security” to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 64795 (July 1, 2011) at n. 76.

<sup>1581</sup> See Section V, *supra*.

<sup>1582</sup> 15 U.S.C. 78q–1(g).

<sup>1583</sup> See Clearing Agency Standards Adopting Release, 77 FR 66265. These three clearing agencies are ICE Clear Europe, Limited, ICE Clear Credit LLC, and Chicago Mercantile Exchange, Inc.

<sup>1584</sup> 15 U.S.C. 78q–1(g).

<sup>1585</sup> See, *e.g.*, S. Comm. on Banking, Hous., & Urban Affairs, The Restoring American Financial Stability Act of 2010, S. Rep. No. 111–176, at 32 (“As a key element of reducing systemic risk and protecting taxpayers in the future, protections must include comprehensive regulation and rules for how the OTC derivatives market operates. Increasing the use of central clearinghouses, exchanges, appropriate margining, capital requirements, and reporting will provide safeguards for American taxpayers and the financial system as a whole.”); *id.* at 34 (“Some parts of the OTC market may not be suitable for clearing and exchange trading due to individual business needs of certain users. Those users should retain the ability to engage in customized, uncleared contracts while bringing in as much of the OTC market under the centrally cleared and exchange-traded framework as possible.”).

<sup>1586</sup> See 15 U.S.C. 78c–3(a)(1).

<sup>1587</sup> See Craig Pirrong, “The Economics of Central Clearing: Theory and Practice,” ISDA Discussion

Central clearing through a CCP generally reduces counterparty risk by interposing a CCP as counterparty to all cleared transactions.<sup>1588</sup> Where security-based swaps are subject to a mandatory clearing requirement the role of the CCP becomes even more critical, as the volume of positions in which the CCP is interposed and becomes the central counterparty will likely increase.<sup>1589</sup>

While central clearing may make sequential counterparty defaults less likely, it does not eliminate systemic risk. CCPs concentrate counterparty risk.<sup>1590</sup> CCPs manage and reduce such concentrated risk by applying mark-to-market pricing and margin requirements to cleared transactions in a consistent manner<sup>1591</sup> and through netting (*i.e.*, by reducing the amounts of funds or other assets that must be exchanged at settlement).<sup>1592</sup> In the event of a clearing member's default in which the losses exceed the collateral posted to the CCP and other available funds, residual losses will be mutualized among the other non-defaulting members.<sup>1593</sup> By placing members under financial strain, mutualization may strain the entire financial system and create systemic impact.<sup>1594</sup> Even in the absence of this feature of CCPs, the default of a CCP has

Papers Series, No. 1 (2011), at 6 ("Widespread defaults on derivatives contracts may harm more than the counterparties on the defaulted contracts. The losses suffered by the victims of the original defaults may be so severe as to force those victims into financial distress, which harms those who have entered into financial contracts with them—including their creditors, and the counterparties to derivatives on which they owe money. Such a cascade of defaults can result in a systemic financial crisis.").

<sup>1588</sup> See Clearing Agency Standards Adopting Release, 77 FR 66264 ("Central clearing facilitates the management of counterparty credit risk among dealers and other institutions by shifting that risk from individual counterparties to CCPs, thereby helping protect counterparties from each other's potential failures and preventing the buildup of risk in such entities, which could be systemically important.").

<sup>1589</sup> See Clearing Procedures Adopting Release, 77 FR 41638.

<sup>1590</sup> See Clearing Agency Standards Adopting Release, 77 FR 66264–65 (stating that "a CCP also concentrates risks and responsibility for risk management in the CCP.").

<sup>1591</sup> See Culp, *supra* note 111. See also Clearing Agency Standards Adopting Release, 77 FR 66264.

<sup>1592</sup> See *e.g.*, Duffie and Zhu, *supra* note 110; see also Clearing Agency Standards Adopting Release, 77 FR 66264.

<sup>1593</sup> See Risk Management Supervision of Designated Clearing Entities (July 2011), Report by the Board of Governors of the Federal Reserve System, Securities and Exchange Commission and Commodity Futures Trading Commission to the Senate Committees on Banking, Housing, and Urban Affairs and Agriculture in fulfillment of Section 813 of Title VIII of the Dodd-Frank Act, at 12.

<sup>1594</sup> See Craig Pirrong, "The Economics of Central Clearing: Theory and Practice," ISDA Discussion Papers Series, No. 1 (2011), at 34–35.

the potential to harm the market in all financial instruments cleared by that CCP, creating liquidity constraints with respect to such financial instruments in the market. Such liquidity constraints would affect all parties transacting in such instruments.<sup>1595</sup>

Given the mutualization of losses, a CCP's concentration of risk, and its responsibility for risk management, the effectiveness of a CCP's risk controls and the adequacy of its financial resources are critical aspects of the infrastructure of the market it serves.<sup>1596</sup> Registration and clearing agency standards are designed to address these considerations.

The Commission preliminarily believes its interpretation that a clearing agency that provides CCP services for security-based swaps directly to U.S. persons must register pursuant to Section 17A(g) of the Exchange Act<sup>1597</sup> generates the benefits of protecting the U.S. financial system against systemic risk that may arise from central clearing functions performed in the United States. In the case of a foreign clearing agency that provides CCP services directly to U.S. persons, the Commission preliminarily believes that requiring such foreign clearing agency to register with the Commission and comply with the Commission's regulatory regime for security-based swap clearing would generate the key benefit of reducing the magnitude of any systemic risk flowing into or within the United States originating in the activities of other members of a clearing agency.

Specifically, the clearing agency standards would provide the minimum standards for CCPs' management of financial risks, including counterparty credit risk, legal risk, and liquidity risk. For example, the clearing agency standards established by the Commission are designed to minimize the CCPs' credit risk by, among other things, establishing eligibility standards for clearing members and requiring registered clearing agencies to measure their credit exposures on a daily basis. The Commission's clearing agency standards also require a registered clearing agency that acts as a CCP to collect initial and variation margin from

<sup>1595</sup> *Id.* See also Risk Management Supervision of Designated Clearing Entities (July 2011), Report by the Board of Governors of the Federal Reserve System, Securities and Exchange Commission and Commodity Futures Trading Commission to the Senate Committees on Banking, Housing, and Urban Affairs and Agriculture in fulfillment of Section 813 of Title VIII of the Dodd-Frank Act, at 8–9.

<sup>1596</sup> See Clearing Agency Standards Adopting Release, 77 FR 66265.

<sup>1597</sup> 15 U.S.C. 78q–1(g).

members, and maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions and, with respect to a registered clearing agency acting as a CCP for security-based swaps, maintain additional financial resources sufficient to withstand, at a minimum, a default by the two participant families to which it has the largest exposures in extreme but plausible market conditions.<sup>1598</sup> The benefits and costs of the clearing agency standards have been discussed in detail in the Clearing Agency Standards Adopting Release.<sup>1599</sup> The proposed interpretive guidance does not change the benefits associated with the substantive registration requirement and clearing agency standards. The aggregate programmatic benefits of the proposed interpretive guidance would flow from its programmatic effect on the number of clearing agencies registered as discussed above.

The proposed interpretive guidance would also entail certain costs, such as direct registration and compliance costs on CCPs.<sup>1600</sup> The proposed interpretive guidance does not change the costs associated with the substantive registration requirement and clearing agency standards. As with the programmatic benefits, the aggregate programmatic costs of the proposed interpretive guidance would flow from its programmatic effect on the number of clearing agencies registered as discussed above.

#### (iv) Assessment Costs

A clearing agency would incur assessment costs to determine whether it would be required to register by determining whether it provides CCP services directly to a U.S. person. Such determination may be made as part of its clearing membership application approval process. As part of the membership application, a prospective clearing member would be required to provide corporate organization documents, such as certificates of incorporation or articles of organization, which would enable the clearing agency

<sup>1598</sup> See 17 CFR 240.17Ad–22(b)(3); see also Clearing Agency Standards Adopting Release, 77 FR 66234–35 and 66274–75.

<sup>1599</sup> See Section V Economic analysis of the Clearing Agency Standards Adopting Release, 77 FR 66263–84.

<sup>1600</sup> The Commission previously estimated the costs for each registered clearing agency associated with compliance with clearing agency standards adopted in the Clearing Agency Standards Adopting Release could total approximately \$3.7 million in initial costs and \$10.1 million in annual ongoing costs. See Clearing Agency Standards Adopting Release, 77 FR 66273.

to determine whether a prospective clearing member is a U.S. person. Since corporate organization documents are part of the clearing membership application package,<sup>1601</sup> the Commission preliminarily believes that the assessment costs associated with the proposed interpretive guidance should be minimal.

#### (v) Alternatives

An alternative to the proposed interpretive guidance would be to require a clearing agency to register if such clearing agency provides CCP services to non-U.S. intermediaries that have U.S. persons as customers. Such an alternative would focus on the fact that intermediaries, whose financial stress or failure would mostly likely affect the U.S. financial system, are exposed to the risk of CCPs, and also transmit that risk to their U.S. customers. However, the Commission believes that the risk exposure that a U.S. customer could incur under its contractual agreements with an intermediary is generally much lower than the risk exposure a U.S. member could incur under a membership agreement with a CCP because a customer is only risking up to the full amount of property entrusted to an intermediary, but is not under any obligation to perform under the contractual agreements that the intermediary enters into with third parties. Consequently, if a clearing agency provides CCP services to an intermediary that has a U.S. person as a customer, the ripple effect of the failure of such clearing agency on the U.S. financial system may not rise to the systemic level.

Alternatively, the Commission could have proposed to require a clearing agency to register if such clearing agency has a member whose obligations under the clearing membership agreement are guaranteed by a U.S. person. The Commission recognizes that guarantees may expose the U.S. guarantor to the performance obligations under the clearing membership agreement and represent conduits through which the risks associated with foreign CCP default may transfer to the U.S. financial system. A non-U.S. member of a foreign CCP will still participate in loss mutualization in the event of member default. In the presence of a guarantee, the losses associated with mutualization may flow back to the guarantor.

However, the Commission preliminarily believes that interpreting a U.S. person providing a guarantee to a non-U.S. clearing member with respect to obligations under a clearing membership agreement as an indication of the clearing agency providing CCP services to a U.S. person may lead to a result that is over-inclusive with respect to the statutory clearing agency registration requirement. A U.S. person could guarantee its foreign affiliate's obligations under a clearing membership agreement with a foreign clearing agency that does not provide CCP services to any U.S. persons. Therefore, as a matter of policy, the Commission declines to propose such alternative interpretation at this time.

Finally, the Commission is not proposing to apply clearing agency registration requirements to a clearing agency solely based on a U.S. domicile of the clearing agency. The Commission believes that the domicile location of a clearing agency is not a sufficient indicator of whether a CCP is performing the functions of a CCP in the United States and the transmission of systemic risk across borders by providing CCP services directly to U.S. persons.

#### (b) Proposed Exemption of Foreign Clearing Agency From Registration

As discussed above, the Commission preliminarily believes that it may be appropriate to consider an exemption as an alternative to application of the registration requirement to a foreign clearing agency in circumstances where the foreign clearing agency is subject to comparable, comprehensive supervision and regulation by appropriate government authorities in its home country, and the nature of the clearing agency's activities and performance of functions within the United States suggest that registration is not necessary to achieve the Commission's regulatory objectives.

The Commission preliminarily believes that the benefits of considering such exemption would be to increase the range of registered and exempt clearing agencies that could be used to satisfy the mandatory clearing requirement. Since the exemption would be considered in circumstances where the foreign clearing agency is subject to comparable, comprehensive supervision and regulation in its home country, the Commission preliminarily believes that such exemption would not compromise the programmatic benefits of the mandatory clearing requirement and at the same time may decrease the costs to market participants associated with the mandatory clearing

requirement. In addition, to the extent that the exemption eliminates or decreases duplicative compliance costs, a foreign clearing agency eligible for the exemption may incur lower programmatic costs associated with implementation of, or compliance with, the clearing agency registration requirements and clearing agency standards than it would otherwise incur without the option of the proposed exemption.

On the other hand, in the case of an exemption order granted with Commission-imposed conditions, it is possible that the programmatic costs may increase because market participants would be required to incur costs to satisfy these conditions. However, the proposed availability of an exemption from registration may enable a foreign clearing agency that would, due to conflicting local laws, otherwise not be able to provide CCP services to U.S. market participants in the absence of an exemption. In such cases, an exemption with Commission-imposed conditions may increase the number of clearing agencies in the U.S. security-based swap market, contributing to the programmatic benefits and costs that flow from the clearing agency registration requirement.

#### (c) Programmatic Effects of Alternative Standards

As stated above,<sup>1602</sup> Section 17A(i) of the Exchange Act permits the Commission to adopt rules for registered clearing agencies that clear security-based swaps and conform its regulatory standards and supervisory practices to reflect evolving United States and international standards.

The Commission preliminarily believes that this approach may be appropriate where the Commission determines not to grant a general exemption from registration under Section 17A(k) of the Exchange Act, but where consistency with some regulatory standards suggests that a targeted regulatory approach is warranted. To avoid compromising the benefits of clearing agency registration discussed above, the Commission would consider the costs and benefits of applying such alternative standards when it contemplates such an action. The Commission preliminarily believes that the alternative standards approach could provide great flexibility for the Commission to promote a great range of registered and exempt clearing agencies for market participants to satisfy the mandatory clearing requirement without compromising the benefit of clearing

<sup>1601</sup> See, e.g., Clearing membership Application Instructions and Forms, ICE Clear U.S., Inc. (Aug. 2012), available at: [https://www.theice.com/publicdocs/clear\\_us/Clear\\_US\\_Member\\_Application.pdf](https://www.theice.com/publicdocs/clear_us/Clear_US_Member_Application.pdf).

<sup>1602</sup> See Section V.B.3, *supra*.



agency registration by considering the adoption of targeted standards when warranted by the circumstances.

## 2. Programmatic Benefits and Costs Associated With the Mandatory Clearing Requirement of Section 3C(a)(1) of the Exchange Act

Prior to the Dodd-Frank Act, ICE Clear Credit and ICE Clear Europe engaged in credit default swap clearing activities pursuant to exemptive orders issued by the Commission.<sup>1603</sup> In part, the exemptive orders were conditioned on those CCPs making certain information available to the Commission, including risk assessment reports and information regarding future changes to risk management practices.<sup>1604</sup>

Following the Dodd-Frank Act becoming effective, ICE Clear Credit and ICE Clear Europe were deemed to be registered with the Commission in July 2011 as clearing agencies for security-based swaps.<sup>1605</sup> ICE Clear Credit began clearing corporate single-name credit default swaps in December 2009,<sup>1606</sup> and, as of December 14, 2012, had cleared a total \$1.8 trillion gross notional of single-name credit default swaps on 153 North American corporate reference entities.<sup>1607</sup> ICE Clear Europe began clearing credit default swaps on

single-name corporate reference entities in December 2009,<sup>1608</sup> and, as of December 14, 2012, had cleared a total €1.5 trillion in gross notional of single-name credit default swaps on 121 European corporate reference entities.<sup>1609</sup> The level of clearing activity appears to have steadily increased as more CDS have become eligible to be cleared.<sup>1610</sup> To date, all of ICE Clear Credit's and ICE Clear Europe's security-based swap clearing activity has involved proprietary transactions between clearing members.<sup>1611</sup>

The economic effects of mandatory clearing may be expected to vary depending on the scope of the requirement and the financial instruments subject to mandatory clearing. Within the subset of instruments that could be subject to a mandatory clearing requirement, a broader clearing mandate may be expected generally to lead to more effective risk mitigation, but it may also increase costs to market participants. The ultimate economic impact of the mandatory clearing requirement in part will be affected by the total set of security-based swaps that will be subject to mandatory clearing, following Commission determinations pursuant to Section 3C(b) of the Exchange Act.<sup>1612</sup>

<sup>1603</sup> See, e.g., Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009) ("ICE Clear Credit Exemptive Order"); Exchange Act Release No. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) ("ICE Clear Europe Exemptive Order"). In connection with those orders, Commission staff considered a number of aspects of those CCPs' clearing practices, including, *inter alia*, their risk management methodologies.

<sup>1604</sup> See ICE Clear Credit Exemptive Order, *supra* note 1603, at 10799; ICE Clear Europe Exemptive Order, *supra* note 1603, at 37756–57.

<sup>1605</sup> Section 17A(l) of the Exchange Act provides in relevant part that a derivative clearing organization registered with the CFTC that clears security-based swaps would be deemed to be registered as a clearing agency under section 17A if, prior to the enactment of the Dodd-Frank Act, it cleared swaps pursuant to an exemption from registration as a clearing agency.

Both ICE Clear Credit and ICE Clear Europe also are registered with the CFTC as Designated Clearing Organizations.

<sup>1606</sup> See Exchange Act Release No. 61662 (Mar. 5, 2010), 75 FR 11589, 11591 (Mar. 11, 2010) (discussing ICE Clear Credit's CDS clearing activities as of March 2010).

ICE Clear Credit (then known as ICE US Trust LLC) began clearing index-based CDS in March 2009. See Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009) (order granting temporary exemptions under the Exchange Act on behalf of ICE US Trust LLC).

<sup>1607</sup> ICE Clear Credit also has cleared a total of \$19.1 trillion gross notional on 59 index CDS as of December 14, 2012. See ICE Clear Credit, Volume of ICE CDS Clearing, available at: [https://www.theice.com/clear\\_credit.jhtml](https://www.theice.com/clear_credit.jhtml).

In addition to clearing single-name CDS on North American corporate reference entities, ICE Clear Credit also clears CDS on certain non-U.S. sovereign entities, and on certain indices based on North American reference entities.

<sup>1608</sup> See Exchange Act Release No. 61973 (Apr. 23, 2010), 75 FR 22656, 22657 (Apr. 29, 2010) (discussing ICE Clear Europe's CDS clearing activity as of April 2010).

ICE Clear Europe commenced clearing index-based CDS in July 2009. See Exchange Act Release No. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009) (order granting temporary exemptions under the Exchange Act on behalf of ICE Clear Europe).

<sup>1609</sup> ICE Clear Europe also has cleared a total of €9.7 trillion in gross notional on 44 index-based CDS. See ICE Clear Europe, Volume of ICE CDS Clearing, available at: [https://www.theice.com/clear\\_credit.jhtml](https://www.theice.com/clear_credit.jhtml).

Aside from clearing single-name CDS on European corporate reference entities, ICE Clear Europe also clears CDS on indices based on European reference entities, as well as futures and instruments on OTC energy and emissions markets.

<sup>1610</sup> See Clearing Procedures Adopting Release, 77 FR 41636–38 (discussing the steady increase in the volume of cleared CDS transactions).

<sup>1611</sup> For purposes of the discussion here, "clearing members," "clearing participants," and similar terms encompass market participants that are approved by a clearing agency to become the clearing agency's counterparty when a single-name CDS is cleared.

<sup>1612</sup> 15 U.S.C. 78c–3(b). Section 3C(b) of the Exchange Act includes two mandatory clearing determination review processes. One is Commission-initiated review and the other is a swaps submissions review processes. The mandatory clearing determinations to be made by the Commission would have impact on the economic consequences of the mandatory clearing requirement. For example, with respect to single-name CDS on certain corporate entities that have high notional size outstanding but are not currently cleared on a voluntary basis, the determination of clearing of these single-name credit default swaps

Accordingly, this section does not seek to address the full range of economic consequences of the mandatory clearing requirement and the proposed application of mandatory clearing in the cross-border context that may result from the Commission's determination to require certain security-based swap transactions to be subject to mandatory clearing. Instead, this section contains two subsections. The first discusses programmatic effects of the mandatory clearing requirement and the second discusses costs and benefits that result from the mandatory clearing requirement generally. We consider these programmatic costs and benefits through analyzing the potential programmatic effects of mandatory clearing based on the data of voluntary clearing activity available to us and the assumptions stated below.

### (a) Programmatic Effects of the Mandatory Clearing Requirement

As stated above, voluntary clearing of security-based swaps in the United States is currently limited to the CDS products cleared by ICE Clear Credit and ICE Clear Europe.<sup>1613</sup> The level of clearing activity appears to have steadily increased over time as more products have become eligible to be cleared.<sup>1614</sup> The notional volume of cleared transactions reported by ICE Clear Credit for U.S.-index CDS products in 2009, 2010 and 2011 represented approximately 32%, 54% and 57% of the total notional volume of the U.S.-index CDS market, and the notional volume of cleared transactions reported by ICE Clear Credit for single-name CDS products referencing U.S. corporate in 2009, 2010 and 2011 represented approximately 0%, 16% and 25% of the total notional volume of the single-name U.S. corporate CDS market.<sup>1615</sup> These figures were

would have impact on the volume of security-based swap transactions subject to mandatory clearing.

<sup>1613</sup> See the discussion of levels of security-based swap clearing in Section XV.B.2(e) above. See also Clearing Procedures Adopting Release, 77 FR 41636 (noting that central clearing of security-based swaps began in March 2009 for index-based CDS products, in December 2009 for single-name CDS products on corporate reference entities, and in November 2011 for single-name CDS products on sovereign reference entities; also noting that at present, there is no central clearing in the United States for security-based swaps that are not CDS products, such as those based on equity securities).

<sup>1614</sup> See Clearing Procedures Adopting Release, 77 FR 41636–38 (discussing the steady increase in the volume of cleared CDS transactions).

<sup>1615</sup> These figures are based on information regarding names accepted for clearing reported by ICE Clear Credit on its public Web site and are calculated based on "price forming transactions" submitted to the DTCC-TIW. See Section XV.B.2(e), *supra*. These figures include the clearing of trades

calculated based on price-forming transactions submitted to the DTCC—TIW.<sup>1616</sup>

Our prior analysis of the level of clearing activity also demonstrated

steady increases of CDS transaction volume in names accepted for clearing over time.<sup>1617</sup> Such analysis compared two measures of transaction volumes in names accepted for clearing within a

year and across years and showed the increase in percentage from 2009 to 2011 in the volume of new transactions in names that have “accepted for clearing” status. See Table 1 below.

TABLE 1—CLEARED TRADES AND ACCEPTED TRADES AS A PERCENTAGE OF GROSS NOTIONAL TRANSACTION VOLUME

	U.S.-Index CDS			Single Name U.S. Corporate CDS		
	2009	2010	2011	2009	2010	2011
Notional volume (\$ billions) .....	10,400	8,900	9,900	4,100	3,900	2,800
Percentage of Notional in Names Accepted for Clearing:						
—at calendar year end .....	88%	90%	91%	1%	23%	33%
—at time of trade execution .....	55%	87%	91%	0%	16%	29%
Cleared transactions: % of total notional volume .....	32%	54%	57%	0%	16%	25%

Although data suggested that clearing of security-based swaps has been increasing, significant segments of the security-based swap market remain uncleared.<sup>1618</sup> Due in part to this data, the Commission recognized in the Clearing Procedures Adopting Release that mandatory clearing determinations made pursuant to Section 3C(a)(1) of the Exchange Act<sup>1619</sup> could alter current clearing practices at the time such determinations are made. One potential consequence of mandatory clearing determinations that require mandatory clearing for certain security-based swaps could be a higher level of clearing for security-based swaps than would take place under a voluntary system.<sup>1620</sup> Where the amount of clearing taking place under a voluntary system is significantly different from the level of clearing that would take place if trading in a product were mandatory and where

such difference marks a shift in existing market clearing practices, the mandatory clearing determination could potentially have a material economic impact.<sup>1621</sup>

(b) Programmatic Benefits and Costs of the Mandatory Clearing Requirement

A key benefit of mandatory clearing is reduction of counterparty credit risk. In a regime with central clearing, the CCP is the counterparty to all trades. Central clearing mitigates counterparty credit risk among dealers and other institutions by shifting that risk from individual counterparties to CCPs, thereby helping protect counterparties from sequential default. CCPs require that members apply mark-to-market pricing and margin requirements in a consistent manner, and generally use liquid margin collateral to manage the risk of a member’s failure. Accordingly,

where CCPs operate under high standards relating to risk management, counterparty credit risk can be lower than in a regime without CCPs where counterparties can engage only in bilateral netting and face margin requirements that may vary significantly between transactions.<sup>1622</sup>

Although central clearing reduces counterparty risk, it is less certain whether a mandatory requirement to centrally clear security-based swap transactions reduces the overall risks to the financial system. Some have expressed the view that central clearing should be imposed wherever possible to help control systemic risk; others, by contrast, have contended that concentrating the default risk of numerous counterparties within a single CCP (or within a small number of CCPs) could introduce new risks.<sup>1623</sup> For

on the same day the trade was executed as well as the clearing of trades entered into in prior years and submitted for clearing on retroactive basis. These figures do not include trades that resulted from the compression of trades previously submitted for clearing. See *id.* The CME Group also clears index CDS products and has reported clearing \$144 billion in gross notional volumes of transactions since inception, with \$21 billion in open interest as of the end of 2011. See CME Group, Cleared OTC Credit Default Swaps, available at: <http://www.cmegroup.com/trading/cds/>. These volumes are small relative to total market activity and are not included in the calculation of notional volume of cleared index CDS in 2011 performed by the Commission staff in the Clearing Procedures Adopting Release. See Clearing Procedures Adopting Release, 77 FR 41636.

<sup>1616</sup> See Section XV.B.2(e) and note 1615, *supra*.

<sup>1617</sup> See Clearing Procedures Adopting Release, 77 FR 41637–38. The analysis there presents two measures with respect to transaction volume accepted for clearing (which ultimately may have been cleared or uncleared). The first measure includes all transaction volume in names accepted for clearing at any time during the calendar year, whether or not a trade was accepted for clearing at the time of its execution. The calculation of this measure was performed by staff in the Division of Risk, Strategy, and Financial Innovation by totaling the sum of price forming transactions reported to DTCC—TIW in the calendar year for index-based and single-name corporate CDS products that match

the list of names accepted for clearing at ICE Clear Credit during the same period. See ICE Clear Credit, Clearing Eligible Products, available at: [https://www.theice.com/publicdocs/clear\\_credit/ICE\\_Clear\\_Credit\\_Clearing\\_Eligible\\_Products.xls](https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Clearing_Eligible_Products.xls).

The second measure includes only transaction volume in names accepted for clearing at the time of trade execution. The calculation of this measure was performed by staff in the Division of Risk, Strategy, and Financial Innovation by totaling the sum of price forming transactions reported to DTCC—TIW in the calendar year for index-based and single-name corporate CDS products that match the list of names accepted for clearing at ICE Clear Credit, including only those transactions executed following the accepted for clearing date reported by ICE Clear Credit. This measure accounts for the fact that, although transactions executed in names prior to the name being accepted for clearing can be cleared later in the same calendar year through a process referred to as “backloading,” names accepted for clearing towards the end of the year allow less time for this to occur. Backloading refers to the submission for clearing of pre-existing bilateral trades that were not submitted for clearing on the date of the transaction. See Clearing Procedures Adopting Release, 77 FR 41637–38.

<sup>1618</sup> Because clearing is voluntary, counterparties to the transaction have no obligation to clear and may elect not to do so for various individual reasons. Further, if the counterparties choose to transact in a reference entity that is accepted for clearing in a currency other than U.S. dollars, the

transaction is no longer eligible for clearing. In addition, because clearing was performed exclusively on a backloading basis prior to April 2011, some transactions have not been cleared because they may have been subject to portfolio compression or otherwise terminated prior to when the option to submit the transactions for clearing became available. See Clearing Procedures Adopting Release, 77 FR 41638.

<sup>1619</sup> 15 U.S.C. 78c–3(a)(1).

<sup>1620</sup> See Clearing Procedures Adopting Release, 77 FR 41638.

<sup>1621</sup> *Id.*

<sup>1622</sup> See note 1021, *supra*.

<sup>1623</sup> See Craig Pirrong, Mutualization of Default Risk, Fungibility, and Moral Hazard: The Economics of Default Risk Sharing in Cleared and Bilateral Markets, at 5 (Univ. of Houston Working Paper, 2010), available at: [http://business.nd.edu/uploadedFiles/Academic\\_Centers/Study\\_of\\_Financial\\_Regulation/pdf\\_and\\_documents/clearing\\_moral\\_hazard\\_1.pdf](http://business.nd.edu/uploadedFiles/Academic_Centers/Study_of_Financial_Regulation/pdf_and_documents/clearing_moral_hazard_1.pdf) (“Clearing of OTC derivatives has been touted as an essential component of reforms designed to prevent a repeat of the financial crisis. A back-to-basics analysis of the economics of clearing suggests that such claims are overstated, and that traditional OTC mechanisms may be more efficient for some instruments and some counterparties.”); see also Derivatives Clearinghouses: Opportunities and Challenges: Hearing Before the Subcomm. on Secs.,

instance, those expressing concern about the systemic effects of central clearing state that risk sharing between members of a CCP may encourage excessive risk taking because the costs of imprudent decisions by one clearing member are borne by other clearing members. This moral hazard concern may be exacerbated to the extent that CCPs are viewed as too important to fail and thus would likely be subject to bailout remedies that would benefit all CCP members.<sup>1624</sup>

While lower counterparty credit risk benefits the financial system as a whole, it can also make hedging less expensive for market participants. An environment in which central clearing is common may see increased participation, greater liquidity, and more efficient risk sharing that promotes capital formation. There also are circumstances under which central clearing can increase participation costs for certain participants. In certain cases where counterparties to a security-based swap transaction are exposed to one another in multiple asset markets, they may face lower costs by bilaterally clearing new contracts against existing exposures instead of clearing through a central counterparty.<sup>1625</sup>

Mandatory clearing can play an important role in developing a strong infrastructure for central clearing.<sup>1626</sup> For instance, mandatory clearing reduces operational risk by promoting the standardization of contract terms. Standardization can simplify the valuation of security-based swaps, increase the liquidity of security-based swaps contracts, and promote competition. Standardized contract terms help avoid inefficiencies in contracting that result from human and processing errors. Standardized terms also facilitate the development of infrastructure technologies that facilitate the prompt and accurate clearance and settlement of security-based swaps.<sup>1627</sup> Mandatory clearing may also have the

effect of reducing total transaction costs by eliminating obscured margin-related pricing that customers may otherwise incur in connection with non-cleared instruments. As with standardization, this would promote inter-dealer competition. However, dealers may take other actions to offset lost revenues resulting from the shift from non-cleared to cleared instruments. Separate from these considerations, several analyses have been conducted suggesting that mandatory clearing would increase the overall margin costs associated with security-based swap transactions compared to the margin market participants would post in the absence of a clearing requirement, though the estimates of the aggregate cost to market participants vary widely.<sup>1628</sup>

<sup>1624</sup> See Manmohan Singh, Collateral, Netting and System Risk in the OTC Derivatives Market (IMF Working Paper, 2010), available at: <http://www.imf.org/external/pubs/ft/wp/2010/wp1099.pdf> (concluding that the initial margin requirements for the central clearing of approximately two-thirds of the then estimated \$36 trillion notional market for credit default swaps would amount to \$40 to \$80 billion, likely closer to \$80 billion due to the increased jump risk associated with single-name credit default swaps even if portfolio compression is available); Daniel Heller & Nicholas Vause, Collateral Requirements for Mandatory Central Clearing of Over-the-Counter Derivatives (BIS Working Paper No. 373, Mar. 2012), available at: <http://www.bis.org/publ/work373.pdf> (concluding that margin required to clear multi-name and single-name credit default swaps held by the largest 14 derivative dealers would vary depending on market volatility, requiring \$10 billion of collateral in a low volatility market, \$51 billion in medium volatility, and \$107 billion in high volatility; further stating that with the inclusion of non-dealer positions, margin requirements would amount to \$36 billion in a low volatility market, \$219 billion in medium volatility and \$425 billion in high volatility; study assumed the existence of one centralized clearing entity, which produced an estimated 25 percent savings compared to a market with multiple regional clearing agencies, where the benefits of portfolio margining would be limited); Che Sidanius & Filip Zikes, OTC Derivatives Reform and Collateral Demand Impact, (Bank of England Fin. Stability Paper No. 18, Oct. 2012), available at: [http://www.bankofengland.co.uk/publications/Documents/fsr/fs\\_paper18.pdf](http://www.bankofengland.co.uk/publications/Documents/fsr/fs_paper18.pdf) (estimating an incremental increase in total initial margin for central clearing of credit default swaps between \$78 billion and \$156 billion, assuming that 80 percent of credit default swaps are cleared and netting is achieved between 90 and 95 percent while noting that the presence and extent of portfolio margining available could affect the analysis); IMF, Safe Assets: Financial System Cornerstone, Global Financial Stability Report (April 2012), available at: <http://www.imf.org/external/pubs/ft/gfsr/2012/01/pdf/c3.pdf> (estimating incremental initial margin and guarantee fund contributions for central clearing of over-the-counter derivatives will amount to between \$100 billion and \$200 billion, and may be higher if mutual recognition is not common among CCPs); see also Letter from Robert Pickel, Chief Executive Officer, ISDA, and Kenneth Bentsen, EVP, Public Policy and Advocacy, SIFMA, to David Stawick, Secretary, CFTC, at 35–37, Sept. 14, 2012 (estimating that the initial margin call for all swap products would be \$193 billion to financial entities

On the other hand, mandatory clearing of certain security-based swaps may reduce the use of security-based swaps to manage the risks associated with other financial products or commercial activity. This could occur if margin requirements prove too burdensome and make cleared transactions expensive relative to alternative means of risk management.

### 3. Programmatic Benefits and Costs of Proposed Rule 3Ca–3

As discussed above, the Commission is proposing Rule 3Ca–3 to apply the mandatory clearing requirement of Section 3C(a)(1) of the Exchange Act<sup>1629</sup> to cross-border security-based swap transactions. Proposed Rule 3Ca–3(a) specifies the security-based swap transactions to which the mandatory clearing requirement would apply, and proposed Rule 3Ca–3(b) carves out certain security-based swap transactions from application of the mandatory clearing requirement.<sup>1630</sup>

Specifically, under proposed Rule 3Ca–3(a), the mandatory clearing requirement would apply to a person that engages in a security-based swap transaction if such person engages in a security-based swap transaction in the United States. The Commission would view a person to be engaging in a security-based swap transaction in the United States if a security-based swap transaction involves (i) a counterparty that is a U.S. person; (ii) a counterparty that is a non-U.S. person whose performance under such security-based swap transaction is guaranteed by a U.S. person (hereinafter referred to as a “guaranteed non-U.S. person”); or (iii) such security-based swap transaction is a transaction conducted within the United States.<sup>1631</sup> Under proposed Rule 3Ca–3(b), the mandatory clearing requirement would not apply to (i) a security-based swap transaction described in proposed Rule 3Ca–3(a) that is not a transaction conducted within the United States if (x) one counterparty is a foreign branch or a guaranteed non-U.S. person and (y) the other counterparty to the transaction is

and \$428 billion to dealers, and that variation margin calls would total \$320 billion to financial entities and \$80 billion to dealers, further noting that anywhere from \$20 to \$228 billion in additional liquidity would be necessary to meet the variation margin calls).

<sup>1629</sup> 15 U.S.C. 78c–3(a)(1).

<sup>1630</sup> This is similar to the proposed approach for the mandatory trade execution requirement. See Exchange XV.G.4, *infra*.

<sup>1631</sup> See proposed Rule 3Ca–3(a) under the Exchange Act. The terms “transaction conducted within the United States” and “U.S. person” would have the meanings set forth in proposed Rules 3a71–3(a)(5) and (7) under the Exchange Act.

Ins., & Inv., of the S. Comm. on Banking, Hous., & Urban Affairs, 112th Cong. 21, 49 (2011) (statement of Chester S. Spatt, Professor of Finance, Carnegie Mellon Univ.) (stating that “[t]he clearinghouse is subject to considerable moral hazard and systemic risk” in part because “there is a strong incentive for market participants to trade with weak counterparties” and noting that “it is unclear whether the extent of use of clearinghouses will ultimately lead to a reduction in systemic risk in the event of a future crisis.”).

<sup>1624</sup> See Pirrong, note 1623, *supra*, at 5 (“Risk sharing through a clearinghouse makes the balance sheets of the clearinghouse members public goods, and encourages excessive risk taking. That is, the clearing mechanism is vulnerable to moral hazard.”).

<sup>1625</sup> Duffie and Zhu, *supra* note 110, at 74–95.

<sup>1626</sup> See note 991 and accompanying text, *supra*.

<sup>1627</sup> See *id.*

a non-U.S. person whose performance under the security-based swap is not guaranteed by a U.S. person (hereinafter referred to as “non-guaranteed non-U.S. persons”) and who is not a foreign security-based swap dealer as defined in proposed Rule 3a71–3(a)(3) under the Exchange Act, and would not apply to (ii) a security-based swap transaction described in proposed Rule 3Ca–3(a) that is a transaction conducted within the United States if (x) both counterparties to the transaction are non-guaranteed non-U.S. persons and (y) neither counterparty to the transaction is a foreign security-based swap dealer, as defined in proposed Rule 3a71–3(a)(3) under the Exchange Act.<sup>1632</sup>

Therefore, proposed Rule 3Ca–3(a) and proposed Rule 3Ca–3(b) apply the mandatory clearing requirement to security-based swap transactions in the cross-border context based on the U.S.-person status of a counterparty, the existence of a guarantee provided by a U.S. person, the registered security-based swap dealer status of a non-U.S. person counterparty, and the location where the transaction is conducted. Taken together, proposed Rules 3Ca–3(a) and 3Ca–3(b) would not apply the mandatory clearing requirement to (i) transactions conducted outside the United States between two counterparties who are non-guaranteed non-U.S. persons, (ii) transactions conducted outside the United States between a foreign branch or a guaranteed non-U.S. person, and a counterparty who is a non-guaranteed non-U.S. person and is not a foreign security-based swap dealer, and (iii) transactions conducted within the United States between two counterparties who are non-guaranteed non-U.S. persons and are not foreign security-based swap dealers.

The Commission preliminarily believes that the combined effect of the proposed Rules 3Ca–3(a) and (b) described above would be that non-guaranteed non-U.S. persons who are not security-based swap dealers may engage in security-based swap transactions with each other both within and without the United States without being subject to the Commission’s mandatory clearing requirement. These non-guaranteed non-U.S. persons that are not security-based swap dealers may include non-U.S. persons that are swap dealers, major swap participants, major security-based swap participants, commodity pools, private funds, employee benefit plans, or persons

predominantly engaged in activities that are banking or financial in nature, as defined in Section 4(k) of the Bank Holding Company Act of 1956.<sup>1633</sup> Such non-U.S. persons would also be able to engage in security-based swap transactions without being subject to the mandatory clearing requirement when the transaction is conducted outside the United States with U.S. persons that are foreign branches of U.S. banks or guaranteed non-U.S. persons or transacting with a foreign security-based swap dealer whose performance under security-based swaps is not guaranteed by a U.S. person.<sup>1634</sup> As discussed below,<sup>1635</sup> the Commission preliminarily believes that the exclusion of transactions between two non-guaranteed non-U.S. persons who are not foreign security-based swap dealers could potentially reduce the aggregate programmatic costs associated with the mandatory clearing requirement. However, these non-guaranteed non-U.S. persons, despite their status of not being foreign security-based swap dealers, may be financial entities that play significant roles in the U.S. or a foreign financial system and their failure may present spillover effect on the stability of the U.S. financial system and security-based swap market.

#### (a) Programmatic Effect of Proposed Rule 3Ca–3

It is not possible to quantify the potential programmatic effect of proposed Rule 3Ca–3 on the future volume of security-based swap transactions when the mandatory clearing requirement becomes effective partly because the Commission has not made any mandatory clearing determinations, partly because the Commission has yet to finalize the end-user exception to the mandatory clearing requirement,<sup>1636</sup> and partly because we do not know future trading volumes of security-based swaps. However, the Commission has examined the data available to it to

<sup>1633</sup> 12 U.S.C. 1843(k).

<sup>1634</sup> In addition, transactions that are subject to the mandatory clearing requirement by operation of the proposed Rule 3Ca–3(a) and (b) may be exempted from the mandatory clearing requirement if the end-user exception is applicable. See Section 3C(g)(1) of the Exchange Act, 15 U.S.C. 78c–3(g)(1). Therefore, the combined effects of the proposed Rule 3Ca–3 may be affected by the implementation of the end-user exception to the mandatory clearing requirement. The Commission has proposed, but not yet adopted, Rule 3Cg–1 under the Exchange Act regarding the end-user exception to mandatory clearing of security-based swaps. See End-User Exception Proposing Release, 75 FR 79992.

<sup>1635</sup> See Section XV.F.3(b), *infra* (discussing the programmatic benefits and costs of proposed Rule 3Ca–3).

<sup>1636</sup> See *id.*

analyze the potential programmatic effects of proposed Rule 3Ca–3. In particular, the Commission has tried to analyze the effects of proposed Rule 3Ca–3 by looking at the portion of single-name U.S. reference CDS transactions that may provide an indication of the size of the security-based swap market that may be included in or excluded from the application of the mandatory clearing requirement as a result of proposed Rule 3Ca–3.

A limitation we face when analyzing the data in order to estimate the size of the security-based swap market that may be affected by proposed Rule 3Ca–3 is that the domicile classifications in the DTCC–TIW database are not identical to the counterparty status or transaction status, both of which are described in proposed Rules 3Ca–3(a) and (b) and would trigger application of, or an exception from, the mandatory clearing requirement. Although the information provided by the data in the DTCC–TIW does not allow us to identify the existence of a guarantee provided by a U.S. person with respect to a counterparty to a transaction or the location where the transaction is conducted, the Commission nevertheless preliminarily believes that the approach taken below would provide the best available estimate of the size of the security-based swap market that could be included in or excluded from the application of the mandatory clearing requirement by proposed Rule 3Ca–3.

As a starting point, the Commission has examined all transactions in single-name CDS during 2011<sup>1637</sup> and estimated that the notional amount of single-name CDS transactions executed during 2011 is \$2,400 billion.<sup>1638</sup>

<sup>1637</sup> For purposes of analyzing the programmatic effect of proposed Rule 3Ca–3, we do not consider historical data regarding the U.S. index-based CDS transactions. The statutory definition of security-based swap in relevant part includes swaps based on single securities or on narrow-based security indices. See Section 3(a)(68)(A) of the Exchange Act, 15 U.S.C. 78c(a)(68)(A). The historical data regarding the U.S. index-based CDS transactions encompass broad-based index CDS transactions that do not fall within the definition of security-based swaps.

<sup>1638</sup> This estimate is based on the calculation by staff of the Division of Risk, Strategy and Financial Innovation of all price-forming DTCC–TIW single-name CDS transactions that are based on North American corporate reference entities, U.S. municipal reference entities, U.S. loans or mortgage-backed securities (“MBS”), using ISDA North American documentation, ISDA U.S. Muni documentation, or other standard ISDA documentation for North American Loan CDS and CDS on MBS, and are denominated in U.S. dollars and executed in 2011. Price-forming transactions include all new transactions, assignments, modifications to increase the notional amounts of previously executed transactions, and terminations

<sup>1632</sup> See proposed Rule 3Ca–3(b) under the Exchange Act.

Proposed Rule 3Ca-3(a) provides that the mandatory clearing requirement shall apply to a security-based swap transaction if (i) a counterparty to the transaction is a U.S. person or a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person or (ii) such transaction is a transaction conducted within the United States. In applying proposed Rule 3Ca-3(a) to the \$2,400 billion single-name CDS transactions executed in 2011, the Commission uses account holders and their domicile information in the DTCC-TIW database to determine the status of the counterparties.<sup>1639</sup> Because the Commission's proposed definition of "U.S. person" is based primarily on the place of organization or principal place of business of a legal person and a legal person's principal place of business and place of organization are usually in the same country, the Commission believes that the domicile of a legal person is a reliable indicator of such person's U.S.-person status. In addition, based on the Commission's understanding that the security-based swap transactions of

of previously executed transactions. Transactions terminated, transactions entered into in connection with a compression exercise, and expiration of contracts at maturity are not considered price-forming and are therefore excluded, as are replacement trades and all bookkeeping-related trades. See note 1312, *supra*.

This figure differs from the single-name CDS notional volume calculated in the Clearing Procedures Adopting Release, \$2,800 billion, by \$400 billion. See Clearing Procedures Adopting Release, 77 FR 41638; see also Section XV.F.2(a) (discussing the programmatic effects of the mandatory clearing requirement), *supra*. This difference is primarily a result of removing the notional amount of security-based swap terminations in 2011 from the set of \$2,800 billion price-forming transactions.

<sup>1639</sup> For purposes of the analysis here, the determination of an account holder's domicile is based on the "registered office location" and the "settlement location" self-reported by account holders in DTCC-TIW. The registered office location typically represents the place of organization or principal place of business of a DTCC-TIW account holder. The settlement location may represent the parent, headquarter, or home office of a DTCC-TIW account holder. Staff in the Division of Risk, Strategy, and Financial Innovation has consistently observed that DTCC-TIW recorded the place of organization of an account holder that is a foreign subsidiary of a U.S. person or a foreign branch as such account holder's registered office location and the parent location or headquarter of the foreign branch (*i.e.*, the United States) as such account holder's settlement location. For purposes of identifying a counterparty's U.S. person status in the analysis here, staff in the Division of Risk, Strategy, and Financial Innovation uses the registered office location in DTCC-TIW as the domicile for a foreign subsidiary of a U.S. person and the settlement office location in DTCC-TIW as the domicile for a foreign branch. It is possible that some market participants may misclassify their "registered office location" and the "settlement location" because the databases in DTCC-TIW do not assign a unique legal entity identifier to each separate entity.

foreign subsidiaries of U.S. entities, unless sufficiently capitalized to have their own independent credit ratings, are generally guaranteed by the most creditworthy U.S.-based entity within the corporate group, *i.e.*, the U.S. parent, the Commission preliminarily believes that it is reasonable to assume that foreign subsidiaries of U.S.-domiciled entities are non-U.S. persons whose performance under security-based swap transactions is guaranteed by a U.S. person. Finally, the DTCC-TIW data do not provide sufficient information for us to identify whether a transaction was conducted in the United States. Solely for purposes of this analysis, we have assumed that transactions involving a U.S.-domiciled counterparty (excluding a foreign branch) or a U.S. foreign branch counterparty were conducted in the United States.<sup>1640</sup>

Based on these assumptions, we estimate that the subset of the single-name U.S. reference CDS market that includes a U.S.-domiciled counterparty (excluding a foreign branch of a U.S. bank), a foreign subsidiary of a U.S.-domiciled entity, or a U.S. branch of a foreign bank as a counterparty is \$1,900 billion notional amount of single-name U.S. reference CDS transactions.<sup>1641</sup> The Commission preliminarily believes that this figure provides an indicative level of the single-name U.S. reference CDS activity, which may present an indicative size of the security-based swap market, that could become subject to mandatory clearing under proposed Rule 3Ca-3(a) when the requirement becomes effective.<sup>1642</sup> In addition, we

<sup>1640</sup> Since the origination location of a transaction is not available in DTCC-TIW, the Commission recognizes that its analysis here may undercount transactions conducted within the United States because some transactions may be solicited, negotiated, or executed within the United States by an agent other than U.S. branches of foreign banks (such as a non-U.S. person counterparty using an unaffiliated third-party agent).

<sup>1641</sup> Such \$1,900 billion estimate does not capture transactions between two non-U.S. domiciled counterparties involving an agent to solicit, negotiate and execute security-based swaps in the United States and therefore, may be an underestimate of the aggregate notional amount of the single-name U.S. reference CDS transactions that may be included in the application of the mandatory clearing requirement under proposed Rule 3Ca-3(a) because of the assumption we make herein regarding transactions conducted within the United States. By the same token, the difference between the \$1,900 billion subset included in the application of the mandatory clearing requirement under proposed Rule 3Ca-3(a) and the \$2,400 billion total single-name U.S. reference CDS transactions (*i.e.*, \$500 billion or 20.8% of the \$2,400 billion) may represent an overestimate of single-name U.S. reference CDS transactions in notional amount that are not included in the application of the mandatory clearing requirement under proposed Rule 3Ca-3(a).

<sup>1642</sup> The Commission recognizes that the security-based swap market includes single-name CDS, CDS

recognize that the level of the security-based swap activity that could become subject to mandatory clearing under proposed Rule 3Ca-3(a) may be affected by the final rules adopted by the Commission regarding the end-user exception to mandatory clearing of security-based swaps.<sup>1643</sup>

Next, we apply proposed Rule 3Ca-3(b) to the transactions described above in order to estimate the portion of the single-name U.S. reference CDS activity, which may present an indicative size of the security-based swap market, that would not be subject to the mandatory clearing requirement under the proposed rule. We restate the assumptions described above with respect to the counterparty status of a U.S. person and a non-U.S. person whose performance under security-based swap transactions is guaranteed by a U.S. person, and the assumption with respect to a transaction conducted within the United States. In addition, because of a lack of information about the location of transactions, solely for assessing the effect of proposed Rule 3Ca-3(b)(i), we have assumed that transactions between a counterparty that is a foreign branch or foreign subsidiary of a U.S.-domiciled entity and another counterparty that is a foreign-domiciled entity that is not a subsidiary of a U.S.-domiciled entity or an ISDA-recognized dealer are not transactions conducted within the United States; and solely for assessing the effect of proposed rule 3Ca-3(b)(ii), we have assumed that transactions conducted between two foreign-domiciled counterparties that are not ISDA-recognized dealers and are not foreign subsidiaries of U.S.-domiciled entities are conducted within the United States. These assumptions likely overestimate the notional volume carved-out by proposed Rule 3Ca-3(b). With respect to the counterparty status as a registered security-based swap dealer, we recognize that as yet there are no dealers designated as security-based swap dealers and subject to the registration requirement. Solely for purposes of this analysis, we have assumed that those counterparties to

based on narrow-based indices, and other non-CDS security-based swaps, primary examples of which are equity swaps and total return swaps based on single equities or narrow-based indices of equities. As previously stated, we believe that the single-name CDS data are sufficiently representative of the security-based swap market as roughly 82% of the security-based swap market, as measured on a notional basis, appears likely to be single-name CDS. See Section XV.B.2 and the text accompanying note 1301, *supra*.

<sup>1643</sup> Solely for purposes of this analysis, we assume that the end-user exception is not available for transactions included in the indicative volume estimated here.

CDS transactions that were ISDA recognized dealers<sup>1644</sup> would be required to register as security-based swap dealers.

Based on the above assumptions, we have estimated that approximately 2.1% of the total notional amount<sup>1645</sup> of single-name U.S. reference CDS transactions executed in 2011, would be excluded from the scope of the application of the mandatory clearing requirement by proposed Rule 3Ca-3(b). Therefore, we preliminarily believe that 22.9% of the total size of the single-name U.S. reference CDS transactions in 2011 presents an indicative size of the U.S. security-based swap market that could be excluded from the application of the mandatory clearing requirement under proposed Rule 3Ca-3.<sup>1646</sup>

The Commission preliminarily believes that this estimate provides the best available proxy for the overall programmatic effect of the application of the mandatory clearing requirement in the cross-border context in terms of the portion of the single-name U.S. reference CDS activity that may be included or excluded in the scope of the application of the mandatory clearing requirement, given the data limitations

<sup>1644</sup> See note 1306, *supra*.

<sup>1645</sup> Based on calculations by staff of the Division of Risk, Strategy, and Financial Innovation applying the criteria provided in proposed Rule 3Ca-3(b) and the assumptions stated herein, approximately \$51 billion in notional amount, constituting approximately 2.1% of the total notional amount, of single-name U.S. reference CDS transactions executed in 2011 would be excluded from the application of the mandatory clearing requirement. Because of the assumptions we make herein regarding transactions conducted within the United States and transactions conducted outside the United States, the 2.1% may be an overestimate of the aggregate notional amount of the single-name U.S. reference CDS transactions that may be excluded from the application of the mandatory clearing requirement under proposed Rule 3Ca-3(b) under the Exchange Act.

<sup>1646</sup> The 22.9% estimate is the sum of the 20.8% estimate of the single-name U.S. reference CDS transactions excluded from mandatory clearing under proposed Rule 3Ca-3(a) and the 2.1% estimate of the single-name U.S. reference CDS transactions excluded from mandatory clearing under proposed Rule 3Ca-3(b). The Commission reiterates that both 20.8% and 2.1% may overestimate the size of the single-name U.S. reference CDS transactions excluded from the application of the mandatory clearing requirement under proposed Rules 3Ca-3(a) and (b).

In addition, as stated above, this calculation is conducted using U.S. reference single-name CDS transaction data in 2011. See the text accompanying notes 1637 and 1787, *supra*. The Commission recognizes that the same calculation could generate a different result if both U.S. reference and non-U.S. reference single-name CDS transaction data were used. However, with respect to non-U.S. reference single-name CDS transaction data, the Commission currently does not have access to the part of such data in DTCC-TIW regarding non-U.S. reference single-name CDS transactions that do not involve a U.S. counterparty on either side of the transaction. See Section XV.B.2, *supra*.

and the underlying assumptions described above.<sup>1647</sup> The Commission is mindful that the above analysis represents only an indicative estimate of the portion of the single-name U.S. reference CDS activity, which may present an indicative size of the security-based swap market, that may be included or excluded from the scope of the application of the mandatory clearing requirement as a result of the proposed Rule 3Ca-3. The Commission also recognizes that the above analysis represents an extrapolation from the limited data that is currently available to the Commission.

#### (b) Programmatic Benefits and Costs of Proposed Rule 3Ca-3

The Commission's approach to application of the mandatory clearing requirement generally focuses on any person engaging in a security-based swap in the United States. As stated above, the Commission would preliminarily interpret the statutory language "engage in a security-based swap" to include transactions in which a counterparty performs any of the functions that are central to carrying out a security-based swap transaction (*i.e.*, solicitation, negotiation, execution, or booking of the transaction) within the United States. The Commission proposes to interpret that a transaction in which one of the counterparties is a U.S. person is a security-based swap in the United States. The Commission also is proposing to interpret the statutory language "engage in a security-based swap" to include transactions in which a U.S. person provides a guarantee on a non-U.S. person's performance under a security-based swap because of the involvement of the U.S. person in the transaction. Therefore, the Commission is proposing a rule that would apply the mandatory clearing requirements to a security-based swap if (i) a counterparty to the security-based swap transaction is (x) a U.S. person or (y) a non-U.S. person counterparty whose performance of obligations under the security-based swap is guaranteed by a U.S. person, or (ii) such transaction is a transaction conducted within the United States, subject to certain exceptions.

Economically, a U.S. person's security-based swap activity poses risk to the U.S. financial system because security-based swap transactions give rise to ongoing obligations on the part of the U.S. person and at the same time the U.S. person is exposed to the credit risk of its non-U.S. counterparties.

<sup>1647</sup> The Commission reiterates that the assumptions made here are solely for purposes of this economic analysis.

Similarly, a guarantee provided by a U.S. person gives the counterparty of the guaranteed entity direct recourse to the U.S. guarantor with respect to any obligations owed by the guaranteed entity under the security-based swap. As a result, the U.S. guarantor exposes itself to the security-based swap risk as if it were a direct counterparty. Therefore, the Commission preliminarily believes that U.S. persons and non-U.S. person whose performance in security-based swap transactions is guaranteed by U.S. persons serve as major conduits of systemic risk to the U.S. financial system, and therefore, transactions involving U.S. persons and non-U.S. persons whose performance under security-based swaps are guaranteed by U.S. persons should fall within the scope of application of the mandatory clearing requirement, regardless of where the security-based swap activity takes place.

On the other hand, as previously discussed,<sup>1648</sup> the Commission has acknowledged that subjecting U.S. persons and non-U.S. persons whose performance in security-based swap transactions is guaranteed by U.S. persons to these requirements may have key consequences for competition, liquidity, and efficiency, and for U.S. persons' access to the foreign security-based swap market.

To the extent that foreign law does not subject participants in the foreign security-based swap market to mandatory clearing or impose margin requirements on non-cleared security-based swaps equivalent to margin that would be required by CCPs, this requirement under Title VII may make it more costly for non-U.S. persons to transact with U.S. person and guaranteed non-U.S. person counterparties because these transactions may be subject to higher margin requirements imposed by CCPs than under foreign law. This may make it difficult for U.S. persons and guaranteed non-U.S. persons to access foreign markets and liquidity provided by non-guaranteed non-U.S. persons, and could generate incentives for U.S. persons and guaranteed non-U.S. persons to restructure their security-based swap businesses to fall outside the scope of Title VII. In such instances, the incentive to restructure operations may decrease if foreign jurisdictions impose margin requirements on non-cleared security-based swaps. If these margin requirements on non-cleared security-based swaps are economically equivalent to or higher than CCP margin

<sup>1648</sup> See Section XV.C, *supra*.

requirements for cleared security-based swaps, restructuring operations would provide few private benefits for market participants.

The Commission preliminarily believes that the carve-out in Rule 3Ca-3(b)(1) excludes from the mandatory clearing requirement those transactions involving foreign branches and guaranteed non-U.S. persons who are most likely to engage in transactions under foreign law. Such a carve-out reduces potential disruption to the foreign business of U.S. persons and guaranteed non-U.S. persons in the foreign security-based swap market.<sup>1649</sup> These benefits come at the cost of increased systemic risk. The counterparty risk associated with non-cleared transactions that involve foreign branches and guaranteed non-U.S. persons is ultimately borne by the U.S. financial system.

The incremental increase in systemic risk would likely be small, since the carve-out in proposed Rule 3Ca-3(b)(1) does not apply to security-based swap dealers. Moreover, as mentioned before, the magnitude of these risks may be further reduced by subjecting non-cleared security-based swap positions to margin requirements that are economically equivalent to margin requirements imposed by a CCP. However, the transactions carved-out by proposed Rule 3Ca-3(b)(1) remain a route over which systemic risk may enter the United States from abroad.

In addition, the Commission recognizes that, in the case of counterparty risk and central clearing, the location of a transaction is not necessarily a proxy for the U.S. market's exposure to counterparty risk. As a result, proposed Rule 3Ca-3(b)(2) would except transactions conducted within the United States between two non-U.S. persons who are not security-based swap dealers and whose performance under security-based swap transactions are not guaranteed by U.S. persons. The Commission preliminarily believes that such an exception could potentially reduce the aggregate programmatic costs associated with the mandatory clearing requirement to non-U.S. participants that engage in security-based swap transactions within the United States. The Commission recognizes that non-guaranteed non-U.S. persons who are not foreign security-based swap dealers may include financial entities that are systemically important, such as major swap participants or major security-based swap participants, or otherwise play an important role in the U.S. or a foreign financial system or the

derivatives market, such as swap dealers, commodity pools, private funds, or banking entities that are financial holding companies. The failure of such financial entities, although they are non-guaranteed non-U.S. persons, may have spillover effects on the U.S. financial system. Such spillover effects may be mitigated by the capital and margin requirements imposed on swap dealers, major swap participants, or major security-based swap participants, the prudential regulators' supervision under banking regulations, the Employee Retirement Income Security Act of 1974<sup>1650</sup> or other applicable law and regulations.

On the other hand, the Commission also preliminarily believes that the proposed application of the mandatory clearing requirement in the cross-border context would still mitigate the U.S. financial system's exposure to systemic risk since the carve-out in proposed Rule 3Ca-3(b)(2) would not apply to participants that are registered security-based swap dealers and those that carry U.S. guarantees on their performance in security-based swap transactions. The Commission has separately considered the potential implications of this exception on competition and efficiency in the security-based swap market.<sup>1651</sup> Specifically, the Commission preliminarily believes that imposing mandatory clearing on U.S. persons, guaranteed non-U.S. persons and foreign security-based swap dealers when they conduct security-based swaps in the United States will mitigate the counterparty credit risk among trading counterparties and increase confidence in trading security-based swaps, thereby increasing competition in the U.S. security-based swap market.

#### (c) Alternatives

The Commission has considered several alternatives in proposing Rule 3Ca-3. First, commenters proposed an alternative framework in which transactions that are "required to be cleared under foreign law" not be "required to be cleared under [Title VII]." <sup>1652</sup> Commenters noted, for example, that conflicts may arise between Title VII and "foreign laws that require swaps to be cleared through local clearinghouses."<sup>1653</sup> Another comment stated that mandatory clearing "is not necessary to protect U.S. financial institutions, markets or customers" where mandatory clearing requirements are imposed by foreign

law because "the risks associated with such transactions reside in the relevant foreign central clearing counterparty."<sup>1654</sup>

The Commission preliminarily believes that the commenters' proposed approach to the mandatory clearing of cross-border security-based swap transactions would not sufficiently address the risk to the U.S. financial system posed by transactions being conducted by non-U.S. persons,<sup>1655</sup> and accordingly seeks comment on whether this preliminary assessment is correct. Whether a security-based swap transaction that is cleared under foreign law represents a risk to the U.S. financial system depends upon whether the foreign jurisdiction has a robust legal framework for the regulation of, and maintains adequate regulatory oversight over, CCPs. Although the Commission recognizes that this alternative may reduce costs to counterparties, the Commission cannot at this time assess the quality of regulation of foreign CCPs. Rather than categorically exclude from the scope of the proposed rule any transaction required to be cleared under foreign law, the Commission preliminarily believes that such transactions should be captured by the rule to further the purposes of Title VII to, among other things, mitigate systemic risk. Determinations regarding substituted compliance and determinations imposing mandatory clearing could address whether and when to include or exclude transactions from the mandatory clearing requirement based on the particular characteristics of the foreign regulatory regime, counterparties, or swap instruments in question.

Second, the Commission could have proposed to apply the mandatory clearing requirement in the same way as the CFTC's proposed interpretive guidance. The CFTC would apply the mandatory clearing requirement to a transaction conducted outside the United States between a foreign branch and a non-guaranteed non-U.S. person. Although we recognize that the guarantees provided by U.S. persons remain a conduit for systemic risk to be transmitted to the United States, the Commission preliminarily believes that subjecting such a transaction to mandatory clearing would impede the ability of U.S.-based dealing entities to

<sup>1654</sup> Davis Polk Letter I at 8.

<sup>1655</sup> The Commission notes that commenters' concerns regarding a potential conflict arising between foreign law requirements that security-based swaps be cleared locally and Title VII are, in part, also addressed by the registration regime for clearing agencies proposed in Section V.B above.

<sup>1649</sup> See Section XV.C, *supra*.

<sup>1650</sup> 28 U.S.C. 1002, *et seq.*

<sup>1651</sup> See Section XV.C, *supra*.

<sup>1652</sup> Davis Polk Letter II at 21.

<sup>1653</sup> *Id.* at 22 n.92.



access foreign markets and potentially promote market fragmentation.

Finally, and in lieu of the proposed rule, the Commission could have proposed Rule 3Ca-3(a) only to apply the mandatory clearing requirement contained in Section 3C(a)(1) of the Exchange Act, without also proposing the carve-out in proposed Rule 3Ca-3(b). The Commission preliminarily believes, however, that proposed Rule 3Ca-3(a), acting alone, does not sufficiently account for the proposed approach's potential effect on competition between security-based swap market participants, as required under Section 3C(b)(4) of the Exchange Act.<sup>1656</sup> As discussed above, market participants seeking to avoid clearing of cross-border security-based swaps may avoid doing business with members of clearing agencies registered with the Commission, U.S. persons who provide guarantees on performance under such swaps, or the foreign branches of U.S. persons, to avoid being subject to the mandatory clearing requirement. This may also create dislocations in the security-based swap market, reducing the anticipated risk-sharing benefits of clearing. As mentioned above, the Commission preliminarily believes that these benefits would come at the cost of increased risk that counterparty failures in foreign jurisdictions generate losses to U.S. financial market participants engaging in uncleared security-based swap transactions under Rule 3Ca-3(b).

#### (d) Assessment Costs

The assessment costs associated with proposed Rule 3Ca-3 would be primarily related to identification of counterparty status and where the transaction was conducted in order to determine whether the mandatory clearing requirement would apply. The same assessment would be performed not only in connection with the proposed application of the mandatory clearing requirement in the cross-border context but also in connection with proposed application of the SDR reporting,<sup>1657</sup> real-time reporting,<sup>1658</sup> and mandatory trade execution requirements<sup>1659</sup> in the cross-border

context, and therefore, would be part of overall Title VII compliance costs.

We preliminarily believe that market participants would request representations from their transaction counterparties to determine the U.S.-person status of their counterparties. In addition, if the transaction is guaranteed by a U.S. person, the guarantee would be part of the trading documentation, and therefore the existence of the guarantee would be a readily ascertainable fact. Similarly, market participants would be able to rely on their counterparty's representation as to whether a transaction is solicited, negotiated or executed by a person within the United States.<sup>1660</sup> Therefore, the Commission preliminarily believes that the assessment costs associated with proposed Rule 3Ca-3 should be limited to the costs of establishing a compliance policy and procedure for requesting and collecting representations from trading counterparties and maintaining the representations collected as part of the recordkeeping procedures. The Commission preliminarily believes that such assessment costs would be approximately \$15,160.<sup>1661</sup> The Commission preliminarily believes that requesting and collecting representations would be part of the standardized transaction process reflected in the policies and procedures regarding security-based swap sales and trading practices and should not result in separate assessment costs.<sup>1662</sup>

We also consider the likelihood that market participants may implement systems to maintain information about counterparty status for purposes of future trading of security-based swaps that are similar to, if not the same as, the systems implemented by market

participants for purposes of assessing security-based swap dealer or major security-based swap participant status. As stated above, we estimated that market participants that perceived the need to perform the security-based swap dealer assessment or major security-based swap participant calculations would incur one-time programming costs of 12,870.<sup>1663</sup> Therefore, the Commission estimates the total one-time costs per entity associated with proposed Rule 3Ca-3 could be \$28,030.<sup>1664</sup> To the extent that market participants have incurred costs relating to similar or the same assessments with respect to counterparty status and location of the transactions for other Title VII requirements, their assessment costs with respect to proposed Rule 3Ca-3 may be less.

#### Request for Comment

The costs and benefits of the proposed rule discussed above represent the Commission's preliminary view regarding the mandatory clearing requirement in the cross-border context. The Commission seeks comment on the proposed rule in all aspects. Interested persons are encouraged to provide supporting data and analysis and, when appropriate, suggest modifications to proposed rule text and interpretations. Responses that are supported by data and analysis provide great assistance to the Commission in considering the benefits and costs of proposed requirements, as well as considering the practicality and effectiveness of the proposed application. In addition, the Commission seeks comment on the following specific questions:

- Are there any benefits and costs not discussed herein? If so, please identify, discuss, analyze, and supply relevant

<sup>1660</sup> See proposed Rules 3a71-3(a)(4)(ii) and (a)(5)(ii) under the Exchange Act, as discussed in Section III.B.6, *supra*.

<sup>1661</sup> This estimate is based on an estimated 40 hours of in-house legal or compliance staff's time to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be built into the form of standardized trading documentation. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379.

<sup>1662</sup> There will be ongoing costs associated with processing representations received from counterparties, including additional due diligence and verification to the extent that a counterparty's representation is contrary to or inconsistent with the knowledge of the collecting party. The Commission believes that these would be compliance costs encompassed within the programmatic costs associated with substituted compliance.

<sup>1663</sup> This is based on an estimate of the time required for a programmer analyst to modify the software to track the U.S.-person status of a counterparty and to record and classify whether a transaction is a transaction conducted within the United States, including consultation with internal personnel, and an estimate of the time such personnel would require to ensure that these modifications conformed to proposed definitions of U.S. person and transaction conducted within the United States. Using the estimated hourly costs described above, we estimate the costs as follows: (Compliance Attorney at \$310 per hour for 2 hours) + (Compliance Manager at \$269 per hour for 4 hours) + (Programmer Analyst at \$234 per hour for 40 hours) + (Senior Internal Auditor at \$217 per hour for 4 hours) + (Chief Financial Officer at \$473 per hour for 2 hours) = \$12,870. For the source of the estimated per hour costs. See note 1425, *supra*.

<sup>1664</sup> The \$28,030 per entity cost is derived from a \$15,160 cost of establishing a written compliance policy and procedures regarding obtaining counterparty representations plus a \$12,870 one-time programming cost relating to system implementation to maintain counterparties representations and track the counterparty status in the system.

<sup>1656</sup> See 15 U.S.C. 78c-3(b)(4) (requiring the Commission, in considering whether to impose a mandatory clearing requirement for security-based swaps, to consider, among other factors, the "effect on competition").

<sup>1657</sup> See proposed Rule 908(a) under the Exchange Act, as discussed in Section VIII.C.1, *supra*, and Section XV.H.3(a), *infra*.

<sup>1658</sup> See proposed Rule 908(b) under the Exchange Act, as discussed in Section VIII.C.2, *supra*, and Section XV.H.3(c), *infra*.

<sup>1659</sup> See proposed Rule 3Ch-1 under the Exchange Act, as discussed in Section X.B, *supra*, and Section XV.G.4, *infra*.

data, information, or statistics regarding any such costs or benefits?

- Are the benefits and costs discussed herein accurate? If not, how can the Commission most accurately assess the benefits and costs arising from the mandatory clearing requirement and the proposed rule?

- Are there quantifiable costs associated with either the mandatory clearing requirement generally or the proposed rule specifically that have not been addressed and should be? If so, identify and describe them as thoroughly as possible, using relevant data and statistics where available.

- To what extent, if any, do the benefits and costs change when comparing the application of mandatory clearing to security-based swap transactions occurring within the United States and outside the United States? Is there relevant data not considered here that would assist the Commission in assessing such potentially disparate benefits and costs? If so, supply the relevant data, information, or statistics.

- To what extent, if any, do the benefits and costs change when considering the application of mandatory clearing of security-based swap transactions to a U.S. person in comparison to a guaranteed non-U.S. person? To a non-guaranteed non-U.S. person? To a foreign branch? To a counterparty that is a security-based swap dealer? Would the benefits and costs differ significantly if we applied mandatory clearing requirements to a person who is a member of a registered clearing agency? Is there relevant data not considered here that would assist the Commission in assessing such disparate costs and benefits? If so, supply the relevant data, information, or statistics.

- (i) The CFTC has proposed to apply the mandatory clearing requirement to all transactions entered into by U.S.-based swap dealers, including foreign branches and transactions entered into by foreign affiliates of U.S. persons or non-U.S.-based swap dealer with U.S. persons or non-U.S. persons guaranteed by U.S. persons, without differentiating where the swap transactions are conducted within the United States or outside the United States. Should the Commission adopt the CFTC's approach to application of the mandatory clearing requirement in the cross-border context from the cost and benefit perspective? What are the cost and benefit considerations associated with taking the CFTC's approach? (ii) The Commission's proposed approach to application of the mandatory clearing requirement differentiates transactions

conducted within the United States and transactions conducted outside the United States. Is such differentiation appropriate from the cost and benefit perspective? Has the Commission appropriately considered the costs and benefits associated with such differentiation? (iii) Are there any other approaches to application of the mandatory clearing requirement that the Commission should consider adopting from a cost and benefit perspective?

- To what extent, if any, should the Commission consider the characteristics of the underlying reference entity in assessing the benefits and costs flowing from the mandatory clearing requirement? Are there any other characteristics of a security-based swap transaction not discussed here that might affect an assessment of the benefits and costs of imposing a mandatory clearing requirement?

- Has the Commission appropriately considered the benefits and costs of the alternative approaches discussed above for application of the mandatory clearing requirement in the cross-border context? In answering this question, consider addressing whether the Commission has appropriately valued the benefits and costs of possible duplicative clearing requirements and whether the Commission has appropriately valued the benefits and costs of creating overlap in the regulatory regimes of the United States and a foreign regulator. Also consider whether the Commission has appropriately valued the benefits and costs of the possible effects on the competitiveness of persons subject to the mandatory clearing requirement and those persons carved out or otherwise excluded from the requirement.

### *G. The Economic Analysis of Application of Rules Governing Security-Based Swap Trading in the Cross-Border Context*

A key goal of the Dodd-Frank Act is to increase the transparency and oversight of the OTC derivatives market by, among other things, bringing trading of security-based swaps onto regulated markets.<sup>1665</sup> Section 763 of the Dodd-Frank Act amends the Exchange Act by adding a mandatory trade execution requirement<sup>1666</sup> and various new statutory provisions governing SB SEFs.<sup>1667</sup> Specifically, Section 3D(a)(1) of the Exchange Act states that no person may operate a facility for the

trading or processing of security-based swaps, unless the facility is registered as a SB SEF or as a national securities exchange under that section.<sup>1668</sup> In addition, Section 3C(h)(1) of the Exchange Act requires, with respect to transactions involving security-based swaps subject to the mandatory clearing requirement of Section 3C(a)(1) of the Exchange Act, that counterparties execute such transactions on an exchange or a SB SEF that is registered under Section 3D of the Exchange Act or is exempt from registration under Section 3D(e) of the Exchange Act,<sup>1669</sup> subject to the exceptions set forth in Section 3C(h)(2) of the Exchange Act.<sup>1670</sup>

This portion of the economic analysis addresses the programmatic benefits and costs associated with these statutory requirements and their proposed application in the cross-border context. Specifically, this section addresses the programmatic benefits and costs of: (1) the Commission's proposed interpretation of the application of the registration requirements of Section 3D of the Exchange Act to foreign security-based swap markets; (2) the potential availability to foreign security-based swap markets of exemptive relief from the registration requirements; (3) the mandatory trade execution requirement of Section 3C(h) of the Exchange Act; and (4) proposed Rule 3Ch-1 regarding application of the mandatory trade execution requirement in the cross-border context.

<sup>1668</sup> See Public Law 111-203, section 763(a) (adding Section 3D(a)(1) of the Exchange Act). The Commission views this requirement as applying only to facilities that meet the definition of "security-based swap execution facility" in Section 3(a)(77) under the Exchange Act. See SB SEF Proposing Release, 76 FR 10949 n.10.

<sup>1669</sup> See 15 U.S.C. 78c-3(h)(1). Section 3D(e) of the Exchange Act states that the Commission may exempt, conditionally or unconditionally, a SB SEF from registration under Section 3D if the Commission finds that the facility is subject to comparable, comprehensive supervision and regulation on a consolidated basis by the CFTC. 15 U.S.C. 78c-4(e).

<sup>1670</sup> Section 3C(h)(2) provides two exceptions to compliance with the mandatory trade execution requirement: (i) if no exchange or SB SEF makes the security-based swap available to trade; or (ii) for security-based swap transactions subject to the clearing exception under Section 3C(g) of the Exchange Act. See 15 U.S.C. 78c-3(h)(2). Security-based swaps that are not subject to the mandatory trade execution requirement would not have to be traded on a registered SB SEF and could be traded in the OTC market for security-based swaps. See SB SEF Proposing Release, 76 FR 10949 n.10.

<sup>1665</sup> See Public Law 111-203, preamble.

<sup>1666</sup> See Public Law 111-203, section 763 (adding Section 3C(h) of the Exchange Act).

<sup>1667</sup> See Public Law 111-203, section 763 (adding Sections 3C and 3D of the Exchange Act).

1. Programmatic Benefits and Costs of the Proposed Application of the Registration Requirements of Section 3D of the Exchange Act to Foreign Security-Based Swap Markets

As discussed above, the Commission has proposed herein to interpret when the registration requirements of Section 3D of the Exchange Act<sup>1671</sup> would apply to a foreign security-based swap market.<sup>1672</sup> The Commission is endeavoring to draw the appropriate lines for the application of those requirements to foreign security-based swap markets when they act in capacities that meet the definition of "security-based swap execution facility" under the Dodd-Frank Act.<sup>1673</sup> As stated above, not all foreign security-based swap markets would be subject to the registration requirements of Section 3D of the Exchange Act and the rules proposed thereunder. The Commission preliminarily believes that only those foreign security-based swap markets that engage in certain activities with respect to U.S. persons, or non-U.S. persons located in the United States, would be subject to the registration requirements.<sup>1674</sup>

The Commission preliminarily believes that the lines the Commission is proposing to draw with respect to the application of Section 3D's registration requirements in the cross border context would result in programmatic benefits for the U.S. security-based swap market as a whole that are intended by Title VII, *i.e.*, increased pre-trade transparency, increased competition, and improved oversight.<sup>1675</sup> The Commission also is mindful, however, that certain costs would be associated with our proposal. The Commission's consideration and discussion of the programmatic benefits and costs of the formation and registration of a SB SEF in the SB SEF Proposing Release did not differentiate between domestic and

foreign security-based swap markets. The Commission notes, however, that the SB SEF Proposing Release contemplated that foreign security-based swap markets would seek to register as SB SEFs and proposed certain requirements specifically for non-resident<sup>1676</sup> persons seeking to register as a SB SEF.<sup>1677</sup> The Commission received no comments on the SB SEF Proposing Release indicating that the benefits and costs associated with SB SEF registration would be different for foreign and domestic security-based swap markets.<sup>1678</sup> Accordingly, the Commission preliminarily believes that the programmatic benefits and costs associated with a security-based swap market registered with the Commission as a SB SEF and subject to the requirements set forth in Section 3D of the Exchange Act, and the proposed rules and regulations thereunder, would be substantially the same for both a domestic and a foreign security-based swap market.<sup>1679</sup>

(a) Programmatic Benefits

The Commission preliminarily believes that application of the statutory registration requirements and Regulation SB SEF to foreign security-based swap markets that engage in the activities noted above with respect to U.S. persons, or non-U.S. persons located in the United States,<sup>1680</sup> would generate programmatic benefits similar to those described in the SB SEF Proposing Release with respect to the registration and regulation of SB SEFs, *i.e.*, enhanced transparency, competition, and oversight of security-based swaps,<sup>1681</sup> which are discussed

below. The Commission also believes that our proposed application of the statutory registration requirements and Regulation SB SEF to foreign security-based swap markets is appropriately tailored to extend these benefits to the security-based swap activity that is most likely to raise the concerns that Congress intended to address in Title VII.<sup>1682</sup> In the Commission's preliminary view, a different application could undermine these goals. By way of example and without limitation, if a foreign security-based swap market could provide proprietary electronic trading screens for the execution or trading of security-based swaps by, or grant membership or participation in the foreign security-based swap market to, U.S. persons, or non-U.S. persons located in the United States, without being required to register under Section 3D, there could be security-based swap trading venues available to U.S. persons, or non-U.S. persons located in the United States, that are not subject to Commission regulation and oversight. The regulatory benefits that the Commission believes Title VII intends to bring to the U.S. security-based swap market would not be fully realized in such a scenario.

*Improved Transparency.* The trading of security-based swaps on regulated markets, such as SB SEFs, should help bring more transparency to the U.S. marketplace for security-based swaps. Increased pre-trade transparency should help alleviate informational asymmetries that may exist today in the security-based swap market and allow an increased number of market participants to see the trading interest of other market participants prior to submitting trades, which should lead to increased price competition among market participants.<sup>1683</sup> As such, the Commission preliminarily believes that proposed Regulation SB SEF should lead to more efficient pricing in the security-based swap market,<sup>1684</sup> but is mindful that, under certain circumstances, pre-trade transparency also could discourage the provision of

competition and pre-trade price transparency. See SDMA Letter I at 8–9 and SDMA Letter II at 2; see also Section XXII, *infra*.

<sup>1682</sup> See Section II.B., *supra*.

<sup>1683</sup> See SB SEF Proposing Release, 76 FR 11036; see also Ananth Madhavan, "Market Microstructure: A Practitioner's Guide," *Fin. Analysts J.*, Vol. 58 (2002), at 38 (nondisclosure of pre-trade price information benefits dealers by reducing price competition).

<sup>1684</sup> See SB SEF Proposing Release, 76 FR 11036; see also Ekkehart Boehmer, *et al.*, "Lifting the Veil: An Analysis of Pre-Trade Transparency at the NYSE," *J. of Fin.*, Vol. LX (2005) (greater pre-trade price transparency leads to more efficient pricing).

<sup>1671</sup> 15 U.S.C. 78c–4.

<sup>1672</sup> See Section VII.B., *supra*. A foreign security-based swap market that would be subject to the registration requirement of Section 3D of the Exchange Act also would be subject to the proposed registration rules for SB SEFs, if adopted. See SB SEF Proposing Release, 76 FR 10949.

<sup>1673</sup> See Public Law 111–203, section 761(a) (adding Section 3(a)(77) of the Exchange Act to define "security-based swap execution facility," 15 U.S.C. 78c(a)(77)). Entities that do not meet the definition of SB SEF may nonetheless be required to register in another capacity under the Exchange Act.

<sup>1674</sup> See Section VII.B., *supra*, for the non-exhaustive discussion of activities that the Commission preliminarily believes would warrant the application of the SB SEF registration requirements to a foreign security-based swap market.

<sup>1675</sup> See SB SEF Proposing Release, 76 FR 11036–38.

<sup>1676</sup> See note 834, *supra* (noting that usage of the term "non-resident," as well as the term "foreign," in connection with a security-based swap market refers to a security-based swap market that is not a U.S. person).

<sup>1677</sup> See note 1697, *infra*, and accompanying text.

<sup>1678</sup> In the SB SEF Proposing Release, the Commission estimated that as many as 20 security-based swap trading platforms or systems could seek to register with the Commission as SB SEFs. See SB SEF Proposing Release, 76 FR 11023. No commenter indicated that the Commission's estimate was erroneous.

<sup>1679</sup> A more detailed description of the benefits and costs associated with the formation and registration of SB SEFs is set forth in the SB SEF Proposing Release, 76 FR 11035–48. As set forth in the Request for Comment section below, the Commission invites comment on whether the benefits and costs associated with SB SEF registration would be the same for domestic and foreign security-based swap markets.

<sup>1680</sup> See Section VII.B., *supra*.

<sup>1681</sup> See SB SEF Proposing Release, 76 FR 11036. One commenter on the SB SEF Proposing Release stated that certain benefits would result from the trading of security-based swaps occurring on SB SEFs, including narrower bid-ask spreads and lower transaction costs as a result of increased

liquidity by some market participants, as discussed in more detail below.<sup>1685</sup>

**Improved Competition.** The Commission preliminarily believes that registration and regulation of SB SEFs, as described in the SB SEF Proposing Release, also would foster greater competition in the trading of security-based swaps by increasing access to security-based swap trading venues.<sup>1686</sup> The proposed SB SEF rules would require SB SEFs to permit all eligible persons that meet the requirements for becoming participants, as set forth in the SB SEF's rules, to become participants in the SB SEF.<sup>1687</sup> The proposed SB SEF rules would require each SB SEF to establish fair, objective and not unreasonably discriminatory standards for granting impartial access to trading on the SB SEF.<sup>1688</sup> These proposed requirements are designed to provide market participants with impartial access.<sup>1689</sup> Having impartial access should, in turn, promote greater participation by liquidity providers and increased competition on each SB SEF.<sup>1690</sup> Impartial access requirements also should help guard against the potential for certain participants in a SB SEF (who also might be owners of the SB SEF) to seek to limit the number of other participants in the SB SEF as a way to reduce competition and increase their own profits.<sup>1691</sup>

**Improved Oversight.** As set forth in the SB SEF Proposing Release, the proposed registration rules for SB SEFs would incorporate the requirement

<sup>1685</sup> See SB SEF Proposing Release, 76 FR 11036; see also Section XV.G.1(b), *infra*; see also Ananth Madhavan, *et al.*, "Should Securities Markets Be Transparent?" J. of Fin. Markets, Vol. 8 (2005) (finding that an increase in pre-trade price transparency leads to lower liquidity and higher execution costs, because limit-order traders are reluctant to submit orders given that their orders essentially represent free options to other traders).

<sup>1686</sup> See SB SEF Proposing Release, 76 FR 11037–38.

<sup>1687</sup> *Id.* at 11037. Proposed Rule 809(a) in Regulation SB SEF would require SB SEFs to permit a person to become a participant in the SB SEF only if such person is registered with the Commission as a security-based swap dealer, major security-based swap participant, or broker (as defined in Section 3(a)(4) of the Exchange Act, 15 U.S.C. 78c(a)(4)), or if such person is an eligible contract participant (as defined in Section 3(a)(65) of the Exchange Act, 15 U.S.C. 78c(a)(65)).

<sup>1688</sup> See SB SEF Proposing Release, 76 FR 11037.

<sup>1689</sup> *Id.*; see also Section 3D(d)(2)(B)(i) of the Exchange Act, 15 U.S.C. 78c–4(d)(2)(B)(i).

<sup>1690</sup> See SB SEF Proposing Release, 76 FR 11037; see also Section XV.C.3, *supra* (stating that in markets with impartial access, security-based swaps would be available to more participants, and that fair and equal access to security-based swaps not only promotes competition, but also encourages participants to express their true valuations for security-based swaps and lowers search costs for participants deciding to enter or exit a security-based swap position).

<sup>1691</sup> See SB SEF Proposing Release, 76 FR 11037.

under the Dodd-Frank Act that a SB SEF, to be registered and maintain registration, must comply with the 14 Core Principles governing SB SEFs in Section 3D(d) of the Exchange Act<sup>1692</sup> ("Core Principles") and any requirement that the Commission may impose by rule or regulation.<sup>1693</sup> The proposed SB SEF rules and proposed Form SB SEF are intended to implement the statutory registration requirements and assist the Commission in overseeing and regulating the security-based swap market.<sup>1694</sup> The information to be provided on proposed Form SB SEF (and the exhibits thereto) is designed to enable the Commission to assess whether an applicant seeking to become a registered SB SEF has the capacity and the means to perform the duties of a SB SEF and to comply with the Core Principles and other requirements governing registered SB SEFs.<sup>1695</sup> In addition, the amendments, supplemental information and notices that the Commission proposed to require registered SB SEFs to file pursuant to Rules 802, 803, and 804 of proposed Regulation SB SEF are designed to further the ability of the Commission to efficiently monitor SB SEFs' compliance with the provisions of the Exchange Act and to oversee the marketplace for security-based swaps and, specifically, the trading of security-based swaps on SB SEFs.<sup>1696</sup> Moreover, as discussed in the SB SEF Proposing Release, any non-resident persons seeking to register as a SB SEF must comply with certain requirements, including that such non-resident persons provide assurances that they are legally permitted to provide the Commission with prompt access to their books and records and to be subject to inspection and examination by the Commission.<sup>1697</sup>

Registration and regulation of SB SEFs would require SB SEFs to maintain an audit trail and surveillance systems to monitor trading.<sup>1698</sup>

<sup>1692</sup> 15 U.S.C. 78c–4(d).

<sup>1693</sup> See SB SEF Proposing Release, 76 FR 10949.

<sup>1694</sup> See *id.* at 10949–50.

<sup>1695</sup> See proposed Form SB SEF under the Exchange Act; see also SB SEF Proposing Release, 76 FR 11004–08.

<sup>1696</sup> See proposed Rules 802–804 under the Exchange Act; see also SB SEF Proposing Release, 76 FR 11002–04.

<sup>1697</sup> See proposed Rule 801(f) under the Exchange Act; see also SB SEF Proposing Release, 76 FR 11001.

<sup>1698</sup> See proposed Rule 818(c) under the Exchange Act, which would require each SB SEF to keep audit trail records relating to all orders, requests for quotations, responses, quotations, other trading interest, and transactions that are received by, originated on, or executed on, the SB SEF; and proposed Rules 811(j), 813(a)(2) and 813(b) under the Exchange Act, which would require each SB

Proposed Regulation SB SEF also would require comprehensive reporting and recordkeeping by SB SEFs.<sup>1699</sup> These requirements would put in place a structure that would provide the SB SEF with information to better enable it to oversee trading on its market by its participants, including detecting and deterring fraudulent and manipulative acts.<sup>1700</sup> The proposed rules for SB SEFs also would provide the Commission with greater access to information on the trading of security-based swaps to support its responsibilities to oversee the security-based swap market.<sup>1701</sup> Further, the proposed rules for SB SEFs would enable the Commission to share that information with other federal financial regulators, including in instances of broad market turmoil.<sup>1702</sup>

Improved regulatory oversight could encourage participation in the U.S. security-based swap market by investors who could benefit from such participation but currently choose to avoid transacting in that market in part because the market is opaque and largely has not been subject to oversight by U.S. regulatory authorities. Indeed, to the extent that market participants consider a well-regulated market as significant to their investment decisions, trust, which is a component of investor confidence, is improved and market participants may be more willing to participate in the U.S. security-based swap market.<sup>1703</sup>

#### (b) Programmatic Costs

Although the Commission believes that application of the registration requirements of Section 3D and proposed Regulation SB SEF to foreign security-based swap markets would result in significant benefits to the U.S. security-based swap market, the Commission recognizes that foreign security-based swap markets also would incur significant costs to comply with the proposed registration requirements for foreign security-based swap markets similar to those that domestic SB SEFs would incur, as discussed in the Regulation SB SEF proposal.<sup>1704</sup> These costs are summarized below.

SEF to electronically surveil its market and to maintain an automated surveillance system; see also SB SEF Proposing Release, 76 FR 11037–38.

<sup>1699</sup> See proposed Rule 818 under the Exchange Act; see also SB SEF Proposing Release, 76 FR 11037–38.

<sup>1700</sup> See SB SEF Proposing Release, 76 FR 11037.

<sup>1701</sup> *Id.*

<sup>1702</sup> *Id.*

<sup>1703</sup> See *id.* at 11037.

<sup>1704</sup> See *id.* 11040–48. A detailed breakdown of the cost estimates associated with all aspects of SB SEF formation and compliance with the rules proposed under proposed Regulation SB SEF are

Continued

**SB SEF Formation.** According to industry sources consulted by Commission staff in connection with the issuance of the SB SEF Proposing Release, the monetary cost of forming a SB SEF is estimated to range from approximately \$15 million to \$20 million per SB SEF for the first year of operation, if an entity were to establish a SB SEF without the benefit of modifying an already existing trading system.<sup>1705</sup> The industry sources consulted by Commission staff estimated at that time that, for the SB SEF's first year of operation, the cost of software and product development would range from approximately \$6.5 million to \$10.5 million per SB SEF.<sup>1706</sup> The technological costs would be expected to decline considerably during the second and subsequent years of operation, with an estimated range of \$3 million to \$4 million per year per SB SEF.<sup>1707</sup>

For entities that currently own and/or operate platforms for the trading of security-based swaps, the cost of forming a SB SEF would be more incremental, given that these entities already have viable technology that could be modified to comply with the requirements that the Commission may impose for SB SEFs.<sup>1708</sup> According to industry sources consulted by Commission staff in connection with the issuance of the SB SEF Proposing Release, the incremental costs of enhancing a trading platform to be compatible with any SB SEF requirements ultimately established by the Commission would range from as low as \$50,000 to as much as \$3 million

contained in the SB SEF Proposing Release. *See id.* Moreover, the Commission notes that it has received comment letters on those cost estimates. *See* MarketAxess Letter and UBS Letter. One commenter remarked on the cost estimates in the SB SEF Proposing Release for many of the individual aspects of SB SEF formation, noting that, in its view, some cost estimates were high and others were low. *See* MarketAxess Letter at 15–17. The commenter stated that generally the estimates in the SB SEF Proposing Release were realistic and that accurate estimates of the true expected costs of establishing and operating a SB SEF and the hourly rates relied upon for the estimates were broadly consistent with industry standards. *Id.* Another commenter urged the Commission to consider the impact of the Regulation SB SEF proposal on broker-dealers and the potential costs that could result. *See* UBS Letter at 3. Neither of these commenters indicated that the costs associated with SB SEF formation and registration would be different for foreign security-based swap markets as compared to domestic security-based swap markets.

<sup>1705</sup> *See* SB SEF Proposing Release, 76 FR 11041.

<sup>1706</sup> *Id.*

<sup>1707</sup> *Id.*

<sup>1708</sup> *Id.* Several commenters on the SB SEF Proposing Release that currently operate swap trading facilities have indicated their intention to register as SB SEFs. *See, e.g.,* Bloomberg Letter; GFI Letter; MarketAxess Letter; and Tradeweb Letter.

per SB SEF, depending on the enhancements needed to make a particular platform compatible with the final Commission rules governing SB SEFs.<sup>1709</sup> As noted in the SB SEF Proposing Release, the annual ongoing cost of maintaining the technology and any improvements is estimated to be in the range of \$2 million to \$4 million.<sup>1710</sup>

In the SB SEF Proposing Release, the Commission preliminarily estimated that the cost for an applicant to file Form SB SEF, including all exhibits thereto, would be approximately \$675,297 per SB SEF.<sup>1711</sup>

**Complying with Core Principles.** As is also discussed in the SB SEF Proposing Release, the regulatory requirement that SB SEFs comply with the statutory Core Principles would increase the ongoing regulatory obligations of SB SEFs with respect to their operations and oversight.<sup>1712</sup> Industry sources consulted by Commission staff in connection with the issuance of the SB SEF Proposing Release estimated that the cost to a SB SEF to comply with the rules relating to surveillance and oversight that they expect the Commission to propose would be in the range of \$1 million to \$3 million annually, with initial costs likely to be at the higher end of that range, since a SB SEF would need to create the technology necessary to monitor and surveil its market participants, as well as establish a rulebook that reflects the Core Principles and related rules.<sup>1713</sup> The ongoing annual compliance costs estimated by those same industry sources would be approximately \$1 million, which would include the salary of a Chief Compliance Officer and at least two junior compliance personnel, who are expected to be attorneys.<sup>1714</sup>

**Unquantifiable Costs.** The Commission also has considered some costs relating to registered SB SEFs that are difficult to quantify precisely.<sup>1715</sup> Security-based swaps traded on registered SB SEFs may be perceived to be subject to increased costs, monetary and otherwise. For example, some industry participants expressed their belief that any proposed pre-trade transparency requirement would force

<sup>1709</sup> *See* SB SEF Proposing Release, 76 FR 11041.

<sup>1710</sup> *Id.*

<sup>1711</sup> *Id.* A more detailed breakdown of the cost estimates associated with each exhibit to Form SB SEF, as well as with registration withdrawal and supplementation, is contained in the SB SEF Proposing Release. *See* SB SEF Proposing Release, 76 FR 11041–43.

<sup>1712</sup> *See* SB SEF Proposing Release, 76 FR 11041.

<sup>1713</sup> *Id.*

<sup>1714</sup> *Id.*

<sup>1715</sup> These unquantifiable costs are discussed more fully in the SB SEF Proposing Release. *See* SB SEF Proposing Release, 76 FR 11040.

market participants to reveal valuable information regarding their trading interest more broadly than they believed would be economically prudent, which in their view could discourage participation in the security-based swap market.<sup>1716</sup> There are perceived costs associated with frontrunning, if customers or dealers were required to show their trading interest before a trade is executed.<sup>1717</sup> These potential costs of pre-trade transparency could change market participants' trading strategies, which could result in their working more orders or finding ways to hide their interest.<sup>1718</sup>

If market participants viewed the Commission's proposed Regulation SB SEF as too burdensome with respect to pre-trade transparency, security-based swap dealers could be less willing to supply liquidity for security-based swaps that trade on SB SEFs, thus reducing liquidity and competition.<sup>1719</sup> On the other hand, if the requirement with respect to pre-trade transparency were too loose, the result could be that there would be no substantive change from the *status quo*, and thus no potential reduction in asymmetric information, increase in price competition, or improvement in executions, beyond the changes in response to the other requirements of the Dodd-Frank Act.<sup>1720</sup>

The import of this concern depends on the degree of pre-trade transparency required and the characteristics of the trading market.<sup>1721</sup> The proposed rules for SB SEFs are intended to provide for greater pre-trade transparency than currently exists without requiring pre-trade transparency in a manner that would cause participants to avoid providing liquidity on SB SEFs.<sup>1722</sup>

An additional unquantifiable cost could result if foreign security-based swap markets perceive the Commission's proposed requirements for SB SEFs as too burdensome or detrimental to their security-based swap business. A foreign security-based swap market that has such a view and that currently operates in a manner that would cause it to be subject to the SB SEF registration requirements could

<sup>1716</sup> *Id.* Several commenters on the SB SEF Proposing Release expressed concerns about pre-trade transparency requirements in the context of block trades. *See* ABC Letter at 2, 4–5; MFA Letter III at 7; ISDA SIFMA Letter II at 7; SIFMA AMG Letter II at 4–5; Blackrock Letter at 8; Cleary Letter III at 20; CME Letter at 3–4; Phoenix Letter at 3–4.

<sup>1717</sup> *See* SB SEF Proposing Release, 76 FR 11040.

<sup>1718</sup> *Id.*

<sup>1719</sup> *Id.*

<sup>1720</sup> *Id.*

<sup>1721</sup> *Id.*

<sup>1722</sup> *Id.*

decide to restructure its security-based swap business such that it would not be subject to the SB SEF registration requirements. This result could have several potential negative implications for participants in the U.S. financial system such as, among other things, fewer registered venues on which security-based swaps could be executed, less competition between the remaining SB SEFs, and thus potentially higher costs for such executions. If restructuring raises trading costs in the domestic security-based swap market, liquidity could flow away from SB SEFs and U.S. participants could find fewer trading opportunities and potentially decreased liquidity in the domestic security-based swap market.

### (c) Alternatives

The Commission could have proposed a different interpretation regarding registration of foreign security-based swap markets. For example, the Commission could have interpreted Section 3D of the Exchange Act broadly to apply the registration requirement to a foreign security-based swap market that meets the definition of “security-based swap execution facility,”<sup>1723</sup> regardless of whether such foreign security-based swap market has engaged in any of the activities, discussed above, with respect to U.S. persons, or non-U.S. persons located in the United States.<sup>1724</sup> The Commission preliminarily believes that, if a foreign security-based swap market is not engaging in such activities with respect to U.S. persons, or non-U.S. persons located in the United States, then it would not trigger the registration requirements under Section 3D of the Exchange Act.

In addition, the Commission could have interpreted Section 3D of the Exchange Act more narrowly than proposed herein, such that, for example, the registration requirement would not apply to a foreign security-based swap market even if it meets the definition of “security-based swap execution facility” and provides U.S. persons, or non-U.S. persons located in the United States, with proprietary electronic trading screens or similar devices for executing or trading security-based swaps on its market. The Commission preliminarily believes that such a narrow interpretation would not accommodate the evolving technological innovation of electronic trading and the availability of global access to electronic trading platforms, and therefore could result in

U.S. persons, or non-U.S. persons located in the United States, having the ability to directly execute or trade security-based swaps on a foreign security-based swap market that is not subject to the SB SEF registration requirements. As discussed above in this section, the Commission preliminarily believes that this, in turn, could result in the intended programmatic benefits of the SB SEF registration requirements, *i.e.*, increased pre-trade transparency, increased competition, and improved oversight, not being extended to all of the security-based swap activity that the Commission believes is most likely to raise the concerns that Congress intended to address in Title VII.<sup>1725</sup>

### 2. Programmatic Benefits and Costs of the Potential Availability of Exemptive Relief to Foreign Security-Based Swap Markets

As discussed above, the Commission may consider exempting a foreign security-based swap market from registration as a SB SEF under Section 3D of the Exchange Act if the foreign security-based swap market is subject to comparable, comprehensive supervision and regulation by the appropriate governmental authorities in its home country.<sup>1726</sup> Any foreign security-based swap market granted such an exemption would be subject to supervision and regulation as a registered security-based swap market in its home jurisdiction that the Commission has determined to be comparable to the supervision and regulation of registered SB SEFs. As a result, the Commission preliminarily believes that the programmatic benefits and costs, as discussed above,<sup>1727</sup> that would result from subjecting registered SB SEFs to the Commission’s supervision and regulation also would be realized by any exempted foreign security-based swap market because of the comparable supervision and regulation of that foreign market by its home jurisdiction.

While a number of foreign jurisdictions are in the process of developing standards for the regulation of security-based swaps and the security-based swap market, few foreign jurisdictions have adopted such standards as yet.<sup>1728</sup> As a result, at this time, the Commission believes that it does not have a sufficient basis to provide an estimate as to how many foreign security-based swap markets would be required to register as SB SEFs

and potentially be eligible for an exemption from that requirement because the Commission currently has no basis to determine whether such foreign security-based swap markets would be subject to comparable, comprehensive supervision and regulation in their home jurisdictions.

Nevertheless, the Commission believes that certain additional programmatic benefits and costs could result specifically from an exempted foreign security-based swap market not having to register as a SB SEF under Section 3D of the Exchange Act while continuing to serve U.S. security-based swap market participants. These additional benefits and costs are discussed below.

### (a) Programmatic Benefits

*Facilitating Cross Border Security-Based Swap Transactions.* As discussed above,<sup>1729</sup> following the publication of the SB SEF Proposing Release, the Commission received comments from the public expressing concerns about the requirements and implications of Section 3D of the Exchange Act and the Commission’s proposed rules governing SB SEFs for foreign-security-based swap markets and the global security-based swap market generally.<sup>1730</sup> Several commenters urged the Commission to work with foreign regulators to develop harmonized rules for the trading of security-based swaps.<sup>1731</sup> As noted above, the Commission currently is in discussions with its foreign counterparts to explore steps toward such harmonization.<sup>1732</sup> The Commission is proposing, as a means to facilitate cross-border security-based swap transactions, that it may consider exempting a foreign security-based swap market from the registration requirements under Section 3D in the circumstances described above.<sup>1733</sup> The Commission preliminarily believes that the potential availability of such an exemption should provide foreign security-based swap markets operating in the United States with appropriate flexibility with respect to SB SEF registration when they are subject to comparable, comprehensive supervision and regulation in their home markets. In addition, the Commission preliminarily

<sup>1729</sup> *Id.*

<sup>1730</sup> See, e.g., Thomson Letter at 3–4; BlackRock Letter at 12–13; Bloomberg Letter at 6–7; TradeWeb Letter at 2; ISDA SIFMA Letter II at 2; WMBAA Letter at 10–11; Cleary Letter III at 4; and Cleary Letter IV at 5, 13; see also Section XXII, *infra*.

<sup>1731</sup> See Thomson Letter; BlackRock Letter; TradeWeb Letter; ISDA SIFMA Letter II; and WMBAA Letter; see also Section XXI, *infra*.

<sup>1732</sup> See Section VII.C, *supra*.

<sup>1733</sup> *Id.*

<sup>1723</sup> See Section 3(a)(77) of the Exchange Act, 15 U.S.C. 78c(a)(77).

<sup>1724</sup> See Section VII.B, *supra*.

<sup>1725</sup> See Section II.B, *supra*.

<sup>1726</sup> See Section VII.C, *supra*.

<sup>1727</sup> See Section XV.G.1, *supra*.

<sup>1728</sup> See Section VII.C, *supra*.

believes that the programmatic benefits associated with registration and other requirements for SB SEFs under Section 3D of the Exchange Act, and rules and regulations thereunder, would not be diminished as a result of the proposed exemptive relief. Therefore, those U.S. financial system participants that opt to trade on any exempted foreign security-based swap market operating in the United States would remain adequately protected because such an exempted foreign market would be subject to oversight and regulation in a manner comparable to the Commission's proposed requirements for SB SEFs.

*Reduction in Programmatic Costs Associated with Registration.* The Commission preliminarily believes that the availability of an exemption from SB SEF registration requirements based on comparable, comprehensive supervision and regulation in the foreign security-based swap market's home country could serve to reduce any potentially duplicative or conflicting regulatory burdens faced by security-based swap markets that operate on a cross-border basis and that otherwise would be required to register in both their home country and the United States. Therefore, to the extent that such foreign security-based swap markets would qualify for and pursue such an exemption, there could be a reduction in the programmatic costs that those foreign security-based swap markets otherwise would incur.

One commenter on the SB SEF Proposing Release stated that harmonized rules for trading security-based swaps would reduce potentially duplicative or conflicting regulatory burdens.<sup>1734</sup> As noted above, few foreign jurisdictions have enacted legislation or adopted standards for the regulation of security-based swap markets, although a number of foreign jurisdictions are in the process of developing such standards.<sup>1735</sup> As the process of developing legislation or regulation regarding security-based swaps continues in other jurisdictions, the Commission believes that the availability of an exemption from the U.S. registration requirements is a reasonably designed measure to address the potential for conflicting or unnecessarily duplicative regulatory burdens that could arise from requiring dual registration in the United States and in a comparably regulated foreign jurisdiction.

For example, a foreign security-based swap market that is registered in a foreign jurisdiction and that provides

U.S. persons, or non-U.S. persons located in the United States, the ability to execute or trade security-based swaps, or that facilitates the execution or trading of security-based swaps, on its market could be required to incur the cost of full registration twice—once to register in the foreign jurisdiction and once more to register as a SB SEF in the United States—if there was no possibility of obtaining an exemption from the U.S. registration requirements. As a further example, such a foreign security-based swap market, as a result of its registration as a SB SEF, would be required to establish rules governing the operation of its trading facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility.<sup>1736</sup> A conflict could arise if, for example, the U.S. requirements for SB SEFs require the foreign market's trading rules to allow trading interest in security-based swaps to be expressed or responded to in a manner that is different from, and that makes it impossible also to comply with, the foreign jurisdiction's requirements regarding trading rules. These examples are not meant to be exhaustive, but rather to be illustrative of scenarios involving potentially conflicting or unnecessarily burdensome regulation that foreign security-based swap markets could face, absent an exemption. The Commission preliminarily believes that the availability of an exemption from registration as a SB SEF should help mitigate the potential impact of such scenarios. At the same time, as discussed above, the Commission believes that granting such an exemption to a foreign security-based swap market would not reduce the programmatic benefits achieved by requiring security-based swap markets to register as a SB SEF because any exempted foreign market would be comparably supervised and regulated by its home country.

As stated above, few jurisdictions have adopted standards for the regulation of security-based swap markets and therefore the Commission does not have a sufficient basis to provide an estimate as to how many foreign security-based swap markets would request, and potentially receive, an exemption from registration.<sup>1737</sup> The Commission preliminarily believes that the estimate in the SB SEF Proposing Release of programmatic costs associated with registration as a SB SEF

would apply equivalently to a foreign security-based swap market that is subject to Section 3D's registration requirement.

Any potential exemption from registration (even though the foreign security-based swap market would incur costs associated with compliance with the comparable regulation in its home country), could result in minimizing the burden of the programmatic costs associated with registration as a SB SEF, and so these programmatic costs constitute an upper bound for the potential cost savings from any such exemption. However, the Commission is not able to estimate the aggregate reduction in programmatic costs that would be associated with reliance on any proposed exemption by foreign security-based swap markets.

#### (b) Programmatic Costs

*Compliance with Potential Conditions of Exemption.* As discussed above, any grant of an exemption from the SB SEF registration requirements may be subject to certain appropriate conditions, which could include, but not be limited to, requiring the exempted foreign security-based swap market to provide the Commission with prompt access to its books and records, including, for example, data related to orders, quotes and transactions, as well as providing an opinion of counsel that, as a matter of law, it is able to provide such access.<sup>1738</sup> The Commission also could require that the foreign security-based swap market appoint an agent for service of process in the United States.<sup>1739</sup>

The Commission preliminarily believes that the costs associated with a commitment by the foreign security-based swap market to provide the Commission with access to books and records would be part of the Commission's \$1 million to \$3 million

<sup>1738</sup> *Id.*

<sup>1739</sup> *Id.* These potential conditions of an exemption from SB SEF registration requirements for a foreign security-based swap market—granting the Commission access to its books and records, providing an opinion of counsel that such access can be granted under the foreign jurisdiction's law, and appointing a process agent in the United States—are proposed requirements of SB SEF registration. See SB SEF Proposing Release, 76 FR 11000. Thus, a foreign security-based swap market that is required to register as a SB SEF would incur the costs associated with complying with these requirements, which costs are included in the estimate provided in Section XV.G.1(b) above of the cost for an applicant to file Form SB SEF, including all exhibits thereto. See *id.* at 11016–17, 11041–42. A foreign security-based swap market that is granted an exemption from SB SEF registration requirements also could incur the costs of complying with these requirements to the extent that the Commission imposes them as conditions to the exemption.

<sup>1734</sup> See Bloomberg Letter.

<sup>1735</sup> See Section VII.C, *supra*.

<sup>1736</sup> See SB SEF Proposing Release, 76 FR 10967, 10971–73.

<sup>1737</sup> See Section VII.C, *supra*.



estimate of the annual cost to a SB SEF to comply with the Commission's proposed rules relating to surveillance and oversight,<sup>1740</sup> but would be difficult to quantify separately at this time. The foreign security-based swap market would maintain books and records in the ordinary course of its business and in conformance with the requirements of its appropriate regulatory authority.<sup>1741</sup> If, after issuance of any such exemptive relief, the Commission considered it necessary to have access to the foreign security-based swap market's books and records, there would be costs to the foreign security-based swap market in granting such access, for example, in copying the requested books and records and supplying them to Commission staff. However, the circumstances that would prompt any Commission request for access to the foreign security-based swap market's books and records and the exact scope of any such request would not be known at the time the Commission were to grant an exemption from the requirements of Section 3D of the Exchange Act.

The Commission believes that the costs for a foreign security-based swap market to appoint an agent for service of process in the United States would be minimal in circumstances in which the foreign security-based swap market has a subsidiary or staff in the United States that is capable of receiving service of process and acting as the foreign market's appointed agent. In circumstances in which a foreign security-based swap market must appoint a third party as its process agent, Commission staff estimates, based on an industry source that provides process agent services, that the cost to do so would be approximately \$400 for the first year and approximately \$300 annually thereafter.

The Commission also believes that an exempted foreign market could incur costs in complying with any additional conditions that accompany the grant of the exemption, but the scope of these conditions and the costs associated with them would depend on the specific circumstances for which the exemption is granted and could vary from foreign jurisdiction to foreign jurisdiction. As a result, the Commission cannot provide an estimated dollar value of the costs

that would be associated with such additional conditions at this time.

#### (c) Alternatives

*Harmonization with Foreign Counterparts.* Apart from interpreting Section 3D of the Exchange Act to apply to foreign security-based swap markets that engage in certain activities with respect to U.S. persons or non-U.S. persons located in the United States,<sup>1742</sup> and potentially providing an exemption from the SB SEF registration requirements for qualifying foreign security-based swap markets that are covered by Section 3D,<sup>1743</sup> the Commission could adopt the approach of harmonizing our rules with the rules of foreign jurisdictions. As noted above, few foreign jurisdictions have enacted legislation or adopted standards for the regulation of security-based swaps markets, although a number of foreign jurisdictions are in the process of developing such standards. Accordingly, the Commission preliminarily believes that our proposal to consider exemptive relief from SB SEF registration for foreign security-based swap markets that are subject to comparable, comprehensive supervision and regulation is a reasonable measure at this time that acknowledges the cross-border nature of the security-based swap market.

*Not Consider Exemptive Relief.* The Commission could have determined not to consider making exemptive relief from Section 3D's registration requirements available. In such a scenario, a foreign security-based swap market subject to Section 3D's registration requirements would be required to register as a SB SEF—and incur the costs attendant to such registration—even if it is subject to comparable, comprehensive supervision and regulation in its home jurisdiction. Moreover, without the availability of an exemption, the Commission believes that there would be a greater potential for such a dually-registered foreign security-based swap market to face duplicative or conflicting regulatory burdens. The Commission preliminarily believes that considering exemptive relief is a more cost-effective and, for the reasons stated above, reasonable measure given the cross-border nature of the security-based swap market.

#### (d) Assessment Costs

A foreign security-based swap market would incur costs in submitting a request or application for an exemption from the SB SEF registration

requirement. The Commission estimates that the costs of submitting such a request or application would be approximately \$110,320.<sup>1744</sup> The use of internal counsel in lieu of outside counsel would reduce this estimate.

An additional assessment cost that a foreign security-based swap market could incur in connection with submitting such an exemption request or application would be obtaining an opinion of counsel letter stating that the foreign security-based swap market is able to give access to its books and records to the Commission, if the Commission were to include such a condition in any exemptive relief. The Commission estimates that the cost associated with obtaining such a letter would be approximately \$25,000.<sup>1745</sup>

<sup>1744</sup> The Commission preliminarily believes that the costs of submitting a request or application for the proposed exemption would be similar to the costs associated with submitting a request for a substituted compliance determination, *i.e.*, \$110,320. See Section XV.I.3, *infra*. This estimate is based on information regarding the average costs associated with preparing and submitting an application to the Commission for a Commission order for exemptive relief under Section 36 of the Exchange Act in accordance with the procedures set forth in 17 CFR 240.0–12. The Commission estimates that preparation of the request would require approximately 80 hours of in-house counsel time and 200 hours of outside counsel time. Such estimate takes into account the time required to prepare supporting documents necessary for the Commission to make a substituted compliance determination, including, without limitation, information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor compliance with these rules. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379. The Commission estimates the costs for outside legal services to be \$400 per hour. Accordingly, the Commission estimates the cost to be \$110,320 (\$30,320 (based on 80 hours of in-house counsel time \* \$379) + \$80,000 (based on 200 hours of outside counsel time \* \$400)) to submit a request for a substituted compliance determination.

<sup>1745</sup> This estimate is based on prior Commission estimates of the cost of obtaining an opinion of counsel, and assumes that foreign security-based swap dealers would seek outside legal counsel to prepare the letter at an hourly rate of \$400. See SB SEF Proposing Release, 76 FR 11025, 11042; Registration Proposing Release, 76 FR 65811; see also note 1744, *supra*. In the SB SEF Proposing Release, the Commission preliminarily estimated that the average initial paperwork cost for a non-resident SB SEF to provide an opinion of counsel that the SB SEF can, as a matter of law, provide the Commission with access to its books and records and submit to onsite inspection and examination by representatives of the Commission would be one hour and \$900 in outside legal costs per non-resident SB SEF. See SB SEF Proposing Release, 76 FR 11025, 11042. In the Registration Proposing Release, the Commission stated that, upon further reflection, it believed that a non-resident security-

<sup>1740</sup> See note 1713 and accompanying text, *supra*; see also SB SEF Proposing Release, 76 FR 11041.

<sup>1741</sup> Prior to the issuance of any exemption the foreign security-based swap market could, however, need to incur the cost of obtaining an opinion of counsel letter stating that it is able to provide access to its books and records. See Section XV.G.2(d), *infra*.

<sup>1742</sup> See Section VII.B, *supra*.

<sup>1743</sup> See Section VII.C, *supra*.

## Request for Comment

- Would the benefits and costs associated with becoming a SB SEF be the same for domestic and foreign security-based swap markets? For example, would the costs of implementing the systems and other necessary technology to operate as a SB SEF be different for foreign security-based swap markets? To the extent the benefits or costs of SB SEF registration would be different for foreign security-based swap markets as compared to domestic markets, please identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such different benefits or costs for foreign security-based swap markets.

- Would the costs associated with developing the other aspects of the infrastructure necessary for SB SEFs be different for foreign security-based swap markets? If so, please describe such differences and quantify them to the extent possible.

- Would the non-infrastructure costs associated with forming and operating a SB SEF be different for foreign security-based swap markets? If so, please describe such differences and quantify them.

- Are there any programmatic benefits and costs associated with the SB SEF registration requirements or the proposed availability of an exemption from those requirements that are not discussed herein? If so, please identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits.

- Are the programmatic benefits and costs associated with the SB SEF registration requirements and the proposed availability of an exemption from those requirements that are discussed herein accurate? If not, how can the Commission more accurately estimate these costs?

- Do the benefits of the proposed availability of an exemption from the SB SEF registration requirements justify the costs? Are there quantifiable programmatic costs associated with the proposed availability of an exemption

based swap entity would incur, on average, approximately \$25,000 in outside legal costs to obtain an opinion of counsel that a non-resident security-based swap entity could provide the Commission with access to its books and records and submit to onsite inspection and examination by the Commission. See Registration Proposing Release, 76 FR 65811. The Commission preliminarily believes that an estimate of \$25,000 may be the more appropriate estimate of the cost that a foreign security-based swap market would incur in obtaining an opinion of counsel from outside counsel with respect to the ability to grant the Commission access to books and records given the research and legal analysis that the Commission believes would be involved in the preparation of the opinion.

from those requirements that should be addressed? If so, please identify them. Are there any additional assessment costs not discussed herein? If so, what are they and are they quantifiable?

- Do commenters agree with the preliminary estimates of the assessment costs relating to the proposed exemption from the SB SEF registration requirement? Are the estimated costs a foreign security-based swap market would incur in submitting an application for an exemption from the SB SEF registration requirements accurate? If not, how should the Commission adjust the cost estimate?

Are there other assessment costs not considered here?

### 3. Programmatic Benefits and Costs Associated With the Mandatory Trade Execution Requirement of Section 3C(h) of the Exchange Act

Unlike the markets for cash equity securities and listed options, the market for security-based swaps currently is characterized by bilateral negotiation in the OTC swap market and is largely decentralized.<sup>1746</sup> The lack of uniform rules concerning the trading of security-based swaps and the historical one-to-one nature of trade negotiation in security-based swaps has resulted in the formation of distinct types of trading venues and execution practices, ranging from bilateral negotiations carried out over the telephone,<sup>1747</sup> to single-dealer RFQ platforms,<sup>1748</sup> to multi-dealer RFQ platforms,<sup>1749</sup> to central limit order

<sup>1746</sup> See SB SEF Proposing Release, 76 FR 10951.

<sup>1747</sup> "Bilateral negotiation" refers to the execution practice whereby one party uses the telephone, email or other communications to contact directly a potential counterparty to negotiate and execute a security-based swap. The bilateral negotiation and execution practice provides no pre-trade or post-trade transparency because only the two parties to the transaction are aware of the terms of the negotiation and the final terms of the agreement. See SB SEF Proposing Release, 76 FR 10951; see also Section II.A.5, *supra*.

<sup>1748</sup> A single-dealer RFQ platform refers to an electronic trading platform where a dealer may post indicative quotes for security-based swaps in various asset classes that the dealer is willing to trade. Only the dealer's approved customers would have access to the platform. When a customer wishes to transact in a security-based swap, the customer requests an executable quote, the dealer provides one, and if the customer accepts the dealer's quote, the transaction is executed electronically. This type of platform generally provides pre-trade transparency in the form of indicative quotes on a pricing screen, but only from one dealer to its customer. See SB SEF Proposing Release, 76 FR 10951; see also Section II.A.5, *supra*.

<sup>1749</sup> A multi-dealer RFQ electronic trading platform refers to a multi-dealer RFQ system whereby a requester can send an RFQ to solicit quotes on a certain security-based swap from multiple dealers at the same time. After the RFQ is submitted, the recipients have a prescribed amount of time in which to respond to the RFQ with a quote. Responses to the RFQ are firm. The requestor

books,<sup>1750</sup> and brokerage trading.<sup>1751</sup> These various trading venues and execution practices provide different degrees of pre-trade transparency and different levels of access. While the Commission currently does not have sufficient information with respect to the volume of security-based swap transactions executed across these different trading venues and execution practices, a common thread to these transactions is that they have all been executed in the unregulated OTC derivatives market. Thus, for purposes of analyzing the economic impact of the statutory mandatory trade execution requirement, as well as proposed Rule 3Ch-1, the Commission is starting from a baseline in which no security-based swaps are currently traded in the United States on an exchange or on a system or platform that otherwise meets the statutory definition of "security-based swap execution facility," the statutory Core Principles governing SB SEFs, and the Commission's proposed requirements governing SB SEFs, if they were to be adopted by the Commission.<sup>1752</sup>

then has the opportunity to review the responses and accept the best quote. A multi-dealer RFQ platform provides a certain degree of pre-trade transparency, depending on its characteristics. See SB SEF Proposing Release, 76 FR 10952; see also Section II.A.5, *supra*.

<sup>1750</sup> A limit order book system or similar system refers to a trading system in which firm bids and offers are posted for all participants to see, with the identity of the parties withheld until a transaction occurs. Bids and offers are then matched based on price-time priority or other established parameters and trades are executed accordingly. The quotes on a limit order book system are firm. In general, a limit order book system provides greater pre-trade transparency than the three platforms described above because all participants can view bids and offers before placing their bids and offers. See SB SEF Proposing Release, 76 FR 10952; see also Section II.A.5, *supra*. Currently, limit order books for the trading of security-based swaps in the United States are utilized by inter-dealer brokers for dealer-to-dealer transactions.

<sup>1751</sup> "Brokerage trading" refers to an execution practice used by brokers to execute security-based swaps on behalf of customers, often in larger sized transactions. In such a system, a broker receives a request from a customer (which may be a dealer) who seeks to execute a specific type of security-based swap. The broker then interacts with other customers to fill the request and execute the transaction. This model often is used by dealers that seek to transact with other dealers through the use of an interdealer broker as an intermediary. In this model, there may be pre-trade transparency to the extent that participants are able to see bids and offers of other participants. See SB SEF Proposing Release, 76 FR 10952; see also Section II.A.5, *supra*.

<sup>1752</sup> Several commenters on the SB SEF Proposing Release that currently operate swap trading facilities have indicated their intention to register as SB SEFs. See note 1708, *supra*. The Commission believes that it is likely that these entities would have to revise their operations to meet the definition of "security-based swap execution facility," the statutory Core Principles governing SB SEFs, and the proposed requirements set forth in

As noted above, this section XV.G.3 addresses the programmatic effect, and benefits and costs of, the mandatory trade execution requirement of Section 3C(h) of the Exchange Act generally. Section XV.G.4 further below addresses the programmatic effect, and benefits and costs of, the proposed application of this requirement to cross-border security-based swap transactions, as delineated by proposed Rule 3Ch-1. The Commission preliminarily believes that proposed Rule 3Ch-1 is appropriately tailored to extend the regulatory benefits intended by the mandatory trade execution requirement—*i. e.*, enhanced transparency and competition, which are discussed below—to the security-based swap activity that the Commission believes is most likely to raise the concerns that Congress intended to address in Title VII.<sup>1753</sup> In the Commission's preliminary view, a different rule, and in particular a rule that would not apply the mandatory trade execution requirement to all such security-based swap activity, could undermine these goals.

#### (a) Programmatic Effect of the Statutory Mandatory Trade Execution Requirement

As discussed above, to increase the transparency and oversight of the OTC derivatives market, Section 763(a) of the Dodd-Frank Act amended the Exchange Act by adding the mandatory trade execution requirement of Section 3C(h).<sup>1754</sup> Security-based swap transactions subject to Section 3C(h)'s mandatory trade execution requirement cannot be executed over-the-counter, but instead must be executed on an exchange or SB SEF that is registered or exempt from registration under the Exchange Act, unless an applicable exception applies.<sup>1755</sup> As such, the mandatory trade execution requirement is important in helping to bring the trading of security-based swaps onto more transparent, regulated markets, from the unregulated OTC swap markets.<sup>1756</sup>

Consequently, the Commission preliminarily believes that an overall programmatic—and positive—effect of the mandatory trade execution requirement would be the potential for a large volume of security-based swap transactions that are currently executed in the OTC market to become subject to

the mandatory trade execution requirement and, therefore, be required to be executed on a regulated platform, such as an exchange or SB SEF. Moreover, because the programmatic benefits and costs attendant to the mandatory trade execution requirement, which are discussed below, would be realized for the volume of security-based swap transactions that are executed on exchanges or SB SEFs, the Commission preliminarily believes that the extent to which those benefits and costs could be realized may best be demonstrated by generating an indicative volume estimate of security-based swap transactions that may potentially be subject to the mandatory trade execution requirement.

As stated above, because the Commission currently does not have comprehensive information regarding the volume of security-based swap transactions currently executed on security-based swap trading platforms,<sup>1757</sup> to estimate the volume of such transactions that could become subject to the mandatory trade execution requirement, as a starting point, the Commission relies on clearing data for single-name CDS transactions, which the Commission believes is currently the best available data for providing an indicative level of security-based swap transaction volume subject to the mandatory trade execution requirement.<sup>1758</sup> The Commission utilizes this data regarding single-name CDS transactions to generate an indicative volume of security-based swap transactions in the

<sup>1757</sup> While several commenters on the SB SEF Proposing Release that currently operate swap trading facilities in the OTC market have indicated their intention to register as SB SEFs, *see* note 1708, *supra*, as is currently the case for the security-based swap market as a whole, the Commission does not have comprehensive information regarding the volume of security-based swap transactions currently executed on security-based swap trading platforms.

<sup>1758</sup> For purposes of the analysis of the programmatic effect of the mandatory trade execution requirement, we do not consider the historical data regarding the clearing level of U.S. index CDS transactions. The statutory definition of security-based swap in relevant part includes swaps based on single securities or on narrow-based security-indices. *See* Section 3(a)(68)(A) of the Exchange Act, 15 U.S.C.78c(a)(68)(A). The historical data regarding the clearing level of U.S. index CDS transactions encompass broad-based index CDS transactions that do not fall within the definition of security-based swaps. The Commission recognizes that the security-based swap market includes not only single-name CDS, but also CDS based on narrow-based indices, and other non-CDS security-based swaps, primary examples of which are equity swaps and total return swaps based on single equities or narrow-based indices of equities. As previously stated, we believe that the single-name CDS data are sufficiently representative of the security-based swap market. *See* note 1301, *supra*.

U.S. security-based swap market that could be subject to the mandatory clearing requirement of Section 3C(a) of the Exchange Act.<sup>1759</sup> Given that the mandatory trade execution requirement of Section 3C(h) of the Exchange Act<sup>1760</sup> could apply to any security-based swap that is subject to the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act,<sup>1761</sup> the Commission preliminarily believes that the volume of single-name CDS transactions that could be subject to the mandatory clearing requirement<sup>1762</sup> presents an indicative level of the volume of security-based swap transactions that potentially could be subject to the mandatory trade execution requirement if these security-based swaps are made available to trade on an exchange or SB SEF.

The Commission notes that it has not yet determined the criteria for assessing whether an exchange or SB SEF has made a security-based swap available to trade. The Commission, however, recognizes that the “made available to trade” determination is an essential element of the mandatory trade execution requirement. Any analysis of the benefits and costs flowing from the full complement of the mandatory trade execution requirement, when it is implemented, would need to take into consideration the Commission's determination of the scope of security-based swaps that would be “made available to trade,” as well as the cross-border rules that may be adopted by the Commission regarding application of the mandatory trade execution requirement. As a result, the “made available to trade” determination, when made by the Commission, will affect the ultimate benefits and costs associated with the mandatory trade execution requirement discussed in this release.<sup>1763</sup> Solely for purposes of analyzing herein the volume of security-based swap transactions that could be subject to the mandatory trade execution requirement, the Commission is assuming that all security-based

<sup>1759</sup> *See* Section XV.F.3(a), *supra*.

<sup>1760</sup> 15 U.S.C. 78c-3(h).

<sup>1761</sup> 15 U.S.C. 78c-3(a)(1).

<sup>1762</sup> As previously stated, the estimate of the volume of single-name CDS transactions that could be subject to the mandatory clearing requirement is conditioned upon and will be affected by the mandatory clearing determination and the final rules regarding the end-user exception to the mandatory clearing requirement and other qualification. *See* Section XV.F.2, *supra*.

<sup>1763</sup> The Commission has indicated its preliminary view that the decision as to when a security-based swap would be considered to be “made available to trade” should be made pursuant to objective measures to be established by the Commission. *See* SB SEF Proposing Release, 76 FR 10969.

the SB SEF Proposing Release, if they were to be adopted by the Commission.

<sup>1753</sup> *See* Sections II.B., *supra*.

<sup>1754</sup> 15 U.S.C. 78c-3(h).

<sup>1755</sup> *Id.*

<sup>1756</sup> *See* SB SEF Proposing Release, 76 FR 10949.

swaps that would be subject to mandatory clearing also would be deemed made available to trade and hence could be subject to the mandatory trade execution requirement.

As stated above, due in part to the data of the level of clearing activity during the years of 2009 to 2011, the Commission has recognized that mandatory clearing determinations made pursuant to Section 3C(a)(1) of the Exchange Act could alter current clearing practices at the time such determinations are made and potentially could result in a higher level of clearing for security-based swaps than would take place under a voluntary system.<sup>1764</sup> Therefore, the Commission preliminarily estimates that 33% of the \$2,800 billion total gross notional volume of the total U.S. single-name CDS market<sup>1765</sup> would provide an indicative volume of the U.S. single-name CDS transactions that may be subject to the mandatory clearing requirement.<sup>1766</sup> Because the mandatory

<sup>1764</sup> As stated above, due in part to the data of the level of clearing activity during the years of 2009 to 2011, the Commission has recognized that mandatory clearing determinations made pursuant to Section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1), could alter current clearing practices at the time such determinations are made and potentially could result in a higher level of clearing for security-based swaps than would take place under a voluntary system. See Section XV.F.2(a), *supra*, and the Clearing Procedures Adopting Release, 77 FR 41638.

<sup>1765</sup> The Commission previously calculated three measures to represent the clearing level of the U.S. single-name CDS transactions. The first measure is the gross notional volume of cleared U.S. single-name CDS transactions reported by ICE Clear Credit in 2011, which represents approximately 25% of the total \$2,800 billion notional U.S. single-name CDS market. The second measure is the gross notional volume of U.S. single-name CDS accepted for clearing at any time during the calendar year of 2011, which represents approximately 33% of the total \$2,800 billion notional U.S. single-name CDS market. The third measure is the gross notional volume of U.S. single-name CDS accepted for clearing at the time of execution, which represents approximately 29% of the total \$2,800 billion notional U.S. single-name CDS market. For reasons stated above, the Commission preliminarily believes that the highest measure among these three would provide an indicative volume of the U.S. single-name CDS transaction that may be subject to the mandatory clearing requirement. See the text accompanying Table 1 in Section XV.F.2(a), *supra*.

<sup>1766</sup> The Commission recognizes that, even if a transaction is determined to be subject to mandatory clearing, such transaction may be excepted from clearing pursuant to the end-user clearing exception under Section 3C(g) of the Exchange Act. See 15 U.S.C. 78c-3(g). However, based on the available data, the Commission estimated that commercial end users that are eligible for the clearing exception currently participate in the security-based swap market on a very limited basis. Data compiled by the Commission's Division of Risk, Strategy, and Financial Innovation on credit default transactions from the DTCC-TIW between January 1, 2011 and December 31, 2011 suggest that the total percentage of trades between buyer and seller principals during the calendar year 2011 for single name credit

trade execution requirement of Section 3C(h) of the Exchange Act<sup>1767</sup> could apply to any security-based swap that is subject to the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act, subject to the "made available to trade" determination, this estimate may provide an indicative volume of U.S. single-name CDS transactions that could have been subject to the "made available to trade" determination in Section 3C(h)(2) of the Exchange Act (if such determination had been made in 2011) and, therefore, subject to the mandatory trade execution requirement.<sup>1768</sup>

The Commission is mindful that this estimate is only an indicative volume of U.S. single-name CDS transactions that may be subject to the mandatory trade execution requirement in Section 3C(h) of the Exchange Act,<sup>1769</sup> as the Commission currently does not have reliable information available with respect to security-based swap transactions due to the fact that such transactions are currently executed on trading platforms that are not exchanges or SB SEFs. However, the Commission preliminarily believes that the statutory mandatory trade execution requirement, together with the statutory definition of SB SEF<sup>1770</sup> and the Commission's proposed interpretation,<sup>1771</sup> when implemented, could alter existing security-based swap execution practices. As more security-based swap products are determined to be mandatorily cleared and once the Commission addresses how to determine whether such security-based swaps are made available for trading on an exchange or SB SEF, the level of trade execution in security-based swaps taking place on such exchanges or SB SEFs should be higher than in the current trading environment, in which

default swaps was only 0.03% of the total trade counterparty distribution for non-financial end users, which are composed of non-financial companies and family trusts. See Capital, Margin and Segregation Proposing Release, 77 FR 70302, in particular, n.960. For purposes of the analysis and estimate here, we assume that the volume of transactions subject to the end user clearing exception under Section 3C(g) of the Exchange Act is negligible.

<sup>1767</sup> 15 U.S.C. 78c-3(h).

<sup>1768</sup> As stated earlier in this Section XV.G.3(a), this indicative volume estimate is based on an assumed scenario in which all mandatorily cleared security-based swaps are deemed made available to trade. The Commission reiterates that this assumption is being made solely for purposes of analyzing herein the volume of security-based swap transactions that could be subject to the mandatory trade execution requirement.

<sup>1769</sup> See 15 U.S.C. 78c-3(h).

<sup>1770</sup> See Section 3(a)(77) of the Exchange Act, 15 U.S.C. 78c(a)(77).

<sup>1771</sup> See SB SEF Proposing Release, 76 FR 10952-58.

no security-based swaps are traded on exchanges or SB SEFs. As a result, the mandatory trade execution requirement could have a material programmatic impact on execution practices in the U.S. security-based swap market by increasing the volume of transactions executed on an exchange or SB SEF.

#### (b) Programmatic Benefits of the Statutory Mandatory Trade Execution Requirement

Given that exchanges and SB SEFs are the essential infrastructure for implementing the mandatory trade execution requirement, there are additional benefits—separate from the fact that a large volume of security-based swap transactions would become subject to that requirement—flowing from the mandatory trade execution requirement that inevitably would overlap with the benefits associated with SB SEF registration, as described in the SB SEF Proposing Release. These benefits would be realized for the volume of security-based swap transactions that become subject to the mandatory trade execution requirement and are summarized below.

*Increased Pre-Trade Price Transparency.* One of the primary benefits of the mandatory trade execution requirement is to bring increased pre-trade transparency to the currently opaque security-based swap market. Increased pre-trade transparency should: (i) Help reduce informational asymmetries that may exist today in the security-based swap market, often to the benefit of large dealers who observe order flow;<sup>1772</sup> (ii) allow an increased number of market participants to see the trading interest of other market participants prior to trading, which should lead to increased price competition among market participants; and, in turn, (iii) lead to more efficient pricing in the security-based swap market.<sup>1773</sup>

*Impartial Access and Competitive Security-Based Swaps Market.* The Dodd-Frank Act's mandate to bring security-based swaps that are subject to the mandatory clearing requirement onto regulated markets, unless the security-based swap is not made available to trade, coupled with the proposed access requirements for SB SEFs in Regulation SB SEF,<sup>1774</sup> should help foster greater competition in the trading of security-based swaps by increasing access to security-based swap

<sup>1772</sup> See Sections XV.C.1, XV.C.2, and XV.C.3, *supra*.

<sup>1773</sup> See SB SEF Proposing Release, 76 FR 11036.

<sup>1774</sup> See proposed Rules 809 and 811(b) under the Exchange Act; see also SB SEF Proposing Release, 76 FR 10961-62.

trading venues.<sup>1775</sup> Such increased competition could lead to more efficient pricing in the security-based swap market.<sup>1776</sup>

#### (c) Programmatic Costs of the Statutory Mandatory Trade Execution Requirement

The Commission is mindful that programmatic costs also would be incurred for security-based swap transactions that become subject to the mandatory trade execution requirement.<sup>1777</sup> The Commission preliminarily believes that there would be transaction costs, such as fees and connectivity costs, that trading counterparties would incur in executing or trading security-based swaps subject to the mandatory trade execution requirement on SB SEFs. The Commission believes that a potential increase in transaction costs could result if the fees and connectivity costs associated with utilizing SB SEFs to secure trading interest and execute security-based swap transactions are higher than the current fees and costs associated with such practices in the OTC market. However, the Commission currently does not have information available to estimate the fees and costs that would be associated with transacting on SB SEFs, as no registered SB SEFs currently exist. Likewise, although unregulated trading venues exist in today's OTC derivatives market, the Commission does not have information regarding what, if any, fees and connectivity costs are associated with transacting on these unregulated trading venues.

In addition, studies suggest that pre-trade transparency can be costly for block trades as prices are likely to move adversely if the existence of a large unexecuted order becomes known.<sup>1778</sup>

As mentioned earlier, pre-trade transparency could also produce concerns about information leakage and frontrunning of trades. These effects could cause market participants to alter their trading strategies in order to hide their interest, potentially reducing liquidity on SB SEFs.<sup>1779</sup>

#### 4. Programmatic Benefits and Costs of Proposed Rule 3Ch-1 Regarding Application of the Mandatory Trade Execution Requirement in Cross-Border Context

As discussed above,<sup>1780</sup> the Commission is proposing Rule 3Ch-1 to clarify the applicability of the mandatory trade execution requirement of Section 3C(h) of the Exchange Act<sup>1781</sup> with respect to cross-border transactions in security-based swaps. Proposed Rule 3Ch-1(a) would identify the circumstances in which the mandatory trade execution requirement would apply, and proposed Rule 3Ch-1(b) then would carve out certain security-based swap transactions involving non-U.S. persons from the mandatory trade execution requirement.<sup>1782</sup>

Specifically, under proposed Rule 3Ch-1(a), the mandatory trade execution requirement would apply to a person that engages in a security-based swap transaction if: (1) A counterparty to the transaction is (i) a U.S. person, or (ii) a non-U.S. person whose performance under such security-based swap transaction is guaranteed by a U.S. person ("guaranteed non-U.S. person"); or (2) such transaction is a transaction conducted within the United States.<sup>1783</sup> Under proposed Rule 3Ch-1(b), the mandatory trade execution requirement would not apply to: (1) A security-based swap transaction described in proposed Rule 3Ch-1(a) that is not a transaction

equity block trades on components of the Dow Jones Industrial Average, the authors find that while the cost reductions for block trades on NYSE's "upstairs" market are economically small, the "upstairs markets allow trades that may not otherwise occur"; Terrence Henderschott and Ananth Madhavan, "Click or Call? Auction versus Search in the Over-the-Counter Market," Working Paper (2012) (using data from an electronic auction market, the authors find evidence that, controlling for venue selection, much of the cost savings from electronic platforms relative to dealer markets comes from small trades whereas coefficient estimates suggest that for large orders, the cost advantage of electronic auctions relative to the OTC market may be reversed).

<sup>1779</sup> See Section XV.G.1(b), *supra*.

<sup>1780</sup> See Section X, *supra*.

<sup>1781</sup> 15 U.S.C. 78c-3(h).

<sup>1782</sup> This is identical to the proposed approach for the mandatory clearing requirement. See Sections IX and XV.F.3, *supra*.

<sup>1783</sup> See proposed Rule 3Ch-1(a) under the Exchange Act. The term "U.S. person" and "transaction conducted within the United States" would have the meanings set forth in proposed Rule 3a71-3(a) under the Exchange Act.

conducted within the United States if (i) one counterparty is a foreign branch or a guaranteed non-U.S. person, and (ii) the other counterparty to the transaction is a non-U.S. person whose performance under the security-based swap is not guaranteed by a U.S. person (hereinafter referred to as "non-guaranteed non-U.S. persons") and who is not a foreign security-based swap dealer; or (2) a security-based swap transaction described in proposed Rule 3Ch-1(a) that is a transaction conducted within the United States if (i) neither counterparty to the transaction is a U.S. person, (ii) neither counterparty's performance under the security-based swap is guaranteed by a U.S. person; and (iii) neither counterparty to the transaction is a foreign security-based swap dealer.<sup>1784</sup>

Therefore, proposed Rule 3Ch-1(a) and proposed Rule 3Ch-1(b) apply the mandatory trade execution requirement to security-based swap transactions in the cross-border context based on the U.S.-person status of a counterparty, the existence of a guarantee provided by a U.S. person, the registered security-based swap dealer status of a counterparty, and the location where the transaction is conducted. Taken together, proposed Rules 3Ch-1(a) and 3Ch-1(b) would not apply the mandatory trade execution requirement to: (i) Transactions conducted outside the United States between two counterparties who are non-guaranteed non-U.S. persons, (ii) transactions conducted outside the United States between a foreign branch or a guaranteed non-U.S. person, and another counterparty who is a non-guaranteed non-U.S. person and is not a foreign security-based swap dealer, and (iii) transactions conducted within the United States between two counterparties who are non-guaranteed non-U.S. persons and are not foreign security-based swap dealers. As stated above,<sup>1785</sup> the Commission preliminarily believes that proposed Rule 3Ch-1 is appropriately tailored to extend the regulatory benefits intended by the mandatory trade execution requirement to the security-based swap activity that the Commission preliminarily believes is most likely to raise the concerns that Congress intended to address in Title VII.<sup>1786</sup>

The analysis in Section XV.G.4(a) below utilizes the best available information with respect to these criteria to assess the overall

<sup>1784</sup> See proposed Rule 3Ch-1(b) under the Exchange Act.

<sup>1785</sup> See Section XV.G.3, *supra*.

<sup>1786</sup> See Section II.B, *supra*.

<sup>1775</sup> See SB SEF Proposing Release, 76 FR 11037.

<sup>1776</sup> *Id.*

<sup>1777</sup> The Commission's consideration of the programmatic costs associated with setting up a SB SEF in the SB SEF Proposing Release and further discussion of such costs in the context of discussing when the SB SEF registration requirements would apply to foreign security-based swap markets and in considering the proposed availability of an exemption to foreign security-based swap markets from the registration requirements could be relevant to the costs associated with the mandatory trade execution requirement given that security-based swaps subject to the mandatory trade execution requirement would be required to be traded on an exchange or a SB SEF that is registered under Section 3D of the Exchange Act or is exempt from such registration. See SB SEF Proposing Release, 76 FR 11040-48; see also Sections XV.G.1 and XV.G.2, *supra*.

<sup>1778</sup> See SB SEF Proposing Release, 76 FR 11040; see also Minder Cheng and Ananth Madhavan, "In Search of Liquidity: Block Trades in the Upstairs and Downstairs Markets," *Review of Financial Studies*, Vol. 10, No. 1 (1997) (analyzing data from

programmatic effect of proposed Rules 3Ch-1(a) and 3Ch-1(b) by estimating the size of the security-based swap market that would be subject to the mandatory trade execution requirement as a result of proposed Rules 3Ch-1(a) and 3Ch-1(b). The Commission then discusses in Section XV.G.4(b) below the benefits and costs that would flow from proposed Rule 3Ch-1 regarding application of the mandatory trade execution requirement in the cross border context.

(a) Programmatic Effect of Proposed Rule 3Ch-1

It is not possible to quantify the potential programmatic effect of proposed Rule 3Ch-1 by estimating the future volume of security-based swap transactions when the mandatory trade execution requirement becomes effective partly because no “made available to trade” determinations have been made and partly because we do not know future trading volumes of security-based swaps. However, the Commission has examined the data available to it to analyze the potential programmatic effects of proposed Rule 3Ch-1. In particular, the Commission has tried to analyze the potential effects of proposed Rule 3Ch-1 by looking at the portion of the single-name U.S. reference CDS transactions that may provide an indication of the size of the security-based swap market that may be included in or excluded from the application of the mandatory trade execution requirement as a result of proposed Rule 3Ch-1.

A limitation we face when analyzing the data in order to estimate the size of the security-based swap market that may be affected by proposed Rule 3Ch-1 is that the domicile classifications in the DTCC-TIW database are not identical to the counterparty statuses that are described in proposed Rules 3Ch-1(a) and 3Ch-1(b), which would trigger application of, or an exception from, the mandatory trade execution requirement. Although the information provided by the data in the DTCC-TIW database does not allow us to identify the existence of a guarantee provided by a U.S. person with respect to a counterparty in a transaction, the registered security-based swap dealer status of a counterparty, or the location where the transaction is conducted, the Commission nevertheless preliminarily believes that the approach taken below would provide the best available estimate of the size of the security-based swap market that could be included in or excluded from the mandatory trade execution requirement by proposed Rule 3Ch-1.

As stated above, the commission has examined all transactions in single-name CDS during 2011 calendar year<sup>1787</sup> and estimated that the notional amount of the single-name CDS transactions executed during the 2011 calendar year is \$2,400 billion.<sup>1788</sup> Proposed Rule 3Ch-1(a) provides that the mandatory trade execution requirement shall apply to a security-based swap transaction if (1) a counterparty to the transaction is a U.S. person or a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person or (2) such transaction is a transaction conducted within the United States. In applying proposed Rule 3Ch-1(a) to the \$2,400 billion single-name CDS transactions executed in 2011, the Commission uses account holders and their domicile information in the DTCC-TIW database to determine the status of the counterparties.<sup>1789</sup> Because the Commission’s proposed definition of “U.S. person” is based primarily on the place of organization or principal place of business of a legal person and a legal person’s principal place of business and place of organization are usually in the same country, the Commission believes that the domicile of a legal person is a reliable indicator of such person’s U.S.-person status. In addition, based on the Commission’s understanding that the security-based swap transactions of foreign subsidiaries of U.S. entities, unless sufficiently capitalized to have their own independent credit ratings, are generally guaranteed by the most creditworthy U.S.-based entity within the corporate group, *i.e.*, the U.S. parent, the Commission preliminarily believes that

<sup>1787</sup> See note 1637, *supra*, and the accompanying text in Section XV.F.2(a), *supra*.

<sup>1788</sup> This estimate is based on the calculation by staff of the Division of Risk, Strategy, and Financial Innovation of all price-forming DTCC-TIW single-name CDS transactions that are based on North American corporate reference entities, U.S. municipal reference entities, U.S. loans or mortgage-backed securities (“MBS”), using ISDA North American documentation, ISDA U.S. Muni documentation, or other standard ISDA documentation for North American Loan CDS and CDS on MBS, and are denominated in U.S. dollars and executed in 2011. Price-forming transactions include all new transactions, assignments, modifications to increase the notional amounts of previously executed transactions, and terminations of previously executed transactions. Transactions terminated, transactions entered into in connection with a compression exercise, and expiration of contracts at maturity are not considered price-forming and are therefore excluded, as are replacement trades and all bookkeeping-related trades. See notes 1312 and 1638, *supra*.

<sup>1789</sup> See note 1639, *supra*, in Section XV.F.2(a) for explanations of the determination of an account holder’s domicile by the Commission staff in the Division of Risk, Strategy, and Financial Innovation using information in the DTCC-TIW.

it is reasonable to assume that foreign subsidiaries of U.S.-domiciled entities are non-U.S. persons whose performance under security-based swap transactions is guaranteed by a U.S. person. Finally, the DTCC-TIW data do not provide sufficient information for us to identify whether a transaction was conducted in the United States. Solely for purposes of this analysis, we have assumed that transactions involving a U.S.-domiciled counterparty (excluding foreign branch) or a U.S. branch counterparty were conducted in the United States.<sup>1790</sup>

Based on these assumptions, we estimate that the subset of the size of the single-name U.S. reference CDS market that includes a U.S.-domiciled counterparty (excluding a foreign branch of a U.S. bank), a foreign subsidiary of a U.S.-domiciled entity, or a U.S. branch of a foreign bank as a counterparty is \$1,900 billion notional amount.<sup>1791</sup> The Commission preliminarily believes that this figure provides an indicative level of the single-name U.S. reference CDS activity that may represent an indicative size of the security-based swap market that could become subject to the mandatory trade execution requirement under proposed Rule 3Ch-1(a) when the requirement becomes effective.<sup>1792</sup> In

<sup>1790</sup> Since the origination location of a transaction is not available in DTCC-TIW, the Commission recognizes that its analysis here may undercount transactions conducted within the United States because some transactions may be solicited, negotiated, or executed within the United States by an agent other than U.S. branches of foreign banks (such as a non-U.S. person counterparty using an unaffiliated third-party agent).

<sup>1791</sup> Such \$1,900 billion estimate does not capture transactions between two non-U.S. domiciled counterparties involving an agent to solicit, negotiate and execute security-based swaps in the United States and therefore, may be an underestimate of the aggregate notional amount of the single-name U.S. reference CDS transactions that may be included in the application of the mandatory trade execution requirement under proposed Rule 3Ch-1(a) because of the assumption we make herein regarding transactions conducted within the United States. By the same token, the difference between the \$1,900 billion subset included in the application of the mandatory trade execution requirement under proposed Rule 3Ch-1(a) and the \$2,400 billion total single-name U.S. reference CDS transactions (*i.e.*, \$500 billion or 20.8% of the \$2,400 billion) may represent an overestimate of single-name U.S. reference CDS transactions in notional amount that are not included in the application of the mandatory trade execution requirement under proposed Rule 3Ch-1(a).

<sup>1792</sup> The Commission recognizes that the security-based swap market includes single-name CDS, CDS based on narrow-based indices, and other non-CDS security-based swaps, primary examples of which are equity swaps and total return swaps based on single equities or narrow-based indices of equities. As previously stated, we believe that the single-name CDS data are sufficiently representative of the security-based swap market as roughly 82% of the security-based swap market, as measured on a



addition, we recognize that the level of the security-based swap activity that could become subject to mandatory trade execution under proposed Rule 3Ch-1(a) may be affected by the “made available to trade” determination by the Commission.<sup>1793</sup>

Next, we apply proposed Rule 3Ch-1(b) to the transactions included in the analysis described above regarding proposed Rule 3Ch-1 in order to estimate the portion of the single-name U.S. reference CDS activity that may represent an indicative size of the security-based swap market that would not be subject to the mandatory trade execution requirement under the proposed rule. We reiterate the assumptions described above with respect to the counterparty status of a U.S. person and a non-U.S. person whose performance under security-based swap transactions is guaranteed by a U.S. person, and the assumption with respect to a transaction conducted within the United States. In addition, because of the lack of information about the location of transactions, solely for assessing the effect of proposed Rule 3Ch-1(b)(1), we have assumed that transactions between a counterparty that is a foreign branch or foreign subsidiary of a U.S.-domiciled entity and another counterparty that is a foreign-domiciled entity that is not a subsidiary of a U.S.-domiciled entity or an ISDA-recognized dealer are not transactions conducted within the United States; and solely for purposes of assessing the effect of proposed rule 3Ch-1(b)(2), we have assumed that transactions conducted between two foreign-domiciled counterparties that are not ISDA-recognized dealers and are not foreign subsidiaries of U.S.-domiciled entities are not conducted within the United States. These assumptions likely result in an overestimate of the notional volume carved-out by proposed Rule 3Ch-1(b). With respect to counterparty status as a registered security-based swap dealer, we recognize that as yet there are no dealers designated as security-based swap dealers and subject to the registration requirement. Solely for purposes of this analysis, we have assumed that those counterparties to CDS transactions that were ISDA recognized dealers<sup>1794</sup> would be required to register as security-based swap dealers.

Based on the above assumptions, we have estimated that approximately 2.1%

notional basis, appears likely to be single-name CDS. See Section XV.B.2 and the text accompanying note 1301, *supra*.

<sup>1793</sup> See note 1763 and accompanying text, *supra*.

<sup>1794</sup> See note 1306, *supra*.

of the total notional amount<sup>1795</sup> of single-name U.S. reference CDS transactions executed in 2011 would be excluded from the application of the mandatory trade execution requirement by proposed Rule 3Ch-1(b). Therefore, we preliminarily believe that 22.9% of the total size of the single-name U.S. reference CDS transactions in 2011 presents an indicative size of the U.S. security-based swap market that could be excluded from the application of the mandatory trade execution requirement under proposed Rule 3Ch-1.<sup>1796</sup>

The Commission preliminarily believes that this estimate provides the best available proxy for the overall programmatic effect of the application of the mandatory trade execution requirement in the cross-border context in terms of the portion of the single-name U.S. reference CDS market that may be included in or excluded from the scope of the application of the mandatory trade execution requirement, given the data limitations and the underlying assumptions described above.<sup>1797</sup> The Commission is mindful that the above analysis represents only

<sup>1795</sup> Based on calculations by the staff of the Division of Risk, Strategy and Financial Innovation applying the criteria provided in proposed rule 3Ch-1(b) and the assumptions stated herein, approximately \$51 billion in notional amount, constituting approximately 2.1% of the total notional amount, of single-name U.S. reference CDS transactions executed in 2011 would be excluded from the application of the mandatory trade execution requirement. Because of the assumptions we made herein regarding transactions conducted within the United States and transactions conducted outside the United States, the 2.1% may be an overestimate of the aggregate notional amount of the single-name U.S. reference CDS transactions that may be excluded from the application of the mandatory trade execution requirement under proposed Rule 3Ch-1(b).

<sup>1796</sup> The 22.9% estimate is the sum of the 20.8% estimate of the single-name U.S. reference CDS transactions excluded from the mandatory trade execution requirement under proposed Rule 3Ca-3(a) and the 2.1% estimate of the single-name U.S. reference CDS transactions excluded from the mandatory trade execution requirement under proposed Rule 3Ca-3(b). The Commission reiterates that both 20.8% and 2.1% may overestimate the size of the single-name U.S. reference CDS transactions excluded from the application of the mandatory trade execution requirement under proposed Rules 3Ch-1(a) and (b).

In addition, this calculation is conducted using U.S. reference single-name CDS transaction data in 2011. See the text accompanying notes 1637 and 1787, *supra*. The Commission recognizes that the same calculation could generate a different result if both U.S. reference and non-U.S. reference single-name CDS transaction data were used. However, with respect to non-U.S. reference single-name CDS transaction data, the Commission currently does not have access to the part of such data in DTCC-TIIF regarding non-U.S. reference single-name CDS transactions that do not involve a U.S. counterparty on either side of the transaction. See Section XV.B.2, *supra*.

<sup>1797</sup> The Commission reiterates that the assumptions made here are solely for purposes of this economic analysis.

an indicative estimate of the portion of the single-name U.S. reference CDS activity that may represent an indicative size of the security-based swap market that may be included in or excluded from the application of the mandatory trade execution requirement as a result of proposed Rule 3Ch-1. The Commission also recognizes that the above analysis represents an extrapolation from the limited data that is currently available to the Commission.

#### (b) Programmatic Benefits and Costs of Proposed Rule 3Ch-1

The Commission preliminarily believes that, in addition to the programmatic effect of a large volume of cross-border security-based swap transactions becoming subject to the mandatory trade execution requirement as a result of proposed Rule 3Ch-1, certain benefits and costs that overlap with the benefits and costs associated with SB SEF registration, as described in the SB SEF Proposing Release, would flow from proposed Rule 3Ch-1 because cross-border security-based swaps covered by proposed Rule 3Ch-1 would have to be executed or traded on SB SEFs or exchanges. Indeed, these benefits and costs would be realized for the volume of cross-border security-based swap transactions, estimated in Section XV.G.4(a) above,<sup>1798</sup> that would be covered by proposed Rule 3Ch-1(a) (and not excepted by proposed Rule 3Ch-1(b)) and, therefore, subject to the mandatory trade execution requirement.<sup>1799</sup> These benefits and costs, which are more fully described in the SB SEF Proposing Release, are summarized above.<sup>1800</sup>

#### (c) Alternatives

The Commission has considered alternatives to proposed Rule 3Ch-1. The Commission could propose to apply the mandatory trade execution requirement in the same way as the CFTC’s proposed interpretive guidance.

<sup>1798</sup> See Section XV.G.4(a), *supra*.

<sup>1799</sup> To the extent that the estimated volume of security-based swap transactions that would be subject to the cross-border application of the statutory mandatory trade execution requirement in proposed Rules 3Ch-1(a) and 3Ch-1(b) (as analyzed in Section XV.G.4(a) above) differs from the estimated upper bound volume of the security-based transactions that would be subject to the statutory requirement (as set forth in Section XV.G.3(a) above), such differential reflects the aggregate programmatic effect of proposed Rules 3Ch-1(a) and 3Ch-1(b), and that the volume of security-based swap transactions that would be subject to those proposed cross-border rules is a subset of the upper bound volume estimate of transactions subject to the statutory requirement, which is not limited to the cross-border context.

<sup>1800</sup> See Sections XV.G.3(b) and (c), *supra*.



The major difference between the CFTC's proposed application of the mandatory trade execution requirement and the Commission's proposed Rule 3Ch-1 is that the CFTC would apply the mandatory trade execution requirement to a transaction conducted outside the United States between a foreign branch and a non-guaranteed non-U.S. person. The Commission preliminarily believes that subjecting such a transaction to mandatory trade execution may hinder a foreign branch's ability to access the foreign local market to a degree that fails to justify the pre-trade transparency benefits to the U.S. financial market.

(d) Assessment Costs for Proposed Rule 3Ch-1

The assessment costs associated with proposed Rule 3Ch-1 would be related primarily to identification of the counterparty status and origination location of the transaction to determine whether the mandatory trade execution requirement would apply. The same assessment would be performed not only in connection with the proposed application of the mandatory trade execution requirement in the cross border context, but also in connection with the proposed application of the reporting,<sup>1801</sup> public dissemination,<sup>1802</sup> and mandatory clearing<sup>1803</sup> requirements in the cross-border context and, therefore, would be part of the overall Title VII compliance costs.

The Commission preliminarily believes that market participants would request representations from their transaction counterparties to determine the U.S.-person status of their counterparties. In addition, if the transaction is guaranteed by a U.S. person, the guarantee would be part of the trading documentation and, therefore, the existence of the guarantee would be a readily ascertainable fact. Similarly, market participants would be able to rely on their counterparties' representations as to whether a transaction is solicited, negotiated or executed by a person within the United States.<sup>1804</sup> Therefore, the Commission preliminarily believes that the assessment costs associated with proposed Rule 3Ch-1 should be limited to the costs of establishing a compliance policy and procedure of requesting and

collecting representations from trading counterparties and maintaining the collected representations as part of the market participants' recordkeeping procedures. The Commission preliminarily believes that such assessment costs would be approximately \$15,160.<sup>1805</sup> The Commission preliminarily believes that requesting and collecting representations would be part of the standardized transaction process reflected in the policies and procedures regarding security-based swap sales and trading practices and should not result in separate assessment costs.<sup>1806</sup>

The Commission also considers the likelihood that market participants may implement systems to keep track of counterparty status for purposes of future trading of security-based swaps that are similar to, if not the same as, the systems implemented by market participants for purposes of assessing security-based swap dealer or major security-based swap participant status. As stated above, the Commission estimated that market participants that perceived the need to perform the security-based swap dealer assessment or major security-based swap participant calculations would incur one-time programming costs of \$12,870.<sup>1807</sup> Therefore, the Commission estimates the total one-time costs per entity associated with proposed Rule 3Ch-1 could be \$28,030.<sup>1808</sup> To the extent that market participants have incurred costs relating to similar or the same assessments with respect to

<sup>1805</sup> This estimate is based on an estimated 40 hours of in-house legal or compliance staff's time to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representations may be built into a form of standardized trading documentation. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379.

<sup>1806</sup> There will be ongoing costs associated with processing representations received from counterparties, including additional due diligence and verification to the extent that a counterparty's representation is contrary to or inconsistent with the knowledge of the collecting party. The Commission believes that these would be compliance costs encompassed within the programmatic costs associated with substituted compliance.

<sup>1807</sup> See note 1428, *supra*. For the source of the estimated per hour costs, see note 1425, *supra*.

<sup>1808</sup> The estimated \$28,030 per-entity cost is the sum of the estimated \$15,160 cost of establishing written compliance policies and procedures regarding obtaining counterparty representations and the estimated \$12,870 one-time programming cost relating to system implementation to maintain counterparties' representations and track counterparty status in the system.

counterparty status and transaction location for other Title VII requirements, their assessment costs with respect to proposed Rule 3Ch-1 may be less.

Request for Comment

• Are there any benefits and costs not discussed herein? How would the benefits and costs affect the various groups of market participants involved in the trading of security-based swaps? To the extent the benefits or costs of complying with mandatory trade execution described above are different for different groups of market participants, please identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such different benefits or costs.

• Would the benefits of complying with mandatory trade execution be the same for foreign and domestic market participants?

• Would the costs associated with complying with mandatory trade execution be the same for domestic and foreign market participants? If not, how would they be different and how could the Commission most accurately estimate them? For example, would either domestic or foreign market participants face higher costs in gaining access to SB SEFs to comply with the mandatory trade execution requirement? Or would the costs be comparable?

• To the extent that the benefits or costs of complying with mandatory trade execution would be different for foreign market participants as compared to domestic market participants, please identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such different benefits or costs.

• Are the assessment cost estimates provided herein appropriate? If not, how should the estimates be adjusted? Please provide data and analysis to support differing cost estimates.

*H. Application of Rules Governing Security-Based Swap Data Repositories in Cross-Border Context*

SDRs are intended to play a critical role in enhancing transparency in the security-based swap market, bolstering market efficiency and liquidity, promoting standardization, and reducing systemic risks by serving as centralized recordkeeping facilities that collect and maintain information relating to security-based swap transactions.<sup>1809</sup> More broadly, the goal

<sup>1809</sup> See SDR Proposing Release, 75 FR 77354; see also 156 Cong. Rec. S5920 (daily ed. July 15, 2010) (statement of Sen. Lincoln) ("These new 'data repositories' will be required to register with the CFTC and the SEC and be subject to the statutory duties and core principles which will assist the

<sup>1801</sup> See re-proposed Rule 908(a)(1) under the Exchange Act, as discussed in Section VIII.C.1, *supra*, and Section XV.H, *infra*.

<sup>1802</sup> See re-proposed Rule 908(a)(2) under the Exchange Act, as discussed in Section VIII.C.1, *supra*, and Section XV.H, *infra*.

<sup>1803</sup> See proposed Rule 3Ca-3 under the Exchange Act, as discussed in Sections IX.C and XV.F, *supra*.

<sup>1804</sup> See proposed Rules 3a71-3(a)(4)(ii) and (a)(5)(ii), as discussed in Sections III.B.5 and III.B.6, *supra*.

of the Dodd-Frank Act is, among other things, to promote the financial stability of the United States by improving accountability and transparency in the financial system.<sup>1810</sup> In furtherance of these goals, the Dodd Frank Act amended the Exchange Act to require the reporting of security-based swaps (whether cleared or uncleared) to an SDR registered with the Commission,<sup>1811</sup> and to require certain persons that perform the functions of an SDR to register with the Commission.<sup>1812</sup> SDRs that are registered with the Commission are subject to Section 13(n) of the Exchange Act<sup>1813</sup> and the rules and regulations thereunder (collectively, “SDR Requirements”), as well as other requirements applicable to SDRs registered with the Commission.<sup>1814</sup> In this section, the Commission first discusses the benefits and costs of the Commission’s proposed interpretive guidance regarding the application of the SDR Requirements and exemption from the SDR Requirements. The Commission then discusses the benefits and costs of the Commission’s proposed interpretive guidance regarding relevant authorities’ access to security-based swap information and exemption from the statutory indemnification requirement that could hinder such access. Finally, the Commission discusses the benefits and costs associated with the Commission’s proposed Regulation SBSR, which sets forth the reporting obligations of counterparties to security-based swaps in the cross-border context.

CFTC and the SEC in their oversight and market regulation responsibilities.”).

<sup>1810</sup> See Dodd-Frank Act, Public Law 111–203 at Preamble.

<sup>1811</sup> Section 13(m)(1)(G) of the Exchange Act, 15 U.S.C. 78m(m)(1)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1812</sup> Section 3(a)(75) of the Exchange Act, 15 U.S.C. 78c(a)(75), as added by Section 761(a) of the Dodd-Frank Act (defining a “security-based swap data repository” to mean “any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, security-based swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for security-based swaps”) and Section 13(n)(1) of the Exchange Act, 15 U.S.C. 78m(n)(1), as added by Section 763(i) of the Dodd-Frank Act (providing that it is “unlawful for any person, unless registered with the Commission, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a security-based swap data repository”).

<sup>1813</sup> 15 U.S.C. 78m(n), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1814</sup> See note 703, *supra*.

## I. Benefits and Costs Associated With Application of the SDR Requirements in the Cross-Border Context

### (a) Benefits of Proposed Approach to SDR Requirements

As discussed above,<sup>1815</sup> the Commission proposes that any U.S. person that performs the functions of an SDR would be required to register with the Commission pursuant to Section 13(n)(1) of the Exchange Act<sup>1816</sup> and previously proposed Rule 13n–1 thereunder. As further discussed above,<sup>1817</sup> the Commission further proposes that, to the extent that any non-U.S. person performs the functions of an SDR within the United States, it would be required to register with the Commission pursuant to Section 13(n)(1) of the Exchange Act<sup>1818</sup> and previously proposed Rule 13n–1 thereunder, absent an exemption. The Commission also is proposing new Rule 13n–12 under the Exchange Act, which provides that a non-U.S. person that performs the functions of an SDR within the United States is exempt from the SDR Requirements, provided that each regulator with supervisory authority over such non-U.S. person has entered into a supervisory and enforcement MOU or other arrangement with the Commission that addresses the confidentiality of data collected and maintained by such non-U.S. person, access by the Commission to such data, and any other matters determined by the Commission (“SDR Exemption”).<sup>1819</sup>

The Commission has considered the benefits and costs associated both with the Commission’s proposed interpretive guidance regarding U.S. persons and non-U.S. persons that would be required to register with the Commission as an SDR and with the SDR Exemption in light of the transparency and other objectives that the Dodd-Frank Act is intended to achieve. The Commission preliminarily believes that our proposed approach would be consistent with achieving these intended benefits of the SDR Requirements, but would avoid imposing the associated costs of these requirements on persons whose registration and regulation may not significantly advance these benefits.

### i. Programmatic Benefits of Proposed Guidance Regarding Registration

The Commission preliminarily believes that there are a number of

<sup>1815</sup> See Section VI.B.3(a), *supra*.

<sup>1816</sup> 15 U.S.C. 78m(n)(1), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1817</sup> See Section VI.B.3(b), *supra*.

<sup>1818</sup> 15 U.S.C. 78m(n)(1), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1819</sup> See Section VI.B.3(b), *supra*.

programmatic benefits to our proposal to require U.S. persons that perform the functions of an SDR and non-U.S. persons that perform the functions of an SDR within the United States to register with the Commission and to comply with the other SDR Requirements. These requirements are intended to help ensure that SDRs function in a manner that will further the transparency and other goals of the Dodd-Frank Act.<sup>1820</sup> The SDR Requirements, including requirements that SDRs register with the Commission, retain complete records of security-based swap transactions, maintain the integrity and confidentiality of those records, and provide effective access to those records to relevant authorities and the public in line with their respective information needs, are intended to help ensure that the data held by SDRs is reliable and that the SDRs provide information that contributes to the transparency of the security-based swap market while protecting the confidentiality of information provided by market participants.<sup>1821</sup>

Enhanced transparency should produce market-wide benefits by, for example, promoting stability in the security-based swap market,<sup>1822</sup> and it should indirectly contribute to improved stability in related financial markets, including equity and bond markets.<sup>1823</sup> Enhanced transparency in the security-based swap market would assist the Commission and other relevant authorities in fulfilling their regulatory mandates and legal responsibilities such as performing market surveillance and detecting market manipulation, fraud, and other market abuses by providing the Commission and other relevant authorities with greater access to security-based swap information.<sup>1824</sup>

<sup>1820</sup> See SDR Proposing Release, 75 FR 77354. See also Dodd-Frank Act, Public Law 111–203 at Preamble.

<sup>1821</sup> See SDR Proposing Release, 75 FR 77307.

<sup>1822</sup> See *id.* (“SDRs may be especially critical during times of market turmoil, both by giving relevant authorities information to help limit systemic risk and by promoting stability through enhanced transparency. By enhancing stability in the [security-based swap] market, SDRs may also indirectly enhance stability across markets, including equities and bond markets.”).

<sup>1823</sup> See Darrell Duffie, Ada Li, and Theo Lubke, “Policy Perspectives of OTC Derivatives Market Infrastructure,” Federal Reserve Bank of New York Staff Report No. 424 (Jan. 2010, as revised Mar. 2010) (“Transparency can have a calming influence on trading patterns at the onset of a potential financial crisis, and thus act as a source of market stability to a wider range of markets, including those for equities and bonds”).

<sup>1824</sup> See SDR Proposing Release, 75 FR 77307 (“The enhanced transparency provided by an SDR is important to help regulators and others monitor

Increased regulatory effectiveness should improve the integrity and transparency of the market and improve the confidence of market participants.<sup>1825</sup>

The Commission preliminarily believes that requiring U.S. persons performing the functions of an SDR to register with the Commission as SDRs and comply with the SDR Requirements, as well as other requirements applicable to SDRs registered with the Commission,<sup>1826</sup> would further the goals of the SDR Requirements and contribute to enhanced transparency in the security-based swap market in the United States. The Commission preliminarily believes that U.S. persons performing the functions of an SDR will play a key role in ensuring that security-based swap transactions affecting the transparency of the security-based swap market within the United States are reported; properly maintained; and made available to the Commission, other relevant authorities, and the public.<sup>1827</sup> Requiring such U.S. persons to comply with the SDR Requirements would help ensure that they maintain data and make it available in a manner that advances the transparency benefits that Title VII is intended to produce.

Non-U.S. persons performing the functions of an SDR within the United States also may affect the transparency of the security-based swap market within the United States, even if transactions involving U.S. persons or U.S. market participants are being reported to such non-U.S. persons in order to satisfy the reporting requirements of a foreign jurisdiction (and not those of Title VII). The Commission preliminarily believes that, to the extent that non-U.S. persons are performing the functions of an SDR within the United States, they will likely receive data relating to transactions involving U.S. persons and other U.S. market participants. Ensuring that such data is maintained and made available in a manner consistent with the SDR Requirements would likely contribute to the transparency of the U.S. market and reduce potential

the build-up and concentration of risk exposures in the [security-based swap] market.”; *see also* DTCC Letter I at 1 (“A registered SDR should be able to provide (i) enforcement agents with necessary information on trading activity; (ii) regulatory agencies with counterparty-specific information about systemic risk based on trading activity; (iii) aggregate trade information for publication on market-wide activity; and (iv) a framework for real-time reporting from swap execution facilities and derivatives clearinghouses.”).

<sup>1825</sup> *See* SDR Proposing Release, 75 FR 77356.

<sup>1826</sup> *See* note 703, *supra*.

<sup>1827</sup> *See* SDR Proposing Release, 75 FR 77356.

confusion that may arise from discrepancies in transaction data due to, among other things, differences in the operational standards governing persons who perform the functions of an SDR in other jurisdictions (or the absence of such standards for any such persons that are not subject to any regulatory regime). Moreover, given the sensitivity of reported security-based swap data and the potential for market abuse and subsequent loss of liquidity in the event that a person performing the function of an SDR within the United States fails to maintain the privacy of such data,<sup>1828</sup> the Commission preliminarily believes that requiring non-U.S. persons that perform the functions of an SDR within the United States to register with the Commission would help ensure that data relating to transactions involving U.S. persons or U.S. market participants is handled in a manner consistent with the confidentiality protections applicable to such data, thereby reducing the risk both of the loss or disclosure of proprietary or other sensitive data and of market abuse arising from the misuse of such data.

#### ii. Programmatic Benefits of the SDR Exemption

As noted above, the Commission is proposing new Rule 13n-12 under the Exchange Act to provide an exemption from the SDR Requirements for non-U.S. persons that perform the functions of an SDR within the United States, provided that each regulator with supervisory authority over any such non-U.S. person has entered into a supervisory and enforcement MOU or other arrangement with the Commission that addresses the confidentiality of data collected and maintained by such non-U.S. person, access by the Commission to such data, and any other matters determined by the Commission.<sup>1829</sup>

The Commission preliminarily believes that this SDR Exemption would not significantly reduce the programmatic benefits associated with the SDR Requirements. Although the proposed approach would potentially reduce the number of persons performing the functions of an SDR that are registered with the Commission,<sup>1830</sup> data relating to transactions involving U.S. persons and U.S. market

<sup>1828</sup> *See id.* at 77307.

<sup>1829</sup> Proposed Rule 13n-12(b) under the Exchange Act.

<sup>1830</sup> It appears that, as of April 2013, there were several non-U.S. persons performing the functions of an SDR or intending to do so in the future. *See* FSB Progress Report April 2013 at 20-21, 63-65. The Commission, however, does not possess data regarding how many, if any, of these persons perform the functions of an SDR within the United States.

participants would still be required to be reported, pursuant to Regulation SBSR, to an SDR registered with the Commission and subject to all SDR Requirements, absent other relief from the Commission.<sup>1831</sup>

Moreover, the SDR Exemption would be conditioned on a supervisory and enforcement MOU or other arrangement with each regulator with supervisory authority over the non-U.S. person that seeks to rely upon the SDR Exemption. This MOU or arrangement would address the Commission's interest in having access to security-based swap data involving U.S. persons and other U.S. market participants that is maintained by non-U.S. persons that perform the functions of an SDR within the United States and in protecting the confidentiality of such data. Further, proposed Rule 13n-12 should not impair the integrity and accessibility of security-based swap data. The Commission, therefore, preliminarily believes that exempting certain non-U.S. persons performing the functions of an SDR within the United States, subject to the condition described above, would likely not significantly affect the programmatic benefits that the SDR Requirements were intended to achieve.<sup>1832</sup>

#### (b) Costs of Proposed Approach to SDR Requirements

##### i. Programmatic Costs of the Commission's Proposed Approach

Registering with the Commission and complying with the SDR Requirements will impose certain costs on an SDR.<sup>1833</sup> The Commission's proposed interpretive guidance and SDR Exemption do not change the costs associated with any particular SDR Requirement, but the Commission preliminarily believes that the SDR Exemption may reduce the costs for certain non-U.S. persons performing the functions of an SDR within the United

<sup>1831</sup> *See* discussion of Regulation SBSR in Section VIII, *supra* and discussion of substituted compliance in Section XI, *supra*.

<sup>1832</sup> The Commission also anticipates that non-U.S. persons that avail themselves of the SDR Exemption would be subject to the regulatory requirements of one or more foreign jurisdictions. The SDR Exemption would help ensure that such persons do not incur costs arising from being required to comply with duplicative regulatory regimes while also ensuring, through the condition that each regulator with supervisory authority enter into a supervisory and enforcement MOU or other arrangement with the Commission, that they are subject to regulatory requirements that would prevent them from undermining the transparency and other purposes of the Title VII SDR Requirements, for example, by failing to protect the confidentiality of data relating to U.S. persons and other U.S. market participants.

<sup>1833</sup> *See* SDR Proposing Release, 75 FR 77354-64.

States without reducing the expected benefits of the SDR Requirements.<sup>1834</sup> The Commission preliminarily believes that such persons would likely be performing the functions of an SDR in order to permit counterparties to satisfy reporting requirements under foreign law. An exemption, if available, would allow these non-U.S. persons to continue to perform this function within the United States, potentially reducing costs to U.S. market participants that have reporting obligations under foreign law and reducing the incentive for non-U.S. persons performing the functions of an SDR within the United States to restructure their operations to avoid registration with the Commission.

The Commission recognizes that making the exemption available subject to a condition may delay the availability of the exemption to certain non-U.S. persons. In some cases, the Commission may be unable to enter into an MOU or other arrangement with each regulator with supervisory authority over a non-U.S. person performing the functions of an SDR within the United States. The resulting delay or unavailability of the exemption may lead some of these non-U.S. persons to exit the U.S. market by, for example, restructuring their business so that they perform the functions of an SDR entirely outside the United States, potentially resulting in business disruptions in the security-based swap market.

#### ii. Assessment Costs

Under the Commission's proposed approach, non-U.S. persons that perform the functions of an SDR may be expected to incur certain assessment costs related to determining whether they can rely on the SDR Exemption and, if not, whether they perform the functions of an SDR within the United States.<sup>1835</sup>

With respect to determining the availability of the SDR Exemption, the Commission preliminarily believes that the costs for a non-U.S. person that performs the functions of an SDR to

determine whether the condition for the availability of the SDR Exemption has been satisfied with respect to it would arise from confirming whether the Commission and each regulator with supervisory authority over such non-U.S. person have entered into a supervisory and enforcement MOU or other arrangement. The Commission preliminarily believes that, given that this information generally should be readily available,<sup>1836</sup> the cost involved in making such assessment should not exceed one hour of in-house counsel's time or \$379 per person,<sup>1837</sup> for an aggregate one-time cost of \$7,580.<sup>1838</sup>

If the condition for the SDR Exemption has not been satisfied with respect to any authority with supervisory authority over such non-U.S. person, that person may determine to analyze where it performs its SDR functions in order to determine whether it performs such functions within the United States. This analysis may involve two separate sets of costs: costs associated with determining whether it has entered into contracts, including user or technical agreements, with a U.S. person to enable the U.S. person to report security-based swap data to it, and costs associated with determining whether it otherwise performs the functions of an SDR within the United States, for example, by maintaining certain operations within the United States.

The Commission preliminarily believes that the assessment costs associated with determining the U.S. person status of parties to agreements with the non-U.S. person that performs the functions of an SDR should be primarily one-time costs of establishing a practice or compliance procedure of requesting and collecting representations from the parties to such

agreements and maintaining the representations collected as part of the recordkeeping procedures and limited ongoing costs associated with requesting and collecting representations. The Commission preliminarily believes that such one-time per-person costs would be approximately \$15,160,<sup>1839</sup> with aggregate one-time costs of approximately \$303,200.

The assessment costs associated with determining whether the non-U.S. person otherwise performs the functions of an SDR within the United States would likely involve an analysis of the location of the non-U.S. person's various operations and, with respect to any operations that occur within the United States, a determination of whether such operations constitute the performance of the functions of an SDR. The Commission preliminarily believes that the aggregate one-time costs associated with this analysis would be approximately \$500,000.<sup>1840</sup>

#### (c) Alternative to Proposed Approach

In developing our approach to the application of the SDR Requirements to non-U.S. persons that perform the functions of an SDR, the Commission considered requiring such persons that perform the functions of an SDR within the United States to comply with the SDR Requirements, including registering with the Commission, as well as other requirements applicable to SDRs registered with the Commission.<sup>1841</sup> In such a scenario, a non-U.S. person performing the functions of an SDR within the United States would be required to register as an SDR and incur the costs associated with the SDR Requirements,<sup>1842</sup> as well as other requirements applicable to SDRs registered with the Commission.<sup>1843</sup> The Commission preliminarily believes that the marginal benefit of requiring all non-U.S. persons that perform the functions of an SDR within the United States to register with the Commission, even where similar objectives could be achieved through an

<sup>1834</sup> As noted above, the data currently available to the Commission does not indicate how many non-U.S. persons performing the functions of an SDR perform such functions within the United States. See note 1830, *supra*. However, even if counterparties with reporting obligations under Regulation SBSR reported their transactions to a non-U.S. person that performs the functions of an SDR within the United States but is exempt from registration, they would still be required to report transactions under Regulation SBSR to an SDR registered with the Commission.

<sup>1835</sup> The Commission recognizes that some non-U.S. persons that perform the functions of an SDR may do so entirely outside the United States and thus may determine that they do not need to incur any assessment costs related to the Commission's proposed approach.

<sup>1836</sup> As a general matter, the Commission provides a list of MOUs and other arrangements, which are available at the following link: [http://www.sec.gov/about/offices/oia/oia\\_cooparrangements.shtml](http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml).

<sup>1837</sup> Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379.

<sup>1838</sup> This total is based on the assumption that as many as 20 non-U.S. persons that perform the functions of an SDR would seek outside legal counsel to determine the nature of any operations or other activity performed within the United States. Although there appear to be fewer than 10 such persons that are currently accepting and reporting on security-based swaps (see FSB Progress Report April 2013 at 20–21, 63–65), our estimate that as many as 20 such persons may perform this analysis is intended to account for the possibility that new market entrants may seek to provide such services in the future.

<sup>1839</sup> This estimate is based on estimated 40 hours of in-house legal or compliance staff's time to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be built into form of standardized trading documentation. As noted above, the staff estimates that the average national hourly rate for an in-house attorney is \$379. See note 1426, *supra*.

<sup>1840</sup> We have estimated that this analysis would cost an average of \$25,000 per person and that as many as 20 non-U.S. persons may incur such costs. This estimate is based on staff experience in undertaking legal analysis of status under federal securities laws.

<sup>1841</sup> See note 703, *supra*.

<sup>1842</sup> See SDR Proposing Release, 75 FR 77354–64.

<sup>1843</sup> See note 703, *supra*.

exemption conditioned on a supervisory and enforcement MOU or other arrangement with each regulatory authority with supervisory authority over such non-U.S. persons, would be insignificant, particularly in light of the costs that such non-U.S. persons would incur in complying with the SDR Requirements, as well as other requirements applicable to SDRs registered with the Commission.<sup>1844</sup>

#### Request for Comment

The Commission seeks comment on the proposed interpretive guidance and SDR Exemption, and alternatives to our proposed approach, in all aspects. Interested persons are encouraged to provide supporting data and analysis and, when appropriate, suggest modifications or alternatives to the proposed interpretive guidance and SDR Exemption. In addition, the Commission seeks comment on the specific questions below.

- Has the Commission appropriately considered the expected programmatic benefits of our proposed interpretive guidance and SDR Exemption? If not, please explain why and provide information on how such costs and benefits should be assessed.

- Are the programmatic benefits and costs discussed above accurate? If not, why not? How should the Commission assess the benefits and costs associated with our proposed interpretive guidance and SDR Exemption compared to their anticipated benefits of increasing transparency in the security-based swap market?

- Are there quantifiable programmatic benefits or costs associated with the Commission's proposed interpretive guidance and the SDR Exemption that are not discussed above, but that the Commission should consider? If so, please identify and describe them as thoroughly as possible, using relevant data and statistics where available.

- Has the Commission appropriately considered the benefits and costs of the alternative approach to the Commission's proposed interpretive guidance and SDR Exemption? In answering this question, consider addressing whether the Commission has appropriately considered the benefits and costs of duplicative regulatory regimes, including duplicative requirements governing SDRs.

- How would the Commission's proposed interpretive guidance and the SDR Exemption affect efficiency, competition, and capital formation, including the competitive or

anticompetitive effects that such guidance and exemption may have on market participants? Are there other existing or proposed laws, rules, or regulations affecting SDRs in particular jurisdictions that affect efficiency, competition, and capital formation that the Commission should consider? If so, please identify and describe these effects as thoroughly as possible.

- Are there costs in fulfilling the condition in the SDR Exemption that the Commission has not discussed above? If so, what?

- Would the condition requiring a supervisory and enforcement MOU with a foreign supervisory regulator impose costs on non-U.S. persons performing the functions of an SDR within the United States? Further, would delay in entering into a supervisory and enforcement MOU or other arrangement (or the inability to enter into such MOU or arrangement) impose costs on such non-U.S. persons or market participants more generally? Would it have adverse consequences for liquidity in the security-based swap market?

- Should the Commission consider other alternatives to our proposed interpretive guidance and the SDR Exemption? What would be the benefits and costs of such alternative approaches?

#### 2. Relevant Authorities' Access to Security-Based Swap Information and the Indemnification Requirement

One key function that SDRs will perform is making available to the Commission and other relevant authorities information relating to security-based swap transactions. As described above,<sup>1845</sup> Section 13(n)(5)(G) of the Exchange Act<sup>1846</sup> and previously proposed Rule 13n-4(b)(9) thereunder provide that an SDR shall on a confidential basis, pursuant to Section 24 of the Exchange Act, and the rules and regulations thereunder, upon request, and after notifying the Commission ("Notification Requirement"), make available all data obtained by the SDR, including individual counterparty trade and position data, to certain domestic authorities and any other person that the Commission determines to be appropriate, including, but not limited to, foreign financial supervisors (including foreign futures authorities), foreign central banks, and foreign ministries. Section 13(n)(5)(H) of the Exchange Act<sup>1847</sup> and previously

<sup>1845</sup> See Section VI.C., *supra*.

<sup>1846</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1847</sup> 15 U.S.C. 78m(n)(5)(H), as added by Section 763(i) of the Dodd-Frank Act.

proposed Rule 13n-4(b)(10) further provide that before sharing information with any entity described in Section 13(n)(5)(G)<sup>1848</sup> or previously proposed Rule 13n-4(b)(9), respectively, an SDR must obtain a written agreement from the entity stating that the entity shall abide by the confidentiality requirements described in Section 24 of the Exchange Act,<sup>1849</sup> and the rules and regulations thereunder, relating to the information on security-based swap transactions that is provided; in addition, the entity shall agree to indemnify the SDR and the Commission for any expenses arising from litigation relating to the information provided under Section 24 of the Exchange Act<sup>1850</sup> and the rules and regulations thereunder ("Indemnification Requirement").

#### (a) Benefits and Costs of Relevant Authorities' Access to Security-Based Swap Data Under the Dodd-Frank Act

As discussed above,<sup>1851</sup> the Commission believes that Sections 13(n)(5)(G) and 13(n)(5)(H) of the Exchange Act<sup>1852</sup> are intended to, among other things, obligate SDRs to make available security-based swap information to relevant authorities and maintain the confidentiality of such information. More broadly, the Dodd-Frank Act is intended to, among other things, promote the financial stability of the U.S. financial system by improving accountability and transparency in the financial system.<sup>1853</sup> To the extent that SDRs fulfill these statutory goals, the Commission preliminarily believes that certain benefits and costs will result.

#### i. Benefits of Relevant Authorities' Access to Security-Based Swap Data

As discussed below, the Commission preliminarily believes that there are a number of benefits associated with providing relevant authorities with access to security-based swap data maintained by SDRs registered with the Commission ("SDR Data").

First, the Commission preliminarily believes that providing relevant authorities with such access would increase transparency in the security-based swap market, thereby facilitating oversight of the security-based swap

<sup>1848</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1849</sup> 15 U.S.C. 78x.

<sup>1850</sup> *Id.*

<sup>1851</sup> See Section VI.C., *supra*.

<sup>1852</sup> 15 U.S.C. 78m(n)(5)(G) and (H), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rules 13n-4(b)(9) and (10) under the Exchange Act.

<sup>1853</sup> See Dodd-Frank Act, Public Law 111-203 at Preamble.

<sup>1844</sup> See *id.*

market. SDRs are expected to retain complete records of security-based swap transactions and maintain the integrity of those records.<sup>1854</sup> To the extent that SDRs provide relevant authorities with effective access to those records in line with the respective information needs arising out of the authorities' regulatory mandates and legal responsibilities, SDRs will play a key role in increasing transparency in the security-based swap market. In having such effective access, these authorities will likely be better positioned to prevent market manipulation, fraud, and other market abuses; monitor the financial responsibility and soundness of market participants; perform market surveillance and macroprudential (systemic risk) supervision; resolve issues and positions after an institution fails; monitor compliance with relevant regulatory requirements; and respond to market turmoil.<sup>1855</sup>

Second, the Commission preliminarily believes that providing relevant foreign authorities with access to SDR Data may minimize fragmentation of security-based swap data among trade repositories globally. If relevant foreign authorities are unable to access SDR Data, then they may establish trade repositories in their jurisdictions to ensure access to data that they need to perform their regulatory mandates and legal responsibilities.<sup>1856</sup> By minimizing such fragmentation, relevant authorities would likely be able to access, aggregate, and analyze relevant data more efficiently, which should, in turn, enhance regulatory effectiveness.

Third, the Commission preliminarily believes that providing relevant foreign

authorities with access to SDR Data may reduce costs to market participants by reducing the potential for duplicative security-based swap transaction reporting requirements in multiple jurisdictions. The Commission anticipates that relevant foreign authorities will likely impose their own reporting requirements on market participants that fall within their jurisdiction; given the global nature of the security-based swap market and the large number of cross-border transactions, the Commission recognizes that it is likely that such transactions may be subject to the reporting requirements of at least two jurisdictions. The Commission preliminarily believes, however, that if relevant authorities are able to access security-based swap data in trade repositories outside their jurisdiction, such as SDRs registered with the Commission, as needed, then relevant authorities may be more inclined to permit market participants involved in such transactions to fulfill their reporting requirements by reporting the transactions to a single trade repository, rather than to separate trade repositories in each applicable jurisdiction, thereby potentially reducing market participants' compliance costs associated with establishing multiple reporting systems to multiple SDRs. Similarly, market participants would likely be able to access, aggregate, and analyze their data more efficiently in a single trade repository, than if they were required to report data to separate trade repositories in each applicable jurisdiction.

#### ii. Costs of Relevant Authorities' Access to Security-Based Swap Data

The Commission preliminarily believes that although there are benefits to SDRs providing access to relevant authorities to SDR Data, such access will likely involve certain costs, or more specifically, risks. For example, the Commission expects that SDRs will maintain data that is proprietary and highly sensitive<sup>1857</sup> and that is subject to strict confidentiality requirements.<sup>1858</sup> Section 13(n)(5)(G) of the Exchange Act, however, requires an SDR to make available data obtained by the SDR to authorities identified in Section 13(n)(5)(G) of the Exchange

Act.<sup>1859</sup> Extending access to SDR Data to anyone, including relevant authorities, increases the risk of the confidentiality of SDR Data not being preserved.<sup>1860</sup> A relevant authority's inability to maintain the confidentiality of SDR Data could erode market participants' confidence in the integrity of the security-based swap market, thereby leading to reduced liquidity in the security-based swap market, hindering price discovery, and impeding the capital formation process.<sup>1861</sup>

To help mitigate these risks, Sections 13(n)(5)(G) and (H) of the Exchange Act impose certain conditions on access to SDR Data by relevant authorities.<sup>1862</sup> Specifically, Section 13(n)(5)(G) of the Exchange Act<sup>1863</sup> limits the authorities that may access SDR Data to an enumerated list of domestic authorities and any other persons, including foreign authorities, determined by the Commission to be appropriate and requires that an SDR notify the Commission when the SDR receives a request for SDR Data from an authority. Section 13(n)(5)(H) of the Exchange Act<sup>1864</sup> requires that, before an SDR shares security-based swap information with a relevant authority, the SDR must receive a written agreement from a relevant authority that it will abide by the confidentiality requirements described in Section 24 of the Exchange Act relating to the information provided by the SDR, and the relevant authority will agree to indemnify the SDR and the Commission for any expenses arising from litigation relating to the information provided under Section 24 of the Exchange Act.<sup>1865</sup>

<sup>1854</sup> See SDR Proposing Release, 75 FR 77307; see also Section 13(n)(5)(C) of the Exchange Act (requiring SDRs to maintain security-based swap data), as added by Section 763(i) of the Dodd-Frank Act, and proposed Rules 13n-5(b)(3) and (4) under the Exchange Act (requiring SDRs to establish, maintain, and enforce policies and procedures reasonably designed to ensure that transaction data and positions are accurate and to maintain the transaction data and positions for specified periods of time).

<sup>1855</sup> See, e.g., SDR Proposing Release, 75 FR 77307, 77356, as corrected at 76 FR 79320 ("The data maintained by an SDR may also assist regulators in (i) preventing market manipulation, fraud, and other market abuses; (ii) performing market surveillance, prudential supervision, and macroprudential (systemic risk) supervision; and (iii) resolving issues and positions after an institution fails . . . [I]ncreased transparency on where exposure to risk reside in financial markets . . . will allow regulators to monitor and act before the risks become systemically relevant. Therefore, SDRs will help achieve systemic risk monitoring.").

<sup>1856</sup> Cf. Cleary Letter IV at 31 (The Indemnification Requirement "could be a significant impediment to effective regulatory coordination, since non-U.S. regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions.").

<sup>1857</sup> As the Commission has noted in the SDR Proposing Release, such data could include information about a market participant's trades or its trading strategy; it may also include nonpublic personal information. See 75 FR 77339.

<sup>1858</sup> See Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(i) of the Dodd-Frank Act, and proposed Rules 13n-4(b)(8) and 13n-9 under the Exchange Act.

<sup>1859</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rules 13n-4(b)(9) and (b)(10) under the Exchange Act.

<sup>1860</sup> See, e.g., ESMA Letter at 2 (noting that relevant authorities must ensure the confidentiality of security-based swap data provided to them).

<sup>1861</sup> See SDR Proposing Release, 75 FR 77307, 77334 ("Failure to maintain privacy of [SDR Data] could lead to market abuse and subsequent loss of liquidity.").

<sup>1862</sup> 15 U.S.C. 78m(n)(5)(G) and (H), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rules 13n-4(b)(9) and (b)(10) under the Exchange Act. In addition, Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(i) of the Dodd-Frank Act, and proposed Rules 13n-4(b)(8) and 13n-9 under the Exchange Act, require SDRs to maintain the privacy of SDR Data.

<sup>1863</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rule 13n-4(b)(9) under the Exchange Act.

<sup>1864</sup> 15 U.S.C. 78m(n)(5)(H), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rule 13n-4(b)(10) under the Exchange Act.

<sup>1865</sup> 15 U.S.C. 78m(n)(5)(H), as added by Section 763(i) of the Dodd-Frank Act.

### (b) Benefits and Costs of Proposed Guidance and Exemptive Rule

As discussed above, the Commission is (1) proposing interpretive guidance to specify how SDRs may comply with the Notification Requirement, (2) specifying how it proposes to determine whether a relevant authority is appropriate for purposes of receiving SDR Data, and (3) proposing the Indemnification Exemption.<sup>1866</sup> The Commission is proposing each of these to facilitate access to SDR Data by relevant authorities and to enable SDRs to fulfill their obligations under Sections 13(n)(5)(G) and 13(n)(5)(H) of the Exchange Act<sup>1867</sup> and previously proposed Rules 13n-4(b)(9) and 13n-4(b)(10) in a manner consistent with relevant authorities' need to have access to SDR Data that will enable them to carry out their regulatory mandates and legal responsibilities effectively and efficiently.<sup>1868</sup> The Commission preliminarily believes that our proposed guidance and the Indemnification Exemption would help realize the anticipated benefits of access to SDR Data by relevant authorities, as discussed above in Section XV.H.2(a)i, while at the same time mitigating the risks and other costs associated with such access, as discussed above in Section XV.H.2(a)ii. The Commission also preliminarily believes that, taken together, our proposed guidance and the Indemnification Exemption will enable the Commission and SDRs to respond promptly and flexibly to the needs of relevant authorities.

#### i. Notification Requirement

The Commission preliminarily believes that an SDR can comply with the Notification Requirement in Section 13(n)(5)(G) of the Exchange Act<sup>1869</sup> and previously proposed Rule 13n-4(b)(9) thereunder by notifying the Commission, upon the initial request for security-based swap data by a relevant authority, that such relevant authority has made a request for security-based swap data from the SDR, and maintaining records of the initial request and all subsequent requests.<sup>1870</sup> Under this proposed interpretation, where an SDR complies with the above, the Commission will consider the notice provided and records maintained as satisfying the Notification Requirement.

In the Commission's preliminary view, SDRs would be less burdened under this interpretation of the Notification Requirement than under an interpretation that would require SDRs to provide the Commission with actual notice of all requests for SDR Data by relevant authorities because SDRs would have to actually notify the Commission only one time for each relevant authority. The Commission estimates that approximately 200 relevant authorities may make requests for SDR Data from SDRs.<sup>1871</sup> Based on the Commission's experience in making requests for security-based swap data from trade repositories, the Commission estimates that each relevant authority may make about 12 requests for SDR Data per year. An alternative interpretation that would require SDRs to provide the Commission with actual notice of all requests for SDR Data by relevant authorities would naturally increase the burden on SDRs to notify the Commission. Therefore, over the course of a year, under the Commission's proposed interpretation of the Notification Requirement, the Commission estimates that an SDR would provide the Commission with actual notice approximately 200 times, whereas under an interpretation that would require SDRs to provide the Commission with actual notice of all requests for SDR Data by relevant authorities, the Commission estimates that the SDR would provide the Commission with actual notice approximately 2400 times. Because SDRs would be required to provide actual notification to the Commission only upon the first request of a relevant authority, rather than upon every request, SDRs should be able to respond to requests for SDR Data by relevant authorities more promptly and at lower

<sup>1871</sup> The Commission preliminarily believes that each of the entities in the United States that is specifically listed in Section 13(n)(5)(G) of the Exchange Act, 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act, may request SDR Data from SDRs. Section 13(n)(5)(G) specifically lists each appropriate prudential regulator (which includes the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency), the Financial Stability Oversight Council, the CFTC, and the Department of Justice. The Commission also preliminarily expects that certain SROs and registered futures associations may request SDR Data from SDRs. Therefore, the Commission estimates that approximately 10 relevant authorities in the United States may request SDR Data from SDRs. The Commission also estimates that each of the G20 countries will have no more than 10 relevant authorities that may request SDR Data from SDRs. Thus, the Commission estimates that there will be a total of no more than 200 relevant domestic and foreign authorities that may request SDR Data from SDRs.

cost than requiring SDRs to notify the Commission of every request.

The Commission's proposed interpretation would also minimize an impediment to relevant authorities' direct access to SDR Data to fulfill their regulatory mandates and legal responsibilities because SDRs would not be required to provide the Commission with actual notice of every request prior to providing access to the requesting relevant authority. If SDRs had to actually notify the Commission every time that a relevant authority requested access to SDR Data (following the initial request), this could interfere with the ability of relevant authorities to obtain efficiently security-based swap data from SDRs to fulfill their own regulatory mandate or legal responsibilities. Such an impediment could be a factor in leading certain relevant authorities to seek to promote the establishment of trade repositories in their own jurisdictions, which would lead to fragmentation of security-based swap data and SDRs geographically. By reducing a potential barrier to relevant authorities' access to SDR Data and reducing the likelihood of fragmentation of data among trade repositories, the Commission's proposed interpretation of the Notification Requirement should enhance the ability of SDRs to perform their intended functions and thereby increase market transparency and regulatory effectiveness. Because SDRs would still be required to maintain records of relevant authorities' requests for SDR Data, the proposed interpretation would also allow the Commission to obtain this information as needed.

The Commission is aware that our proposed interpretation of the Notification Requirement will not provide the Commission with actual notice of all relevant authorities' requests for SDR Data prior to an SDR fulfilling such requests. The Commission preliminarily believes, however, that the benefits of receiving such notice does not justify the additional costs that SDRs would incur in providing such notice and the potential delay in relevant authorities receiving SDR Data that they need to fulfill their regulatory mandates and legal responsibilities.

#### ii. Determination of Appropriate Regulators

The Commission is proposing an approach to determining whether an authority, other than those expressly identified in Section 13(n)(5)(G) of the

<sup>1866</sup> See Section VI.C.3, *supra*.

<sup>1867</sup> 15 U.S.C. 78m(n)(5)(G) and (H), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1868</sup> See SDR Proposing Release, 75 FR 77356.

<sup>1869</sup> 15 U.S.C. 78m(n)(5)(G), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1870</sup> See Section VI.C.3(a), *supra*.



Exchange Act<sup>1872</sup> and previously proposed Rule 13n-4(b)(9) thereunder, should be determined to be appropriate for purposes of requesting SDR Data. As described above, the Commission preliminarily envisions that this process will involve consideration of, among other things, the scope of the relevant authority's regulatory mandate and legal responsibilities, the authority's ability to provide the Commission with reciprocal assistance in securities matters within the Commission's jurisdiction, and a supervisory and enforcement MOU or other arrangement that would be designed to protect the confidentiality of any SDR Data provided to the authority.<sup>1873</sup>

The Commission preliminarily believes that our proposed approach has the benefit of appropriately limiting access to SDR Data by relevant authorities in order to seek to protect the confidentiality of SDR Data.<sup>1874</sup> The Commission expects that relevant authorities from a wide range of jurisdictions may seek to obtain a determination by the Commission that they may appropriately have access to SDR Data. Each of these jurisdictions may have a distinct approach to supervision, regulation, or oversight of its financial markets or market participants and to the protection of proprietary and other confidential information. The Commission preliminarily believes that the process that it is contemplating has the benefit of enabling the Commission to determine whether an authority has a legitimate interest in the SDR Data, based on its regulatory mandate or legal responsibilities, and whether the authority is capable of protecting the confidentiality of SDR Data provided to it. In addition, the Commission preliminarily believes that this process will allow the Commission to be able to revoke its determination in certain instances, including, for example, if a relevant authority fails to keep confidential data that an SDR provides to the authority.

The Commission also preliminarily believes that our proposed approach will reduce the potential for fragmentation of security-based swap data among trade repositories because it will reduce the risks of improper disclosure, misappropriation, or misuse of SDR Data. Concerns about these risks

could prompt relevant authorities to promote the development and maintenance of SDRs in their own jurisdictions rather than entrusting data reported by persons within their jurisdictions to consolidated trade repositories. As described above, the Commission envisions that any determination order by the Commission will likely be conditioned on a relevant authority and the Commission entering into a supervisory and enforcement MOU or other arrangement, which will likely address the confidentiality of SDR Data obtained by the authority.<sup>1875</sup> Because the Commission's determination process will likely address confidentiality concerns, the Commission preliminarily believes that our proposed approach would increase relevant authorities' confidence in the preservation of the confidentiality of SDR Data shared with the authorities' counterparts in other jurisdictions, and, in conjunction with the Commission's approach to ensuring access to SDR Data by relevant authorities discussed above,<sup>1876</sup> may reduce incentives for relevant authorities to seek to promote the establishment and maintenance of SDRs in other jurisdictions. If concerns over confidentiality reduce relevant authorities' incentives to promote the establishment and maintenance of SDRs in their own jurisdictions and market participants operating in those jurisdictions conclude that they may, under applicable foreign law, use SDRs registered with the Commission for reporting purposes and therefore do so, then the Commission preliminarily believes that this will improve market transparency and regulatory efficiency.

Furthermore, the Commission preliminarily believes that our proposal represents an efficient approach to the determination process that will promote the intended benefits of access by relevant authorities to SDR Data, as discussed above in Section XV.H.2(a)i. The Commission routinely negotiates MOUs or other arrangements with foreign authorities in order to secure mutual assistance or for other purposes, and the Commission preliminarily believes that the approach that it is proposing is generally consistent with this practice. As such, the Commission preliminarily believes that the burden of entering into supervisory and enforcement MOUs or other arrangements with relevant authorities during the Commission's determination process will be outweighed by the benefits to relevant authorities in gaining access to SDR Data to carry out

their regulatory mandates or legal responsibilities.

### iii. Exemptive Relief From the Indemnification Requirement

Finally, the Commission is proposing the Indemnification Exemption, which would provide SDRs registered with the Commission with the option of permitting relevant authorities to obtain SDR Data without agreeing to indemnify the SDR and the Commission, subject to three conditions. The first two conditions would limit the exemption to (1) requests by a relevant authority for security-based swap information made to fulfill a regulatory mandate and/or legal responsibility of the requesting authority, and (2) requests pertaining to a person or financial product subject to the jurisdiction, supervision, or oversight of the requesting authority.<sup>1877</sup> The third condition would require the relevant authority to have entered into a supervisory and enforcement MOU or other arrangement with the Commission that addresses the confidentiality of the security-based swap information provided and any other matters as determined by the Commission.<sup>1878</sup> The Commission preliminarily believes that the benefits of the Indemnification Exemption would include the benefits associated with permitting relevant authorities to access SDR Data, as discussed in Section XV.H.2(a)i above.

As discussed above, the Commission preliminarily believes that a rigid application of the Indemnification Requirement could prevent some relevant domestic authorities and some relevant foreign authorities from obtaining security-based swap information from SDRs because they cannot provide an indemnification agreement.<sup>1879</sup> Effectively prohibiting access to SDR Data by authorities other than the Commission would greatly reduce the ability of an SDR to provide the market transparency and regulatory efficiency benefits intended under Title VII.<sup>1880</sup> Although relevant authorities could obtain SDR Data from the Commission,<sup>1881</sup> it would likely be less efficient for relevant authorities to do so than obtaining access to SDR Data directly from SDRs, particularly in periods of market stress and particularly

<sup>1877</sup> See Section VI.C.3(c), *supra*.

<sup>1878</sup> See *id.*

<sup>1879</sup> See Section VI.C.3(c), *supra*.

<sup>1880</sup> See SDR Proposing Release, 75 FR 77307 (describing expected benefits of SDRs, including the market transparency benefits of access by regulators); *id.* at 77356 ("The ability of the Commission and other regulators to monitor risk and detect fraudulent activity depends on having access to market data.")

<sup>1881</sup> See Section VI.C.1, *supra*; see also SDR Proposing Release, 75 FR 77319.

<sup>1872</sup> 15 U.S.C. 78m(n)(5)(G) (permitting access to SDR Data by "any other person that the Commission determines to be appropriate"), as added by Section 763(i) of the Dodd-Frank Act.

<sup>1873</sup> See Section VI.C.3(b), *supra*.

<sup>1874</sup> See ESMA Letter at 2 (noting that relevant authorities must ensure the confidentiality of security-based swap data provided to them).

<sup>1875</sup> See Section VI.C.3(b), *supra*.

<sup>1876</sup> See Section VI.C., *supra*.

since SDRs are likely to have expertise in, and business incentives for, providing such data to relevant authorities efficiently.

The Commission also preliminarily believes that a rigid application of the Indemnification Requirement could reduce the amount of data held by SDRs registered with the Commission, thereby potentially reducing the usefulness of such SDRs to relevant authorities and market participants. To the extent that relevant foreign authorities are effectively limited in obtaining SDR Data, the relevant authorities may seek to promote the development and maintenance of SDRs in their own jurisdictions, which would likely lead to fragmentation of security-based swap data among trade repositories in multiple jurisdictions.<sup>1882</sup> Such fragmentation could result in higher reporting costs for market participants,<sup>1883</sup> who may be subject to duplicative security-based swap transaction reporting requirements in multiple jurisdictions, and would likely increase other costs that both relevant authorities and market participants may incur, including, for example, their inability to aggregate data across multiple SDRs.<sup>1884</sup>

The Commission preliminarily believes that, in addition to addressing the concerns raised by a rigid

<sup>1882</sup> Cf. Cleary Letter IV at 31 (The Indemnification Requirement “could be a significant impediment to effective regulatory coordination, since non-U.S. regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions.”).

<sup>1883</sup> In the SDR Proposing Release, the Commission noted that multiple SDRs per asset class would allow for market competition to determine how data is collected. 75 FR 77358. Although the Commission continues to recognize that multiple SDRs may in some circumstances increase competition and lower costs associated with reporting and other Title VII requirements, the Commission preliminarily believes that fragmentation of security-based swap data among trade repositories under the circumstances described here would not likely increase competition or reduce costs. In a jurisdictionally-fragmented global market, an increase in the number of trade repositories in one jurisdiction may not increase the number of alternative trade repositories in another jurisdiction to which a counterparty may report. In such a market, counterparties to security-based swap transactions occurring wholly within one jurisdiction would likely not be free to choose to report to a trade repository in another jurisdiction to satisfy applicable reporting requirements. Similarly, cross-border transactions subject to the reporting requirements of two or more jurisdictions would likely be required to be reported to trade repositories in each of the jurisdictions that require the transactions to be reported.

<sup>1884</sup> See SDR Proposing Release, 75 FR 77358. The costs associated with aggregating the data of multiple SDRs would likely be significantly higher under the circumstances described here, as different jurisdictions are likely to impose different requirements regarding how data is to be reported and maintained.

application of the Indemnification Requirement, the Indemnification Exemption is beneficial because it would mitigate the risks associated with permitting relevant authorities to obtain access to SDR Data, as discussed above in Section XV.H.2(a)ii. The Indemnification Exemption would be available only for requests that are consistent with each requesting authority’s regulatory mandate or legal responsibilities and only for SDR Data pertaining to a person or financial product subject to the requesting authority’s jurisdiction, supervision, or oversight. The Commission preliminarily believes that these conditions significantly reduce the confidentiality concerns relating to relevant authorities’ access to SDR Data,<sup>1885</sup> as authorities are likely to be sensitive to the need for confidentiality of data, particularly if the data pertains to matters in which they have an interest, *i.e.*, data within their own regulatory mandates or legal responsibilities and to persons and financial products under their own jurisdiction, supervision, or oversight. Similarly, because the Indemnification Exemption is voluntary, the SDR may choose not to rely on the Indemnification Exemption, such as under circumstances where the risks associated with providing access to SDR Data may be unreasonably high—for example, where a relevant authority has a previous history of weak protections for preserving the confidentiality of SDR Data. Further, even where the SDR opts to rely on the Indemnification Exemption, the Commission will have an opportunity to evaluate the confidentiality protections provided by the relevant authority in the context of negotiations of a supervisory and enforcement MOU or other arrangement.<sup>1886</sup>

The Commission envisions that, to meet the first two conditions in the

<sup>1885</sup> See, *e.g.*, ESMA Letter at 2 (noting that relevant authorities must ensure the confidentiality of security-based swap data provided to them).

<sup>1886</sup> For the Indemnification Exemption to apply to the requests of a particular requesting authority, the Commission would be required to enter into a supervisory and enforcement MOU or other arrangement with such authority, which would enable the Commission to determine, prior to operation of the Indemnification Exemption, that the authority has a regulatory mandate or legal responsibilities to access SDR Data, that it agrees to protect the confidentiality of any security-based swap information provided to it, and that it will provide reciprocal assistance in securities matters within the Commission’s jurisdiction. See Section VI.C.3(c), *supra*. In addition, if an SDR determines that it would prefer not to invoke the exemption, it would have the option to require an indemnification agreement from a relevant authority that seeks to access SDR Data. See Section VI.C.3(c), *supra*.

Indemnification Exemption, an SDR may incur costs in determining whether a relevant authority’s request for data falls within its regulatory mandate or legal responsibilities and pertains to a person or financial product subject to the authority’s jurisdiction, supervision, or oversight. The Commission preliminarily believes, however, that an SDR’s costs for meeting the first two conditions in the Indemnification Exemption would be minimal, if any, in light of the burden already imposed by an SDR’s statutory duty to maintain the privacy of security-based swap information that it receives.<sup>1887</sup> With respect to the third condition in the Indemnification Exemption, the

<sup>1887</sup> See Section 13(n)(5)(F) of the Exchange Act, 15 U.S.C. 78m(n)(5)(F), as added by Section 763(i) of the Dodd-Frank Act; see also proposed Rule 13n-4(b)(8) under the Exchange Act (requiring SDRs to maintain the privacy of any and all security-based swap transaction information that the SDR receives from a security-based swap dealer, counterparty, or certain registered entity) and proposed Rule 13n-9 under the Exchange Act (requiring an SDR to protect the privacy of security-based swap transaction information that the SDR receives by, among other things, establishing safeguards, policies, and procedures that are reasonably designed to protect such information and that address, without limitation, the SDR limiting access to confidential information, material, nonpublic information, and intellectual property). The Commission preliminarily believes that in order to comply with an SDR’s statutory privacy duty, the SDR will most likely decide that it is reasonable to consider whether a relevant authority’s request for security-based swap information is within its regulatory mandate or legal responsibilities and pertains to a person or financial product within the authority’s jurisdiction, supervision, or oversight before the SDR provides the information. If so, then the Commission preliminarily believes that the SDR’s costs for meeting the first two conditions in the Indemnification Exemption would be minimal, if any, because these conditions will most likely be already addressed in the SDR’s policies and procedures required by previously proposed Rule 13n-9 under the Exchange Act. As discussed in the SDR Proposing Release, the Commission anticipated that the primary costs to SDRs for complying with proposed Rule 13n-9 would be derived from developing, maintaining, and ensuring compliance with the required policies and procedures. 75 FR 77363. Based upon data from SIFMA’s Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the Commission now estimates that the average initial paperwork cost associated with proposed Rule 13n-9 would be 630 hours and \$60,000 in outside legal costs for each SDR. The Commission also estimates that the average ongoing paperwork cost would be 180 hours per year for each SDR and that assuming a maximum of ten SDRs, the aggregate one-time estimated dollar cost to comply with proposed Rule 13n-9 would be \$2,553,000, which is calculated as follows: (\$60,000 for outside legal services + (Compliance Attorney at \$310 per hour for 630 hours) \* 10 registrants = \$2,553,000. The Commission further estimates that the aggregate ongoing estimated dollar cost per year to comply with proposed Rule 13n-9 would be \$558,000, which is calculated as follows: (Compliance Attorney at \$310 per hour for 180 hours) \* 10 registrants = \$558,000.

Commission preliminarily believes that the costs for an SDR to confirm whether the Commission and a relevant authority have entered into a supervisory and enforcement MOU or other arrangement would be minimal because such information should generally be readily available.<sup>1888</sup>

Even if all the conditions in the Indemnification Exemption are satisfied, SDRs would have the option to seek to obtain an indemnification agreement from a relevant authority. The Commission recognizes that the conditions in the Indemnification Exemption would not necessarily provide SDRs that invoke the exemption with the same level of protection that an indemnification agreement would provide (*i.e.*, coverage for any expenses arising from litigation relating to information provided to a relevant authority) and thus, SDRs may decide to weigh the potential risks in not seeking an indemnification agreement from a relevant authority with the benefits of invoking the exemption.

The Commission preliminarily believes, however, that the conditions in the exemption would provide an additional layer of protection of the confidentiality of SDR Data—albeit different from the protection provided by an indemnification agreement—and that in cases where SDRs choose the exemption, such SDRs presumably believe that the benefits of the exemption, as discussed above, justify the costs of invoking the exemption. However, even in cases where the exemption is not chosen, the availability of the option is valuable to SDRs because the exemption would provide SDRs with an alternative to the Indemnification Requirement and an opportunity to choose the lower cost alternative.

### (c) Alternatives to Proposed Guidance and Exemptive Relief

#### i. Notification Requirement

The Commission considered requiring SDRs to provide actual notice to the Commission of all requests for SDR Data by relevant authorities prior to SDRs fulfilling such requests. The Commission preliminarily believes, however, that the benefits of receiving actual notice for each and every request does not justify the additional costs imposed on SDRs to provide such notice and the potential delay in relevant authorities receiving SDR Data that they need to fulfill their regulatory mandates

and legal responsibilities. The Commission also preliminarily believes that our proposed approach is the most efficient way to interpret the Notification Requirement and would allow the Commission access to the information needed.

#### ii. Determination of Appropriate Regulators

The Commission considered prescribing by rule a specific process to determine whether a relevant authority is appropriate for purposes of receiving security-based swap data directly from SDRs that would require, for example, a supervisory and enforcement MOU or other arrangement.<sup>1889</sup> The Commission preliminarily believes, however, that such a rule is not necessary because our process for determining an appropriate authority provides the Commission and relevant authorities greater flexibility to consult on appropriate terms of access to SDR Data, confidentiality commitments, and reciprocal access commitments on a case-by-case basis.

#### iii. Exemptive Relief From the Indemnification Requirement

The Commission considered whether to not propose any exemptive relief from the Indemnification Requirement. For the reasons discussed below, the Commission believes that the Indemnification Exemption is a better, and more appropriate, alternative to a rigid application of the Indemnification Requirement.<sup>1890</sup>

The Commission preliminarily believes that a rigid application of the Indemnification Requirement may reduce the expected benefits associated with relevant authorities' access to SDR Data, as discussed in Section XV.H.2(a) above. In particular, the Indemnification Requirement may prevent some relevant authorities from accessing SDR Data directly from SDRs registered with the Commission.<sup>1891</sup> Although relevant authorities could obtain SDR Data from the Commission,<sup>1892</sup> it would likely be less efficient for relevant authorities to do so than obtaining SDR Data access directly from SDRs, particularly in

<sup>1889</sup> See, e.g., CFTC Rule 49.17(b), 17 CFR 49.17(b) (requiring "Appropriate Foreign Regulators" to have an MOU or similar type of information sharing agreement, or as the CFTC determines on a case-by-case basis).

<sup>1890</sup> See also Section VI.C.3(c), *supra* (discussing how a rigid application of the Indemnification Requirement would frustrate the purposes of the Dodd-Frank Act).

<sup>1891</sup> See, e.g., DTCC Letter I at 3 (discussing how the Indemnification Requirement would result in the reduction of information accessible to regulators on a timely basis and would greatly diminish regulators' ability to carry out oversight functions).

<sup>1892</sup> See Section VI.C.1, *supra*; see also SDR Proposing Release, 75 FR 77319.

periods of market stress and particularly since SDRs are likely to have expertise in, and business incentives for, providing such data to relevant authorities efficiently.

Moreover, the inability of relevant foreign authorities to obtain direct access to SDR Data from SDRs registered with the Commission would likely increase the risk of data fragmentation among trade repositories, as many foreign authorities may require establishment and maintenance of trade repositories in their jurisdictions if such authorities determine that they are unable to satisfy the Indemnification Requirement; such fragmentation may lead to higher reporting costs for market participants and less transparency in the security-based swap market.<sup>1893</sup>

The Commission also considered whether to prescribe additional conditions in or limitations to the Indemnification Exemption, but decided against it. Any additional conditions or limitations to the Indemnification Exemption would likely impose additional costs on SDRs that the Commission preliminarily believes are not warranted at this time. The Commission presently believes that the Indemnification Exemption strikes the right balance in furthering the goals of the Dodd-Frank Act by providing relevant authorities with access to SDR Data to fulfill their regulatory mandates and legal requirements while incorporating appropriate limitations to such access to guard against over-broad or unfettered access to all SDR Data as well as certain mechanisms to seek to preserve the confidentiality of the SDR Data.

#### Request for Comment

The Commission requests comments on all aspects of the economic analysis of our proposed interpretive guidance, Indemnification Exemption, and alternatives to our proposed approach. Interested persons are encouraged to provide supporting data and analysis and, when appropriate, suggest modifications to the Commission's proposed interpretive guidance and Indemnification Exemption. Responses that are supported by data and analysis provide great assistance to the Commission in considering the benefits and costs of proposed alternatives, as well as considering the practicality and effectiveness of the proposed alternatives. In addition, the

<sup>1893</sup> See, e.g., Cleary Letter IV at 31 (The Indemnification Requirement "could be a significant impediment to effective regulatory coordination, since non-U.S. regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions.").

<sup>1888</sup> As a general matter, the Commission provides a list of MOUs and other arrangements, which are available at the following link: [http://www.sec.gov/about/offices/oia/oia\\_cooparrangements.shtml](http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml).

Commission requests commenters' views on the following:

- Has the Commission appropriately considered the expected programmatic benefits and costs of our proposed interpretative guidance and Indemnification Exemption? If not, please explain why and provide information on how such benefits and costs should be assessed.
- Are the programmatic benefits and costs discussed above accurate? If not, why not and how can the Commission more accurately describe such benefits and costs?
- Are there quantifiable programmatic benefits or costs associated with the Commission's proposed interpretive guidance and Indemnification Exemption that are not discussed above, but that the Commission should consider? If so, please discuss, analyze, and supply relevant data, information, or statistics regarding any such benefits or costs. For example, how many relevant authorities will likely request SDR Data from SDRs? What is the average number of requests for SDR Data that an SDR may receive from relevant authorities per year?
- Are there costs in fulfilling any of the conditions in the Indemnification Exemption that the Commission has not discussed above? If so, what?
- Do you agree that an SDR's costs for meeting the first two conditions in the Indemnification Exemption would be minimal, if any, because these conditions will most likely be already addressed in the SDR's policies and procedures required by previously proposed Rule 13n-9 under the Exchange Act? If not, please explain.
- Do SDRs have appropriate incentives to rely on the Indemnification Exemption? Are there circumstances in which an SDR may rely on an Indemnification Exemption when it is inappropriate to do so? Conversely, would SDRs have incentives to require indemnification despite the availability of the Indemnification Exemption? Please explain.
- What kinds of legal frameworks will relevant authorities operate under? Will some relevant authorities operate under legal frameworks that do not impose confidentiality restrictions on the use of data that are comparable to those governing SDRs and those applicable to the Commission?
- Do the benefits of the Commission's proposed interpretive guidance and Indemnification Exemption justify the costs? If not, why not?
- Has the Commission appropriately considered the benefits and costs of the alternative approaches to the

Commission's interpretive guidance and Indemnification Exemption? If not, why not?

### 3. Economic Analysis of the Re-proposal of Regulation SBSR

As discussed above, although the Commission is re-proposing all of Regulation SBSR, the new elements of the re-proposal relate directly to cross-border issues, are conforming changes necessitated by those larger changes, or are technical changes designed to facilitate understanding of those other changes. However, since Regulation SBSR was proposed but has not yet been adopted, the discussion below will include costs and benefits of the initial proposal from a pre-statutory baseline and then consider the changes to the initial assessments of costs and benefits implied by the re-proposal.

Broadly, the Commission continues to believe, as described in the Regulation SBSR Proposing Release, that Regulation SBSR taken as a whole would result in improved market quality, improved risk management, greater efficiency, and improved Commission oversight.<sup>1894</sup> Today's re-proposal of Regulation SBSR is intended to further these goals while further limiting, to the extent practicable, the overall costs associated with security-based swap reporting and public dissemination in cross-border situations. As described in more detail below, the proposed revisions were suggested by many commenters to the initial proposal and are designed, among other things, to better align reporting duties with larger entities that have greater resources and capability to report<sup>1895</sup> and to reduce the potential

<sup>1894</sup> See Regulation SBSR Proposing Release, 75 FR 75261–62.

<sup>1895</sup> See, e.g., SIFMA AMG Letter at 2 (stating that, due to their commercial interests and technological expertise, non-U.S. security-based swap dealers and major security-based swap participants would be as likely as U.S. security-based swap dealers and major security-based swap participants to comply with the reporting obligations, or would be best positioned to develop at the lowest cost the necessary technological infrastructure or relationships with third party service providers); Vanguard Letter at 6 (stating that requiring U.S. end users to report security-based swaps would be costly and burdensome for end users, particularly for end users that enter into security-based swaps on an isolated basis); MarkitSERV Letter I at 9 (noting that, in light of end users' resources and the operational and technical challenges of security-based swap reporting, it will often be most efficient for a U.S. end user to delegate reporting to its non-U.S. security-based swap dealer or major security-based swap participant counterparty); DTCC Letter II at 27 (stating that the Commission's failure to encourage arrangements through which non-U.S. dealers could submit transaction reports for customers that are U.S. persons would impose significant burdens and costs on U.S. money managers, which likely would

for duplicative reporting.<sup>1896</sup> These revisions should help to maximize the benefits and minimize the potential costs of regulatory reporting and public dissemination of security-based swaps faced by market participants.

The Commission seeks public comment on the costs and benefits that re-proposed Regulation SBSR would entail. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits. In particular, the Commission seeks comment on the following:

- Taken together, what are the costs and benefits of re-proposed Regulation SBSR?
- Would the revisions contained in re-proposed Regulation SBSR result in benefits or costs not identified by the Commission? If so, please describe.
- Has the Commission accurately identified and described all relevant benefits and costs associated with re-proposed Regulation SBSR?
- Could re-proposed Regulation SBSR be further enhanced, consistent with the Dodd-Frank Act, to maximize aggregate benefits and minimize costs to the security-based swap market?

(a) Modifications to "Reporting Party" Rules and Jurisdictional Reach of Regulation SBSR—Re-proposed Rules 901(a) and 908(a)

#### i. Initial Proposal

Rule 901(a), as initially proposed, set forth three scenarios for assigning the duty to report a security-based swap transaction. Proposed Rule 901(a)(1) would provide that, where only one counterparty to a security-based swap is a U.S. person, the U.S. person would be the reporting party. Proposed Rule 901(a)(2) would assign reporting responsibilities as follows:

- With respect to a security-based swap in which only one counterparty is a security-based swap dealer or major

be passed to individual investors, pension funds, and state and local governments); Cleary Letter IV at 28 (stating that requiring U.S. end users to report security-based swaps entered into with non-U.S. security-based swap dealers would be unduly burdensome for end users and could negatively impact the competitiveness of affected U.S. markets); ISDA/SIFMA Letter I at 19 (the end-user reporting requirement could result in the inadvertent exclusion of non-U.S. security-based swap dealers, which could increase systemic risk by decreasing liquidity and further concentrating the U.S. security-based swap market); Cleary Letter II at 18 (end users and other unregistered counterparties might refuse to enter into security-based swaps with foreign security-based swap dealers or major security-based swap participants to avoid the costs of developing the necessary reporting systems, thereby potentially reducing price competition).

<sup>1896</sup> See notes 1136–1141, *supra*.

security-based swap participant, the security-based swap dealer or major security-based swap participant would be the reporting party;

- With respect to a security-based swap in which one counterparty is a security-based swap dealer and the other counterparty is a major security-based swap participant, the security-based swap dealer would be the reporting party; and

- With respect to any other security-based swap not described in the first two cases, the counterparties to the security-based swap would select a counterparty to be the reporting party.

Proposed Rule 901(a)(3), as originally proposed, would provide that, if neither party is a U.S. person but the security-based swap is executed in the United States or through any means of interstate commerce, or is cleared through a clearing agency having its principal place of business in the United States, the counterparties to the security-based swap would be required to select a counterparty to be the reporting party.

Rule 908(a), as initially proposed, would delineate the scope of the security-based swap market that would be subject to regulatory reporting and public dissemination under Regulation SBSR. Proposed Rule 908(a) provided that a security-based swap would be subject to these requirements if the security-based swap: (1) has at least one counterparty that is a U.S. person; (2) is executed in the United States or through any means of interstate commerce; or (3) is cleared through a registered clearing agency having its principal place of business in the United States. If a security-based swap met any of the tests in proposed Rule 908(a), the counterparties would then look to proposed Rule 901(a) to determine which of them would be required to report the security-based swap. Rule 908(a), as initially proposed, would not impose reporting requirements in connection with a security-based swap solely because one of the counterparties is guaranteed by a U.S. person.

Rule 902, as initially proposed, would require the public dissemination of security-based swaps that met the scope requirements of proposed Rule 908(a). Proposed Rule 902(a) set out the core requirement that a registered SDR, immediately upon receiving a transaction report of a security-based swap, would be required to publicly disseminate information about that security-based swap consisting of all the information reported by the reporting party pursuant to proposed Rule 901(c), plus any indicator(s) contemplated by the registered SDR's policies and

procedures that would be required by proposed Rule 907.<sup>1897</sup>

#### a. Programmatic Benefits of Initial Proposal

The Regulation SBSR Proposing Release discussed various benefits that could result from proposed Rule 901.<sup>1898</sup> For example, the Commission anticipated that proposed Rule 901 would provide the Commission with a better understanding of the security-based swap market generally, including the size and scope of that market, as the Commission would have access to data held by SDRs.<sup>1899</sup> Such access is designed to promote more effective systemic regulation, and provide the Commission with better information to examine for improper market behavior and to take enforcement actions. Furthermore, specifying general types of information to be reported and publicly disseminated could increase the efficiency and level of standardization in the security-based swap market. Proposed Rule 901 also could facilitate the reports about the security-based swap marketplace that the Commission is required to provide to Congress.<sup>1900</sup>

The Commission anticipated that proposed Rule 901 would likely require reporting parties to establish and maintain order management systems (“OMSs”) for capturing and transmitting data about their security-based swap transactions. Such systems would be necessary to report data within the timeframes set forth in proposed Rules 901(c) and 901(d), because it is unlikely that manual processes could capture and report in real time the numerous required data elements relating to a security-based swap. There could be substantial benefits in the form of reduced operational risk in requiring all reporting parties to have such capability, as more timely capture and storage at firm level of all security-based

<sup>1897</sup> Block trades would be subject to special dissemination rules. Section 13(m)(1)(E) of the Exchange Act, 15 U.S.C. 78m(1)(E), provides that, with respect to cleared security-based swaps, the rule promulgated by the Commission related to public dissemination shall contain provisions that “specify the criteria for determining what constitutes a large notional security-based swap transaction (block trade) for particular market and contracts” and “specify the appropriate time delay for reporting large notional security-based swap transactions (block trades) to the public.” The Commission in the Regulation SBSR Proposing Release did not propose how to define a “block trade.” As noted in Regulation SBSR Proposing Release, the Commission intends to do so in a separate proposal. See Regulation SBSR Proposing Release, 75 FR 75228.

<sup>1898</sup> See *id.* at 75262–64.

<sup>1899</sup> See, e.g., 15 U.S.C. 78m(n)(5)(D) (requiring SDRs to provide the Commission with direct electronic access to their data).

<sup>1900</sup> See Section 719 of the Dodd-Frank Act.

swap transaction information would support effective risk management. Counterparties, SDRs, clearing agencies (in some cases), and regulators would obtain accurate knowledge of new security-based swap transactions more quickly. Reporting parties that obtain such systems could see additional benefits in being able to process and manage risk or to exploit operational efficiency gains to expand their participation in the security-based swap market.

The information reported by reporting parties pursuant to proposed Rule 901(c) would be used by registered SDRs to publicly disseminate real-time reports of security-based swap transactions under proposed Rule 902. In the Regulation SBSR Proposing Release, the Commission highlighted numerous benefits of the public dissemination requirement in proposed Rule 902. Among other things, the Commission stated that “[b]y reducing information asymmetries, post-trade transparency has the potential to lower transaction costs, improve confidence in the market, encourage participation by a larger number of market participants, and increase liquidity in the security-based swap market.”<sup>1901</sup> The Commission noted the opacity of the current security-based swap market and stated that “[m]arket participants, even dealers, lack an effective mechanism to learn the prices at which other market participants transact.”<sup>1902</sup> Requiring prompt dissemination of last-sale information would provide all market participants with more extensive and more accurate information on which to make trading and valuation determinations. Moreover, the Commission noted that post-trade pricing and volume information “could allow valuation models to be adjusted to reflect how [security-based swap] counterparties have valued a [security-based swap] instrument at a specific moment in time”<sup>1903</sup> and that public, real-time dissemination of last-sale information “also could aid dealers in deriving better quotations, because they would know the prices at which other market participants have recently traded.”<sup>1904</sup> Post-trade transparency of security-based swap transactions also could improve market participants’ ability to value security-based swaps, especially in opaque markets or markets with low liquidity where recent quotations or last-sale prices may not

<sup>1901</sup> See Regulation SBSR Proposing Release, 75 FR 75267.

<sup>1902</sup> *Id.*

<sup>1903</sup> *Id.*

<sup>1904</sup> *Id.*

exist or, if they do exist, may not be widely available. Better valuations could create a benefit in the form of more efficient capital allocation and ultimately could reduce systemic risks.<sup>1905</sup>

#### b. Programmatic Costs of Initial Proposal

The proposed security-based swap reporting requirements would also impose initial and ongoing costs on reporting parties. In the Regulation SBSR Proposing Release, the Commission stated our preliminary belief that certain of these costs would be a function of the number of reportable events<sup>1906</sup> and the data elements required to be submitted for each reportable event. The Commission preliminarily estimated that security-based swap market participants would face three categories of costs to comply with proposed Rule 901. First, each reporting party would have to develop an internal OMS capable of capturing relevant security-based swap transaction information so that it could be reported. Second, each reporting party would have to implement a reporting mechanism. Third, each reporting party would have to establish an appropriate compliance program and support for operating the OMS and reporting mechanism.<sup>1907</sup> The Commission preliminarily estimated that up to 1,000 entities could be reporting parties under proposed Rule 901(a) and that the first-year aggregate costs associated with proposed Rule 901 would be \$511,013 per reporting party, for a total of \$511,013,000 for all reporting parties.<sup>1908</sup> The Commission preliminarily estimated that the ongoing aggregate annualized costs associated with proposed Rule 901 would be \$316,116 per reporting party, for a total of \$316,116,000 for all reporting parties.<sup>1909</sup> These cost estimates all relied on the Commission's preliminary estimate of 1,000 reporting parties. In the Regulation SBSR Proposing Release, the Commission did not break down the costs of Rule 901 by each paragraph of Rule 901, but instead calculated costs arising from proposed Rule 901 as a whole.

The Commission noted that the costs associated with required reporting pursuant to proposed Regulation SBSR could represent a barrier to entry for new, smaller firms that might not have the ability to comply with the proposed reporting requirements or for whom the expected benefits of compliance might not justify the costs of compliance. To the extent that proposed Regulation SBSR might deter new firms from entering the security-based swap market, this would be a cost of the proposal and could negatively impact competition. Nevertheless, the Commission preliminarily believed that the proposed reporting requirements would not impose insurmountable barriers to entry, as firms that were reluctant to acquire and build reporting infrastructure would be able to engage with third-party service providers that carry out any reporting duties that they incurred under Regulation SBSR.<sup>1910</sup>

In the Regulation SBSR Proposing Release, the Commission preliminarily estimated that the initial one-time aggregate costs for registered SDRs to develop and implement the systems needed to disseminate the required transaction information would be \$40,004,000, which corresponds to \$4,000,400 per SDR. Further, the Commission preliminarily estimated that aggregate annual costs on registered SDRs for systems and connectivity upgrades associated with real-time public dissemination would be \$24,002,400, which corresponds to \$2,400,240 per SDR. Overall, the initial aggregate costs associated with proposed Rule 901 for all SDRs were estimated to be \$64,006,400, which corresponds to \$6,400,640 per registered SDR.<sup>1911</sup>

#### ii. Re-Proposal

For the reasons discussed above, the Commission is now re-proposing certain provisions of Regulation SBSR that would extend the scope of security-based swaps that would be subject to regulatory reporting and public dissemination and, in some cases, to shift the duty to report to a different counterparty. This re-proposal is being made, in part, to reflect the Commission's preliminary belief that in many cases the reporting and public dissemination requirements of Regulation SBSR should extend to security-based swaps executed outside the United States but having a U.S. person as an indirect counterparty. The Commission also is revising our approach to assigning the duty to report

to minimize consideration of the domicile of the counterparties, and to focus more on their registration status (*i.e.*, whether or not a counterparty is a security-based swap dealer or major security-based swap participant).

To facilitate these revisions, the Commission is proposing to add certain new terms and definitions and to redefine other terms contained in Rule 900. First, the Commission is now proposing to redefine the term "counterparty" as "a direct or indirect counterparty of a security-based swap." Re-proposed Rule 900 would define "direct counterparty" as "a person that enters directly with another person into a contract that constitutes a security-based swap" and "indirect counterparty" as "a person that guarantees the performance of a direct counterparty to a security-based swap or that otherwise provides recourse to the other side for the failure of the direct counterparty to perform any obligation under the security-based swap." Second, re-proposed Rule 900 would eliminate the term "reporting party" and replace it with "reporting side," and define "reporting side" as "the side of a security-based swap having the duty to report information in accordance with §§ 242.900–911 to a registered security-based swap data repository, or if there is no registered security-based swap data repository that would receive the information, to the Commission." "Side" would be defined as "a direct counterparty and any indirect counterparty that guarantees its performance on the security-based swap."

The Commission's revisions would leave much of Rule 901, as initially proposed, substantially unchanged. Importantly, the Commission is not proposing to modify the basic duty to report security-based swap transactions to a registered SDR, as set forth in proposed Rule 901(b). Nor is the Commission proposing to add, delete, or substantively change any of the specific data elements set forth in proposed Rules 901(c) and 901(d) that reporting sides would be required to report.<sup>1912</sup> Rather, in this re-proposal, the Commission's substantive revisions to Rule 901 occur only in paragraph (a), which governs who must report security-based swap transactions. As described in more detail below, these changes are intended to better align reporting duties with larger entities that have greater resources and capability to

<sup>1912</sup> However, re-proposed Rules 901(c) and 901(d) under the Exchange Act include certain conforming changes due to the use of new and revised terms in re-proposed Rule 900 under the Exchange Act.

<sup>1905</sup> See *id.* at 75268.

<sup>1906</sup> A reportable event would include both an initial security-based swap transaction, required to be reported pursuant to proposed Rule 901(b) and the data elements of which would be set forth in proposed Rule 901(c), as well as a life cycle event, the reporting of which is governed by proposed Rule 901(e). See *id.* at 75264–66.

<sup>1907</sup> See *id.* at 75264.

<sup>1908</sup> See *id.* at 75266.

<sup>1909</sup> See *id.*

<sup>1910</sup> See *id.*

<sup>1911</sup> See *id.* at 75269.

report. Specifically, re-proposed Rule 901(a) would provide that a security-based swap dealer or major security-based swap participant that is not a U.S. person could incur the duty to report a security-based swap in various cases. Re-proposed Rule 901(a) would now provide as follows:

- If both sides of the security-based swap include a security-based swap dealer, the sides would be required to select the reporting side.
- If only one side of the security-based swap includes a security-based swap dealer, that side would be the reporting side.
- If both sides of the security-based swap include a major security-based swap participant, the sides would be required to select the reporting side.
- If one side of the security-based swap includes a major security-based swap participant and the other side includes neither a security-based swap dealer nor a major security-based swap participant, the side including the major security-based swap participant would be reporting side.
- If neither side of the security-based swap includes a security-based swap dealer or major security-based swap participant: (i) If both sides include a U.S. person, the sides would be required to select the reporting side; and (ii) If only one side includes a U.S. person, that side would be the reporting side.

In conjunction with the proposed changes to Rule 901(a), the Commission also is now proposing to modify Rule 908(a) to extend the reporting requirement to all security-based swaps that are guaranteed by a U.S. person and all security-based swaps of security-based swap dealers and major security-based swap participants, regardless of whether or not they are U.S. persons.<sup>1913</sup> To reflect these changes, re-proposed Rule 908(a)(1) would provide that a security-based swap is subject to regulatory reporting if:

- The security-based swap is a transaction conducted within the United States;
- There is a direct or indirect counterparty that is a U.S. person on either side of the transaction;
- There is a direct or indirect counterparty that is a security-based swap dealer or major security-based swap participant on either side of the transaction; or
- The security-based swap is cleared through a clearing agency having its

principal place of business in the United States.

Re-proposed Rule 908(a)(2) would provide that a security-based swap shall be subject to public dissemination if:

- The transaction is conducted within the United States;
- There is a direct or indirect counterparty that is a U.S. person on each side of the transaction;
- At least one direct counterparty is a U.S. person (except in the case of a transaction conducted through a foreign branch);
- One side includes a U.S. person and the other side includes a non-U.S. person that is a security-based swap dealer; or
- The security-based swap is cleared through a clearing agency having its principal place of business in the United States.

Taken together, these changes to Rule 901(a) and 908(a) would have the cumulative effect of substantially preserving the reporting hierarchy contemplated in Section 766 of the Dodd-Frank Act while also taking into account the existence of indirect counterparties that could affect how the reporting duty is allocated. Thus, the new approach set forth in re-proposed Rule 901(a) would focus more on the status of an entity (*i.e.*, whether it is a security-based swap dealer or major security-based swap participant), and less on whether or not the counterparties are U.S. persons. Moreover, re-proposed Rule 908(a)(1) would extend the requirement for regulatory reporting to all security-based swaps that are guaranteed by a U.S. person or executed by security-based swap dealers and major security-based swap participants, regardless of whether or not they are U.S. persons.

As discussed above, the Commission is re-proposing Rule 902(a) to provide that certain security-based swaps would be subject to regulatory reporting but not public dissemination. Therefore, the Commission is re-proposing Rule 902(a) to provide that a registered SDR would have no obligation to publicly disseminate a transaction report for any such security-based swap. The remainder of Rule 902 is substantively unchanged.<sup>1914</sup> However, as result of the modifications to Rule 908(a)(2), certain transactions involving non-U.S. person security-based swap dealers, non-U.S. person major swap participants, and/or U.S. person indirect counterparties that would not have been

subject to public dissemination under the initial proposal would be required to be publicly disseminated under re-proposed Regulation SBSR.

#### a. Programmatic Benefits

Re-proposed Rule 901(a) would, relative to the initial proposal, change which counterparty to a security-based swap transaction would be required to report the transaction in some instances, as the Commission is refocusing the reporting duty primarily on the status of the counterparties, rather than on whether or not they are U.S. persons. The remainder of the rule (aside from technical and conforming changes) would remain unchanged from the original proposal. The Commission preliminarily believes that the benefits identified in the Regulation SBSR Proposing Release associated with proposed Rule 901 would continue to be applicable to re-proposed Rule 901. These include providing a means for the Commission to gain a better understanding of the security-based swap market; facilitating public dissemination of security-based swap transaction information, thus enabling market participants and regulatory authorities to know the current state of the security-based swap markets and track those markets over time; and improving risk management by security-based swap counterparties, which would need to capture and store their transactions in security-based swaps to facilitate reporting.

The Commission preliminarily believes that requiring reporting of security-based swap transactions that are guaranteed by U.S. persons would provide benefits beyond those under Rule 908(a), as originally proposed. As discussed above, the Commission's access to such additional information could facilitate more thorough and complete monitoring of individual security-based swap market participants and more accurate systemic risk monitoring across the security-based swap market. In addition, expanding the reach of the security-based swap reporting regime in this manner is designed to mitigate certain unintended consequences of the original proposal, such as market participants shifting business to other jurisdictions to avoid reporting obligations.

The Commission preliminarily believes that the benefits identified in the Regulation SBSR Proposing Release associated with proposed Rule 902 would continue to be applicable to re-proposed Rule 902. Specifically, the Commission continues to believe that post-trade transparency has the potential to lower transaction costs,

<sup>1913</sup> However, the Commission also preliminarily believes that certain of these security-based swaps need not be subject to public dissemination. See Section VIII.C.1, *supra*.

<sup>1914</sup> However, re-proposed Rule 902 under the Exchange Act includes some conforming changes due to the use of new and revised terms in re-proposed Rule 900 under the Exchange Act.



improve confidence in the market, encourage participation by a larger number of market participants, and increase liquidity in the security-based swap market.<sup>1915</sup> Furthermore, the Commission continues to believe that public, real-time dissemination of last-sale information could aid dealers in deriving better quotations, because they would know the prices at which other market participants have recently traded.<sup>1916</sup> In addition, the Commission continues to believe that requiring prompt dissemination of last-sale information would provide all market participants with more extensive and more accurate information on which to make trading and valuation determinations and could allow valuation models to be adjusted to reflect how security-based swap counterparties have valued a security-based swap instrument at a specific moment in time.<sup>1917</sup> Such information, when made publicly available, could enhance market participants' ability to value security-based swaps, especially in opaque markets or markets with low liquidity where recent quotations or last-sale prices may not exist or are not widely available. Better valuations could create a benefit in the form of more efficient capital allocation and ultimately could help reduce systemic risks.<sup>1918</sup>

#### b. Programmatic Costs

Because the majority of proposed Rule 901 is not being revised and the overall emphasis of the rule and the majority of its specific provisions would not change under the re-proposal, the Commission preliminarily believes that the infrastructure-related costs identified in the Regulation SBSR Proposing Release associated with proposed Rule 901, on a per-entity basis, would not change. These include the costs for each reporting party: (i) To develop an OMS capable of capturing relevant security-based swap transaction information so that it can be reported; (ii) to implement a reporting mechanism; and (iii) to establish an appropriate compliance program and support for the operation of the OMS and reporting mechanism.<sup>1919</sup> The bulk of the costs resulting from Regulation SBSR derive from the infrastructure-related costs of

complying with reporting obligations, which include establishing and maintaining the systems necessary to capture, store, and report transaction information; the establishment and maintenance of appropriate policies and procedures; and employing and training the necessary compliance personnel.<sup>1920</sup> The Commission preliminarily estimated and continues to believe that the marginal burden of reporting additional transactions once a respondent's reporting infrastructure and compliance systems are in place would be *de minimis* when compared to the costs of putting those systems in place. This is because the only additional costs of reporting an individual transaction would be entering the required data elements into the firm's OMS, which could subsequently deliver the required transaction information to a registered SDR. In many cases, particularly with standardized instruments and instruments traded electronically, transaction information could be generated and maintained in electronic form, which could then be provided to a registered SDR through wholly automated processes.

Re-proposed Rule 901(a) is designed to reduce the number of instances where a counterparty that is not a security-based swap dealer or major security-based swap participant would bear the responsibility to report a security-based swap transaction under Regulation SBSR. In other words, re-proposed Rule 901(a) is designed to assign the reporting duty to the larger counterparties that have greater resources and operational capability to carry out the reporting function. Consequently, re-proposed Rule 901(a) could result in each reporting counterparty being required to report, on average, more security-based swap transactions than envisioned under the original proposal, although smaller unregistered counterparties that previously would have been required to report a small number of security-based swap transactions under the original proposal would, under re-proposed Rule 901(a), be less likely to have to incur reporting duties under Regulation SBSR, and thus less likely to have to incur the initial infrastructure-related costs of reporting.<sup>1921</sup> The counterparties that

would continue to have the reporting duty under re-proposed Rule 901(a)—primarily security-based swap dealers and major security-based swap participants—would have the reporting duty for nearly all security-based swap transactions. Security-based swap dealers and major security-based swap participants, whether or not they are U.S. persons, typically have greater resources and operational capability than non-registered U.S. counterparties and are likely to already have the reporting infrastructure, policies and procedures, and staff that could be adapted to carry out the reporting obligations under Regulation SBSR. The Commission preliminarily agrees with certain commenters<sup>1922</sup> that basing the reporting duty primarily on status as a security-based swap dealer or major security-based swap participant rather than on whether or not the entity is a U.S. person would, in the aggregate, reduce costs to the security-based swap market, as discussed in more detail below.

In addition, in re-proposing Rule 901(a), the Commission is proposing to revise the term “reporting party” to “reporting side.” Under the re-proposal, a reporting side could consist of multiple entities: the direct counterparty to the transaction and any guarantor of the direct counterparty. Although this has the potential to increase the number of counterparties that could incur a duty to report—by placing such duty on both the direct counterparty and any indirect counterparty—the Commission preliminarily believes that this would not be the result. The Commission preliminarily believes instead that, in practice, large groups that engage in security-based swaps transactions would likely centralize the reporting function for all entities within the group into a single operational unit. Thus, even if two counterparties on the reporting side each incurred the legal duty under re-proposed Rule 901(a) to report a security-based swap transaction, only one entity (either one of the counterparties itself or one of its affiliates) would in fact carry out the reporting function.

Although the Commission preliminarily estimated that there

<sup>1915</sup> See Regulation SBSR Proposing Release, 75 FR 75267.

<sup>1916</sup> See *id.*

<sup>1917</sup> See *id.*

<sup>1918</sup> See *id.* at 75268.

<sup>1919</sup> The Commission's complete assessment of the costs associated with proposed Rule 901 of Regulation SBSR is included in Section XIV.B of the Regulation SBSR Proposing Release. See *id.* at 75264–66.

<sup>1920</sup> See *id.* at 75261–80.

<sup>1921</sup> The Commission notes, however, that non-reporting sides would be required to provide certain information about a reportable transaction on a non-real-time basis. See Rule 906(a), as originally proposed (requiring reporting, if applicable, of participant ID, broker ID, desk ID, and trader ID). See also Regulation SBSR Proposing Release, 75 FR

75221 (discussing rationale for proposed Rule 906(a)).

<sup>1922</sup> See, e.g., DTCC I at 8; ICI Letter at 5; Multiple Firms Letter at 31. See also Vanguard Letter at 6; Multiple Firms Letter at 28 (stating that requiring U.S. end users to report security-based swaps entered into with non-U.S. person security-based swap dealers would be unduly burdensome for end users and could negatively impact the competitiveness of affected U.S. markets).

would be 1,000 reporting entities,<sup>1923</sup> the Commission is now revising that estimate to 300.<sup>1924</sup> In the original proposal, the Commission preliminarily estimated that the initial, aggregate annualized costs associated with proposed Rule 901 would be \$511,013 per reporting party, and that the ongoing aggregate annualized costs associated with proposed Rule 901 would be \$316,116 per reporting party.<sup>1925</sup> The Commission continues to preliminarily believe that these per-respondent costs are appropriate. Given the same per-respondent costs—but adjusting for the decreased estimate of the number of respondents—the Commission now preliminarily believes that the total one-time costs of re-proposed Rule 901 would be \$153,303,900,<sup>1926</sup> and the annual ongoing costs would be \$94,834,800.<sup>1927</sup> The Commission seeks comment on and data to quantify these estimated costs.

It is possible that certain smaller market participants that are currently active in the security-based swap market could reduce their trading activity or exit the market completely, if they believed the compliance costs of re-proposed Regulation SBSR to be too high. This could result in adverse impacts on competition if there were fewer participants competing in the market. However, the Commission preliminarily believes that this outcome would be unlikely, given that the re-proposal is designed to further limit the instances where non-registered U.S. persons would be required to incur the infrastructure-related costs of reporting. The Commission preliminarily believes instead that, by focusing the reporting duty more on the status and away from whether or not entities are U.S. persons, re-proposed Rule 901(a) would lower the incentive of non-registered U.S. persons to reduce their participation in the market out of fear of incurring the infrastructure-related costs of complying with Regulation SBSR.

Furthermore, although the Commission is now proposing to extend the reach of the security-based swap reporting requirements, as described in re-proposed Rule 908(a), to all transactions guaranteed by a U.S. person, the Commission preliminarily believes that this would not result in a significant increase in the number of

entities that incur reporting duties. The Commission preliminarily believes that organizations that operate through foreign subsidiaries that are guaranteed by a U.S. parent are likely to be large financial institutions that already were included in the Commission's estimate of reporting parties in the Regulation SBSR Proposing Release. Furthermore, these organizations are the most likely to have robust risk management systems that extend across business units and across geographic boundaries, and likely already have a presence in the United States and currently are engaging in transactions that they are reporting (on a voluntary basis) to the DTCC-TIW. Thus, such entities were included in the Commission's initial estimate of reporting parties in the Regulation SBSR Proposing Release. Re-proposing Rule 908(a) to require non-U.S. person security-based swap dealers and major security-based swap participants to report all of their transactions to a registered SDR would likely not impose any additional infrastructure-related costs beyond those that were already assessed in the Regulation SBSR Proposing Release. However, this aspect of the re-proposal could impose small additional costs on a per-reporting entity basis in the form of having to report additional transactions using that existing infrastructure.

The Commission notes that there may be a small number of entities that are in the business, or contemplate entering the business, of guaranteeing security-based swaps. Such entities may not have been included in the Commission's original analysis of potential reporting parties, because as indirect counterparties they may not have appeared in the TIW's records as counterparties. Under re-proposed Rule 908, any U.S. person that guarantees a security-based swap could incur the duty to report under re-proposed Regulation SBSR. However, based on consultation with market participants, the Commission preliminarily believes that the net effect on the number of reporting sides would be *de minimis* and would not impact the Commission's revised estimate of 300 reporting counterparties, discussed above. To the extent that there could be entities that act only as an indirect counterparty to security-based swap transactions and would not otherwise have been required to report their security-based swap transactions, the Commission preliminarily believes that our estimate takes these entities into account.

In addition, the Commission preliminarily believes that there may be a slight increase in costs for those reporting counterparties that continue to

incur the reporting duty, as each such reporting counterparty would be required to report, on average, a larger percentage of the total number of reportable events than under the initial proposal. Under re-proposed Rule 901(a), smaller unregistered counterparties that previously would have been required to report a small number of security-based swap transactions under the original proposal would, under the re-proposal, be less likely to incur the reporting duty under re-proposed Rule 901(a). Under re-proposed Rules 901(a) and 908(a)(1)(iii), non-U.S. person security-based swap dealers and major security-based swap participants, rather than unregistered U.S. persons, would have the reporting duty for most of these transactions. Nonetheless, under the re-proposal, the per-transaction reporting cost should not change from what was originally proposed. Moreover, the Commission preliminarily believes that the additional cost for non-U.S. person security-based swap dealers and major security-based swap participants absorbing the costs of reporting these additional transactions should be *de minimis*, since these larger market participants have likely already taken significant steps to establish and maintain the systems, processes and procedures, and staff resources to report security-based swap transactions to existing data repositories.

In the Regulation SBSR Proposing Release, the Commission preliminarily estimated that 1,000 reporting parties would be required to report approximately 15.5 million security-based swap transactions at a total cost, exclusive of the infrastructure-related costs, of approximately \$5,400,000.<sup>1928</sup> The Commission preliminarily believes that nothing in the re-proposal would affect the initial estimate of the cost of an individual reportable event. However, the Commission now is revising our assumptions about the number of reportable events covered by re-proposed Regulation SBSR. Since issuing the Regulation SBSR Proposing Release, the Commission has obtained additional and more granular data regarding participation in the security-based swap market from DTCC-TIW. These historical data suggest that the Commission overestimated the number of security-based swap transactions that would be subject to regulatory reporting in the future. As a result, the Commission now estimates that 300 reporting counterparties would be required to report approximately 5

<sup>1928</sup> See Regulation SBSR Proposing Release, 75 FR 75265.

<sup>1923</sup> See Regulation SBSR Proposing Release, 75 FR 75247.

<sup>1924</sup> See Section XIV.F.2(d)(ii), *supra*.

<sup>1925</sup> See Regulation SBSR Proposing Release, 75 FR 75266.

<sup>1926</sup> The Commission estimates: (300 reporting counterparties) \* \$511,013 = \$153,303,900.

<sup>1927</sup> The Commission estimates: (300 reporting counterparties) \* \$316,116 = \$94,834,800.

million security-based swap transactions per year.<sup>1929</sup>

As discussed in the PRA section above, the Commission now preliminarily estimates that each reporting side would incur, on average, a burden of 83.3 hours per year—not including any infrastructure-related costs—to report individual security-based swap transactions to a registered SDR.<sup>1930</sup> In the Regulation SBSR Proposing Release, the Commission estimated that each reporting party would spend \$5,400 to report specific security-based swap transactions to a registered SDR as required by proposed Rule 901.<sup>1931</sup> Given the Commission's revised estimate of the number of reportable events per year, the Commission also now preliminarily estimates that each reporting side would, on average, incur costs of \$5,630 to report specific security-based swap transactions and life cycle events to a registered SDR.<sup>1932</sup>

The Commission further notes two factors that could serve to limit the per-transaction costs across all affected entities. First, to the extent that security-based swap instruments become more standardized and trade more frequently on electronic platforms (rather than manually), the act of reporting transactions to a registered SDR should become less costly. Together, these trends are likely to reduce the number of transactions that would necessitate the manual capture of bespoke data

<sup>1929</sup> Data provided by the DTCC—TIW indicate that there were approximately 4,000,000 transactions in single-name CDS in 2012. The Commission believes that the single-name CDS data are sufficiently representative of the security-based swap market. See Section XV.B.2 and note 1301 and accompanying text, *supra*. The Commission believes that single-name CDS transactions account for 82% of the security-based swap market. As a result, the Commission preliminarily estimates that there were 4.88 million (*i.e.*, 4,000,000/0.82) security-based swap transactions in 2012, and is basing its estimate of the future number of transactions on recent historical activity.

<sup>1930</sup> The Commission estimates: (5 million \* 0.005)/(300 reporting sides) = 83.3 burden hours per reporting counterparty, or 25,000 total burden hours for all reporting counterparties.

<sup>1931</sup> See Regulation SBSR Proposing Release, 75 FR 75265. In arriving at this figure, the Commission preliminarily estimated that 1,000 reporting parties would be responsible for reporting 15,458,824 security-based swap transactions at a total cost of approximately \$5,400,000. The Commission is not revising its initial estimate of the average cost of reporting an individual security-based swap transactions. However, the Commission now estimates that approximately 300 reporting sides will have the duty to report approximately 5 million security-based swap transactions per year.

<sup>1932</sup> The Commission estimates: ((Compliance Clerk (41.7 hours) at \$59 per hour) + (Sr. Computer Operator (41.7 hours) at \$76 per hour)) \* 300 reporting sides = \$1,688,850 for all reporting sides, or \$5,630 per reporting side. See also note 1270, *supra*.

elements, which is likely to take more time and be more expensive than electronic capture. Second, the larger entities that would incur additional reporting duties under re-proposed Rules 901(a) and 908(a)(1)(iii)—*i.e.*, non-U.S. person security-based swap dealers and major security-based swap participants—can benefit from certain economies of scale in carrying out reporting duties might elude smaller, unregistered counterparties. The Commission preliminarily believes that, all other things being equal, a larger reporting counterparty is likely to handle a greater number of reportable events, including those requiring manual data capture, than a smaller counterparty and thus would develop greater expertise and greater speed in reporting transactions. Moreover, a larger reporting counterparty is likely to have greater incentive and ability to develop systems that support the reporting function, and the fixed cost of this infrastructure can be spread across the larger number of transactions handled by the larger counterparty. The extent of these effects, however, is difficult to quantify. The Commission seeks comments on the extent of these effects and their impact on average per-transaction reporting costs.

The Commission preliminarily believes that re-proposed Rule 901(a) would not increase the previously estimated costs for registered SDRs. The Commission preliminarily believes, rather, that the estimated costs for registered SDRs might be less than the original estimate, for two reasons. First, given that the Commission now estimates that there would be fewer entities incurring the duty to report (300 rather than the original estimate of 1,000), there would be fewer entities that would have to establish linkages to a registered SDR and thus fewer relationships for a registered SDR to manage. Second, given the Commission's reduced estimates of the number of reportable events, the Commission preliminarily believes that registered SDRs could face slightly lower costs because they would have fewer transactions to process than originally estimated. The extent of these effects, however, is difficult to quantify. The Commission seeks comments on the extent of these effects and their impact on average per-transaction costs. Finally, the Commission has no reason to believe and sees no reason to expect that re-proposed Rules 901(a) and 908(a)(1)(iii) would result in the registration of additional SDRs. Thus, given any fixed costs than any entity registering as a registered SDR might

incur under re-proposed Regulation SBSR, the Commission is *not* increasing our cost estimates to account for a larger number of entities anticipated to incur those per-entity costs.

Furthermore, the Commission preliminarily believes that extending the scope of transactions that would be subject to public dissemination, as reflected in re-proposed Rules 908(a)(2) and 902(a), would not significantly increase or decrease the previously estimated costs for registered SDRs identified in the Regulation SBSR Proposing Release. The Commission preliminarily believes that these revisions would not result in the registration of additional SDRs or require them to bear the costs of connecting to additional reporting sides. Even if there would be a slight increase in the percentage of security-based swap transactions subject to public dissemination as a result of the applicability of the re-proposed Regulation SBSR to a larger universe of transactions involving non-U.S. entities and/or U.S. indirect counterparties, given the Commission's reduced estimates of the overall number of reportable events,<sup>1933</sup> the Commission now estimates that registered SDRs would be required to publicly disseminate fewer transactions than estimated in the Regulation SBSR Proposing Release. The Commission further notes that our original estimate of the costs of public dissemination was not calculated on a per-transaction basis, but represented instead the one-time aggregate estimated costs associated with development and implementation of the necessary infrastructure, as well as the aggregate annual estimated costs for supporting and upgrading that infrastructure as necessary.<sup>1934</sup>

The Commission continues to believe that the preliminary estimates contained in the Regulation SBSR Proposing Release are valid, and that implementing and complying with the real-time public dissemination requirement of Rule 902 would add 20% to the start-up and ongoing operational expenses that would otherwise be required of a registered SDR.<sup>1935</sup> In particular, the Commission continues to estimate that the initial one-time aggregate costs for development and implementation of the systems needed to disseminate the required transaction information would

<sup>1933</sup> See notes 1267–1268, *supra*.

<sup>1934</sup> See Regulation SBSR Proposing Release, 75 FR 75269.

<sup>1935</sup> See SDR Proposing Release, 75 FR 77354–64. See also Regulation SBSR Proposing Release, 75 FR 75269.

be \$40,004,000, which corresponds to \$4,000,400 per registered SDR. Further, the Commission continues to estimate that aggregate annual costs for systems and connectivity upgrades associated with real-time public dissemination would be \$24,002,400, which corresponds to \$2,400,240 per registered SDR. Thus the initial aggregate costs associated with proposed Rule 902 are estimated to be \$64,006,400, which corresponds to \$6,400,640 per registered SDR.

#### Request for Comment

The Commission requests comment on the costs and benefits of re-proposed Rules 901, 902, and 908(a) discussed above, as well as any costs and benefits not already described that could result. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests comment on the following:

- How can the Commission more accurately assess the costs and benefits of re-proposed Rule 901?
- How many entities would be affected by re-proposed Rule 901? How many transactions would be subject to re-proposed Rule 901?
- Are there additional costs involved in complying with re-proposed Rule 901 that have not been identified? What are the types and amounts of those costs?
- Do the reporting requirements in re-proposed Rule 901(a), by potentially placing the duty to report upon a security-based swap dealer or major security-based swap participant that is not a U.S. person, mitigate any barrier to entry that Rule 901, as originally proposed, might have created? How can this benefit or reduction in potential cost be tabulated?
- How should the Commission assess the benefits and costs associated with re-proposed Rule 901(a), if any, compared to the anticipated benefits from increased transparency to the security-based swap market from the re-proposal?
- Would there be additional benefits or costs of re-proposed Rule 901, 902, and 908(a) that have not been identified?
- Are there methods to minimize the costs associated with re-proposed Rule 908(a)?
- Would re-proposed Rule 908(a) create any additional costs not discussed here? If so, please identify and quantify these costs.
- Is the Commission's revised estimate of the number of transactions subject to Regulation SBSR accurate? If not, how many transactions would be impacted by re-proposed Regulation SBSR? Please provide detailed

information on the number and types of transactions impacted.

- Would re-proposed Rule 902 result in benefits or costs that the Commission has not considered? Are the Commission's estimates of the costs and benefits of re-proposed Rule 902 accurate? If not, please provide detailed information identifying and quantifies the costs and benefits of re-proposed Rule 902.

#### (b) Proposed Modification of the Definition of "U.S. Person"

Regulation SBSR, as originally proposed, would have defined a "U.S. person" as "a natural person that is a U.S. citizen or U.S. resident or a legal person that is organized under the corporate laws of any part of the United States or has its principal place of business in the United States." In this re-proposal, the Commission is proposing a new definition of "U.S. person" that is consistent with usage in our other Title VII proposals.<sup>1936</sup> The Commission preliminarily believes that these Title VII rules would benefit from having the same terms throughout and could, therefore, reduce assessment costs for market participants that might be subject to the proposed rules. Furthermore, the Commission preliminarily believes that the revised definition of "U.S. person" is intended to clarify application of Regulation SBSR and would not significantly change the number of entities that would be subject to Regulation SBSR. The Commission preliminarily believes that the revised definition of "U.S. person" would not entail any material costs to market participants, nor would it intrinsically impose any obligation or duty on market participants. Therefore, the Commission preliminarily believes that the new definition would not increase the aggregate compliance costs of re-proposed Regulation SBSR.

#### Request for Comment

The Commission requests comment on the costs and benefits of the re-proposed definition of "U.S. person" as used in re-proposed Regulation SBSR, and data to support those comments. In particular, the Commission requests comment on the following:

- Would the re-proposed definition of "U.S. person" as used in Regulation SBSR result in any costs or benefits not discussed here? Please distinguish any costs and benefits stemming from the re-proposed definition itself, rather than any costs or benefits attributable to

<sup>1936</sup> Specifically, the re-proposed definition provides that the term "U.S. person" would have the same meaning as set forth in proposed Rule 3a71-3(a)(7) under the Exchange Act.

other provisions of Regulation SBSR in which the term appears, such as re-proposed Rules 901, 902, and 908(a).

#### (c) Revisions to Proposed Rule 908(b)

##### i. Initial Proposal

Rule 908(b), as initially proposed, attempted to clarify when reporting duties would be imposed on counterparties of security-based swaps that are not U.S. persons when some connections to the United States might be present. Proposed Rule 908(b) provided that no duties would be imposed on a counterparty unless one of the following conditions were true:

- The counterparty is a U.S. person;
- The security-based swap is executed in the United States or through any means of interstate commerce; or
- The security-based swap is cleared through a clearing agency having its principal place of business in the United States.

##### ii. Re-proposal

As described above, the Commission now believes, in light of other revisions being made to Regulation SBSR, that certain conforming revisions to Rule 908(b) are appropriate. Specifically, Rule 908(b) is being re-proposed to account for the possibility that a non-U.S. person security-based swap dealer or major security-based swap participant could incur a duty to report. In addition, the "interstate commerce clause" is being replaced with the new concept of a "transaction conducted within the United States."

##### a. Programmatic Benefits

The Commission now preliminarily believes that there are benefits to requiring all security-based swap dealers and major security-based swap participants, whether or not they are U.S. persons, to report their security-based swap transactions pursuant to re-proposed Regulation SBSR. Having access to security-based swaps of all such entities through data reported to a registered SDR would give the Commission greater ability to supervise such entities and assess the overall security-based swap market. Furthermore, requiring all such entities to report security-based swap information would help provide the Commission and other regulators with detailed, up-to-date information both about positions of particular entities and financial groups, as well as positions held by multiple market participants in particular instruments.

##### b. Programmatic Costs

The Commission preliminarily believes that the revisions to Rule 908(b)

would not result in any significant increase in the overall cost of compliance for affected entities. The Commission preliminarily believes, rather, that many unregistered U.S. persons that participate in the security-based swap market would face lower costs, as they could be more likely to avoid entirely having to incur the infrastructure-related costs of reporting security-based swap transactions. Furthermore, to the extent that non-U.S. person security-based swap dealers and major security-based swap participants would be required to report security-based swap transactions, such entities were already included in the estimate of 1,000 reporting parties used in the Regulation SBSR Proposing Release and are also included in the new estimate of 300 reporting sides becoming subject to re-proposed Regulation SBSR. Although the number of security-based swap transactions that these reporting sides would be required to report would increase, the Commission preliminarily does not believe that they would be required to expand their systems capabilities to account for the additional transaction volume.

#### Request for Comment

The Commission requests comment on the costs and benefits of re-proposed Rule 908(b) and data to assess any potential costs or benefits. In addition, the Commission requests comment on the following:

- Would re-proposed Rule 908(b) result in any benefits or costs that the Commission has not considered?
- Are there methods to minimize the costs associated with re-proposed Rule 908(b)?
- Would re-proposed Rule 908(b) create any additional costs not discussed here? If so, please identify and quantify these costs.

#### (d) Other Technical Revisions in Re-Proposed Regulation SBSR

In addition to the revisions described above, the Commission is re-proposing certain technical or conforming changes to other rules contained in Regulation SBSR. Specifically, certain changes are required to re-proposed Rules 901(c) and 901(d), which address the data elements to be reported to a registered SDR, to reflect the re-proposal's approach that certain security-based swaps may be subject to regulatory reporting but not public dissemination. The introductory language to Rule 901(c) is being re-proposed as follows: "For any security-based swap that must be publicly disseminated pursuant to §§ 242.902 and 242.908 and for which it is the reporting side, the reporting side

shall report the following information in real time. If a security-based swap is required by §§ 242.901 and 242.908 to be reported but not publicly disseminated, the reporting side shall report the following information no later than the time that the reporting side is required to comply with paragraph (d) of this section:" Re-proposed Rule 901(c) would be retitled "Primary trade information"—since not all information reported pursuant to Rule 901(c) would be required to be provided in real time—and re-proposed Rule 901(d) would be retitled "Secondary trade information." The Commission also is re-proposing Rule 901(c)(10) as follows: "If both sides of the security-based swap include a security-based swap dealer, an indication to that effect." The re-proposed rule clarifies that a security-based swap dealer might be a direct or indirect counterparty to a security-based swap. Rule 901(d)(1)(ii) is also being re-proposed to require reporting of the broker ID, desk ID, and trader ID, as applicable, only of the direct counterparty on the reporting side. Rule 901(d)(1)(iii) is being re-proposed to require reporting of a description of the terms and contingencies of the payment streams only of each direct counterparty to the other. The word "direct" is necessary to avoid extending Rule 901(d)(1)(iii) to indirect counterparty relationships, where payments might not (except in unusual circumstances) flow to or from an indirect counterparty.

Additional technical or conforming revisions include changes to Rule 901(e), which sets forth provisions for reporting life cycle events of a security-based swap. The Commission is re-proposing Rule 901(e) to provide that the duty to report would switch to the other side only if the new side did not include a U.S. person (as in the originally proposed rule) or a security-based swap dealer or major security-based swap participant (references to which are being added to Rule 901(e)). Re-proposed Rule 908 contemplates situations where a security-based swap would be required to be reported to a registered SDR but not publicly disseminated. Therefore, the Commission is re-proposing Rule 902(a) to provide that a registered SDR would have no obligation to publicly disseminate a transaction report for any such security-based swap.

Re-proposed Rules 903, 905, 906, 907, 910, and 911 are each conformed to incorporate the use of the term "side," while re-proposed Rules 904, 905, 906, and 907 each replace "§§ 242.900 through 242.911" with "§§ 242.900–911."

Rule 905(b)(2) is being re-proposed to clarify that, if a registered SDR receives corrected information relating to a previously submitted transaction report, it would be required to publicly disseminate a corrected transaction report only if the initial security-based swap was subject to public dissemination.

As originally proposed, Rule 907(a)(6) would require a registered SDR to establish and maintain written policies and procedures "[f]or periodically obtaining from each participant information that identifies the participant's ultimate parent(s) and any other participant(s) which the counterparty is affiliated, using ultimate parent IDs and participant IDs." The Commission now is re-proposing Rule 907(a)(6) with the word "participant" in place of the word "counterparty."

Rule 910(b)(4), as originally proposed, would provide that, in Phase 4 of the Regulation SBSR compliance schedule, "[a]ll security-based swaps reported to the registered security-based swap data repository shall be subject to real-time public dissemination as specified in § 242.902." As noted above, certain security-based swaps would be subject to regulatory reporting but not public dissemination. Therefore, the Commission is re-proposing Rule 910(b)(4) to provide that, "All security-based swaps received by the registered security-based swap data repository shall be handled consistent with §§ 242.902, 242.905, and 242.908."

Because the changes discussed above are technical in nature, the Commission preliminarily believes that they would not have any significant impact, negative or positive, on re-proposed Regulation SBSR. Nonetheless, the Commission preliminarily believes that, to the extent these changes clarify the application of certain aspects of Regulation SBSR, they could enhance consistency, reduce potential uncertainties related to the interpretation and application of Regulation SBSR, and thus reduce assessment costs. The Commission solicits comment on that preliminary view.

#### (e) Aggregate Total Quantifiable Costs

Based on the foregoing, the Commission preliminarily estimates that re-proposed Regulation SBSR would impose an estimated total first-year cost of approximately \$511,243<sup>1937</sup>

<sup>1937</sup> The Commission derived its estimate from the following: (\$511,013 (per entity total first-year cost of Regulation SBSR)—(\$5,400 (entity transaction reporting cost of Regulation SBSR)—\$5,630 (revised reporting side transaction reporting

per reporting counterparty for a total first-year cost of \$153,372,900.<sup>1938</sup> The Commission preliminarily estimates that re-proposed Regulation SBSR would impose ongoing annualized aggregate costs of approximately \$316,346<sup>1939</sup> per reporting side, for a total aggregate annualized cost of \$94,903,800.<sup>1940</sup>

As noted above, the Commission preliminarily believes that re-proposed Regulation SBSR would not significantly change the costs of registered SDRs, as estimated in the Regulation SBSR Proposing Release. The Commission preliminarily believes that the revisions contained in re-proposed Rules 901, 902, and 908(a) would not result in the registration of additional SDRs or require them to bear the costs of connecting to additional reporting sides. To the extent that the re-proposal would assign reporting responsibilities to fewer respondents, registered SDRs could face lower costs to support their connectivity.

In total, the Commission preliminarily estimates the total first-year cost of re-proposed Regulation SBSR to be \$681,307,400.<sup>1941</sup> The Commission preliminarily estimates the total ongoing annual cost of re-proposed Regulation SBSR to be \$481,935,340.<sup>1942</sup> The compliance costs attributable to re-proposed Regulation SBSR could be significantly reduced to the extent that foreign jurisdictions are deemed comparable in a substituted compliance order, which would enable market participants to comply with the foreign jurisdiction's rules relating to regulatory reporting and public dissemination and thus would relieve them of their

primary obligations—and the associated costs—under Regulation SBSR.

### *I. Economic Analysis of Substituted Compliance*

The Commission is proposing a policy and procedural framework that would allow for the possibility of substituted compliance with respect to four categories of rules in recognition of the potential, in a market as global as the security-based swap market, for security-based swap market participants to be subject to conflicting or duplicative compliance obligations. These four categories are: (i)

Requirements applicable to registered security-based swap dealers in Section 15F of the Exchange Act and the rules and regulations thereunder; (ii) requirements relating to regulatory reporting and public dissemination of security-based swaps; (iii) requirements relating to clearing for security-based swaps; and (iv) requirements relating to trade execution for security-based swaps.<sup>1943</sup> Specifically, the Commission is proposing rules and interpretative guidance in this release to provide that: (i) The Commission may, conditionally or unconditionally, by order, make a substituted compliance determination with respect to a foreign regulatory system that compliance with specific requirements under such foreign regulatory system by a registered foreign security-based swap dealer (or class thereof) may satisfy the corresponding requirements in Section 15F of the Exchange Act,<sup>1944</sup> and the rules and regulations thereunder, that would otherwise apply to such foreign security-based swap dealer (or class thereof);<sup>1945</sup> (ii) the Commission may, conditionally or unconditionally, by order, make a substituted compliance determination regarding regulatory reporting and public dissemination of security-based swaps in a foreign jurisdiction if such foreign jurisdiction's requirements for the regulatory reporting and public dissemination of security-based swaps are comparable to otherwise applicable requirements under Section 13A(a)(1) of the Exchange Act,<sup>1946</sup> Section 13(m)(1)(G) of the Exchange Act<sup>1947</sup> and Section 13(m)(1)(C) of the Exchange Act,<sup>1948</sup> and the rules and regulations

thereunder;<sup>1949</sup> (iii) the Commission may exempt persons from the mandatory clearing requirement in Section 3C(a)(1) of the Exchange Act<sup>1950</sup> if the relevant security-based swap transaction is submitted to a foreign clearing agency that is the subject of a substituted compliance determination by Commission order;<sup>1951</sup> and (iv) the Commission may, conditionally or unconditionally, by order, make a substituted compliance determination with respect to a foreign jurisdiction to permit a person subject to the mandatory trade execution requirement in Section 3C(h) of the Exchange Act to execute such transaction, or have such transaction executed on their behalf, on a security-based swap market (or class of markets) that is neither registered under the Exchange Act nor exempt from registration under the Exchange Act if the Commission determines that such security-based swap market (or class of markets) is subject to comparable, comprehensive supervision and regulation by a foreign financial regulatory authority or authorities in such foreign jurisdiction.<sup>1952</sup>

#### 1. Programmatic Benefits and Costs

The Commission recognizes that the programmatic costs and benefits of substituted compliance may vary depending on the specific nature of a particular substituted compliance determination. If the Commission imposes conditions on a substituted compliance determination, such conditions may have effects on the programmatic costs and benefits. The proposed rules and interpretive guidance regarding substituted compliance described above provide that the Commission would only make a determination that substituted compliance is permitted if the foreign regulatory system in a particular area, taking into consideration any relevant principles, regulations, or rules in other areas of the foreign regulatory system to the extent they are relevant to the analysis, achieves the regulatory outcomes that are comparable to the regulatory outcomes of the relevant provisions of the Exchange Act.

The Commission preliminarily believes that substituted compliance would not substantially change the programmatic benefits intended by the requirements in Section 15F of the Exchange Act, the programmatic benefits intended by the regulatory

cost))) = \$511,243. See notes 1908, 1931, and 1932 and accompanying text, *supra*.

<sup>1938</sup> The Commission derived its estimate from the following: (\$511,243 \* 300 reporting sides) = \$153,372,900.

<sup>1939</sup> The Commission derived its estimate from the following: (\$316,116 (per entity annualized cost of Regulation SBSR) — (\$5,400 (entity transaction reporting cost of Regulation SBSR) — \$5,630 (revised reporting side transaction reporting cost))) = \$316,346. See notes 1909, 1931, and 1932 and accompanying text, *supra*.

<sup>1940</sup> The Commission derived its estimate from the following: (\$316,346 \* 300 reporting sides) = \$94,903,800.

<sup>1941</sup> The Commission derived its estimate from the following: (\$1,038,947,500 (total first-year cost of Regulation SBSR) — \$511,013,000 (Regulation SBSR Rule 901 first-year costs on reporting parties) + \$153,372,900 (re-proposed Regulation SBSR Rule 901 first-year costs on reporting sides)) = \$681,307,400.

<sup>1942</sup> The Commission derived its estimate from the following: (\$703,147,540 (total ongoing annualized cost of Regulation SBSR) — \$316,116,000 (Regulation SBSR Rule 901 annual ongoing costs on reporting sides) + \$94,903,800 (re-proposed Regulation SBSR Rule 901 annual ongoing costs on reporting sides)) = \$481,935,340.

<sup>1943</sup> See Section XI, *supra* (providing detailed discussions of substituted compliance).

<sup>1944</sup> 15 U.S.C. 78o–10.

<sup>1945</sup> See proposed Rule 3a71–5 under the Exchange Act, as discussed in Section XI.C, *supra*.

<sup>1946</sup> 15 U.S.C. 78m–1(a)(1).

<sup>1947</sup> 15 U.S.C. 78m(m)(1)(G).

<sup>1948</sup> 15 U.S.C. 78m(m)(1)(C).

<sup>1949</sup> See proposed Rule 908(c)(2) under the Exchange Act, as discussed in Section XI.D, *supra*.  
<sup>1950</sup> 15 U.S.C. 78c–3(a)(1).

<sup>1951</sup> See Section XI.E, *supra*.

<sup>1952</sup> See proposed Rule 3Ch–2(b)(1) under the Exchange Act, as discussed in Section XI.F, *supra*.

reporting and public dissemination requirements in Section 13(m)(1)(G), Section 13(m)(1)(C), and Section 13A(a)(1) of the Exchange Act, the programmatic benefits intended by the mandatory clearing requirement in Sections 3C(a)(1) of the Exchange Act, or the programmatic benefits intended by the mandatory trade execution requirement set forth in Section 3C(h) of the Exchange Act. To the extent that substituted compliance eliminates duplicative compliance costs, registered foreign security-based swap dealers or market participants entering into security-based swap transactions that are eligible for substituted compliance may incur lower programmatic costs associated with implementation or compliance with the specified Title VII requirements than they would otherwise incur without the option of substituted compliance available, either because such registered foreign security-based swap dealers may have implemented or begun to implement the foreign regulatory requirements that are determined comparable by the Commission, or because parties to a security-based swap transaction eligible for substituted compliance determination do not need to duplicate compliance with two sets of comparable requirements.

In the case of a substituted compliance determination made with Commission-imposed conditions in order to achieve comparable programmatic benefits intended by the applicable Title VII requirements, we cannot preclude the possibility that substituted compliance may increase programmatic costs because market participants would be required to incur costs to satisfy those conditions. On the other hand, substituted compliance also may enable certain foreign market participants subject to comparable foreign regulation to enter or stay in the U.S. security-based swap market. These are participants that would, due to conflicting local laws, otherwise not be able to participate under Title VII regulation in the absence of substituted compliance. In such cases, substituted compliance may either increase the number of market participants in the U.S. security-based swap market or prevent certain existing market participants from exiting the market, thereby contributing to the programmatic benefits and costs that flow from Title VII requirements.

The decision to request substituted compliance is purely voluntary. Market participants would choose to make a request for a substituted compliance determination only if, in their own assessment, compliance with applicable

requirements under a foreign regulatory system were less costly than compliance with both the foreign regulatory regime and the relevant Title VII requirement. Even after a substituted compliance determination is made, market participants would only choose substituted compliance if the private benefits they expect to receive from participating in U.S. markets exceeds the private costs they expect to bear, including any conditions the Commission may attach to the substituted compliance determination. Therefore, the proposed rules regarding substituted compliance are based on the consideration that the net programmatic benefits associated with specific Title VII requirements could be increased by the Commission making the substituted compliance option available. Where substituted compliance increases the number of market participants in the U.S. security-based swap market or prevents existing participants from leaving the U.S. security-based swap market, there may be contributions to both programmatic benefits and costs associated with the applicable Title VII requirements.

## 2. Alternatives

The Commission could have proposed that substituted compliance determinations with respect to regulatory reporting, public dissemination and mandatory trade execution apply to all cross-border transactions involving at least one foreign counterparty or foreign branch of a U.S. bank. However, we propose in Rule 908(c)(2), the interpretive guidance regarding substituted compliance with the mandatory clearing requirement, and Rule 3Ch-2(b)(1) that substituted compliance would not be available to a security-based swap transaction that involves persons within the United States in executing, soliciting or negotiating the terms of such transaction on both sides of a transaction, even though at least one counterparty to the transaction is a non-U.S. person or foreign branch.<sup>1953</sup> In other words, if both counterparties to a security-based swap transaction conduct such transaction within the United States, it is a transaction in the United States. One of the primary objectives of making substituted compliance available to cross-border security-based swap transactions is to accommodate the global nature of the security-based swap

<sup>1953</sup> See proposed Rule 908(c)(2) under the Exchange Act, interpretive guidance regarding substituted compliance with the mandatory clearing requirement, and proposed Rule 3Ch-2(b)(1) under the Exchange Act, as discussed in Section XI.D-XI.F, *supra*.

market and cross-border security-based swap activity. In circumstances where both parties to a security-based swap are transacting in the United States, either from a U.S. office or U.S. branch, or using an affiliate or agent, to conduct the security-based swap, we do not believe that substituted compliance would be necessary or appropriate. Both parties (or their respective agents) to the transaction are conducting a transaction in the United States and should be able to satisfy the applicable Title VII requirements by reporting the transaction to a registered SDR or executing the transaction on a registered exchange of SB SEF in the United States without the need to rely on substituted compliance. In addition, because both parties (or their respective agents) are conducting a transaction in the United States, there is a strong public interest to subject such transaction to the Title VII mandatory execution, regulatory reporting, and public dissemination requirements. Therefore, the Commission does not believe that it would be appropriate to provide substitute compliance with respect to a transaction where both parties (or their agents) conduct the transaction within the United States.

## 3. Assessment Costs

The assessment costs associated with the proposed rules regarding substituted compliance would, in part, flow from the assessment of whether a registered security-based swap dealer is a foreign security-based swap dealer and whether a transaction counterparty is a non-U.S. person or a foreign branch and whether a transaction involves a person within the United States in soliciting, negotiating, or execution. The status of a foreign security-based swap dealer would be determined by analyzing the U.S. person definition, which may be done by an in-house counsel reviewing readily ascertainable information, such as the foreign security-based swap dealer's certificate of incorporation or formation or other internal documents evidencing residence, place of incorporation, or principal business location. The Commission preliminarily believes that the cost involved in making such assessment should not exceed one hour of in-house counsel's time or \$379.<sup>1954</sup>

<sup>1954</sup> Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379.



The assessment costs associated with proposed Rule 908(c), proposed interpretive guidance with respect to substituted compliance with the mandatory clearing requirement, and proposed Rule 3Ch-2(c)(2)(ii) would involve costs of determining a transaction counterparty's U.S. person status, as well as determining whether counterparty conducts the security-based swap in the United States or involves any persons in the United States to solicit, negotiate or execute a security-based swap transaction.

The Commission preliminarily believes that market participants would likely incur costs arising from the need to identify and maintain records concerning the U.S.-person status of their counterparties and the location of their transactions. We anticipate that potential applicants for substituted compliance are likely to request representations from their transaction counterparties to determine the counterparties' U.S.-person status and whether the transaction was conducted within the United States. Therefore, the Commission preliminarily believes that the assessment costs associated with determining the status of counterparties and the location of transactions should be primarily one-time costs of establishing a practice or compliance procedure of requesting and collecting representations from trading counterparties and maintaining the representations collected as part of the recordkeeping procedures and limited ongoing costs associated with requesting and collecting representations. Consistent with the analysis of the assessment costs associated with the *de minimis* exception relating to the security-based swap dealer definition that involves determining the status of counterparties and the location of transactions,<sup>1955</sup> the Commission preliminarily believes that such one-time costs would be approximately \$15,160.<sup>1956</sup> The Commission preliminarily believes that requesting and collecting representations would be part of the standardized transaction process reflected in the policies and

procedures regarding security-based swap sales and trading practices and should not result in separate assessment costs.<sup>1957</sup> To the extent that market participants have incurred costs relating to similar or same assessments with respect to the counterparty status and location of the transactions for other Title VII requirements, their assessment costs with respect to substituted compliance may be less.

In addition, a registered security-based swap dealer or a security-based swap transaction eligible for a substituted compliance determination would incur costs in submitting a request to the Commission for a substituted compliance determination. The Commission preliminarily estimates the costs of submitting such request pursuant to proposed Rule 3a71-5(c), proposed Rule 908(c), proposed interpretive guidance with respect to substituted compliance with the mandatory clearing requirement, or proposed Rule 3Ch-2(c)(2)(ii) would be approximately \$110,320.<sup>1958</sup> Once such

<sup>1957</sup> There will be ongoing costs associated with processing representations received from counterparties, including additional due diligence and verification to the extent that a counterparty's representation is contrary to or inconsistent with the knowledge of the collecting party. The Commission believes that these would be compliance costs encompassed within the programmatic costs associated with substituted compliance.

<sup>1958</sup> This estimate is based on information indicating that the average costs associated with preparing and submitting an application to the Commission for a Commission order for exemptive relief under Section 36 of the Exchange Act in accordance with the procedures set forth in 17 CFR 240.0-12. The Commission recognizes that a substituted compliance determination request made pursuant to proposed Rule 3a71-5(c), proposed Rule 908(c), proposed interpretive guidance with respect to substituted compliance with the mandatory clearing requirement, and proposed Rule 3Ch-2(c)(2)(ii) would be made under proposed Rule 0-13 under the Exchange Act, which establishes procedures similar to those used by the Commission in considering exemptive order applications under Section 36 of the Exchange Act. The staff estimates that costs associated with a request pursuant to these proposed rules would be approximately \$110,320. The Commission estimates that preparation of the request would require approximately 80 hours of in-house counsel time and 200 hours of outside counsel time. Such estimate takes into account the time required to prepare supporting documents necessary for the Commission to make a substituted compliance determination, including, without limitation, information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor compliance with these rules. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379. The Commission estimates the costs for

request is made, however, other market participants that seek to request a substituted compliance determination with respect to the same area of a foreign regulatory system relevant to the requirements in Section 15F or regulatory reporting and public dissemination, the same foreign clearing agency, or the same foreign regulatory regime that a foreign exchange or SB SEF is subject to, would be able to rely on the Commission's substituted compliance determination. Accordingly, the assessment costs would only need to be incurred once with respect to the same area of a foreign regulatory system or the same foreign clearing agency.

#### Request for Comment

The Commission seeks comment on the costs and benefits associated with substituted compliance in all aspects. Responses that are supported by data and analysis provide great assistance to the Commission in considering the benefits and costs of the substituted compliance policy framework. In addition, the Commission seeks comment on the following specific questions:

- Would substituted compliance reduce costs associated with the applicable Title VII requirements? Would the analysis of the benefits and costs of substituted compliance differ between the case of regulatory duplication or overlap and the case of regulatory conflict?
- Does a substituted compliance determination based on comparability achieve the same benefits intended by Title VII? Could there be significant economic consequences if the Commission permitted substituted compliance in cases in which the foreign requirements are not identical, but, as contemplated, only comparable to the applicable Title VII requirements? What would those effects be? In cases where substituted compliance were granted but where requirements were comparable and not identical, are there certain differences, or types of differences, in regulation that would have more significant economic effects than others? Are there particular areas of Title VII regulation in which the effects of differences between comparable and identical standards would be more pronounced than in others?
- Could there be significant economic consequences, including effects on

outside legal services to be \$400 per hour. Accordingly, the Commission estimates the cost to be \$110,320 (\$30,320 (based on 80 hours of in-house counsel time \* \$379) + \$80,000 (based on 200 hours of outside counsel time \* \$400)) to submit a request for a substituted compliance determination.

<sup>1955</sup> See Section XV.D.2(a), *supra*.

<sup>1956</sup> This estimate is based on estimated 40 hours of in-house legal or compliance staff's time to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be built into form of standardized trading documentation. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2012 (modified by the SEC staff to account for an 1800-hour-work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead), the staff estimates that the average national hourly rate for an in-house attorney is \$379.

competition, if a substituted compliance determination is made conditionally? What would those effects be?

- Could market participants be prompted to restructure in anticipation of substituted compliance determinations? What effects on market structure and competition might result? Are there other potential spillovers from strategic restructuring related to substituted compliance determinations?

- Do commenters agree with the preliminary estimates of the assessment costs and the costs to request a substituted compliance determination discussed above? Are there any other assessment costs not considered here? Specifically, the Commission requests comment on (i) the assessment costs of determining whether a market participant or a transaction is eligible for substituted compliance, and (ii) the costs of preparing and submitting a request for a substituted compliance determination.

#### J. General Request for Comments

In responding to the specific requests above for comment on the economic effects of our proposed rules, interested persons are encouraged to provide supporting data and analysis and, when appropriate, identify alternative models for assessing the costs and benefits of our proposed rules, as well as their expected effect on efficiency, competition and capital formation. Responses that are supported by data and analysis provide great assistance to the Commission in considering the economic effects of proposed new requirements, including the associated benefits and costs.

In addition to the specific requests for comment set forth above, the Commission also seeks comment on the expected economic effects of the interplay between our rules and those [adopted/proposed] by the CFTC. In particular, to the extent that the Commission's proposed rules and interpretations take a different approach from the CFTC's approach to the application of Title VII requirements in the cross-border context, what would be the economic impact, including the costs and benefits, of these differences on market participants and the U.S. security-based swap market as a whole? What effect would such differences have on efficiency, competition and capital formation in the U.S. security-based swap market? Commenters should provide analysis and empirical data to support their views on the costs, benefits and other economic effects associated with the differences between the Commission's proposed approach and the CFTC's approach.

The Commission also seeks comment on the relevant economic considerations for the Commission if we modify our proposed approach to conform to the CFTC's [proposed/final] guidance. Similarly, what would the economic considerations be for the Commission to adopt any cross-border interpretations proposed by the CFTC, but not proposed by the Commission?

#### XVI. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA")<sup>1959</sup> the Commission must advise the OMB whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of these proposed rules on the economy on an annual basis, on the costs or prices for consumers or individual industries, and on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

#### XVII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")<sup>1960</sup> requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) of the Administrative Procedure Act,<sup>1961</sup> as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."<sup>1962</sup>

<sup>1959</sup> Public Law 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

<sup>1960</sup> 5 U.S.C. 601 *et seq.*

<sup>1961</sup> 5 U.S.C. 603(a).

<sup>1962</sup> Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 under the Exchange Act, 17 CFR 240.0-10. See Exchange Act Release No. 18451 (Jan.

Section 605(b) of the RFA<sup>1963</sup> provides that this requirement shall not apply to any proposed rule or proposed rule amendment which, if adopted, would not have a significant economic impact on a substantial number of small entities.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (1) When used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of \$5 million or less;<sup>1964</sup> or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,<sup>1965</sup> or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>1966</sup> Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) For entities engaged in credit intermediation and related activities, entities with \$175 million or less in assets;<sup>1967</sup> (ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with \$7 million or less in annual receipts;<sup>1968</sup> (iii) for entities engaged in financial investments and related activities, entities with \$7 million or less in annual receipts;<sup>1969</sup> (iv) for insurance carriers and entities engaged in related activities, entities with \$7 million or less in annual receipts;<sup>1970</sup> and (v) for funds, trusts, and other financial vehicles, entities with \$7 million or less in annual receipts.<sup>1971</sup>

Based on feedback from industry participants and our own information about the security-based swap markets, the Commission preliminarily believes that non-U.S. entities that would be required to register and be regulated as

28, 1982), 47 FR 5215 (Feb. 4, 1982) (File No. AS-305).

<sup>1963</sup> 5 U.S.C. 605(b).

<sup>1964</sup> See 17 CFR 240.0-10(a).

<sup>1965</sup> 17 CFR 240.17a-5(d).

<sup>1966</sup> See 17 CFR 240.0-10(c).

<sup>1967</sup> See 13 CFR 121.201 (Subsector 522).

<sup>1968</sup> See *id.* at Subsector 522.

<sup>1969</sup> See *id.* at Subsector 523.

<sup>1970</sup> See *id.* at Subsector 524.

<sup>1971</sup> See *id.* at Subsector 525.

security-based swap dealers and major security-based swap participants exceed the thresholds defining “small entities” set out above. Thus, the Commission preliminarily believes it is unlikely that the proposed rules regarding registration of security-based swap dealers and major security-based swap market participants would have a significant economic impact any small entity.

In addition, based on the Commission’s own information about the cross-border security-based swap market, the Commission believes that only persons or entities with assets significantly in excess of \$5 million participate in the security-based swap market, and such persons or entities would thus not qualify as “small entities.” Therefore, the Commission preliminarily believes that the application of the mandatory clearing requirement to cross-border security-based swap transactions is unlikely to impact any small entities. Moreover, the Commission preliminarily believes that the entities likely to register as a security-based swap clearing agency located outside the United States are not likely to qualify as a “small entity” as defined above. Thus, the Commission preliminarily believes it is unlikely that the proposed rules regarding registration of security-based swap clearing agencies located outside the United States would have a significant economic impact any small entity.

In addition, as discussed in the Regulation SBSR Proposing Release, the Commission believes that the number of security based swap transactions involving a “small entity” is *de minimis*. Therefore, the Commission preliminarily believes that the application of the mandatory trade reporting requirement to cross-border security-based swap transactions is unlikely to impact any small entities. Moreover, the Commission preliminarily believes that the entities likely to register as a SDR located outside the United States are not likely to qualify as a “small entity” as defined above. Thus, the Commission preliminarily believes it is unlikely that the proposed rules regarding registration of SDRs located outside the United States would have a significant economic impact any small entity.

In addition, based on the Commission’s own information about the cross-border security-based swap market, the Commission preliminarily believes that the proposed application of the mandatory trade execution requirement to cross-border security-based swap transactions is not likely to impact any small entities. Moreover, as discussed in the SB SEF Proposing

Release, based on our understanding of the market and conversations with industry sources, the Commission preliminarily believes that approximately 20 SB SEFs could be subject to the requirements of proposed Regulation SB SEF. Based on the Commission’s existing information about the security-based swap market and the entities likely to register as SB SEFs, the Commission preliminarily believes that the entities likely to register as SB SEFs would not be considered small entities. The Commission preliminarily believes that most, if not all, of the SB SEFs would be large business entities or subsidiaries of large business entities, and that all SB SEFs would have assets in excess of \$5 million and annual receipts in excess of \$7,000,000. Therefore, the Commission preliminarily believes that none of the potential SB SEFs would be considered small entities.

For the foregoing reasons, the Commission certifies that the proposed rules would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission encourages written comments regarding this certification. In particular, the Commission encourages written comments regarding the Commission’s preliminary belief that the proposed application of the mandatory clearing requirement and the mandatory trade reporting requirement to cross-border security-based swap transactions is unlikely to impact any small entities. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

#### Statutory Basis and Text of Proposed Rules

Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.*, and particularly, Section 3(b), Section 15(d)(1), Section 23(a)(1), Section 30(c) thereof, Sections 712(a)(2), (6), and 761(b) of the Dodd-Frank Act, the SEC is proposing to adopt rules 0–13, 3a67–10, 3a71–3, 3a71–4, 3a71–5, 3Ca–3, 3Ch–1, 3Ch–2, 13n–4(d), 13n–12, 18a–4, and 900 through 911, and Forms SBSE, SBSE–A, and SBSE–BD, under the Exchange Act.

#### List of Subjects

##### 17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

##### 17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

##### 17 CFR Part 249

Brokers, Reporting and recordkeeping requirements, Securities.

#### Text of Proposed Rules

For the reasons stated in the preamble, the SEC is proposing to amend Title 17, Chapter II of the Code of the Federal Regulations as follows:

#### PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The authority citation for part 240 is amended by adding an authority for §§ 240.3a67–10, 240.3a71–3, 240.3a71–4, and 240.3a71–5 in numerical order to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78ll, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.*, 12 U.S.C. 5221(e)(3), 15 U.S.C. 8302, and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

Sections 240.3a67–10, 240.3a71–3, 240.3a71–4, and 240.3a71–5 are also issued under Public Law 111–203, secs. 712, 761(b), 124 Stat. 1754 (2010).

\* \* \* \* \*

■ 2. Add § 240.0–13 to read as follows:

#### § 240.0–13 Commission procedures for filing applications to request a substituted compliance order under the Exchange Act.

(a) The application shall be in writing in the form of a letter, must include any supporting documents necessary to make the application complete, and otherwise must comply with § 240.0–3. All applications must be submitted to the Office of the Secretary of the Commission. Requestors may seek confidential treatment of their applications to the extent provided under § 200.81 of this chapter. If an application is incomplete, the Commission, through the Division of Trading and Markets, may request that the application be withdrawn unless the applicant can justify, based on all the facts and circumstances, why supporting materials have not been submitted and undertakes to submit the omitted materials promptly.

(b) An applicant may submit a request electronically. The electronic mailbox to use for these applications is described on the Commission’s Web site at [www.sec.gov](http://www.sec.gov) in the “Exchange Act Substituted Compliance Applications”

section. In the event electronic mailboxes are revised in the future, applicants can find the appropriate mailbox by accessing the "Electronic Mailboxes at the Commission" section.

(c) All filings and submissions filed pursuant to this rule must be in the English language. If a filing or submission filed pursuant to this rule requires the inclusion of a document that is in a foreign language, a party must submit instead a fair and accurate English translation of the entire foreign language document. A party may submit a copy of the unabridged foreign language document when including an English translation of a foreign language document in a filing or submission filed pursuant to this rule. A party must provide a copy of any foreign language document upon the request of Commission staff.

(d) An applicant also may submit a request in paper format. Five copies of every paper application and every amendment to such an application must be submitted to the Office of the Secretary at 100 F Street NE., Washington, DC 20549-1090.

Applications must be on white paper no larger than 8½ by 11 inches in size. The left margin of applications must be at least 1½ inches wide, and if the application is bound, it must be bound on the left side. All typewritten or printed material must be set forth in black ink so as to permit photocopying.

(e) Every application (electronic or paper) must contain the name, address, telephone number, and email address of each applicant and the name, address, telephone number, and email address of a person to whom any questions regarding the application should be directed. The Commission will not consider hypothetical or anonymous requests for a substituted compliance order. Each applicant shall provide the Commission with any supporting documentation it believes necessary for the Commission to make such determination, including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor compliance with such rules. Applicants should also cite to and discuss applicable precedent.

(f) Amendments to the application should be prepared and submitted as set forth in these procedures and should be marked to show what changes have been made.

(g) After the filing is complete, the Division of Trading and Markets will review the application. Once all questions and issues have been

answered to the satisfaction of the Division of Trading and Markets, the staff will make an appropriate recommendation to the Commission. After consideration of the recommendation by the Commission, the Commission's Office of the Secretary will issue an appropriate response and will notify the applicant.

(h) The Commission, in its sole discretion, may choose to publish in the **Federal Register** a notice that the application has been submitted. The notice would provide that any person may, within the period specified therein, submit to the Commission any information that relates to the Commission action requested in the application. The notice also would indicate the earliest date on which the Commission would take final action on the application, but in no event would such action be taken earlier than 25 days following publication of the notice in the **Federal Register**.

(i) The Commission may, in its sole discretion, schedule a hearing on the matter addressed by the application.

■ 3a. Add § 240-3a67-10 to read as follows:

**§ 240.3a67-10 Foreign major security-based swap participants.**

(a) *Definitions.* As used in this rule, the following terms shall have the meanings indicated:

(1) *Foreign major security-based swap participant* means a major security-based swap participant, as defined in section 3(a)(67) of the Act (15 U.S.C. 78c(a)(67)), and the rules and regulations thereunder, that is not a U.S. person.

(2) *U.S. person* has the meaning set forth in § 240.3a71-3(a)(7).

(b) *Application of customer protection requirements.* A registered foreign major security-based swap participant shall not be subject, with respect to its security-based swap transactions with counterparties that are not U.S. persons, to the requirements relating to business conduct standards described in section 15F(h) of the Act (15 U.S.C. 78o-10(h)), and the rules and regulations thereunder, other than rules and regulations prescribed by the Commission pursuant to section 15F(h)(1)(B) of the Act (15 U.S.C. 78o-10(h)(1)(B)).

(c) *Application of major security-based swap participant tests in the cross-border context.* For purposes of calculating a person's status as a major security-based swap participant as defined in section 3(a)(67) of the Act (15 U.S.C. 78c(a)(67)), and the rules and regulations thereunder, a person shall

include the following security-based swap transactions:

(1) If such person is a U.S. person, all security-based swap transactions entered into by such person; or

(2) If such person is a non-U.S. person, all security-based swap transactions entered into by such person with U.S. persons.

■ 3b. Add §§ 240.3a71-3, 240.3a71-4, and 240.3a71-5 to read as follows:

Sec.

240.3a71-3 Cross-border security-based swap dealing activity.

240.3a71-4 Exception from aggregation for affiliated groups with registered security-based swap dealers.

240.3a71-5 Substituted compliance for foreign security-based swap dealers.

\* \* \* \* \*

**§ 240.3a71-3 Cross-border security-based swap dealing activity.**

(a) *Definitions.* As used in this rule, the following terms shall have the meanings indicated:

(1) *Foreign branch* means any branch of a U.S. bank if:

(i) The branch is located outside the United States;

(ii) The branch operates for valid business reasons; and

(iii) The branch is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located.

(2) *Foreign business* means security-based swap transactions that are entered into, or offered to be entered into, by or on behalf of, a foreign security-based swap dealer or a U.S. security-based swap dealer, other than the U.S. Business of such person.

(3) *Foreign security-based swap dealer* means a security-based swap dealer, as defined in section 3(a)(71) of the Act (15 U.S.C. 78c(a)(71)), and the rules and regulations thereunder, that is not a U.S. person.

(4) *Transaction conducted through a foreign branch—(i) Definition.* *Transaction conducted through a foreign branch* means a security-based swap transaction that is solicited, negotiated, or executed by a U.S. person through a foreign branch of such U.S. person if:

(A) The foreign branch is the counterparty to such security-based swap transaction; and

(B) The security-based swap transaction is not solicited, negotiated, or executed by a person within the United States on behalf of the foreign branch or its counterparty.

(ii) *Representations.* A person shall not be required to consider its counterparty's activity in connection with paragraph (a)(4)(i)(B) of this

section in determining whether a security-based swap transaction is a transaction conducted through a foreign branch if such person receives a representation from its counterparty that no person within the United States is directly involved in soliciting, negotiating, or executing the security-based swap transaction on behalf of such counterparty, unless such person knows that the representation is not accurate.

(5) *Transaction conducted within the United States*—(i) *Definition.*

*Transaction conducted within the United States* means a security-based swap transaction that is solicited, negotiated, executed, or booked within the United States, by or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty to the transaction.

(ii) *Foreign branch exception.* Notwithstanding paragraph (a)(5)(i) of this section, a transaction conducted within the United States shall not include a transaction conducted through a foreign branch.

(iii) *Representations.* A person shall not be required to consider its counterparty's activity in connection with a transaction in determining whether such transaction is conducted within the United States if such person receives a representation from its counterparty that the transaction is not solicited, negotiated, executed, or booked within the United States by or on behalf of such counterparty, unless such person knows that the representation is not accurate.

(6) *U.S. business* means:

(i) With respect to a foreign security-based swap dealer:

(A) Any transaction entered into, or offered to be entered into, by or on behalf of such foreign security-based swap dealer, with a U.S. person (other than with a foreign branch); or

(B) Any transaction conducted within the United States; and

(ii) With respect to a U.S. security-based swap dealer, any transaction by or on behalf of such U.S. security-based swap dealer, wherever entered into or offered to be entered into, other than a transaction conducted through a foreign branch with a non-U.S. person or another foreign branch.

(7) *U.S. person.* (i) Except as provided in paragraph (a)(7)(ii) of this section, *U.S. person* means:

(A) Any natural person resident in the United States;

(B) Any partnership, corporation, trust, or other legal person organized or incorporated under the laws of the United States or having its principal

place of business in the United States; and

(C) Any account (whether discretionary or non-discretionary) of a U.S. person.

(ii) The term *U.S. person* does not include 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.

(8) *U.S. security-based swap dealer* means a security-based swap dealer, as defined in section 3(a)(71) of the Act (15 U.S.C. 78c(a)(71)), and the rules and regulations thereunder, that is a U.S. person.

(9) *United States* means the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.

(b) *Application of de minimis exception to cross-border dealing activity.* For purposes of calculating the amount of security-based swap positions connected with dealing activity under § 240.3a71–2(a)(1), a person shall include the following security-based swap transactions:

(1)(i) If such person is a U.S. person, all security-based swap transactions connected with the dealing activity in which such person engages, including transactions conducted through a foreign branch; or

(ii) If such person is a non-U.S. person, security-based swap transactions connected with the dealing activity in which such person engages that are entered into with a U.S. person (other than with a foreign branch) or that are transactions conducted within the United States; and

(2) If such person engages in transactions described in paragraph (b)(1)(i) or (ii) of this section,

(i) All security-based swap transactions connected with the dealing activity in which any U.S. person controlling, controlled by, or under common control with such person engages, including transactions conducted through a foreign branch; and

(ii) All security-based swap transactions connected with the dealing activity in which any non-U.S. person controlling, controlled by, or under common control with such person engages that are entered into with U.S. persons (other than with a foreign branch) or that are transactions conducted within the United States.

(c) *Application of customer protection requirements.* A registered foreign security-based swap dealer and a registered U.S. security-based swap dealer, with respect to their Foreign Business, shall not be subject to the requirements relating to business conduct standards described in section 15F(h) of the Act (15 U.S.C. 78o–10(h)), and the rules and regulations thereunder, other than the rules and regulations prescribed by the Commission pursuant to section 15F(h)(1)(B) of the Act (15 U.S.C. 78o–10(h)(1)(B)).

**§ 240.3a71–4 Exception from aggregation for affiliated groups with registered security-based swap dealers.**

Notwithstanding §§ 240.3a71–2(a)(1) and 240.3a71–3(b)(2), a person shall not include the security-based swap transactions of another person controlling, controlled by, or under common control with such person where such other person is registered with the Commission as a security-based swap dealer, provided that the security-based swap dealing activity of such person is operationally independent of the security-based swap dealing activity of such registered security-based swap dealer.

**§ 240.3a71–5 Substituted compliance for foreign security-based swap dealers.**

(a) *Determinations*—(1) *In general.* Subject to paragraph (a)(2) of this section and except as provided in paragraph (a)(3) of this section, the Commission may, conditionally or unconditionally, by order, make a determination with respect to a foreign financial regulatory system that compliance with specified requirements under such foreign financial regulatory system by a registered foreign security-based swap dealer (or class thereof) may satisfy the corresponding requirements in section 15F of the Act (15 U.S.C. 78o–10), and the rules and regulations thereunder, that would otherwise apply to such foreign security-based swap dealer (or class thereof).

(2) *Standard.* The Commission shall not make a substituted compliance determination under paragraph (a)(1) of this section unless the Commission:

(i) Determines that the requirements of such foreign financial regulatory system applicable to such foreign security-based swap dealer (or class thereof) are comparable to otherwise applicable requirements, after taking into account such factors as the Commission determines are appropriate, such as the scope and objectives of the relevant foreign regulatory requirements, as well as the

effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by a foreign financial regulatory authority or authorities in such system to support its oversight of such foreign security-based swap dealer (or class thereof); and

(ii) Has entered into a supervisory and enforcement memorandum of understanding or other arrangement with the relevant foreign financial regulatory authority or authorities under such foreign financial regulatory system addressing oversight and supervision of applicable security-based swap dealers under the substituted compliance determination.

(3) *Limitation.* The Commission will not make a substituted compliance determination under paragraph (a)(1) of this section with respect to the requirements relating to the registration process described in sections 15F(a) through (d) of the Act (15 U.S.C. 78o–10(a) through (d)) and the rules and regulations thereunder.

(4) *Withdrawal or modification.* The Commission may, on its own initiative, by order, modify or withdraw a substituted compliance determination under paragraph (a)(1) of this section, after appropriate notice and opportunity for comment.

(b) *Reliance by foreign security-based swap dealers.* A registered foreign security-based swap dealer may satisfy requirements in section 15F of the Act (15 U.S.C. 78o–10), and the rules and regulations thereunder, by complying with corresponding legislative requirements and rules and regulations under a foreign financial regulatory system, provided:

(1) The Commission has made a substituted compliance determination pursuant to paragraph (a)(1) of this section regarding such foreign financial regulatory system providing that compliance with specified requirements under such foreign financial regulatory system by such registered foreign security-based swap dealer (or a class of registered foreign security-based swap dealers that includes such registered foreign security-based swap dealer) may satisfy the corresponding requirements in section 15F of the Act (15 U.S.C. 78o–10) and the rules and regulations thereunder; and

(2) Such registered foreign security-based swap dealer satisfies any conditions set forth in a substituted compliance determination made by the Commission pursuant to paragraph (a)(1) of this section.

(c) *Requests for determinations.* (1) A foreign security-based swap dealer or group of foreign security-based swap dealers of the same class may file an

application, pursuant to the procedures set forth in § 240.0–13, requesting that the Commission make a substituted compliance determination pursuant to paragraph (a)(1) of this section, with respect to one or more requirements in section 15F of the Act (15 U.S.C. 78o–10), and the rules and regulations thereunder, and provide the reasons therefor and such other supporting documentation as the Commission may request.

(2) A foreign security-based swap dealer or group of foreign security-based swap dealers may make a request under paragraph (a)(1) of this section only if the foreign security-based swap dealer(s):

(i) Is directly supervised by the foreign financial regulatory authority or authorities under the system with respect to the foreign regulatory requirements relating to the applicable requirements in section 15F of the Act (15 U.S.C. 78o–10) and the rules and regulations thereunder; and

(ii) Provides the certification and opinion of counsel as described in § 240.15Fb2–4(c).

■ 4. Add § 240.3Ca–3 to read as follows:

**§ 240.3Ca–3 Application of the mandatory clearing requirement to cross-border security-based swap transactions.**

(a) *Application.* Subject to paragraph (b) of this section, the clearing requirement in section 3C(a)(1) of the Act (15 U.S.C. 78c–3(a)(1)), and the rules and regulations thereunder, shall apply to a person that engages in a security-based swap transaction if:

(1) A counterparty to the transaction is:

(i) A U.S. person; or

(ii) A non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person; or

(2) Such transaction is a transaction conducted within the United States.

(b) *Exceptions.* The clearing requirement in section 3C(a)(1) of the Act (15 U.S.C. 78c–3(a)(1)), and the rules and regulations thereunder, shall not apply to a transaction described in paragraph (a) of this section if:

(1) With respect to a security-based swap transaction that is not a transaction conducted within the United States,

(i) One counterparty to the transaction is:

(A) A foreign branch; or

(B) A non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person; and

(ii) The other counterparty to the transaction is a non-U.S. person:

(A) Whose performance under the security-based swap is not guaranteed by a U.S. person; and

(B) Who is not a foreign security-based swap dealer; or

(2) With respect to a security-based swap transaction that is a transaction conducted within the United States,

(i) Neither counterparty to the transaction is a U.S. person;

(ii) Neither counterparty's performance under the security-based swap is guaranteed by a U.S. person; and

(iii) Neither counterparty to the transaction is a foreign security-based swap dealer.

(c) For purposes of this section, the terms *foreign branch*, *foreign security-based swap dealer*, *transaction conducted within the United States*, and *U.S. person* shall have the meanings set forth in § 240.3a71–3(a).

■ 5. Add an undesignated center heading following § 240.3Ca–2, and add §§ 240.3Ch–1 and 240.3Ch–2 to read as follows:

**Trade Execution of Security-Based Swaps**

\* \* \* \* \*

Sec.

240.3Ch–1 Application of the mandatory trade execution requirement to cross-border security-based swap transactions.

240.3Ch–2 Substituted compliance for mandatory trade execution.

**§ 240.3Ch–1 Application of the mandatory trade execution requirement to cross-border security-based swap transactions.**

(a) *Application.* Subject to paragraph (b) of this section, the mandatory trade execution requirement in section 3C(h) of the Act (15 U.S.C. 78c–3(h)), and the rules and regulations thereunder, shall apply to a person that engages in a security-based swap transaction if:

(1) A counterparty to the transaction is:

(i) A U.S. person; or

(ii) A non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person; or

(2) Such transaction is a transaction conducted within the United States.

(b) *Exceptions.* The mandatory trade execution requirement in section 3C(h) of the Act (15 U.S.C. 78c–3(h)), and the rules and regulations thereunder, shall not apply to a transaction described in paragraph (a) of this section if:

(1) With respect to a security-based swap transaction that is not a transaction conducted within the United States,

(i) One counterparty to the transaction is:

(A) A foreign branch; or

(B) A non-U.S. person whose performance under the security-based

swap is guaranteed by a U.S. person; and

(ii) The other counterparty to the transaction is a non-U.S. person:

(A) Whose performance under the security-based swap is not guaranteed by a U.S. person; and

(B) Who is not a foreign security-based swap dealer; or

(2) With respect to a security-based swap transaction that is a transaction conducted within the United States,

(i) Neither counterparty to the transaction is a U.S. person;

(ii) Neither counterparty's performances under the security-based swap is guaranteed by a U.S. person; and

(iii) Neither counterparty to the transaction is a foreign security-based swap dealer.

(c) For purposes of this section, the terms *foreign branch*, *foreign security-based swap dealer*, and *transaction conducted within the United States*, and *U.S. person* shall have the meanings set forth in § 240.3a71–3(a).

**§ 240.3Ch–2 Substituted compliance for mandatory trade execution.**

(a) A person that is subject to the mandatory trade execution requirement in section 3C(h) of the Act (15 U.S.C. 78c–3(h)), and the rules and regulations thereunder, with respect to a security-based swap transaction may execute such transaction, or have such transaction executed on its behalf, on a security-based swap market that is neither registered under the Act nor exempt from registration under the Act if such security-based swap market is covered by, or is in a class of markets that is covered by, a Commission order described in paragraph (b) of this section, provided that with respect to at least one of the counterparties to the transaction:

(1) Such counterparty is either a non-U.S. person or a foreign branch; and

(2) The security-based swap transaction is not solicited, negotiated, or executed by a person within the United States on behalf of such counterparty.

(b)(1) The Commission may, conditionally or unconditionally, by order, make a substituted compliance determination with respect to a foreign jurisdiction to permit a person subject to the mandatory trade execution requirement in section 3C(h) of the Act (15 U.S.C. 78c–3(h)), and the rules and regulations thereunder, with respect to a security-based swap transaction to execute such transaction, or have such transaction executed on its behalf, on a security-based swap market (or class of markets) if it determines that such

security-based swap market (or class of markets) is subject to comparable, comprehensive supervision and regulation by the relevant foreign financial regulatory authority or authorities in such foreign jurisdiction.

(2) In making a determination under paragraph (b)(1) of this section, the Commission shall take into account such factors as the Commission determines are appropriate, such as the scope and objectives of the relevant foreign regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by the relevant foreign financial regulatory authority or authorities in the foreign jurisdiction to support the oversight of the security-based swap market (or class of markets).

(3) Before issuing a substituted compliance order pursuant to paragraph (b)(1) of this section, the Commission shall have entered into a supervisory and enforcement memorandum of understanding or other arrangement with the relevant foreign regulatory authority or authorities in the foreign jurisdiction addressing the oversight and supervision of the security-based swap market (or class of markets).

(4) The Commission may, on its own initiative, modify or withdraw such order at any time, after appropriate notice and opportunity for comment.

(c) One or more security-based swap markets in a foreign jurisdiction may file an application, in writing, pursuant to the procedures set forth in § 240.0–13, requesting that the Commission make a substituted compliance determination with respect to such foreign jurisdiction pursuant to paragraph (b)(1) of this section. Such application must include the reasons therefor and such other documentation as the Commission may request.

(d) For purposes of this section, the terms *foreign branch* and *U.S. person* shall have the meanings set forth in § 240.3a71–3(a).

■ 6. Add paragraph (d) to § 240.13n–4 as previously proposed at 75 FR 77367, Dec. 10, 2010, to read as follows:

**§ 240.13n–4 Duties and core principles of security-based swap data repository.**

\* \* \* \* \*

(d) *Exemption from the indemnification requirement.* A registered security-based swap data repository is not required to comply with the indemnification requirement set forth in Section 13(n)(5)(H)(ii) of the Act (15 U.S.C. 78m(n)(5)(H)(ii)) and paragraph (b)(10) of this section with respect to disclosure of security-based

swap information by the security-based swap data repository if:

(1) An entity described in paragraph (b)(9) of this section requests security-based swap information from the security-based swap data repository to fulfill a regulatory mandate and/or legal responsibility of the entity;

(2) The request of such entity pertains to a person or financial product subject to the jurisdiction, supervision, or oversight of the entity; and

(3) Such entity has entered into a supervisory and enforcement memorandum of understanding or other arrangement with the Commission that addresses the confidentiality of the security-based swap information provided and any other matters as determined by the Commission.

■ 7. Add § 240.13n–12 following § 240.13n–11 as previously proposed at 75 FR 77366, Dec. 10, 2010, to read as follows:

**§ 240.13n–12 Exemption from requirements governing security-based swap data repositories for certain non-U.S. persons.**

(a) *Definitions.* For purposes of this section—

(1) *Non-U.S. person* means a person that is not a U.S. person.

(2) *U.S. person* shall have the same meaning as set forth in § 240.3a71–3(a)(7).

(b) A non-U.S. person that performs the functions of a security-based swap data repository within the United States shall be exempt from the registration and other requirements set forth in Section 13(n) of the Act (15 U.S.C. 78m(n)), and the rules and regulations thereunder, provided that each regulator with supervisory authority over such non-U.S. person has entered into a supervisory and enforcement memorandum of understanding or other arrangement with the Commission that addresses the confidentiality of data collected and maintained by such non-U.S. person, access by the Commission to such data, and any other matters determined by the Commission.

■ 8. Add paragraphs (e) and (f) to § 240.18a–4 as previously proposed at 77 FR 70350, Nov. 23, 2012, to read as follows:

**§ 240.18a–4 Segregation requirements for security-based swap dealers and major security-based swap participants**

\* \* \* \* \*

(e) *Segregation requirements for foreign security-based swap dealers—*(1) *Non-cleared security-based swaps.* (i) A registered foreign security-based swap dealer (as defined in § 240.3a71–3(a)(3)) that is a registered broker-dealer shall be subject to the requirements relating to



segregation of assets held as collateral set forth in section 3E of the Act (15 U.S.C. 78c-5) and paragraphs (a) through (d) of this section, with respect to any assets received from, for, or on behalf of a counterparty to margin, guarantee, or secure a non-cleared security-based swap (including money, securities, or property accruing to such counterparty as the result of such a security-based swap transaction).

(ii) A registered foreign security-based swap dealer (as defined in § 240.3a71-3(a)(3)) that is not a registered broker-dealer shall be subject to the requirements relating to segregation of assets held as collateral set forth in section 3E of the Act (15 U.S.C. 78c-5) and paragraphs (a) through (d) of this section, with respect to non-cleared security-based swap transactions, solely with respect to any assets received from, for, or on behalf of a counterparty that is a U.S. person (as defined in § 240.3a71-3(a)(7)) to margin, guarantee, or secure a non-cleared security-based swap (including money, securities, or property accruing to such U.S. person counterparty as the result of such a security-based swap transaction).

(2) *Cleared security-based swaps.* (i) A registered foreign security-based swap dealer (as defined in § 240.3a71-3(a)(3)) that is a registered broker-dealer shall be subject to the requirements relating to segregation of assets held as collateral set forth in section 3E of the Act (15 U.S.C. 78c-5) and paragraphs (a) through (d) of this section, with respect to any assets received from, for, or on behalf of a counterparty to margin, guarantee, or secure a cleared security-based swap (including money, securities, or property accruing to such counterparty as the result of such a security-based swap transaction).

(ii) A registered foreign security-based swap dealer (as defined in § 240.3a71-3(a)(3)) that is not a registered broker-dealer and is not a person described in 11 U.S.C. 109(b)(3) shall be subject to the requirements relating to segregation of assets held as collateral set forth in section 3E of the Act (15 U.S.C. 78c-5) and paragraphs (a) through (d) of this section, with respect to cleared security-based swap transactions with any counterparty if such registered foreign security-based swap dealer accepts any assets from, for, or on behalf of a counterparty that is a U.S. person (as defined in § 240.3a71-3(a)(7)) to margin, guarantee, or secure a security-based swap (including money, securities, or property accruing to such U.S. person counterparty as the result of such a security-based swap).

(iii) A registered foreign security-based swap dealer (as defined in

§ 240.3a71-3(a)(3)) that is a person described in 11 U.S.C. 109(b)(3) shall be subject to the requirements relating to segregation of assets held as collateral set forth in section 3E of the Act (15 U.S.C. 78c-5) and paragraphs (a) through (d) of this section, with respect to cleared security-based swap transactions, solely with respect to any assets received from, for, or on behalf of a counterparty who is a U.S. person (as defined in § 240.3a71-3(a)(7)) to margin, guarantee, or secure a security-based swap cleared by or through a clearing agency (including money, securities, or property accruing to such U.S. person counterparty as the result of such a security-based swap transaction). The special account maintained by a registered foreign security-based swap dealer that is a person described in 11 U.S.C. 109(b)(3) in accordance with paragraph (c) of this section shall be designated for the exclusive benefit of U.S. person security-based swap customers.

(3) *Disclosures.* A registered foreign security-based swap dealer (as defined in § 240.3a71-3(a)(3)) must disclose to its counterparty that is a U.S. person, prior to accepting any assets from, for, or on behalf of such counterparty to margin, guarantee, or secure a security-based swap, the potential treatment of the assets segregated by such registered foreign security-based swap dealer pursuant to section 3E of the Act (15 U.S.C. 78c-5), and the rules and regulations thereunder, in insolvency proceedings under U.S. bankruptcy law and any applicable foreign insolvency laws. Such disclosure shall include whether the foreign security-based swap dealer is subject to the segregation requirement set forth in Section 3E of the Act, and the rules and regulations thereunder, with respect to the assets collected from the U.S. person counterparty who will receive the disclosure, whether the foreign security-based swap dealer could be subject to the stockbroker liquidation provisions in the U.S. Bankruptcy Code, whether the segregated assets could be afforded customer property treatment under the U.S. bankruptcy law, and any other relevant considerations that may affect the treatment of the assets segregated under Section 3E of the Act in insolvency proceedings of the foreign security-based swap dealer.

(f) *Segregation requirements for foreign major security-based swap participants.* A registered foreign major security-based swap participant (as defined in § 240.3a67-10(a)(1)) that is not a registered broker-dealer shall not be subject to the requirements relating to segregation of assets held as collateral

set forth in section 3E(f) of the Act (15 U.S.C. 78c-5(f)) and paragraph (d) of this section, with respect to non-cleared security-based swap transactions, solely with respect to any assets received from, for, or on behalf of a counterparty that is not a U.S. person (as defined in § 240.3a71-3(a)(7)) to margin, guarantee, or secure a non-cleared security-based swap (including money, securities, or property accruing to such non-U.S. person counterparty as the result of such a security-based swap transaction).

## PART 242—REGULATIONS M, SHO, ATS, AC, NMS, AND SBSR AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

■ 9. The authority citation for part 242 continues to read as follows:

**Authority:** 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-l(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

■ 10a. Revise the heading of part 242 to read as set forth above.

■ 10b. Add an undesignated center heading and revise §§ 242.900 through 242.911 as previously proposed at 75 FR 75283, Dec. 2, 2010, to read as follows:

### Regulation SBSR—Regulatory Reporting and Public Dissemination of Security-Based Swap Information

Sec.	
242.900	Definitions
242.901	Reporting obligations.
242.902	Public dissemination of transaction reports.
242.903	Coded information.
242.904	Operating hours of registered security-based swap data repositories.
242.905	Correction of errors in security-based swap information.
242.906	Other duties of participants.
242.907	Policies and procedures of registered security-based swap data repositories.
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#### § 242.900 Definitions.

Terms used in §§ 242.900 through 242.911 that appear in Section 3 of the Exchange Act (15 U.S.C. 78c) have the same meaning as in Section 3 of the Exchange Act and the rules or regulations thereunder. In addition, for purposes of Regulation SBSR (§§ 242.900 through 242.911), the following definitions shall apply:

(a) *Affiliate* means any person that, directly or indirectly, controls, is

controlled by, or is under common control with, a person.

(b) *Asset class* means those security-based swaps in a particular broad category, including, but not limited to, credit derivatives, equity derivatives, and loan-based derivatives.

(c) *Block trade* means a large notional security-based swap transaction that meets the criteria set forth in § 242.907(b).

(d) *Broker ID* means the UIC assigned to a person acting as a broker for a participant.

(e) *Confirm* means the production of a confirmation that is agreed to by the parties to be definitive and complete and that has been manually, electronically, or, by some other legally equivalent means, signed.

(f) *Control* means, for purposes of §§ 242.900 through 242.911, the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise. A person is presumed to control another person if the person:

(1) Is a director, general partner or officer exercising executive responsibility (or having similar status or functions);

(2) Directly or indirectly has the right to vote 25 percent or more of a class of voting securities or has the power to sell or direct the sale of 25 percent or more of a class of voting securities; or

(3) In the case of a partnership, has the right to receive, upon dissolution, or has contributed, 25 percent or more of the capital.

(g) *Counterparty* means a person that is a direct counterparty or indirect counterparty of a security-based swap.

(h) *Derivatives clearing organization* means the same as provided under the Commodity Exchange Act.

(i) *Desk ID* means the UIC assigned to the trading desk of a participant or of a broker of a participant.

(j) *Direct counterparty* means a person that is a primary obligor on a security-based swap.

(k) *Direct electronic access* has the same meaning as in § 240.13n-4(a)(5) of this chapter.

(l) *Effective reporting date*, with respect to a registered security-based swap data repository, means the date six months after the registration date.

(m) *Exchange Act* means the Securities Exchange Act of 1934 (15 U.S.C. 78a, *et seq.*), as amended.

(n) *Foreign branch* has the same meaning as in § 240.3a71-3(a)(1) of this chapter.

(o) *Indirect counterparty* means a guarantor of a direct counterparty's

performance of any obligation under a security-based swap.

(p) *Life cycle event* means, with respect to a security-based swap, any event that would result in a change in the information reported to a registered security-based swap data repository under § 242.901, including a counterparty change resulting from an assignment or novation; a partial or full termination of the security-based swap; a change in the cash flows originally reported; for a security-based swap that is not cleared, any change to the collateral agreement; or a corporate action affecting a security or securities on which the security-based swap is based (*e.g.*, a merger, dividend, stock split, or bankruptcy). Notwithstanding the above, a life cycle event shall not include the scheduled expiration of the security-based swap, a previously described and anticipated interest rate adjustment (such as a quarterly interest rate adjustment), or other event that does not result in any change to the contractual terms of the security-based swap.

(q) *Non-U.S. person* means a person that is not a U.S. person.

(r) *Parent* means a legal person that controls a participant.

(s) *Participant* means a person that is a counterparty to a security-based swap that meets the criteria of § 242.908(b).

(t) *Participant ID* means the UIC assigned to a participant.

(u) *Phase-in period* means the period immediately after a security-based swap data repository has registered with the Commission during which it is not required to disseminate security-based swap data pursuant to an implementation schedule, as provided in § 242.910.

(v) *Pre-enactment security-based swap* means any security-based swap executed before July 21, 2010 (the date of enactment of the Dodd-Frank Act (Pub. L. 111-203, H.R. 4173)), the terms of which had not expired as of that date.

(w) *Price* means the price of a security-based swap transaction, expressed in terms of the commercial conventions used in that asset class.

(x) *Product ID* means the UIC assigned to a security-based swap instrument.

(y) *Publicly disseminate* means to make available through the Internet or other electronic data feed that is widely accessible and in machine-readable electronic format.

(z) *Real time* means, with respect to the reporting of security-based swap information, as soon as technologically practicable, but in no event later than 15 minutes after the time of execution of the security-based swap transaction.

(aa) *Registered security-based swap data repository* means a person that is registered with the Commission as a security-based swap data repository pursuant to section 13(n) of the Exchange Act (15 U.S.C. 78m(n)) and any rules or regulations thereunder.

(bb) *Registration date*, with respect to a security-based swap data repository, means the date on which the Commission registers the security-based swap data repository, or, if the Commission registers the security-based swap data repository before the effective date of §§ 242.900 through 242.911, the effective date of §§ 242.900 through 242.911.

(cc) *Reporting side* means the side of a security-based swap having the duty to report information in accordance with §§ 242.900 through 242.911 to a registered security-based swap data repository, or if there is no registered security-based swap data repository that would receive the information, to the Commission.

(dd) *Security-based swap instrument* means each security-based swap in the same asset class, with the same underlying reference asset, reference issuer, or reference index.

(ee) *Side* means a direct counterparty and any indirect counterparty that guarantees the direct counterparty's performance of any obligation under a security-based swap.

(ff) *Time of execution* means the point at which the counterparties to a security-based swap become irrevocably bound under applicable law.

(gg) *Trader ID* means the UIC assigned to a natural person who executes security-based swaps.

(hh) *Transaction conducted through a foreign branch* has the same meaning as in § 240.3a71-3(a)(4) of this chapter.

(ii) *Transaction conducted within the United States* has the same meaning as in § 240.3a71-3(a)(5) of this chapter.

(jj) *Transaction ID* means the unique identification code assigned by a registered security-based swap data repository to a specific security-based swap.

(kk) *Transitional security-based swap* means a security-based swap executed on or after July 21, 2010, and before the effective reporting date.

(ll) *Ultimate parent* means a legal person that controls a participant and that itself has no parent.

(mm) *Ultimate parent ID* means the UIC assigned to an ultimate parent of a participant.

(nn) *Unique Identification Code* or *UIC* means the unique identification code assigned to a person, unit of a person, or product by or on behalf of an internationally recognized standards-

setting body that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory. If no standards-setting body meets these criteria, a registered security-based swap data repository shall assign all necessary UICs using its own methodology. If a standards-setting body meets these criteria but has not assigned a UIC to a particular person, unit of a person, or product, a registered security-based swap data repository shall assign a UIC to that person, unit of a person, or product using its own methodology.

(oo) *United States* has the same meaning as in § 240.3a71-3(a)(9) of this chapter.

(pp) *U.S. person* has the same meaning as in § 240.3a71-3(a)(7) of this chapter.

#### § 242.901 Reporting obligations.

(a) *Reporting side.* The reporting side for a security-based swap shall be as follows:

(1) If both sides of the security-based swap include a security-based swap dealer, the sides shall select the reporting side.

(2) If only one side of the security-based swap includes a security-based swap dealer, that side shall be the reporting side.

(3) If both sides of the security-based swap include a major security-based swap participant, the sides shall select the reporting side.

(4) If one side of the security-based swap includes a major security-based swap participant and the other side includes neither a security-based swap dealer nor a major security-based swap participant, the side including the major security-based swap participant shall be the reporting side.

(5) If neither side of the security-based swap includes a security-based swap dealer or major security-based swap participant:

(i) If both sides include a U.S. person or neither side includes a U.S. person, the sides shall select the reporting side.

(ii) If only one side includes a U.S. person, that side shall be the reporting side.

(b) *Recipient of security-based swap information.* For each security-based swap for which it is the reporting side, the reporting side shall provide the information required by §§ 242.900 through 242.911 to a registered security-based swap data repository or, if there is no registered security-based swap data repository that would accept the information, to the Commission.

(c) *Primary trade information.* For any security-based swap that must be publicly disseminated pursuant to §§ 242.902 and 242.908 and for which it

is the reporting side, the reporting side shall report the following information in real time. If a security-based swap is required by §§ 242.901 and 242.908 to be reported but not publicly disseminated, the reporting side shall report the following information no later than the time that the reporting side is required to comply with paragraph (d) of this section:

(1) The asset class of the security-based swap and, if the security-based swap is an equity derivative, whether it is a total return swap or is otherwise designed to offer risks and returns proportional to a position in the equity security or securities on which the security-based swap is based;

(2) Information that identifies the security-based swap instrument and the specific asset(s) or issuer(s) of any security on which the security-based swap is based;

(3) The notional amount(s), and the currenc(ies) in which the notional amount(s) is expressed;

(4) The date and time, to the second, of execution, expressed using Coordinated Universal Time (UTC);

(5) The effective date;

(6) The scheduled termination date;

(7) The price;

(8) The terms of any fixed or floating rate payments, and the frequency of any payments;

(9) Whether or not the security-based swap will be cleared by a clearing agency;

(10) If both sides of the security-based swap include a security-based swap dealer, an indication to that effect;

(11) If applicable, an indication that the transaction does not accurately reflect the market; and

(12) If the security-based swap is customized to the extent that the information provided in paragraphs (c)(1) through (11) of this section does not provide all of the material information necessary to identify such customized security-based swap or does not contain the data elements necessary to calculate the price, an indication to that effect.

(d) *Secondary trade information.* (1) In addition to the information required under paragraph (c) of this section, for each security-based swap for which it is the reporting side, the reporting side shall report:

(i) The participant ID of each counterparty;

(ii) As applicable, the broker ID, desk ID, and trader ID of the direct counterparty on the reporting side;

(iii) The amount(s) and currenc(ies) of any up-front payment(s) and a description of the terms and contingencies of the payment streams of each direct counterparty to the other;

(iv) The title of any master agreement, or any other agreement governing the transaction (including the title of any document governing the satisfaction of margin obligations), incorporated by reference and the date of any such agreement;

(v) The data elements necessary for a person to determine the market value of the transaction;

(vi) If the security-based swap will be cleared, the name of the clearing agency;

(vii) If the security-based swap is not cleared, whether the exception in Section 3C(g) of the Exchange Act (15 U.S.C. 78c-3(g)) was invoked;

(viii) If the security-based swap is not cleared, a description of the settlement terms, including whether the security-based swap is cash-settled or physically settled, and the method for determining the settlement value; and

(ix) The venue where the security-based swap was executed.

(2) Any information required to be reported pursuant to paragraph (d)(1) of this section must be reported promptly, but in no event later than:

(i) Fifteen minutes after the time of execution for a security-based swap that is executed and confirmed electronically;

(ii) Thirty minutes after the time of execution for a security-based swap that is confirmed electronically but not executed electronically; or

(iii) Twenty-four hours after the time of execution for a security-based swap that is not executed or confirmed electronically.

(e) *Duty to report any life cycle event of a security-based swap.* For any life cycle event, and any adjustment due to a life cycle event, that results in a change to information previously reported pursuant to paragraph (c), (d), or (i) of this section, the reporting side shall promptly provide updated information reflecting such change to the entity to which it reported the original transaction, using the transaction ID, subject to the following exceptions:

(1) If a reporting side ceases to be a counterparty to a security-based swap due to an assignment or novation, the new side shall be the reporting side following such assignment or novation, if the new side includes a U.S. person, a security-based swap dealer, or a major security-based swap participant.

(2) If, following an assignment or novation, the new side does not include a U.S. person, a security-based swap dealer, or a major security-based swap participant, the other side shall be the reporting side following such assignment or novation.

(f) *Time stamping incoming information.* A registered security-based swap data repository shall time stamp, to the second, its receipt of any information submitted to it pursuant to paragraph (c), (d), (e), or (i) of this section.

(g) *Assigning transaction ID.* A registered security-based swap data repository shall assign a transaction ID to each security-based swap.

(h) *Format of reported information.* The reporting side shall electronically transmit the information required under this section in a format required by the registered security-based swap data repository, and in accordance with any applicable policies and procedures of the registered security-based swap data repository.

(i) *Reporting of pre-enactment and transitional security-based swaps.* With respect to any pre-enactment security-based swap or transitional security-based swap, the reporting side shall report all of the information required by paragraphs (c) and (d) of this section, to the extent such information is available.

#### **§ 242.902 Public dissemination of transaction reports.**

(a) *General.* Unless a security-based swap is a block trade or a cross-border security-based swap that is required to be reported but not publicly disseminated, a registered security-based swap data repository shall publicly disseminate a transaction report of the security-based swap immediately upon receipt of information about the security-based swap, or upon re-opening following a period when the registered security-based swap data repository was closed. The transaction report shall consist of all the information reported pursuant to § 242.901, plus any indicator or indicators contemplated by the registered security-based swap data repository's policies and procedures that are required by § 242.907.

(b) *Dissemination of block trades.* A registered security-based swap data repository shall publicly disseminate a transaction report of a security-based swap that constitutes a block trade immediately upon receipt of information about the block trade from the reporting side. The transaction report shall consist of all the information reported by the reporting side pursuant to § 242.901(c), except for the notional size, plus the transaction ID and an indicator that the report represents a block trade. The registered security-based swap data repository shall publicly disseminate a complete transaction report for such block trade

(including the transaction ID and the full notional size) as follows:

(1) If the security-based swap was executed on or after 05:00 UTC and before 23:00 UTC of the same day, the transaction report (including the transaction ID and the full notional size) shall be disseminated at 07:00 UTC of the following day.

(2) If the security-based swap was executed on or after 23:00 UTC and up to 05:00 UTC of the following day, the transaction report (including the transaction ID and the full notional size) shall be disseminated at 13:00 UTC of that following day.

(3) Notwithstanding the foregoing, if a registered security-based swap data repository is in normal closing hours or special closing hours at a time when it would be required to disseminate information about a block trade pursuant to this section, the registered security-based swap data repository shall instead disseminate information about the block trade immediately upon re-opening.

(c) *Non-disseminated information.* A registered security-based swap data repository shall not disseminate:

(1) The identity of either counterparty to a security-based swap;

(2) With respect to a security-based swap that is not cleared at a registered clearing agency and that is reported to the registered security-based swap data repository, any information disclosing the business transactions and market positions of any person; or

(3) Any information regarding a security-based swap reported pursuant to § 242.901(i).

(d) *Temporary restriction on other market data sources.* No person other than a registered security-based swap data repository shall make available to one or more persons (other than a counterparty) transaction information relating to a security-based swap before the earlier of 15 minutes after the time of execution of the security-based swap; or the time that a registered security-based swap data repository publicly disseminates a report of that security-based swap.

#### **§ 242.903 Coded information.**

The reporting side may provide information to a registered security-based swap data repository pursuant to § 242.901 and a registered security-based swap data repository may publicly disseminate information pursuant to § 242.902 using codes in place of certain data elements, provided that the information necessary to interpret such codes is widely available on a non-fee basis.

#### **§ 242.904 Operating hours of registered security-based swap data repositories.**

A registered security-based swap data repository shall have systems in place to continuously receive and disseminate information regarding security-based swaps pursuant to §§ 242.900 through 242.911, subject to the following exceptions:

(a) A registered security-based swap data repository may establish normal closing hours during periods when, in its estimation, the U.S. market and major foreign markets are inactive. A registered security-based swap data repository shall provide reasonable advance notice to participants and to the public of its normal closing hours.

(b) A registered security-based swap data repository may declare, on an *ad hoc* basis, special closing hours to perform system maintenance that cannot wait until normal closing hours. A registered security-based swap data repository shall, to the extent reasonably possible under the circumstances, avoid scheduling special closing hours during periods when, in its estimation, the U.S. market and major foreign markets are most active; and provide reasonable advance notice of its special closing hours to participants and to the public.

(c) During normal closing hours, and to the extent reasonably practicable during special closing hours, a registered security-based swap data repository shall have the capability to receive and hold in queue information regarding security-based swaps that has been reported pursuant to §§ 242.900 through 242.911.

(d) When a registered security-based swap data repository re-opens following normal closing hours or special closing hours, it shall disseminate transaction reports of security-based swaps held in queue, in accordance with the requirements of § 242.902.

(e) If a registered security-based swap data repository could not receive and hold in queue transaction information that was required to be reported pursuant to §§ 242.900 through 242.911, it must immediately upon re-opening send a message to all participants that it has resumed normal operations. Thereafter, any participant that had an obligation to report information to the registered security-based swap data repository pursuant to §§ 242.900 through 242.911, but could not do so because of the registered security-based swap data repository's inability to receive and hold in queue data, must immediately report the information to the registered security-based swap data repository.

**§ 242.905 Correction of errors in security-based swap information.***(a) Duty of counterparties to correct.*

Any counterparty to a security-based swap that discovers an error in information previously reported pursuant to §§ 242.900 through 242.911 shall correct such error in accordance with the following procedures:

(1) If a side that was not the reporting side for a security-based swap transaction discovers an error in the information reported with respect to such security-based swap, the counterparty shall promptly notify the reporting side of the error; and

(2) If the reporting side for a security-based swap transaction discovers an error in the information reported with respect to a security-based swap, or receives notification from its counterparty of an error, the reporting side shall promptly submit to the entity to which the security-based swap was originally reported an amended report pertaining to the original transaction report. If the reporting side reported the initial transaction to a registered security-based swap data repository, the reporting side shall submit an amended report to the registered security-based swap data repository in a manner consistent with the policies and procedures contemplated by § 242.907(a)(3).

*(b) Duty of security-based swap data repository to correct.* A registered security-based swap data repository shall:

(1) Upon discovery of the error or receipt of a notice of the error from the reporting side, verify the accuracy of the terms of the security-based swap and, following such verification, promptly correct the erroneous information regarding such security-based swap contained in its system; and

(2) If such erroneous information relates to a security-based swap that the registered security-based swap data repository previously disseminated and falls into any of the categories of information enumerated in § 242.901(c), publicly disseminate a corrected transaction report of the security-based swap promptly following verification of the trade by the counterparties to the security-based swap, with an indication that the report relates to a previously disseminated transaction.

**§ 242.906 Other duties of participants and guarantors.**

*(a) Reporting by non-reporting-side.* A registered security-based swap data repository shall identify any security-based swap reported to it for which the registered security-based swap data repository does not have the participant

ID and (if applicable) the broker ID, desk ID, and trader ID of each direct counterparty. Once a day, the registered security-based swap data repository shall send a report to each participant identifying, for each security-based swap to which that participant is a counterparty, the security-based swap(s) for which the registered security-based swap data repository lacks participant ID and (if applicable) broker ID, desk ID, and trader ID. A participant that receives such a report shall provide the missing information to the registered security-based swap data repository within 24 hours.

*(b) Duty to provide ultimate parent and affiliate information.* Each participant of a registered security-based swap data repository shall provide to the registered security-based swap data repository information sufficient to identify its ultimate parent(s) and any affiliate(s) of the participant that also are participants of the registered security-based swap data repository, using ultimate parent IDs and participant IDs. A participant shall promptly notify the registered security-based swap data repository of any changes to that information.

*(c) Policies and procedures of security-based swap dealers and major security-based swap participants.* Each participant that is a security-based swap dealer or major security-based swap participant shall establish, maintain, and enforce written policies and procedures that are reasonably designed to ensure that it complies with any obligations to report information to a registered security-based swap data repository in a manner consistent with §§ 242.900 through 242.911 and the registered security-based swap data repository's applicable policies and procedures. Each such participant shall review and update its policies and procedures at least annually.

**§ 242.907 Policies and procedures of registered security-based swap data repositories.**

*(a) General policies and procedures.* With respect to the receipt, reporting, and dissemination of data pursuant to §§ 242.900 through 242.911, a registered security-based swap data repository shall establish and maintain written policies and procedures:

(1) That enumerate the specific data elements of a security-based swap or a life cycle event that the reporting side must report, which shall include, at a minimum, the data elements specified in § 242.901(c) and (d);

(2) That specify one or more acceptable data formats (each of which must be an open-source structured data

format that is widely used by participants), connectivity requirements, and other protocols for submitting information;

(3) For specifying how reporting sides are to report corrections to previously submitted information, making corrections to information in its records that is subsequently discovered to be erroneous, and applying an appropriate indicator to any transaction report required to be disseminated by § 242.905(b)(2) that the report relates to a previously disseminated transaction;

(4) Describing how reporting sides shall report and, consistent with the enhancement of price discovery, how the registered security-based swap data repository shall publicly disseminate, reports of, and adjustments due to, life cycle events; security-based swap transactions that do not involve an opportunity to negotiate any material terms, other than the counterparty; and any other security-based swap transactions that, in the estimation of the registered security-based swap data repository, do not accurately reflect the market;

(5) For assigning:

(i) A transaction ID to each security-based swap that is reported to it; and

(ii) UICs established by or on behalf of an internationally recognized standards-setting body that imposes fees and usage restrictions that are fair and reasonable and not unreasonably discriminatory (or, if no standards-setting body meets these criteria or a standards-setting body meets these criteria but has not assigned a UIC to a particular person, unit of a person, or product, using its own methodology); and

(6) For periodically obtaining from each participant information that identifies the participant's ultimate parent(s) and any participant(s) with which the participant is affiliated, using ultimate parent IDs and participant IDs.

*(b) Policies and procedures regarding block trades.* (1) A registered security-based swap data repository shall establish and maintain written policies and procedures for calculating and publicizing block trade thresholds for all security-based swap instruments reported to the registered security-based swap data repository, in accordance with the criteria and formula for determining block size as specified by the Commission.

(2) *Exceptions.* Notwithstanding the above, a registered security-based swap data repository shall not designate as a block trade any security-based swap:

(i) That is an equity total return swap or is otherwise designed to offer risks and returns proportional to a position in

the equity security or securities on which the security-based swap is based; or

(ii) Contemplated by Section 13(m)(1)(C)(iv) of the Exchange Act ((15 U.S.C. 78m(m)(1)(C)(iv)).

(c) *Public availability of policies and procedures.* A registered security-based swap data repository shall make the policies and procedures required by §§ 242.900 through 242.911 publicly available on its Web site.

(d) *Updating of policies and procedures.* A registered security-based swap data repository shall review, and update as necessary, the policies and procedures required by §§ 242.900 through 242.911 at least annually. Such policies and procedures shall indicate the date on which they were last reviewed.

(e) A registered security-based swap data repository shall have the capacity to provide to the Commission, upon request, information or reports related to the timeliness, accuracy, and completeness of data reported to it pursuant to §§ 242.900 through 242.911 and the registered security-based swap data repository's policies and procedures thereunder.

**§ 242.908 Cross-border matters.**

(a) *Application of Regulation SBSR to cross-border transactions—(1) Regulatory reporting.* A reporting side shall report a security-based swap if:

(i) The security-based swap is a transaction conducted within the United States;

(ii) There is a direct or indirect counterparty that is a U.S. person on either side of the transaction;

(iii) There is a direct or indirect counterparty that is a security-based swap dealer or major security-based swap participant on either side of the transaction; or

(iv) The security-based swap is cleared through a clearing agency having its principal place of business in the United States.

(2) *Public dissemination.* A security-based swap shall be subject to public dissemination if:

(i) The security-based 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 security-based swap dealer; or

(v) The security-based swap is cleared through a clearing agency having its principal place of business in the United States.

(b) *Limitation on counterparty duties.* Notwithstanding any other provision of §§ 242.900 through 242.911, a counterparty to a security-based swap shall not incur any obligation under §§ 242.900 through 242.911 unless it is:

(1) A U.S. person;

(2) A security-based swap dealer or major security-based swap participant; or

(3) A counterparty to a transaction conducted within the United States.

(c) *Substituted compliance—(1) General.* Compliance with the regulatory reporting and public dissemination requirements in sections 13(m) and 13A of the Act (15 U.S.C. 78m(m) and 78m–1), and the rules and regulations thereunder, may be satisfied by compliance with the rules of a foreign jurisdiction that is the subject of a Commission order described in paragraph (c)(2) of this section, provided that with respect to at least one of the direct counterparties to the security-based swap:

(i) Such counterparty is either a non-U.S. person or a foreign branch; and

(ii) The security-based swap transaction is not solicited, negotiated, or executed by a person within the United States on behalf of such counterparty.

(2) *Procedure.* (i) The Commission may, conditionally or unconditionally, by order, make a substituted compliance determination regarding regulatory reporting and public dissemination of security-based swaps with respect to a foreign jurisdiction if that jurisdiction's requirements for the regulatory reporting and public dissemination of security-based swaps are comparable to otherwise applicable requirements.

(ii) Any person that executes security-based swaps that would, in the absence of a substituted compliance order, be required to be reported pursuant to §§ 242.900 through 242.911 may file an application, pursuant to the procedures set forth in § 240.0–13 of this chapter, requesting that the Commission make a substituted compliance determination regarding regulatory reporting and public dissemination with respect to a foreign jurisdiction the rules of which also would require reporting and public dissemination of those security-based swaps. Such application shall include the reasons therefor and such other information as the Commission may request.

(iii) In making such a substituted compliance determination, the Commission shall take into account

such factors as the Commission determines are appropriate, such as the scope and objectives of the relevant foreign regulatory requirements, as well as the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised, by the foreign financial regulatory authority to support oversight of its regulatory reporting and public dissemination system for security-based swaps. The Commission shall not make such a substituted compliance determination unless it finds that:

(A) The data elements that are required to be reported pursuant to the rules of the foreign jurisdiction are comparable to those required to be reported pursuant to § 242.901;

(B) The rules of the foreign jurisdiction require the security-based swap to be reported and publicly disseminated in a manner and a timeframe comparable to those required by §§ 242.900 through 242.911;

(C) The Commission has direct electronic access to the security-based swap data held by a trade repository or foreign regulatory authority to which security-based swaps are reported pursuant to the rules of that foreign jurisdiction; and

(D) Any trade repository or foreign regulatory authority in the foreign jurisdiction that receives and maintains required transaction reports of security-based swaps pursuant to the laws of that foreign jurisdiction is subject to requirements regarding data collection and maintenance; systems capacity, resiliency, and security; and recordkeeping that are comparable to the requirements imposed on security-based swap data repositories by §§ 240.13n–5 through 240.13n–7 of this chapter.

(iv) Before issuing a substituted compliance order pursuant to this section, the Commission shall have entered into a supervisory and enforcement memorandum of understanding or other arrangement with the relevant foreign financial regulatory authority or authorities under such foreign financial regulatory system addressing oversight and supervision of the applicable security-based swap market under the substitute compliance determination.

(v) The Commission may, on its own initiative, modify or withdraw such order at any time, after appropriate notice and opportunity for comment.

**§ 242.909 Registration of security-based swap data repository as a securities information processor.**

A registered security-based swap data repository shall also register with the

Commission as a securities information processor on Form SIP (§ 249.1001 of this chapter).

**§ 242.910 Implementation of security-based swap reporting and dissemination.**

(a) *Reporting of pre-enactment security-based swaps.* The reporting side shall report to a registered security-based swap data repository any pre-enactment security-based swaps no later than January 12, 2012 (180 days after the effective date of the Dodd-Frank Act (Pub. L. 111–203, H.R. 4173)).

(b) *Phase-in of compliance dates.* A registered security-based swap data repository and its participants shall be subject to the following phased-in compliance schedule:

(1) *Phase 1*, six months after the registration date (*i.e.*, the effective reporting date):

(i) Reporting sides shall report to the registered security-based swap data repository any transitional security-based swaps.

(ii) With respect to any security-based swap executed on or after the effective reporting date, reporting sides shall comply with § 242.901.

(iii) Participants and the registered security-based swap data repository shall comply with § 242.905 (except with respect to public dissemination) and § 242.906(a) and (b).

(iv) Participants that are security-based swap dealers or major security-based swap participants shall comply with § 242.906(c).

(2) *Phase 2*, nine months after the registration date: *Wave 1* of public dissemination—The registered security-based swap data repository shall comply with §§ 242.902 and 242.905 (with respect to public dissemination of corrected transaction reports) for 50 security-based swap instruments.

(3) *Phase 3*, 12 months after the registration date: *Wave 2* of public dissemination—The registered security-based swap data repository shall comply with §§ 242.902 and 242.905 (with respect to public dissemination of corrected transaction reports) for an additional 200 security-based swap instruments.

(4) *Phase 4*, 18 months after the registration date: *Wave 3* of public dissemination—All security-based swaps received by the registered security-based swap data repository

shall be treated in a manner consistent with §§ 242.902, 242.905, and 242.908.

**§ 242.911 Prohibition during phase-in period.**

A reporting side shall not report a security-based swap to a registered security-based swap data repository in a phase-in period described in § 242.910 during which the registered security-based swap data repository is not yet required or able to publicly disseminate transaction reports for that security-based swap instrument unless:

(a) The security-based swap is also reported to a registered security-based swap data repository that is disseminating transaction reports for that security-based swap instrument consistent with § 242.902; or

(b) No other registered security-based swap data repository is able to receive, hold, and publicly disseminate transaction reports regarding that security-based swap instrument.

**PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934**

■ 11. The authority citation for Part 249 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; 12 U.S.C. 5461 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

■ 12. Section 249.1600, § 249.1600a, and § 249.1600b as previously proposed to be added at 76 FR 65824, Oct. 24, 2011, are further revised to read as follows:

**Subpart Q—Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants**

Sec.

249.1600 Form SBSE, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration.

249.1600a Form SBSE–A, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant that are not also registered or registering with the Commission as a broker or dealer.

249.1600b Form SBSE–BD, for application for registration as a security-based swap

dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commission as a broker or dealer.

\* \* \* \* \*

**§ 249.1600 Form SBSE, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration.**

This form shall be used for application for registration as a security-based swap dealer or major security-based swap participant by firms that are not registered with the Commission as a broker or dealer and that are not registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant, pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(b)) and to amend such an application for registration.

**§ 249.1600a Form SBSE–A, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant that are not also registered or registering with the Commission as a broker or dealer.**

This form shall be used instead of Form SBSE (§ 249.1600) to apply for registration as a security-based swap dealer or major security-based swap participant by firms that are not registered or registering with the Commission as a broker or dealer but that are registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant, pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(b)) and to amend such an application for registration. An entity that is registered or registering with the Commission as a broker or dealer and is also registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant shall apply for registration as a security-based swap dealer or major security-based swap participant on Form SBSE–BD (§ 249.1600b) and not on this Form SBSE–A.



**§ 249.1600b Form SBSE–BD, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commission as a broker or dealer.**

This form shall be used instead of either Form SBSE (§ 249.1600) or SBSE–A (§ 249.1600a) to apply for registration as a security-based swap dealer or major security-based swap participant solely by firms registered or registering with the Commission as a broker or dealer, pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o–10(b)) and to amend such an application for registration. An entity that is registered or registering with the Commission as a broker or dealer and is also registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant, the entity shall apply for registration as a security-based swap dealer or major security-based swap participant on this Form SBSE–BD and not on Form SBSE–A.

**Note:** The following Appendices will not appear in the Code of Federal Regulations.

**Appendix A: Application of Subtitle B of Title VII in the Cross-Border Context**

The following tables summarize the Commission's proposed approach to applying requirements in Subtitle B of Title VII of the Dodd-Frank Act in the cross-border context.<sup>1972</sup> Specifically, as explained more fully in the main body of the release, the tables show how the entity-level requirements in Title VII apply to various dealing entities (identified in row 1 of each of the tables).<sup>1973</sup> The tables also show how various transaction-level requirements in Title VII apply to transactions between such dealing entities and various transaction counterparties (identified in row 8 of each of the tables), depending on the location of the dealer or the dealer's agent (identified in row 7). For the sake of completeness, these tables may include transaction scenarios that are unlikely to occur in practice.

**Guide to Reading the Title VII Tables**

The following provides a guide to reading the tables below.

- “Yes”—Indicates that the Commission is proposing to apply a particular transaction-level requirement in Title VII to a security-

based swap transaction between the dealing entity identified in row 1 and the transaction counterparty identified in row 8, or that the Commission is proposing to apply a particular entity-level requirement in Title VII to the dealing entity identified in row 1, and that substituted compliance would not be permitted.

- “No”—Indicates that the Commission is not proposing to apply the particular Title VII requirement.

- “N/A”—Indicates that the Title VII requirement is not applicable because it applies only to registered security-based swap dealers.

- “Substituted Compliance” (or “Sub Comp”)—Indicates that the Commission is proposing to apply the Title VII requirement, but that we also are proposing to establish a policy and procedural framework under which we would consider permitting compliance with comparable regulatory requirements in a foreign jurisdiction to substitute for compliance with requirements of the Exchange Act, and the rules and regulations thereunder, relating to security-based swaps.

- “Location of Dealer/Agent”—Refers to the location of the dealing entity booking the transaction or its agent.

- Table I describes the application of Title VII to registered U.S. security-based swap dealers and is divided between security-based swap transactions that are conducted:

- Other than through a U.S. bank's foreign branch (columns 2 through 6); or

- Through a U.S. bank's foreign branch (columns 7 through 11).<sup>1974</sup>

- Tables II–V are divided between transactions in which the dealing entity or its agent is:

- “Within the U.S.”—Indicates that a person within the United States acting on behalf of such non-U.S. dealer has solicited, negotiated, executed, or booked the transaction within the United States; or

- “Outside the U.S.”—Indicates that such non-U.S. dealer has solicited, negotiated, executed, and booked the transaction, without involving any person within the United States acting on its behalf.<sup>1975</sup>

- “Transaction counterparty”—Refers to the counterparty with which the dealing entity (identified in row 1) enters into a transaction and whose counterparty credit risk the dealing entity ultimately bears. Therefore, the transaction counterparty is the booking location or booking entity of the trading counterparty with which the dealing entity transacts. A transaction counterparty may use personnel or an agent in a different location than the booking location or booking entity to negotiate the transaction with the

dealing entity. The five transaction counterparties identified in the tables are as follows:

- “U.S. Person (other than Foreign Branch)” —Indicates the transaction counterparty of the dealing entity (identified in row 1) is a U.S. person (other than a foreign branch of a U.S. bank);

- “Non-U.S. Person Within the U.S.” —Indicates the transaction counterparty of the dealing entity (identified in row 1) is a non-U.S. person and the security-based swap transaction is conducted (*i.e.*, solicited, negotiated, executed, or booked) by or on behalf of the non-U.S. person transaction counterparty within the United States. This includes a non-U.S. person counterparty that uses its own personnel in its U.S. branch or office to conduct the transaction or that uses a U.S. affiliate or third party acting as its agent to conduct the transaction on its behalf;<sup>1976</sup>

- “Foreign Branch of U.S. Bank”—Indicates the transaction counterparty of the dealing entity (identified in row 1) is a foreign branch of a U.S. bank and the security-based swap transaction is conducted (*i.e.*, solicited, negotiated, executed, and booked) by or on behalf of such foreign branch without involving any person within the United States acting on behalf of the foreign branch;

- “Non-U.S. Person w/U.S. Guarantee Outside the U.S.”—Indicates the transaction counterparty of the dealing entity (identified in row 1) is a non-U.S. person whose performance under the security-based swap is guaranteed by a U.S. person (the “U.S. Guarantor”) such that its counterparty has direct recourse to the U.S. Guarantor for performance of obligations owed by such non-U.S. person (*i.e.*, the guaranteed entity) under the security-based swap, and the security-based swap transaction is conducted (*i.e.*, solicited, negotiated, executed, and booked) by or on behalf of such non-U.S. person counterparty without involving any person within the United States acting on behalf of such non-U.S. person; and

- “Non-U.S. Person w/o U.S. Guarantee Outside the U.S.”—Indicates the transaction counterparty of the dealing entity (identified in row 1) is a non-U.S. person whose performance under the security-based swap is not guaranteed by a U.S. person, and the security-based swap transaction is conducted (*i.e.*, solicited, negotiated, executed, and booked), by or on behalf of such non-U.S. person counterparty, without involving any person within the United States acting on behalf of such non-U.S. person.<sup>1977</sup>

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dealer, see Table II or IV for application of other transaction-level requirements. If the non-U.S. person transaction counterparty is an unregistered dealer or market participant that receives a U.S. guarantee, see Table II or III for application of other transaction-level requirements.

<sup>1977</sup> If the non-U.S. person counterparty is a registered security-based swap dealer, see Table IV for application of other transaction-level requirements.

<sup>1972</sup> The tables in this appendix are only a summary of the rules and interpretations proposed in this release and are provided for ease of reference. They do not supersede, and should be read in conjunction with, the proposed rules and interpretations discussed in the release. All defined terms used in the tables have the same meaning as set forth in the release, unless otherwise indicated.

<sup>1973</sup> Tables III and V also apply to non-U.S. dealers and other non-U.S. market participants.

<sup>1974</sup> The transactions identified in columns 7 and 8 of Table I are transactions in which a foreign branch of a U.S. bank is the counterparty to the

transaction, but such transactions would not fall within the definition of “transaction conducted through a foreign branch” in proposed Rule 3a71–3(a)(4) under the Exchange Act.

<sup>1975</sup> A transaction in which the non-U.S. dealing entity and its agent are outside the United States may still be a “transaction conducted within the United States,” as defined in proposed Rule 3a71–3(a)(5) under the Exchange Act. For example, the non-U.S. dealing entity may direct its solicitation activity to a U.S. or non-U.S. person counterparty located within the United States.

<sup>1976</sup> If the non-U.S. person transaction counterparty is a registered security-based swap









Table V—Unregistered Non-U.S. Dealer (or Market Participant) Without U.S. Guarantee

Unregistered Non-U.S. Dealer (or Market Participant) Without U.S. Guarantee										
<i>Entity-Level Requirements</i>										
Capital	N/A									
Margin	N/A									
Other	N/A									
<i>Transaction-Level Requirements</i>										
Location of Dealer /Agent	Within the U.S.					Outside the U.S.				
Transaction Counter-Party	U.S. Person (other than Foreign Branch)	Non-U.S. Person Within the U.S.	Foreign Branch of U.S. Bank	Non-U.S. Person w/ Guarantee Outside the U.S.	Non-U.S. Person w/o Guarantee Outside the U.S.	U.S. Person (other than Foreign Branch)	Non-U.S. Person Within the U.S.	Foreign Branch of U.S. Bank	Non-U.S. Person w/ Guarantee Outside the U.S.	Non-U.S. Person w/o Guarantee Outside the U.S.
<i>Transaction-Level Requirements Applicable to Security-Based Swap Dealers</i>										
External Business Conduct	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Segregation	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
<i>Other Transaction-Level Requirements</i>										
Regulatory Reporting	Yes	Yes	Sub Comp	Sub Comp	Sub Comp	Sub Comp	Sub Comp	Sub Comp	Sub Comp	No
Public Reporting	Yes	Yes	Sub Comp	Sub Comp	Sub Comp	Sub Comp	Sub Comp	No	No	No
Clearing	Sub Comp	No	Sub Comp	Sub Comp	No	Sub Comp	No	No	No	No
Trade Execution	Yes	No	Sub Comp	Sub Comp	No	Sub Comp	No	No	No	No

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**Appendix B: Registration of Security-Based Swap Dealers**

This table shows the Commission’s proposed approach to applying the *de*

*minimis* threshold in the security-based swap dealer definition in the cross-border context.<sup>1978</sup> Specifically, it indicates whether a potential security-based swap dealer listed along the top of the table would be required to count a transaction conducted in a dealing

capacity with the various counterparties listed along the left hand column of the table toward its *de minimis* threshold.

<sup>1978</sup> This table in this appendix is only a summary of the rules and interpretations proposed in this release and is provided for ease of reference. It does

not supersede, and should be read in conjunction with, the proposed rules and interpretations discussed in the release. All defined terms used in

this table have the same meaning as set forth in the release, unless otherwise indicated.

Security-Based Swap Dealer Registration				
		Potential Security-Based Swap Dealer		
		U.S. Person	Non-U.S. Person	
			Potential Dealer/Agent Located Within the U.S.	Potential Dealer/Agent Located Outside the U.S.
Counterparty	U.S. Person (other than Foreign Branch)	Count	Count	Count
	Non-U.S. Person Within the U.S.	Count	Count	Count
	Non-U.S. Branch of U.S. Bank	Count	Count	Don't Count
	Non-U.S. Person Outside the U.S.	Count	Count	Don't Count

**Appendix C: Re-Proposal of Registration Forms**

*Form SBSE-A*  
*Form SBSE-BD*

*Form SBSE*



## Form SBSE

OMB Approval
OMB Number: .....3235-_____
Expires:..... Month __, 2016
Estimated average burden hours per response: . . . . . _____.
per amendment: . . . . . _____.

# Application for Registration of Security-based Swap Dealers and Major Security-based Swap Participants

### Form SBSE Instructions

#### A. General Instructions

1. FORM—Form SBSE is the Application for Registration as either a Security-based Swap Dealer or Major Security-based Swap Participant (collectively, “SBS Entities”). SBS Entities that are not registered with the Commission as broker-dealers nor registered or registering with the Commodity Futures Trading Commission (“CFTC”) as a swap dealer or major swap participant must file this form to register with the Securities and Exchange Commission. An applicant must also file Schedules A, B, D, E, F, and G as appropriate. There is no Schedule C.

2. ELECTRONIC FILING—The applicant must file Form SBSE through the EDGAR system, and must utilize the EDGAR Filer Manual (as defined in 17 CFR 232.11) to file and amend Form SBSE electronically to assure the timely acceptance and processing of those filings.<sup>1979</sup>

3. UPDATING—By law, the *applicant* must promptly update Form SBSE information by submitting amendments whenever the information on file becomes inaccurate or incomplete for

<sup>1979</sup> As discussed in the release proposing this Form, the Commission is currently developing a system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.

any reason [17 CFR 240.15Fb2–2]. In addition, the *applicant* must update any incomplete or inaccurate information contained on Form SBSE prior to filing a notice of withdrawal from registration on Form SBSE–W [17 CFR 15Fb3–2(a)].

4. CONTACT EMPLOYEE—The individual listed as the contact employee must be authorized to receive all compliance information, communications, and mailings, and be responsible for disseminating it within the *applicant's* organization.

5. FEDERAL INFORMATION LAW AND REQUIREMENTS—An agency may not conduct or sponsor, and a *person* is not required to respond to, a collection of information unless it displays a currently valid control number. Sections

15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§ 78o–10, 78q and 78w. Filing of this form is mandatory; however, the social security number information, which aids in identifying the applicant, is voluntary. The principal purpose of this Form is to permit the Commission to determine whether the *applicant* meets the statutory requirements to engage in the security-based swap business. The Commission maintain[s] a file of the information on this form and will make certain information collected via the form publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. § 3507. The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the **Federal Register** the Privacy Act Systems of Records Notice for these records.

## B. Filing Instructions

### 1. FORMAT

a. Sections 1–14 must be answered and all fields requiring a response must be completed before the filing will be accepted.

b. Failure to follow instructions or properly complete the form may result in the application being delayed or rejected.

c. *Applicant* must complete the execution screen certifying that Form SBSE and amendments thereto have been executed properly and that the information contained therein is accurate and complete.

d. To amend information, the *applicant* must update the appropriate Form SBSE screens.

e. A paper copy, with original signatures, of the initial Form SBSE filing and amendments to Disclosure Reporting Pages (DRPs) must be retained by the *applicant* and be made available for inspection upon a regulatory request.

2. DISCLOSURE REPORTING PAGE (DRP)—Information concerning the *applicant* or *control affiliate* that relates to the occurrence of an event reportable under Item 12 must be provided on the *applicant's* appropriate DRP.

3. DIRECT AND INDIRECT OWNERS—Amend the Direct Owners and Executive Officers screen and the

Indirect Owners screen when changes in ownership occur.

The mailing address for questions and correspondence is:

### Explanation of Terms

#### (The Following Terms are Italicized Throughout This Form.)

##### 1. General

APPLICANT—The security-based swap dealer or major security-based swap participant applying on or amending this form.

CONTROL—The power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any *person* that (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% or more of a class of voting security or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive upon dissolution, or has contributed, 25% or more of the capital, is presumed to *control* that company.

STATE—Any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, any other territory of the United States, or any subdivision or regulatory body thereof.

PERSON—An individual, partnership, corporation, trust, or other organization.

SELF-REGULATORY ORGANIZATION (SRO)—Any national securities or futures exchange, registered securities or futures association, registered clearing agency, or derivatives clearing organization.

SUCCESSOR—The term “successor” is defined to be an unregistered entity that assumes or acquires substantially all of the assets and liabilities, and that continues the business of, a predecessor security-based swap dealer or major security-based swap participant that ceases its security-based swap activities. [See Exchange Act Rule 15Fb2–5 (17 CFR 240.15Fb2–5)]

##### 2. FOR THE PURPOSE OF ITEM 12 AND THE CORRESPONDING DISCLOSURE REPORTING PAGES (DRPs)

CHARGED—Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge).

CONTROL AFFILIATE—A person named in Items 10 or 11 as a control person or any other individual or organization that directly or indirectly

controls, is under common control with, or is controlled by, the *applicant*, including any current employee of the applicant except one performing only clerical, administrative, support or similar functions, or who, regardless of title, performs no executive duties or has no senior policy making authority.

ENJOINED—Includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining order.

FELONY—For jurisdictions that do not differentiate between a *felony* and a *misdemeanor*, a *felony* is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least \$1,000. The term also includes a general court martial.

FOUND—Includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters.

INVESTMENT OR INVESTMENT-RELATED—Pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency).

INVOLVED—Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

MINOR RULE VIOLATION—A violation of a *self-regulatory organization* rule that has been designated as “minor” pursuant to a plan approved by the SEC or CFTC. A rule violation may be designated as “minor” under a plan if the sanction imposed consists of a fine of \$2,500 or less, and if the sanctioned person does not contest the fine. (Check with the appropriate *self-regulatory organization* to determine if a particular rule violation has been designated as “minor” for these purposes).

MISDEMEANOR—For jurisdictions that do not differentiate between a *felony* and a *misdemeanor*, a *misdemeanor* is an offense punishable by a sentence of less than one year imprisonment and/or a fine of less than

\$1,000. The term also includes a special court martial.

ORDER—A written directive issued pursuant to statutory authority and procedures, including orders of denial, suspension, or revocation; does not include special stipulations, undertakings or agreements relating to payments, limitations on activity or

other restrictions unless they are included in an *order*.

PROCEEDING—Includes a formal administrative or civil action initiated by a governmental agency, *self-regulatory organization* or a *foreign financial regulatory authority*; a *felony* criminal indictment or information (or equivalent formal charge); or a

*misdemeanor* criminal information (or equivalent formal charge). Does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge).

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<b>FORM SBSE</b> Page 1 (Execution Page)	<b>Uniform Application for Security-based Swap Dealer and Major Security-based Swap Participant Registration</b> Date: _____ SEC Filer No: _____	<b>Official Use</b>	Official Use Only
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**WARNING:** Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as an SBS Entity, would violate the Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

**INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.**

[ ] APPLICATION [ ] AMENDMENT

1. Exact name, principal business address, mailing address, if different, and telephone number of the *applicant*:

A. Full name of the *applicant*:

B. Tax Identification No.:  Applicant's CIK # (if any):

C. (1)  The *business name* under which the *applicant* primarily conducts business, if different from 1A.  
 (2)  List on Schedule D, Page 1, Section I any other name by which the *applicant* conducts business and where it is used.

D. If this filing makes a name change on behalf of an *applicant*, enter the new name and specify whether the change is to the [ ] *applicant's name* (1A) or [ ] *business name* (1C):  
 Please check above.

E. *Applicant's Main Address*: (Do not use a P.O. Box)  
 Number and Street 1:  Number and Street 2:   
 City:  State:  Country:  Zip/Postal Code:

Other business locations must be reported on Schedule E. Security-based swap dealers and major security-based swap participants that do not reside in the United States of America shall designate a U.S. agent for service of process on Schedule F.

F. *Mailing Address*, if different:  
 Number and Street 1:  Number and Street 2:   
 City:  State:  Country:  Zip/Postal Code:

G. Business Telephone Number:

H. Website/URL:

I. Contact Employee:  
 Name:  Title:   
 Telephone Number:  Email Address:

J. Chief Compliance Officer designated by the *applicant* in accordance with Exchange Act Section 15F(k):  
 Name:  Title:   
 Telephone Number:  Email Address:

**EXECUTION:**

The applicant consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission in connection with the applicant's security-based swap activities, unless the applicant is a nonresident SBS Entity, may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 1E and 1F. If the applicant is a nonresident SBS Entity, it must complete Schedule F to designate a U.S. agent for service of process.

The undersigned certifies that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including schedules attached hereto, and other information filed herewith are current, true and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended such information is currently accurate and complete.

Date (MM/DD/YYYY) Name of Applicant  
 By:    
 Signature Name and Title of Person Signing on *Applicant's* behalf

*This page must always be completed in full.*

DO NOT WRITE BELOW THIS LINE – FOR OFFICIAL USE ONLY

FORM SBSE Page 2		Applicant Name: _____ Date: _____ SEC Filer No: _____	Official Use	Official Use Only
2.	A.	The applicant is registering as a security-based swap dealer: <span style="float: right;"><input type="checkbox"/> Yes <input type="checkbox"/> No</span>		
	B.	The applicant is registering as a major security-based swap participant: <span style="float: right;"><input type="checkbox"/> Yes <input type="checkbox"/> No</span> Because it: (check all that apply) <input type="checkbox"/> maintains a substantial security-based swap position <input type="checkbox"/> has substantial counterparty exposure <input type="checkbox"/> is highly leveraged relative to its capital position		
3.	A.	Is the <i>applicant</i> a foreign security-based swap dealer that intends to: • work with the Commission and its primary regulator to have the Commission determine whether the requirements of its primary regulator's regulatory system are comparable to the Commission's <input type="checkbox"/> Yes <input type="checkbox"/> No • avail itself of a previously granted substituted compliance determination <span style="float: right;"><input type="checkbox"/> Yes <input type="checkbox"/> No</span> with respect to the requirements of Section 15F of the Exchange Act of 1934 and the rules and regulations thereunder?		
	B.	If "yes" to either of the questions in Item 3.A. above, identify the foreign financial regulatory authority that serves as the <i>applicant's</i> primary regulator and for which the Commission has made, or may make, a substituted compliance determination: _____		
	C.	If the applicant is relying on a previously granted substituted compliance determination, please describe how the <i>applicant</i> satisfies any conditions the Commission may have placed on such substituted compliance determination: _____		
4.		Does the applicant intend to compute capital or margin, or price customer or proprietary positions, using mathematical models? <span style="float: right;"><input type="checkbox"/> Yes <input type="checkbox"/> No</span>		
5.		Is the <i>applicant</i> subject to regulation by a prudential regulator, as defined in Section 1a(39) of the Commodity Exchange Act. <span style="float: right;"><input type="checkbox"/> Yes <input type="checkbox"/> No</span> If "yes," identify the prudential regulator: _____		
6.		Is the <i>applicant</i> a U.S. branch of a non-resident entity? <span style="float: right;"><input type="checkbox"/> Yes <input type="checkbox"/> No</span> If "yes," identify the non-resident entity and its location: _____		
7.		Briefly describe the <i>applicant's</i> business: _____ _____ _____		
8.	A.	Indicate legal status of the <i>applicant</i> : <input type="checkbox"/> Corporation <input type="checkbox"/> Limited Liability Company <input type="checkbox"/> Other (specify) _____ <input type="checkbox"/> Partnership <span style="float: right;">_____</span>		
	B.	Month <i>applicant's</i> fiscal year ends: _____		
	C.	Indicate date and place <i>applicant</i> obtained its legal status (i.e., state or country where incorporated, where partnership agreement was filed, or where <i>applicant</i> entity was formed): State of formation: _____ Country of formation: _____ Date of formation: MM/DD/YYYY _____		
<i>Schedule A and, if applicable, Schedule B must be completed as part of all initial applications.</i>				
9.		Is the <i>applicant</i> at the time of this filing succeeding to the business of a currently registered SBS Entity? If "Yes," complete appropriate items on Schedule D, Page 1, Section III.	YES NO <input type="checkbox"/> <input type="checkbox"/>	
10.		Does the <i>applicant</i> hold or maintain any funds or securities to collateralize counterparty transactions?	<input type="checkbox"/> <input type="checkbox"/>	

11.	<p>Does the <i>applicant</i> have any arrangement:</p> <p>A. With any other <i>person</i>, firm, or organization under which any books or records of the <i>applicant</i> are kept, maintained, or audited by such other <i>person</i>, firm or organization?</p> <p>B. Under which any other person, firm or organization executes, trades, custodies, clears or settles on behalf of the applicant (including any SRO or swap execution facility in which the applicant is a member)?</p> <p><i>If "Yes" to any part of Item 11, complete appropriate items on Schedule D, Page 1, Section IV.</i></p>	[ ] [ ]	[ ] [ ]
12.	<p>Does any <i>person</i> directly or indirectly:</p> <p>A. <i>Control</i> the management or policies of the <i>applicant</i> through agreement or otherwise?</p> <p>B. Wholly or partially finance the business of the <i>applicant</i>?</p> <p><i>Do not answer "Yes" to 12B if the person finances the business of the applicant through: 1) a public offering of securities made pursuant to the Securities Act of 1933; or 2) credit extended in the ordinary course of business by suppliers, banks, and others.</i></p> <p><i>If "Yes" to any part of Item 12, complete appropriate items on Schedule D, Page 1, Section IV.</i></p>	[ ] [ ]	[ ] [ ]
13.	<p>A. Directly or indirectly, does the <i>applicant control</i>, is the <i>applicant controlled</i> by, or is the <i>applicant</i> under common <i>control</i> with, any partnership, corporation, or other organization that is engaged in the securities or investment advisory business?</p> <p><i>If "Yes" to item 13A, complete appropriate items on Schedule D, Page 2, Section V.</i></p> <p>B. Directly or indirectly, is applicant controlled by any bank holding company or does applicant control, is applicant controlled by, or is applicant under common control with any bank (as defined in 15 U.S.C. 78c(a)(6)) or any foreign bank?</p> <p><i>If "Yes" to item 13B, complete appropriate items on Schedule D, Page 3, Section VI.</i></p>	[ ] [ ]	[ ] [ ]

FORM SBSE Page 3	Applicant Name: _____ Date: _____ SEC Filer No: _____	Official Use	Official Use Only
14. Use the appropriate DRP for providing details to "yes" answers to the questions in Item 14. Refer to the Explanation of Terms section of Form SBSE Instructions for explanations of italicized terms.			
CRIMINAL DISCLOSURE	<p>A. In the past ten years has the <i>applicant</i> or a <i>control affiliate</i>:</p> <p>(1) Been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to any <i>felony</i>?</p> <p>(2) Been charged with a <i>felony</i></p> <p>B. In the past ten years has the <i>applicant</i> or a <i>control affiliate</i>:</p> <p>(1) Been convicted of or pled guilty or or nolo contendere ("no contest") in a domestic, foreign or military court to a <i>misdemeanor involving</i>: investments or an <i>investment-related</i> business, or any fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?</p> <p>(2) Been <i>charged</i> with a <i>misdemeanor</i> specified in 14B(1)?</p>	<p>YES NO</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p>	
	<p>C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:</p> <p>(1) <i>Found</i> the <i>applicant</i> or a <i>control affiliate</i> to have made a false statement or omission?</p> <p>(2) <i>Found</i> the <i>applicant</i> or a <i>control affiliate</i> to have been involved in a violation of its regulations or statutes?</p> <p>(3) <i>Found</i> the <i>applicant</i> or a <i>control affiliate</i> to have been a cause of an <i>investment-related</i> business having its authorization to do business denied, revoked, or restricted?</p> <p>(4) Entered an <i>order</i> against the <i>applicant</i> or a <i>control affiliate</i> in connection with <i>investment-related</i> activity?</p> <p>(5) Imposed a civil money penalty on the <i>applicant</i> or a <i>control affiliate</i>, or ordered the <i>applicant</i> or a <i>control affiliate</i> to cease and desist from any activity?</p>	<p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p>	
	<p>D. Has any other federal regulatory agency, state regulatory agency, or <i>foreign financial regulatory authority</i>:</p> <p>(1) Ever found the <i>applicant</i> or a <i>control affiliate</i> to have made a false statement or omission or been dishonest, unfair, or unethical?</p> <p>(2) Ever found the <i>applicant</i> or a <i>control affiliate</i> to have been involved in a violation of <i>investment-related</i> regulations or statutes?</p> <p>(3) Ever found the <i>applicant</i> or a <i>control affiliate</i> to have been a cause of an <i>investment-related</i> business having its authorization to do business denied, suspended, revoked or restricted?</p> <p>(4) In the past ten years, entered an order against the <i>applicant</i> or a <i>control affiliate</i> in connection with an <i>investment-related</i> activity?</p> <p>(5) Ever denied, suspended, or revoked the <i>applicant's</i> or a <i>control affiliate's</i> registration or license or otherwise, by order, prevented it from associating with an <i>investment-related</i> business or restricted its activities?</p> <p>E. Has any <i>self-regulatory organization</i>:</p> <p>(1) <i>found</i> the <i>applicant</i> or a <i>control affiliate</i> to have made a false statement or omission?</p> <p>(2) <i>found</i> the <i>applicant</i> or a <i>control affiliate</i> to have been involved in a violation of its rules (other than a violation designated as a "<i>minor rule violation</i>" under a plan approved by the U.S. Securities and exchange Commission)?</p> <p>(3) <i>found</i> the <i>applicant</i> or a <i>control affiliate</i> to have been the cause of an <i>investment-related</i> business having its authorization to do business denied, suspended, revoked or restricted?</p> <p>(4) Disciplined the <i>applicant</i> or a <i>control affiliate</i> by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?</p> <p>F. Has the <i>applicant's</i> or a <i>control affiliate's</i> authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?</p> <p>G. Is the <i>applicant</i> or a <i>control affiliate</i> now the subject of any regulatory <i>proceeding</i> that could result in a "yes" answer to any part of 14C, D, or E?</p>	<p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p> <p>[ ] [ ]</p>	



FORM SBSE Page 4		Applicant Name: _____ Date: _____ SEC Filer No: _____		Official Use	Official Use Only
CIVIL JUDICIAL DISCLOSURE	H.	(1) Has any domestic or foreign civil judicial court:		YES NO	
		(a) In the past ten years, enjoined the <i>applicant</i> or a <i>control affiliate</i> in connection with any investment-related activity?		<input type="checkbox"/> <input type="checkbox"/>	
		(b) Ever <i>found</i> that the <i>applicant</i> or a <i>control affiliate</i> was involved in a violation of <i>investment-related</i> statutes or regulations?		<input type="checkbox"/> <input type="checkbox"/>	
		(c) Ever dismissed, pursuant to a settlement agreement, an <i>investment-related</i> civil judicial action brought against the <i>applicant</i> or <i>control affiliate</i> by a state or <i>foreign financial regulatory authority</i> ?		<input type="checkbox"/> <input type="checkbox"/>	
	(2) Is the <i>applicant</i> or a <i>control affiliate</i> now the subject of any civil judicial <i>proceeding</i> that could result in a "yes" answer to any part of 14H(1)?		<input type="checkbox"/> <input type="checkbox"/>		
FINANCIAL DISCLOSURE	I.	In the past ten years has the <i>applicant</i> or a <i>control affiliate</i> ever been a securities firm or a futures firm, or a control affiliate of a securities firm or a futures firm that:			
		(1) Has been the subject of a bankruptcy petition?		<input type="checkbox"/> <input type="checkbox"/>	
	(2) Has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?		<input type="checkbox"/> <input type="checkbox"/>		
15.		Is the <i>applicant</i> registered with the Commission as an investment adviser or municipal securities advisor or with the CFTC as a commodity trading adviser? If "yes," provide all unique identification numbers assigned to the firm relating to this business on Schedule D, Page 1, Section II.		<input type="checkbox"/> <input type="checkbox"/>	
16.	A.	Does <i>applicant</i> effect transactions in commodity futures, commodities or commodity options as a broker for others or as a dealer for its own account? If "yes," provide all unique identification numbers assigned to the firm relating to this business on Schedule D, Page 1, Section II.		<input type="checkbox"/> <input type="checkbox"/>	
	B.	Does <i>applicant</i> engage in any other investment-related, non-securities business? If "yes," provide all unique identification numbers assigned to the firm relating to this business and describe each other business briefly on Schedule D, Page 1, Section II.		<input type="checkbox"/> <input type="checkbox"/>	
17.		Is the <i>applicant</i> registered with a foreign financial regulatory authority? If "yes," list all such registrations on Schedule F, Page 1, Section II.		<input type="checkbox"/> <input type="checkbox"/>	

<b>Schedule A of FORM SBSE DIRECT OWNERS AND EXECUTIVE OFFICERS</b> (Answer for Form SBSE Item 8)	Applicant Name: _____ Date: _____ SEC Filer No: _____	<b>Official Use</b>					
1. Use Schedule A to provide information on the <b>direct</b> owners and executive officers of the applicant. Use Schedule B to provide information on <b>indirect</b> owners. <b>Complete each column.</b>							
2. List below the names of: (a) Each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, Director, and individuals with similar status or function; (b) In the case of an <i>applicant</i> that is a corporation, each shareholder that directly owns 5% or more of a class of a voting security of the <i>applicant</i> , unless the <i>applicant</i> is a public reporting company (a company subject to Sections 12 or 15(d) of the Securities Exchange Act of 1934). Direct owners include any <i>person</i> that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 5% or more of a class of a voting security of the <i>applicant</i> . For purposes of this Schedule, a <i>person</i> beneficially owns any securities (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence, or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant or right to purchase the security. (c) In the case of an <i>applicant</i> that is a partnership, <b>all</b> general partners, and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of the partnership's capital; and (d) In the case of a trust that directly owns 5% or more of a class of a voting security of the <i>applicant</i> , or that has the right to receive upon dissolution, or has contributed, 5% or more of the <i>applicant's</i> capital, the trust and each trustee. (e) In the case of an <i>applicant</i> that is a Limited Liability Company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.							
3. Are there any indirect owners of the applicant required to be reported on Schedule B? <span style="float:right">[ ] Yes [ ] No</span>							
4. In the "DE/FE/I" column, enter "DE" if the owner is a domestic entity, or enter "FE" if owner is an entity incorporated or domiciled in a foreign country, or enter "I" if the owner is an individual.							
5. Complete the "Title or Status" column by entering board/management titles; status as partner, trustee, sole proprietor, or shareholder; and for shareholders, the class of securities owned (if more than one is issued).							
6. Ownership Codes are: NA - less than 5%                      B - 10% but less than 25%                      D - 50% but less than 75% A - 5% but less than 10%                      C - 25% but less than 50%                      E - 75% or more							
7. (a) In the "Control Person" column, enter "Yes" if <i>person</i> has <i>control</i> as defined in the instructions to this form, and enter "No" if the <i>person</i> does not have <i>control</i> . Note that under this definition most executive officers and all 25% owners, general partners, and trustees would be " <i>control persons</i> ". (b) In the "PR" column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934.							
FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Title or Status	Date Title or Status Acquired MM    YYYY	Ownership Code	Control Person PR	CRD and/or IARD No. and/or foreign business No. If None, IRS Tax No.	Official Use Only
For individuals not presently registered through CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):							
For individuals not presently registered through CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):							
For individuals not presently registered through CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):							
For individuals not presently registered through CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):							



<b>Schedule D of FORM SBSE</b> Page 1	Applicant Name: _____ Date: _____ SEC Filer No: _____	<b>Official Use</b>	Official Use Only
Use Schedule D Page 1 to report details for items listed below. This is an <input type="checkbox"/> INITIAL <input type="checkbox"/> AMENDED detail filing for the Form SBSE items checked below:			
<b>Section I Other Business Names</b>			
(Check if applicable) <input type="checkbox"/> Item 1C(2) List each of the "other" names and the state(s) or country(ies) in which they are used.			
1. Name	State/Country	2. Name	State/Country
3. Name	State/Country	4. Name	State/Country
<b>Section II Other Business</b>			
(Check if applicable) <input type="checkbox"/> Item 15 <input type="checkbox"/> Item 16A <input type="checkbox"/> Item 16B Applicant must complete a separate Schedule D Page 1 for each affirmative response in this section.			
Unique Identification Number(s):		Assigning Regulator(s)/Entity(s):	
Briefly describe any other investment-related, non-securities business. Use reverse side of this sheet for additional comments if necessary.			
<b>Section III Successions</b>			
(Check if applicable) <input type="checkbox"/> Item 9			
Date of Succession MM DD YYYY / /		Name of Predecessor	
IRS Employer Number (if any)		SEC File Number (if any)	
Briefly describe details of the succession including any assets or liabilities not assumed by the successor. Use reverse side of this sheet for additional comments if necessary.			
<b>Section IV Record Maintenance Arrangements / Business Arrangements / Control Persons / Financings</b>			
(Check one) <input type="checkbox"/> Item 11A <input type="checkbox"/> Item 11B <input type="checkbox"/> Item 12A <input type="checkbox"/> Item 12B Applicant must complete a separate Schedule D Page 1 for each affirmative response in this section including any multiple responses to any item. Complete the "Effective Date" box with the Month, Day and Year that the arrangement or agreement became effective. When reporting a change or termination of an arrangement, enter the effective date of the change.			
Firm or Organization Name		SEC File, CRD, NFA, IARD, foreign business No., and/or CIK Number (if any)	
Business Address (Street, City, State/Country, Zip + 4 Postal Code)		Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /
Individual Name		CRD, NFA, and/or IARD Number (if any)	
Business Address (if applicable) (Street, City, State/Country, Zip + 4 Postal Code)		Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /
Briefly describe the nature of the arrangement with respect to books or records (ITEM 11A); the nature of the execution, trading, custody, clearing or settlement arrangement (ITEM 11B); the nature of the control or agreement (ITEM 12A); or the method and amount of financing (ITEM 12B). Use reverse side of this sheet for additional comments if necessary.			
For ITEM 12A ONLY - If the control person is an individual not presently registered through CRD or IARD, describe prior investment-related experience (e.g., for each prior position - employer, job title, and dates of service).			

<b>Schedule D of FORM SBSE</b> Page 2	Applicant Name: _____ Date: _____ SEC Filer No: _____	<b>Official Use</b>	Official Use Only
Use this Schedule D Page 2 to report details for Item 13A. Supply details for all partnerships, corporations, organizations, institutions and individuals necessary to answer each item completely. Use additional copies of Schedule D Page 2 if necessary.  Use the "Effective Date" box to enter the Month, Day, and Year that the affiliation was effective or the date of the most recent change in the affiliation.  This is an <input type="checkbox"/> INITIAL <input type="checkbox"/> AMENDED detail filing for Form SBSE Item 13A			
<input type="checkbox"/> 13A. Directly or indirectly, does <i>applicant control</i> , is <i>applicant controlled by</i> , or is <i>applicant</i> under common control with, any partnership, corporation, or other organization that is engaged in the securities or investment advisory business?			
<b>Section V</b> Complete this section for control issues relating to ITEM 13A only.			
The details supplied relate to:			
1.	Partnership, Corporation, or Organization Name	CRD Number (if any)	
(check only one) This Partnership, Corporation, or Organization <input type="checkbox"/> controls applicant <input type="checkbox"/> is controlled by applicant <input type="checkbox"/> is under common control with applicant			
Business Address (Street, City, State/Country, Zip + 4/Postal Code)		Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /
Is Partnership, Corporation or Organization a foreign entity <input type="checkbox"/> Yes <input type="checkbox"/> No	If Yes, provide country of domicile or incorporation	Check "Yes" or "No" for activities of this partnership Corporation, or organization: Securities <input type="checkbox"/> Yes <input type="checkbox"/> No Activities:	Investment Advisory <input type="checkbox"/> Yes <input type="checkbox"/> No Activities:
Briefly describe the control relationship. Use reverse side of this sheet for additional comments if necessary.			
2.	Partnership, Corporation, or Organization Name	CRD Number (if any)	
(check only one) This Partnership, Corporation, or Organization <input type="checkbox"/> controls applicant <input type="checkbox"/> is controlled by applicant <input type="checkbox"/> is under common control with applicant			
Business Address (Street, City, State/Country, Zip + 4/Postal Code)		Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /
Is Partnership, Corporation or Organization a foreign entity <input type="checkbox"/> Yes <input type="checkbox"/> No	If Yes, provide country of domicile or incorporation	Check "Yes" or "No" for activities of this partnership Corporation, or organization: Securities <input type="checkbox"/> Yes <input type="checkbox"/> No Activities:	Investment Advisory <input type="checkbox"/> Yes <input type="checkbox"/> No Activities:
Briefly describe the control relationship. Use reverse side of this sheet for additional comments if necessary.			
3.	Partnership, Corporation, or Organization Name	CRD Number (if any)	
(check only one) This Partnership, Corporation, or Organization <input type="checkbox"/> controls applicant <input type="checkbox"/> is controlled by applicant <input type="checkbox"/> is under common control with applicant			
Business Address (Street, City, State/Country, Zip + 4/Postal Code)		Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /
Is Partnership, Corporation or Organization a foreign entity <input type="checkbox"/> Yes <input type="checkbox"/> No	If Yes, provide country of domicile or incorporation	Check "Yes" or "No" for activities of this partnership Corporation, or organization: Securities <input type="checkbox"/> Yes <input type="checkbox"/> No Activities:	Investment Advisory <input type="checkbox"/> Yes <input type="checkbox"/> No Activities:
Briefly describe the control relationship. Use reverse side of this sheet for additional comments if necessary.			
If applicant has more than 3 organizations to report, complete additional Schedule D Page 2s.			

Schedule D of FORM SBSE Page 3	Applicant Name: _____ Date: _____ SEC Filer No: _____	Official Use	Official Use Only
<p>Use Schedule D Page 3 to report details for Item 13B. Report only new information or changes/updates to previously submitted details. Do not report previously submitted information. Supply details for all partnerships, corporations, organizations, institutions and individuals necessary to answer each item completely. Use additional copies of Schedule D Page 3 if necessary.</p> <p>Use the "Effective Date" box to enter the Month, Day, and Year that the affiliation was effective or the date of the most recent change in the affiliation.</p> <p>This is an <input type="checkbox"/> INITIAL <input type="checkbox"/> AMENDED detail filing for Form SBSE Item 13B</p> <p><input type="checkbox"/> 13B. Directly or indirectly, is applicant controlled by any bank holding company or does applicant control, is applicant controlled by, or is applicant under common control with any bank (as defined in 15 U.S.C. 78c(a)(6)) or any foreign bank?</p>			
<b>Section VI</b>			
<b>Complete this section for control issues relating to ITEM 12B only.</b>			
Provide the details for each organization or institution that controls the applicant, including each organization or institution in the applicant's chain of ownership. The details supplied relate to:			
1.	Financial Institution Name	CRD Number (if applicable)	
Institution Type (e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.)		Effective Date	MM DD YYYY / /
		Termination Date	MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code)		If foreign, country of domicile or incorporation	
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.			
2.	Financial Institution Name	CRD Number (if applicable)	
Institution Type (e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.)		Effective Date	MM DD YYYY / /
		Termination Date	MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code)		If foreign, country of domicile or incorporation	
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.			
3.	Financial Institution Name	CRD Number (if applicable)	
Institution Type (e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.)		Effective Date	MM DD YYYY / /
		Termination Date	MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code)		If foreign, country of domicile or incorporation	
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.			
4.	Financial Institution Name	CRD Number (if applicable)	
Institution Type (e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.)		Effective Date	MM DD YYYY / /
		Termination Date	MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code)		If foreign, country of domicile or incorporation	
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.			
If applicant has more than 4 organizations/institutions to report, complete additional Schedule D page 3s.			

<b>Schedule E of FORM SBSE</b> Page 1	Applicant Name: _____  Date: _____ SEC Filer No: _____	<b>Official Use</b>
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**INSTRUCTIONS**

**General:** Use this schedule to identify other business locations of the *applicant*. Repeat Items 1-6 for each other business location. Each item must be completed unless otherwise noted. Use additional copies of this schedule as necessary.

**Specific:**

- Item 1. Specify only one box. Check "Add" when the applicant is filing the initial notice to inform the Commission that it has opened another business location, "Delete" when the applicant closes another business location, and "Amendment" to indicate any other change to previously filed information.
- Item 2. Complete this item for all entries. Provide the date that the other business location was opened (ADD), closed (DELETE), or the effective date of the change (AMENDMENT).
- Item 3. Complete this item for all entries. A physical location must be included; post office box designations alone are not sufficient.
- Item 4. Complete this item only when the *applicant* changes the address of an existing other business location.
- Item 5. If the other business location occupies or shares space on premises within a bank, or other financial institution, enter the name of the institution in the space provided.
- Item 6. Complete this item for all entries. Enter the name of the associated person who is responsible for the operations of, and is physically at, this location.

1. Check only one box: <input type="checkbox"/> Add <input type="checkbox"/> Delete <input type="checkbox"/> Amendment	
2. Effective Date: _____	4. Street: _____
3. Street: _____	P.O. Box (if applicable), Suite, Floor: _____
P.O. Box (if applicable), Suite, Floor: _____	City, State/Country, Zip Code +4/Postal Code: _____
City, State/Country, Zip Code +4/Postal Code: _____	5. Institution Name: _____
	6. Responsible Associated Person: _____

1. Check only one box: <input type="checkbox"/> Add <input type="checkbox"/> Delete <input type="checkbox"/> Amendment	
2. Effective Date: _____	4. Street: _____
3. Street: _____	P.O. Box (if applicable), Suite, Floor: _____
P.O. Box (if applicable), Suite, Floor: _____	City, State/Country, Zip Code +4/Postal Code: _____
City, State/Country, Zip Code +4/Postal Code: _____	5. Institution Name: _____
	6. Responsible Associated Person: _____

1. Check only one box: <input type="checkbox"/> Add <input type="checkbox"/> Delete <input type="checkbox"/> Amendment	
2. Effective Date: _____	4. Street: _____
3. Street: _____	P.O. Box (if applicable), Suite, Floor: _____
P.O. Box (if applicable), Suite, Floor: _____	City, State/Country, Zip Code +4/Postal Code: _____
City, State/Country, Zip Code +4/Postal Code: _____	5. Institution Name: _____
	6. Responsible Associated Person: _____



<b>Schedule F of FORM SBSE</b> Page 1	Applicant Name: _____ Date: _____ SEC Filer No: _____	<b>Official Use</b>
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**Section I Service of Process and Certification Regarding Access to Records**

Each nonresident security-based swap dealer and non-resident security-based swap participant shall use Section I to identify its United States agent for service of process and the certify that it can

- (1) provide the Commission with prompt access to its books and records, and
- (2) submit to onsite inspection and examination by the Commission.

1. Service of Process:

A. Name of United States person *applicant* designates and appoints as agent for service of process

B. Address of United States person *applicant* designates and appoints as agent for service of process

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

- (a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the *applicant* may have information; and
- (b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2. Certification regarding access to records:

*Applicant* can as a matter of law;

- (1) provide the Commission with prompt access to its books and records, and
- (2) submit to onsite inspection and examination by the Commission.

*Applicant must attach to this Form SBSE a copy of the opinion of counsel it is required to obtain in accordance with paragraph (c)(2) or (c)(3) of Exchange Act Rule 15Fb2-4, as appropriate [paragraphs (c)(2) or (c)(3) of 17 CFR 240.15Fb2-4.*

Signature: \_\_\_\_\_

Name and Title: \_\_\_\_\_

Date: \_\_\_\_\_

**Section II Registration with Foreign Financial Regulatory Authorities**

**Complete this Section for Registration with Foreign Financial Regulatory Authorities relating to ITEM 17.** Each security-based swap dealer and major security-based swap participant that is registered with a foreign financial regulatory authority must list on Section II of this Schedule F, for each foreign financial regulatory authority with which it is registered, the following information:

1. _____ English Name of Foreign Financial Regulatory Authority	Foreign Registration No. (if any) _____	English Name of Country: _____
2. _____ English Name of Foreign Financial Regulatory Authority	Foreign Registration No. (if any) _____	English Name of Country: _____
3. _____ English Name of Foreign Financial Regulatory Authority	Foreign Registration No. (if any) _____	English Name of Country: _____

If applicant has more than 3 Foreign Financial Regulatory Authorities to report, complete additional Schedule F Page 1s.

<b>Schedule G of FORM SBSE CERTIFICATION ON STATUTORY DISQUALIFICATION</b>	<i>Applicant Name:</i> _____	<b>Official Use</b>
	<i>Date:</i> _____ <i>SEC Filer No.:</i> _____	

Use Schedule G to certify that none of the *applicant's* associated persons is subject to statutory disqualification (as that term is defined in Section 3(a)(39) of the Exchange Act [15 U.S.C. 78c(a)(39)]).

Instructions: This certification must be signed by the *applicant's* Chief Compliance Officer designated pursuant to Exchange Act Section 15F(k) or by his or her designee.  
For purposes of this Form, the term *associated person* shall have the meaning as specified in Section 3(a)(70) of the Exchange Act [15 U.S.C. 78c(a)(70)].

This is a:  CERTIFICATION       RE-CERTIFICATION

The *applicant* certifies that it has

- (a) performed background checks on all of its *associated persons* who effect or are involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf, and
- (b) determined that no *associated person* who effects or is involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(39)].

Applicant Name:	Date:
Signature of Chief Compliance Officer or Designee:	
Name of Chief Compliance Officer or Designee:	If Designee, Title of Designee:

**CRIMINAL DISCLOSURE REPORTING PAGE (SBSE)**

**GENERAL INSTRUCTIONS**

This Disclosure Reporting Page [DRP (SBSE)] is an  INITIAL **OR**  AMENDED response to report details for affirmative responses to **Items 14A and 14B** of Form SBSE;

Check  item(s) being responded to:

14A. In the past ten years has the applicant or a control affiliate:

- (1) Been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to any felony?
- (2) Been charged with a felony?

14B. In the past ten years has the applicant or a control affiliate:

- (1) Been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to a misdemeanor involving: investments or an investment-related business, or any fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?
- (2) Been charged with a misdemeanor specified in 14B(1)?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

Multiple counts of the same charge arising out of the same event(s) should be reported on the same DRP. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. Use this DRP to report all charges arising out of the same event. One event may result in more than one affirmative answer to the above items.

If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *control affiliate's* appropriate DRP (BD) or DRP (U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *control affiliate* of its obligation to update its CRD records.

Applicants must attach a copy of each applicable court document (*i.e.*, criminal complaint, information or indictment as well as judgment of conviction or sentencing documents) if not previously submitted through CRD (as they could be in the case of a *control affiliate* registered through CRD). Documents will not be accepted as disclosure in lieu of answering the questions on this DRP.

**PART I**

A. The *person(s)* or entity(ies) for whom this DRP (SBSE) is being filed is (are):

- The *Applicant*
- Applicant* and one or more *control affiliate(s)*
- One or more *control affiliate(s)*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Applicant*

**SBSE DRP – CONTROL AFFILIATE**

CRD NUMBER  This *Control Affiliate* is  Firm  Individual

Registered:  Yes  No

NAME (For individuals, Last, First, Middle)

This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

- Yes  No

**Note:** The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

## CRIMINAL DISCLOSURE REPORTING PAGE (SBSE)

*(continuation)*

### PART II

1. If charge(s) were brought against an organization over which the applicant or control affiliate exercise(d) control: Enter organization name, whether or not the organization was an investment-related business and the applicant's or control affiliate's position, title or relationship.

2. Formal Charge(s) were brought in: (include name of Federal, Military, State or Foreign Court, Location of Court – City or County and State or Country, Docket/Case number).

3. Event Disclosure Detail (Use this for both organizational and individual charges.)

A. Date First Charged (MM/DD/YYYY):  [ ] Exact [ ] Explanation

If not exact, provide explanation:

B. Event Disclosure Detail (include Charge(s)/Charge Description(s), and for each charge provide: 1. number of counts, 2. *felony* or *misdemeanor*, 3. plea for each charge, and 4. product type if charge is *investment-related*):


C. Current status of the Event? [ ] Pending [ ] On Appeal [ ] Final

D. Event Status Date (complete unless status is Pending) (MM/DD/YYYY):  [ ] Exact [ ] Explanation

If not exact, provide explanation:

4. Disposition Disclosure Detail: Include for each charge, A. Disposition Type [e.g., convicted, acquitted, dismissed, pretrial.], B. Date, C. Sentence/Penalty, D. Duration [if sentence-suspension, probation, etc.], E. Start Date of Penalty, F. Penalty/Fine Amount and G. Date Paid.


5. Provide a brief summary of the circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct which was the subject of the char(s) occurred. (The information must fit within the space provided.)

## REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE)

### GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an  INITIAL **OR**  AMENDED response to report details for affirmative responses to **Items 14C, 14D, 14E, 14F, or 14G** of Form SBSE;

Check  item(s) being responded to:

- 14C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:
- (1) Found the applicant or a control affiliate to have made a false statement or omission?
  - (2) Found the applicant or a control affiliate to have been involved in a violation of its regulations or statutes?
  - (3) The applicant or a control affiliate to have been a cause of an investment-related business having its authorization to do business denied, revoked, or restricted?
  - (4) Entered an order against the applicant or a control affiliate in connection with investment-related activity?
  - (5) Imposed a civil money penalty on the applicant or a control affiliate, or ordered the applicant or a control affiliate to cease and desist from any activity?
- 14D. Has any other federal regulatory agency, state regulatory agency, or foreign financial regulatory authority:
- (1) Ever found the applicant or a control affiliate to have made a false statement or omission or been dishonest, unfair, or unethical?
  - (2) Ever found the applicant or a control affiliate to have been involved in a violation of investment-related regulations or statutes?
  - (3) Ever found the applicant or a control affiliate to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted?
  - (4) In the past ten years, entered an order against the applicant or a control affiliate in connection with an investment-related activity?
  - (5) Ever denied, suspended, or revoked the applicant's or a control affiliate's registration or license or otherwise, by order, prevented it from associating with an investment-related business or restricted its activities?
- 14E. Has any self-regulatory organization or commodities exchange ever:
- (1) found the applicant or a control affiliate to have made a false statement or omission?
  - (2) found the applicant or a control affiliate to have been involved in a violation of its rules (other than a violation designated as a "minor rule violation" under a plan approved by the U.S. Securities and exchange Commission)?
  - (3) found the applicant or a control affiliate to have been the cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted?
  - (4) Disciplined the applicant or a control affiliate by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?
- 14F.  Has the applicant's or a control affiliate's authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?
- 14G.  Is the applicant or a control affiliate now the subject of any regulatory proceeding that could result in a "yes" answer to any part of 14C, D, or E?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 14C, 14D, 14E, 14F or 14G. Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *control affiliate's* appropriate DRP (BD) or DRP (U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *control affiliate* of its obligation to update its CRD records.

### PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):

- The *Applicant*
- Applicant and one or more *control affiliate(s)*
- One or more *control affiliate(s)*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of Applicant

SBSE DRP – CONTROL AFFILIATE

CRD NUMBER

This Control Affiliate is  Firm  Individual

Registered:  Yes  No

NAME (For individuals, Last, First, Middle)

This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

- Yes
- No

**Note:** The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

## REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE)

*(continuation)*

**PART II**

1. Regulatory Action initiated by:  
 SEC     Other Federal     State     SRO     Foreign  
 (Full name of regulator, foreign financial regulatory authority, federal, state or SRO)
2. Principal Sanction: (check appropriate item)
- |  |                                       |                                      |
|--|---------------------------------------|--------------------------------------|
| <input type="checkbox"/> Civil and Administrative Penalty(ies)/Fine(s) | <input type="checkbox"/> Disgorgement | <input type="checkbox"/> Restitution |
| <input type="checkbox"/> Bar   | <input type="checkbox"/> Expulsion    | <input type="checkbox"/> Revocation  |
| <input type="checkbox"/> Cease and Desist                              | <input type="checkbox"/> Injunction   | <input type="checkbox"/> Suspension  |
| <input type="checkbox"/> Censure                                       | <input type="checkbox"/> Prohibition  | <input type="checkbox"/> Undertaking |
| <input type="checkbox"/> Denial  | <input type="checkbox"/> Reprimand    | <input type="checkbox"/> Other _____ |
- Other Sanctions:
3. Date Initiated (MM/DD/YYYY)   Exact     Explanation
- If not exact, provide explanation: \_\_\_\_\_
4. Docket/Case Number: \_\_\_\_\_
5. Control Affiliate Employing Firm when activity occurred which led to the regulatory action (if applicable): \_\_\_\_\_
6. Principal Product Type: (check appropriate item)
- |  |  |   |
|--|--|---|
| <input type="checkbox"/> Annuity(ies) - Fixed                | <input type="checkbox"/> Debt - Municipal                            | <input type="checkbox"/> Investment Contract(s)   |
| <input type="checkbox"/> Annuity(ies) - Variable             | <input type="checkbox"/> Derivative(s)                               | <input type="checkbox"/> Money Market Fund(s)     |
| <input type="checkbox"/> Banking Products (other than CD(s)) | <input type="checkbox"/> Direct Investment(s) - DPP & LP Interest(s) | <input type="checkbox"/> Mutual Fund(s)           |
| <input type="checkbox"/> CD(s)                               | <input type="checkbox"/> Equity - OTC                                | <input type="checkbox"/> No Product               |
| <input type="checkbox"/> Commodity Option(s)                 | <input type="checkbox"/> Equity Listed (Common & Preferred Stock)    | <input type="checkbox"/> Options                  |
| <input type="checkbox"/> Debt - Asset Backed                 | <input type="checkbox"/> Futures - Commodity                         | <input type="checkbox"/> Penny Stock(s)           |
| <input type="checkbox"/> Debt - Corporate                    | <input type="checkbox"/> Futures - Financial                         | <input type="checkbox"/> Unit Investment Trust(s) |
| <input type="checkbox"/> Debt - Government                   | <input type="checkbox"/> Index Option(s)                             | <input type="checkbox"/> Other _____              |
|  | <input type="checkbox"/> Insurance                                   |   |
- Other Product Type: \_\_\_\_\_
7. Describe the allegations related to this regulatory action. (The information must fit within the space provided.):
8. Current Status?     Pending     On Appeal     Final
9. If on appeal, regulatory action appealed to: (SEC, SRO, Federal or State Court) and Date Appeal Filed: \_\_\_\_\_

## REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE) (continuation)

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

10. How was matter resolved: (check appropriate item)

- |  |                                    |  |
|--|------------------------------------|--|
| <input type="checkbox"/> Acceptance, Waiver & Consent (AWC)      | <input type="checkbox"/> Consent   | <input type="checkbox"/> Settled                 |
| <input type="checkbox"/> Decision & Order of Offer of Settlement | <input type="checkbox"/> Dismissed | <input type="checkbox"/> Stipulation and Consent |
| <input type="checkbox"/> Decision                                | <input type="checkbox"/> Order     | <input type="checkbox"/> Vacated                 |

11. Resolution Date (MM/DD/YYYY)   Exact  Explanation

If not exact, provide explanation:

12. A. Were any of the following Sanctions Ordered? (Check all appropriate items):

- |  |  |   |
|--|--|---|
| <input type="checkbox"/> Monetary/Fine | <input type="checkbox"/> Revocation/Expulsion/Denial | <input type="checkbox"/> Disgorgement/Restitution   |
| Amount \$_____                         | <input type="checkbox"/> Censure                     | <input type="checkbox"/> Cease and Desist/Injunction <input type="checkbox"/> Bar <input type="checkbox"/> Suspension |

B. Other Sanctions Ordered:

C. Sanction Detail: If suspended, enjoined or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification, by exam/retraining was a condition of the sanction, provide length of time given to re-qualify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against applicant or control affiliate, date paid and if any portion of penalty was waived.

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13. Provide a brief summary of details related to the action status and (or) disposition and include relevant terms, conditions and dates. (The information must fit within the space provided.)

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**CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE)****GENERAL INSTRUCTIONS**

This Disclosure Reporting Page [DRP (BD)] is an  INITIAL **OR**  AMENDED response to report details for affirmative responses to **Items 14H** of Form BD;

Check  item(s) being responded to:

14H(1) Has any domestic or foreign civil judicial court:

- (a) in the past ten years, enjoined the applicant or a control affiliate in connection with any investment-related activity?
- (b) ever found that the applicant or a control affiliate was involved in a violation of investment-related statutes or regulations?
- (c) ever dismissed, pursuant to a settlement agreement, an investment-related civil judicial action brought against the applicant or a control affiliate by a state or foreign financial regulatory authority?

14H(2)  Is the applicant or a control affiliate now the subject of any civil judicial proceeding that could result in a "yes" answer to any part of 14H(1)?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 14H. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *control affiliate's* appropriate DRP (BD) or DRP (U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *control affiliate* of its obligation to update its CRD records.

**PART I**

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):

- The *Applicant*
- Applicant and one or more *control affiliate(s)*
- One or more *control affiliate(s)*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Applicant*

## DRP SBSE – CONTROL AFFILIATE

CRD NUMBER

This *Control Affiliate* is  Firm  Individual

Registered:  Yes  No

NAME (For individuals, Last, First, Middle)

- This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or BD DRP to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

- Yes  No

**Note:** The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

# CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE) (continuation)

**PART II**

1. Court Action initiated by: (Name of regulator, foreign financial regulatory authority, SRO, commodities exchange, agency, firm, private plaintiff, etc.)

2. Principal Relief Sought: (check appropriate item)

- |   |                                       |  |  |
|---|---------------------------------------|--|--|
| <input type="checkbox"/> Cease and Desist           | <input type="checkbox"/> Disgorgement | <input type="checkbox"/> Money Damages (Private/Civil Complaint) | <input type="checkbox"/> Restraining Order |
| <input type="checkbox"/> Civil Penalty(ies)/Fine(s) | <input type="checkbox"/> Injunction   | <input type="checkbox"/> Restitution                             | <input type="checkbox"/> Other _____       |

Other Relief Sought:

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3. Filing Date of Court Action (MM/DD/YYYY)   Exact  Explanation

If not exact, provide explanation: \_\_\_\_\_

4. Principal Product Type: (check appropriate item)

- |  |  |   |
|--|--|---|
| <input type="checkbox"/> Annuity(ies) - Fixed                | <input type="checkbox"/> Debt - Municipal                            | <input type="checkbox"/> Investment Contract(s)   |
| <input type="checkbox"/> Annuity(ies) - Variable             | <input type="checkbox"/> Derivative(s)                               | <input type="checkbox"/> Money Market Fund(s)     |
| <input type="checkbox"/> Banking Products (other than CD(s)) | <input type="checkbox"/> Direct Investment(s) – DPP & LP Interest(s) | <input type="checkbox"/> Mutual Fund(s)           |
| <input type="checkbox"/> CD(s)                               | <input type="checkbox"/> Equity - OTC                                | <input type="checkbox"/> No Product               |
| <input type="checkbox"/> Commodity Option(s)                 | <input type="checkbox"/> Equity Listed (Common & Preferred Stock)    | <input type="checkbox"/> Options                  |
| <input type="checkbox"/> Debt – Asset Backed                 | <input type="checkbox"/> Futures - Commodity                         | <input type="checkbox"/> Penny Stock(s)           |
| <input type="checkbox"/> Debt - Corporate                    | <input type="checkbox"/> Futures - Financial                         | <input type="checkbox"/> Unit Investment Trust(s) |
| <input type="checkbox"/> Debt - Government                   | <input type="checkbox"/> Index Option(s)                             | <input type="checkbox"/> Other _____              |
|  | <input type="checkbox"/> Insurance                                   |   |

Other Product Type:

5. Formal Action was brought in (include name of Federal, State or Foreign Court, Location of Court – City or County and State or Country, Docket/Case Number):

6. Control Affiliate Employing Firm when activity occurred which led to the civil judicial action (if applicable):

7. Describe the allegations related to this civil judicial action. (The information must fit within the space provided.):

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8. Current Status?  Pending  On Appeal  Final

9. If on appeal, action appealed to (provide name of court): Date Appeal Filed (MM/DD/YYYY):

10. If pending, date notice/process was served (MM/DD/YYYY)   Exact  Explanation

If not exact, provide explanation: \_\_\_\_\_



BANKRUPTCY / SIPC DISCLOSURE REPORTING PAGE (SBSE)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an an [ ] INITIAL OR [ ] AMENDED response to report details for affirmative responses to Questions 14I on Form SBSE;

Check [x] item(s) being responded to:

14I In the past ten years has the applicant or a control affiliate of the applicant ever been a securities firm or a control affiliate of a securities firm that:

[ ] (1) has been the subject of a bankruptcy petition?

[ ] (2) has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?

Use a separate DRP for each event or proceeding. An event or proceeding may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a control affiliate is an individual or organization registered through CRD, such control affiliate need only complete Part I of the applicant's appropriate DRP (SBSE). Details of the event must be submitted on the control affiliate's appropriate DRP (BD) or DRP (U-4). If a control affiliate is an individual or organization not registered through the CRD, provide complete answers to all the items on the applicant's appropriate DRP (SBSE). The completion of this DRP does not relieve the control affiliate of its obligation to update its CRD records.

PART I

A. The person or entity for whom this DRP (SBSE) is being filed is:

[ ] The Applicant

[ ] Applicant and one or more control affiliate(s)

[ ] One or more control affiliate(s)

If this DRP is being filed for a control affiliate, give the full name of the control affiliate below (for individuals, Last name, First name, Middle name).

If the control affiliate is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of Applicant

BD DRP - CONTROL AFFILIATE

CRD NUMBER

This Control Affiliate is [ ] Firm [ ] Individual

Registered: [ ] Yes [ ] No

NAME (For individuals, Last, First, Middle)

[ ] This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the control affiliate is registered through the CRD, has the control affiliate submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the control affiliate of its obligation to update its CRD records.

PART II

1. Action Type: (check appropriate item)

[ ] Bankruptcy [ ] Declaration [ ] Receivership

[ ] Compromise [ ] Liquidated [ ] Other

2. Action Date (MM/DD/YYYY) [ ] Exact [ ] Explanation

If not exact, provide explanation:

(continued)

3. If the financial action relates to an organization over which the applicant or the control affiliate exercise(d) control, enter organization name and the applicant's or control affiliate's position, title or relationship:



# Form SBSE-A

OMB Approval
OMB Number: .....3235-_____
Expires:..... Month __, 2016
Estimated average burden hours per response: . . . . . _____.
per amendment: . . . . . _____.

# Application for Registration of Security-based Swap Dealers and Major Security-based Swap Participants that are Registered or Registering with the Commodity Futures Trading Commission as a Swap Dealer or Major Swap Participant

BILLING CODE 8011-01-C

**Form SBSE-A Instructions***A. General Instructions*

1. **FORM**—Form SBSE-A is the Application for Registration as either a Security-based Swap Dealer or Major Security-based Swap Participant (collectively, “SBS Entities”) by an entity that is not registered or registering with the Commission as a broker-dealer but is registered or registering with the Commodity Futures Trading Commission (“CFTC”) as a swap dealer or major swap participant. These SBS Entities must file this form and a copy of the Form 7-R they file with the CFTC (or its designee) to register with the Securities and Exchange Commission. An applicant must also file Schedules A, B, C, F, and G, as appropriate. There are no Schedules D, or E. An entity that is registered with the Commission as a broker-dealer and also is registered or registering with the Commodity Futures Trading Commission (“CFTC”) as a swap dealer or major swap participant should file Form SBSE-BD to register with the Commission as an SBS Entity.

2. **ELECTRONIC FILING**—This Form SBSE-A must be filed electronically with the Commission through the EDGAR system, and must utilize the EDGAR Filer Manual (as defined in 17 CFR 232.11) to file and amend Form SBSE-A electronically to assure the timely acceptance and processing of those filings.<sup>1980</sup> Additional documents shall be attached to this electronic application.

3. **UPDATING**—By law, the *applicant* must promptly update Form SBSE-A information by submitting amendments whenever the information on file becomes inaccurate or incomplete for any reason [17 CFR 240.15Fb2-2]. In addition, the applicant must update any incomplete or inaccurate information contained on Form SBSE-A prior to filing a notice of withdrawal from registration on Form SBSE-W [17 CFR 15Fb3-2(a)].

4. **CONTACT EMPLOYEE**—The individual listed as the contact employee must be authorized to receive all compliance information, communications, and mailings, and be responsible for disseminating it within the *applicant's* organization.

5. **FEDERAL INFORMATION LAW AND REQUIREMENTS**—An agency may not conduct or sponsor, and a *person* is not required to respond to, a collection

of information unless it displays a currently valid control number. Sections 15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§ 78o-10, 78q and 78w. Filing of this form is mandatory; however, the social security number information, which aids in identifying the applicant, is voluntary. The principal purpose of this Form is to permit the Commission to determine whether the *applicant* meets the statutory requirement to engage in the security-based swap business. The Commission maintain[s] a file of the information on this form and will make certain information collected via the form publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. § 3507. The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the **Federal Register** the Privacy Act Systems of Records Notice for these records.

*B. Filing Instructions*1. **FORMAT**

a. Items 1-16 and the accompanying Schedules and DRP pages must be answered and all fields requiring a response must be completed before the filing will be accepted.

b. Failure to follow instructions or properly complete the form may result in the application being delayed or rejected.

c. *Applicant* must complete the execution screen certifying that Form SBSE-A and amendments thereto have been executed properly and that the information contained therein is accurate and complete.

d. To amend information, the *applicant* must update the appropriate Form SBSE-A screens.

e. A paper copy, with original signatures, of the initial Form SBSE-A filing [and amendments to Disclosure Reporting Pages (DRPs)] must be retained by the *applicant* and be made available for inspection upon a regulatory request.

2. **DISCLOSURE REPORTING PAGE (DRP)**—Information concerning a *principal* that relates to the occurrence of an event reportable in Schedule C must be provided on the appropriate DRP.

The mailing address for questions and correspondence is:

**Explanation of Terms**

(The following terms are italicized throughout this form.)

1. *General*

Terms used in this Form SBSE-A that are defined in the form the CFTC requires that swap dealers and major swap participants use to apply for registration with the CFTC shall have the same meaning as set forth in that form.

**APPLICANT**—The security-based swap dealer or major security-based swap participant applying on or amending this form.

**CONTROL**—The power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any *person* that (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% or more of a class of a voting security or has the power to sell or direct the sale of 25% or more of a class of voting securities; or (iii) in the case of a partnership, has the right to receive upon dissolution, or has contributed, 25% or more of the capital, is presumed to *control* that company.

**JURISDICTION**—A state, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, or any subdivision or regulatory body thereof.

**SUCCESSOR**—The term “successor” is defined to be an unregistered entity that assumes or acquires substantially all of the assets and liabilities, and that continues the business of, a predecessor security-based swap dealer or major security-based swap participants that ceases its security-based swap activities. [See Exchange Act Rule 15b2-5 (17 CFR 240.15Fb2-5)]

3. *For the Purpose of Schedule C and the Corresponding Disclosure Reporting Pages (DRPs)*

**FOREIGN FINANCIAL REGULATORY AUTHORITY**—Includes (1) a foreign securities authority; (2) other governmental body or foreign equivalent of a *self-regulatory organization* empowered by a foreign government to administer or enforce its laws relating to the regulation of *financial services industry-related* activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above.

<sup>1980</sup> As discussed in the release proposing this Form, the Commission is currently developing a system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.



FINANCIAL SERVICES INDUSTRY-RELATED—Pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency). (This definition is

used solely for the purpose of Form SBSE-A.)

INVOLVED—Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

ORDER—A written directive issued pursuant to statutory authority and procedures, including orders of denial, suspension, or revocation; does not include special stipulations, undertakings or agreements relating to payments, limitations on activity or other restrictions unless they are included in an *order*.

PROCEEDING—Includes a formal administrative or civil action initiated by a governmental agency, *self-regulatory organization* or a *foreign financial regulatory authority*; a *felony* criminal indictment or information (or equivalent formal charge); or a *misdemeanor* criminal information (or equivalent formal charge). Does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge).

BILLING CODE 8011-01-P

<b>FORM SBSE-A</b> Page 1 (Execution Page)	<b>Application for Registration as a Security-based Swap Dealer and Major Security-based Swap Participant that is Registered or Registering with the CFTC as a Swap Dealer or Major Swap Participant</b>  Date: _____ Applicant NFA Number: _____	<b>Official Use</b>	Official Use Only
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**WARNING:** Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as an SBS Entity, would violate the Federal securities laws and the laws of the *jurisdictions* and may result in disciplinary, administrative, injunctive or criminal action.

**INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.**

[ ] APPLICATION [ ] AMENDMENT

1. Exact name, principal business address, mailing address, if different, and telephone number of the *applicant*:

A. Full name of the *applicant*:

B. IRS Empl. Ident. No.:

C. Applicant's NFA ID #:  Applicant's CIK # (if any):

D. *Applicant's* Main Address: (Do not use a P.O. Box)  
 Number and Street 1:  Number and Street 2:   
 City:  State:  Country:  Zip/Postal Code:

E. Mailing Address, if different:  
 Number and Street 1:  Number and Street 2:   
 City:  State:  Country:  Zip/Postal Code:

F. Business Telephone Number:

G. Website/URL:

H. Contact Employee:  
 Name:  Title:   
 Telephone Number:  Email Address:

I. Chief Compliance Officer designated by the *applicant* in accordance with Exchange Act Section 15F(k):  
 Name:  Title:   
 Telephone Number:  Email Address:

**EXECUTION:**

The applicant consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission in connection with the applicant's security-based swap activities, unless the applicant is a nonresident SBS Entity, may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 1E and 1F. If the applicant is a nonresident SBS Entity, it must complete Schedule F to designate a U.S. agent for service of process.

The undersigned certifies that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including schedules attached hereto, and other information filed herewith are current, true and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended such information is currently accurate and complete.

<input style="width: 90%;" type="text"/>	<input style="width: 90%;" type="text"/>
Date (MM/DD/YYYY)	Name of Applicant
By: <input style="width: 300px;" type="text"/>	<input style="width: 300px;" type="text"/>
Signature	Name and Title of Person Signing on <i>Applicant's</i> behalf

*This page must always be completed in full.*

DO NOT WRITE BELOW THIS LINE – FOR OFFICIAL USE ONLY

FORM SBSE-A Page 2		Applicant Name: _____ Date: _____ Applicant NFA No.: _____	Official Use	Official Use Only
2.	A. The <i>applicant</i> is registering as a security-based swap dealer: <input type="checkbox"/> Yes <input type="checkbox"/> No B. The <i>applicant</i> is registering as a major security-based swap participant: <input type="checkbox"/> Yes <input type="checkbox"/> No Because it: (check all that apply) <input type="checkbox"/> maintains a substantial security-based swap position <input type="checkbox"/> has substantial counterparty exposure <input type="checkbox"/> is highly leveraged relative to its capital position			
3.	A. Is the <i>applicant</i> a foreign security-based swap dealer that intends to: • work with the Commission and its primary regulator to have the Commission determine whether the requirements of its primary regulator's regulatory system are comparable to the Commission's <input type="checkbox"/> Yes <input type="checkbox"/> No • avail itself of a previously granted substituted compliance determination <input type="checkbox"/> Yes <input type="checkbox"/> No with respect to the requirements of Section 15F of the Exchange Act of 1934 and the rules and regulations thereunder? B. If "yes" to either of the questions in Item 3.A. above, identify the foreign financial regulatory authority that serves as the <i>applicant's</i> primary regulator and for which the Commission has made, or may make, a substituted compliance determination: _____ C. If the applicant is relying on a previously granted substituted compliance determination, please describe how the <i>applicant</i> satisfies any conditions the Commission may have placed on such substituted compliance determination: _____			
4.	Does the <i>applicant</i> intend to compute capital or margin, or price customer or proprietary positions, using mathematical models? <input type="checkbox"/> Yes <input type="checkbox"/> No			
5.	A. The <i>applicant</i> is currently registered with the Commodity Futures Trading Commission as a: <input type="checkbox"/> Swap Dealer <input type="checkbox"/> Major Swap Participant B. The <i>applicant</i> is registering with the Commodity Futures Trading Commission as a: <input type="checkbox"/> Swap Dealer <input type="checkbox"/> Major Swap Participant			
6.	Is the <i>applicant</i> a U.S. branch of a non-resident entity? <input type="checkbox"/> Yes <input type="checkbox"/> No If "yes," identify the non-resident entity and its location: _____			
7.	Briefly describe the <i>applicant's</i> business: _____ _____ _____			
8.	Is the <i>applicant</i> subject to regulation by a prudential regulator, as defined in Section 1a(39) of the Commodity Exchange Act. If "yes," identify the prudential regulator: _____.		YES NO	<input type="checkbox"/> <input type="checkbox"/>
9.	Is the <i>applicant</i> registered with the Commission as an investment adviser? Applicant's IARD #: _____		<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
10.	A. Is the <i>applicant</i> registered with the Commodity Futures Trading Commission in any capacity other than as a swap dealer or major swap participant? <input type="checkbox"/> <input type="checkbox"/> B. If "yes," as a: <input type="checkbox"/> Futures Commission Merchant <input type="checkbox"/> Introducing Broker <input type="checkbox"/> Commodity Pool Operator <input type="checkbox"/> Other: _____		<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>
11.	Does <i>applicant</i> engage in any other non-securities, <i>financial services industry-related</i> business? If "yes," describe each other business briefly on Schedule B, Section I.		<input type="checkbox"/> <input type="checkbox"/>	<input type="checkbox"/> <input type="checkbox"/>

12.	Does the <i>applicant</i> hold or maintain any funds or securities to collateralize counterparty transactions?	[ ] [ ]
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FORM SBSE-A Page 3	Applicant Name: _____ Date: _____ Applicant NFA No.: _____	Official Use	Official Use Only
13.	Does the <i>applicant</i> have any arrangement: A. With any other <i>person</i> , firm, or organization under which any books or records of the <i>applicant</i> are kept, maintained, or audited by such other <i>person</i> , firm or organization? B. Under which such other person, firm or organization executes, trades, custodies, clears or settles on behalf of the applicant (including any SRO in which the applicant is a member)? <i>If "yes" to any part of Item 11, complete appropriate items on Schedule B, Section II.</i>	[ ] [ ] [ ] [ ]	
14.	Does any <i>person</i> directly or indirectly <i>control</i> the management or policies of the <i>applicant</i> through agreement or otherwise? <i>If "yes," complete appropriate item on Schedule B, Section II.</i>	[ ] [ ]	
15.	Does any <i>person</i> directly or indirectly finance (wholly or partially) the business of the <i>applicant</i> ? <i>Do not answer "Yes" to Item 15 if the person finances the business of the applicant through: 1) a public offering of securities made pursuant to the Securities Act of 1933; or 2) credit extended in the ordinary course of business by suppliers, banks, and others.</i> <i>If "yes," complete appropriate item on Schedule B, Section II.</i>	[ ] [ ]	
16.	Is the <i>applicant</i> at the time of this filing <i>succeeding</i> to the business of a currently registered SBS Entity? <i>If "yes," complete appropriate items on Schedule B, Section III.</i>	[ ] [ ]	
17.	Is the <i>applicant</i> registered with a foreign financial regulatory authority? <i>If "yes," list all such registrations on Schedule F, Page 1, Section II.</i>	[ ] [ ]	
18.	The applicant has _____ principals who are individuals. <i>Please list all principals who are individuals on Schedule A.</i>		
19.	Does any principal not identified in Item 18 and Schedule A effect, or is any principal not identified in Item 18 and Schedule A involved in effecting security-based swaps on behalf of the applicant, or will such principals effect or be involved in effecting such business on the applicant's behalf? <i>If "yes," complete appropriate item on Schedule B, Section IV.</i>		

<p><b>Schedule A of FORM SBSE</b>  <b>PRINCIPALS THAT ARE INDIVIDUALS</b>                  (Answer for Form SBSE-A Item 18)</p>	Applicant Name: _____ Date: _____ Applicant NFA No.: _____	<b>Official Use</b>
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Use Schedule A to identify all principals of the applicant who are individuals.

Complete the "Title or Status" column by entering board/management titles; status as partner, trustee, sole proprietor, or shareholder; and for shareholders, the class of securities owned (if more than one is issued).

Ownership Codes are:

- |                          |                           |                           |
|--------------------------|---------------------------|---------------------------|
| NA - less than 5%        | B - 10% but less than 25% | D - 50% but less than 75% |
| A - 5% but less than 10% | C - 25% but less than 50% | E - 75% or more           |

1.	FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	Title or Status	Date Title or Status Acquired		Date Individual began working for applicant		Does person have an ownership interest in the applicant	If yes, include ownership code	NFA Identification No., CRD No. and/or IARD No.	Official Use Only
			MM	YYYY	MM	YYYY				
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									
							Y / N			
	For individuals not presently registered through NFA, CRD or IARD, describe prior <i>investment-related</i> experience (e.g., for each prior position - employer, job title, and dates of service):									

Schedule B of FORM SBSE-A Page 1		Applicant Name: _____ Date: _____ Applicant NFA No.: _____		Official Use	Official Use Only
Use this Schedule B to report details for items listed below. Report only new information or changes/updates to previously submitted details. Do not repeat previously submitted information. This is an <input type="checkbox"/> INITIAL <input type="checkbox"/> AMENDED detail filing for the Form SBSE-A items checked below:					
<b>Section I</b>		<b>Other Business</b>			
Item 11: Does applicant engage in any other non-securities, financial services industry-related business?					
Unique Identification Number(s):			Assigning Regulator(s)/Entity(s):		
Briefly describe any other financial services industry-related, non-securities business in which the applicant is engaged:					
<b>Section II</b>		<b>Record Maintenance Arrangements / Business Arrangements / Control Persons / Financings</b>			
(Check one) <input type="checkbox"/> Item 13A <input type="checkbox"/> Item 13B <input type="checkbox"/> Item 14 <input type="checkbox"/> Item 15 Applicant must complete a separate Schedule B Page 1 for each affirmative response in this section including any multiple responses to any item. Complete the "Effective Date" box with the Month, Day and Year that the arrangement or agreement became effective. When reporting a change or termination of an arrangement, enter the effective date of the change.					
Firm or Organization Name			SEC File, CRD, NFA, IARD, and/or CIK Number (if any)		
Business Address (Street, City, State/Country, Zip + 4 Postal Code)			Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /	
Individual Name			CRD, NFA, and/or IARD Number (if any)		
Business Address (if applicable) (Street, City, State/Country, Zip + 4 Postal Code)			Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /	
Briefly describe the nature of the arrangement with respect to books or records (ITEM 13A); the nature of the execution, trading, custody, clearing or settlement arrangement (ITEM 13B); the nature of the control or agreement (ITEM 14); or the method and amount of financing (ITEM 15). Use reverse side of this sheet for additional comments if necessary.					
For ITEM 14 ONLY - If the control person is an individual not presently registered through CRD or IARD, describe prior investment-related experience (e.g., for each prior position - employer, job title, and dates of service).					
<b>Section III</b>		<b>Successions</b>			
Item 16: Is the applicant at the time of this filing succeeding to the business of a currently registered SBS Entity?					
Date of Succession MM DD YYYY / /		Name of Predecessor			
SEC File, CRD, NFA, IARD, and/or CIK Number (if any)			IRS Employer Number (if any)		
Briefly describe details of the succession including any assets or liabilities not assumed by the successor. Use reverse side of this sheet for additional comments if necessary.					
<b>Section IV</b>		<b>Principals Effecting or Involved in Effecting SBS Business</b>			
Item 19: Does any principal not identified in Item 18 and Schedule A effect, or is any principal not identified in Item 15 and Schedule A involved in effecting security-based swaps on behalf of the applicant, or will such principals effect or be involved in effecting such business on the applicant's behalf? For each Principal identified in Section IV, complete Schedule C of the Form SBSE-A and the relevant DRP pages.					
1.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number		
	Business Address (Street, City, State/Country, Zip + 4/Postal Code)				
	This entity <input type="checkbox"/> effects <input type="checkbox"/> is involved in effecting security based swaps on behalf of the applicant. (check only one)				
Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:					

Schedule B of FORM SBSE-A Page 2		Applicant Name: _____ Date: _____ Applicant NFA No.: _____		Official Use	Official Use Only	
<b>Section IV, Continued</b>		<b>Principals Effecting or Involved in Effecting SBS Business</b>				
For each Principal identified in Section IV, complete Schedule C of the Form SBSE-A and the relevant DRP pages.						
2.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number			
	Business Address (Street, City, State/Country, Zip + 4/Postal Code)					
	This entity <input type="checkbox"/> effects <input type="checkbox"/> is involved in effecting security based swaps on behalf of the applicant. (check only one)					
Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:						
3.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number			
	Business Address (Street, City, State/Country, Zip + 4/Postal Code)					
	This entity <input type="checkbox"/> effects <input type="checkbox"/> is involved in effecting security based swaps on behalf of the applicant. (check only one)					
Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:						
4.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number			
	Business Address (Street, City, State/Country, Zip + 4/Postal Code)					
	This entity <input type="checkbox"/> effects <input type="checkbox"/> is involved in effecting security based swaps on behalf of the applicant. (check only one)					
Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:						
5.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number			
	Business Address (Street, City, State/Country, Zip + 4/Postal Code)					
	This entity <input type="checkbox"/> effects <input type="checkbox"/> is involved in effecting security based swaps on behalf of the applicant. (check only one)					
Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:						
6.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number			
	Business Address (Street, City, State/Country, Zip + 4/Postal Code)					
	This entity <input type="checkbox"/> effects <input type="checkbox"/> is involved in effecting security based swaps on behalf of the applicant. (check only one)					
Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:						



Schedule C of FORM SBSE-A Page 1		Applicant Name: _____ Principal Name: _____ Date: _____ Applicant NFA No.: _____		Official Use	Official Use Only
Use the appropriate DRP for providing details to "yes" answers to the questions in Schedule C. Refer to the Explanation of Terms section of Form SBSE-A Instructions for explanations of italicized terms.					
CRIMINAL DISCLOSURE	A. In the past ten years has the <i>principal</i> :			YES	NO
	(1) Been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to any <i>felony</i> ?			<input type="checkbox"/>	<input type="checkbox"/>
	(2) Been charged with a <i>felony</i>			<input type="checkbox"/>	<input type="checkbox"/>
	B. In the past ten years has the <i>principal</i> :				
	(1) Been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to a <i>misdemeanor involving: financial services industry-related business, or any fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?</i>			<input type="checkbox"/>	<input type="checkbox"/>
	(2) Been <i>charged with a misdemeanor</i> specified in B(1)?			<input type="checkbox"/>	<input type="checkbox"/>
REGULATORY ACTION DISCLOSURE	C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:				
	(1) <i>Found the principal</i> to have made a false statement or omission?			<input type="checkbox"/>	<input type="checkbox"/>
	(2) <i>Found the principal</i> to have been involved in a violation of its regulations or statutes?			<input type="checkbox"/>	<input type="checkbox"/>
	(3) <i>Found the principal</i> to have been a cause of a <i>financial services industry-related business</i> having its authorization to do business denied, revoked, or restricted?			<input type="checkbox"/>	<input type="checkbox"/>
	(4) Entered an <i>order</i> against the <i>principal</i> in connection with <i>financial services industry-related activity</i> ?			<input type="checkbox"/>	<input type="checkbox"/>
	(5) Imposed a civil money penalty on the <i>principal</i> , or ordered the <i>principal</i> to cease and desist from any activity?			<input type="checkbox"/>	<input type="checkbox"/>
REGULATORY ACTION DISCLOSURE	D. Has any other federal regulatory agency, state regulatory agency, or <i>foreign financial regulatory authority</i> :				
	(1) Ever found the <i>principal</i> to have made a false statement or omission or been dishonest, unfair, or unethical?			<input type="checkbox"/>	<input type="checkbox"/>
	(2) Ever found the <i>principal</i> to have been involved in a violation of <i>financial services industry-related regulations or statutes</i> ?			<input type="checkbox"/>	<input type="checkbox"/>
	(3) Ever found the <i>principal</i> to have been a cause of a <i>financial services industry-related business</i> having its authorization to do business denied, suspended, revoked or restricted?			<input type="checkbox"/>	<input type="checkbox"/>
	(4) In the past ten years, entered an order against the <i>principal</i> in connection with a <i>financial services industry-related activity</i> ?			<input type="checkbox"/>	<input type="checkbox"/>
	(5) Ever denied, suspended, or revoked the <i>principal's</i> registration or license or otherwise, by order, prevented it from associating with a <i>financial services industry-related business</i> or restricted its activities?			<input type="checkbox"/>	<input type="checkbox"/>
	E. Has any <i>self-regulatory organization</i> or commodities exchange ever:				
	(1) <i>found the principal</i> to have made a false statement or omission?			<input type="checkbox"/>	<input type="checkbox"/>
	(2) <i>found the principal</i> to have been involved in a violation of its rules (other than a violation designated as a " <i>minor rule violation</i> " under a plan approved by the U.S. Securities and exchange Commission)?			<input type="checkbox"/>	<input type="checkbox"/>
	(3) <i>found the principal</i> to have been the cause of a <i>financial services industry-related business</i> having its authorization to do business denied, suspended, revoked or restricted?			<input type="checkbox"/>	<input type="checkbox"/>
	(4) Disciplined the <i>principal</i> by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?			<input type="checkbox"/>	<input type="checkbox"/>
	F. Has the <i>principal's</i> authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?			<input type="checkbox"/>	<input type="checkbox"/>
	G. Is the <i>principal</i> now the subject of any regulatory <i>proceeding</i> that could result in a "yes" answer to any part of C, D, or E?			<input type="checkbox"/>	<input type="checkbox"/>

<b>Schedule C of FORM SBSE-A</b> Page 2		Applicant Name: _____ Principal Name: _____ Date: _____ Applicant NFA No.: _____		<b>Official Use</b>		Official Use Only
<b>CIVIL JUDICIAL DISCLOSURE</b>	H.	(1) Has any domestic or foreign civil judicial court:				
		(a) In the past ten years, enjoined the <i>principal</i> in connection with any <i>financial services industry-related</i> activity?	YES	NO	<input type="checkbox"/>	<input type="checkbox"/>
		(b) Ever <i>found</i> that the <i>principal</i> was involved in a violation of <i>financial services industry-related</i> statutes or regulations?			<input type="checkbox"/>	<input type="checkbox"/>
		(c) Ever dismissed, pursuant to a settlement agreement, a <i>financial services industry-related</i> civil judicial action brought against the <i>principal</i> by a state or foreign <i>financial regulatory authority</i> ?			<input type="checkbox"/>	<input type="checkbox"/>
	(2) Is the <i>principal</i> now the subject of any civil judicial <i>proceeding</i> that could result in a "yes" answer to any part of H(1)?			<input type="checkbox"/>	<input type="checkbox"/>	
<b>FINANCIAL DISCLOSURE</b>	I.	In the past ten years has the <i>principal</i> ever been a securities firm or a <i>principal</i> of a securities firm that:				
		(1) Has been the subject of a bankruptcy petition?			<input type="checkbox"/>	<input type="checkbox"/>
		(2) Has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?			<input type="checkbox"/>	<input type="checkbox"/>

<b>Schedule F of FORM SBSE-A</b>	Applicant Name: _____ Date: _____ Applicant NFA No.: _____	<b>Official Use</b>
----------------------------------	---	---------------------

**Section I Service of Process and Certification Regarding Access to Records**

Each nonresident security-based swap dealer and non-resident security-based swap participant shall use Schedule F to identify its United States agent for service of process and the certify that it can

- (3) provide the Commission with prompt access to its books and records, and
- (4) submit to onsite inspection and examination by the Commission.

1. Service of Process:
- A. Name of United States person *applicant* designates and appoints as agent for service of process  
 \_\_\_\_\_
  - B. Address of United States person *applicant* designates and appoints as agent for service of process  
 \_\_\_\_\_

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

- (a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the *applicant* may have information; and
- (b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2. Certification regarding access to records:
- Applicant* can as a matter of law;
- (3) provide the Commission with prompt access to its books and records, and
  - (4) submit to onsite inspection and examination by the Commission.
- Applicant must attach to this Form SBSE a copy of the opinion of counsel it is required to obtain in accordance with paragraph (c)(2) or (c)(3) of Exchange Act Rule 15Fb2-4, as appropriate [paragraphs (c)(2) or (c)(3) of 17 CFR 240.15Fb2-4].*
- Signature:  
 \_\_\_\_\_  
 Name and Title:  
 \_\_\_\_\_  
 Date:  
 \_\_\_\_\_

**Section II Registration with Foreign Financial Regulatory Authorities**

**Complete this Section for Registration with Foreign Financial Regulatory Authorities relating to ITEM 17.** Each security-based swap dealer and major security-based swap participant that is registered with a foreign financial regulatory authority must list on Section II of this Schedule F, for each foreign financial regulatory authority with which it is registered, the following information:

- |  |                                     |                                |
|--|-------------------------------------|--------------------------------|
| 1. _____   | Foreign Registration No. (if _____) | English Name of Country: _____ |
| English Name of Foreign Financial Regulatory Authority | any)                                |                                |
| 2. _____   | Foreign Registration No. (if _____) | English Name of Country: _____ |
| English Name of Foreign Financial Regulatory Authority | any)                                |                                |
| 3. _____   | Foreign Registration No. (if _____) | English Name of Country: _____ |
| English Name of Foreign Financial Regulatory Authority | any)                                |                                |

If applicant has more than 3 Foreign Financial Regulatory Authorities to report, complete additional Schedule F Page 1s.

<b>Schedule G of FORM SBSE-A CERTIFICATION ON STATUTORY DISQUALIFICATION</b>	<i>Applicant Name:</i> _____	<b>Official Use</b>
	Date: _____ <i>Applicant NFA No.:</i> _____	

Use Schedule G to certify that none of the *applicant's* associated persons is subject to statutory disqualification (as that term is defined in Section 3(a)(39) of the Exchange Act [15 U.S.C. 78c(a)(39)]).

Instructions: This certification must be signed by the *applicant's* Chief Compliance Officer designated pursuant to Exchange Act Section 15F(k) or by his or her designee.  
 For purposes of this Form, the term *associated person* shall have the meaning as specified in Section 3(a)(70) of the Exchange Act [15 U.S.C. 78c(a)(70)].

This is a:  CERTIFICATION                       RE-CERTIFICATION

The *applicant* certifies that it has

- (c) performed background checks on all of its *associated persons* who effect or are involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf, and
- (d) determined that no *associated person* who effects or is involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(39)].

Applicant Name:	Date:
Signature of Chief Compliance Officer or Designee:	
Name of Chief Compliance Officer or Designee:	If Designee, Title of Designee:

**CRIMINAL DISCLOSURE REPORTING PAGE (SBSE-A)****GENERAL INSTRUCTIONS**

This Disclosure Reporting Page [DRP (SBSE)] is an  INITIAL **OR**  AMENDED response to report details for affirmative responses to **Items A and B** of Schedule C of Form SBSE-A;

Check  item(s) being responded to:

A. In the past ten years has the principal:

(1) Been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign or military court to any felony?

(2) Been charged with a felony?

B. In the past ten years has the principal:

(1) Been convicted of or pled guilty or or nolo contendere ("no contest") in a domestic, foreign or military court to a misdemeanor involving: investments or an investment-related business, or any fraud, false statements or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?

(2) Been charged with a misdemeanor specified in B(1)?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

Multiple counts of the same charge arising out of the same event(s) should be reported on the same DRP. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. Use this DRP to report all charges arising out of the same event. One event may result in more than one affirmative answer to the above items.

If a *principal* is an organization registered through the CRD, such *principal* need only complete Part I of the *applicant's* appropriate DRP (SBSE-A). Details of the event must be submitted on the *principal's* appropriate DRP (BD) or DRP (U-4). If a *principal* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE-A). The completion of this DRP does not relieve the *principal* of its obligation to update its CRD records.

Applicants must attach a copy of each applicable court document (*i.e.*, criminal complaint, information or indictment as well as judgment of conviction or sentencing documents) if not previously submitted through CRD (as they could be in the case of a *control affiliate* registered through CRD). Documents will not be accepted as disclosure in lieu of answering the questions on this DRP.

**PART I**

A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Principal*

CRD NUMBER

Registered:  Yes  No

This DRP should be removed from the SBS Entity's record because the principal is no longer associated with the SBS Entity.

B. If the *principal* is registered through the CRD, has the *principal* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

Yes  No

**Note:** The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.

# CRIMINAL DISCLOSURE REPORTING PAGE (SBSE-A)

(continuation)

## PART II

1. If charge(s) were brought against an organization over which the principal exercise(d) control: Enter organization name, whether or not the organization was an investment-related business and the principal's position, title or relationship.

\_\_\_\_\_

2. Formal Charge(s) were brought in: (include name of Federal, Military, State or Foreign Court, Location of Court – City or County and State or Country, Docket/Case number).

\_\_\_\_\_

3. Event Disclosure Detail (Use this for both organizational and individual charges.)

A. Date First Charged (MM/DD/YYYY):  [ ] Exact [ ] Explanation

If not exact, provide explanation: \_\_\_\_\_

B. Event Disclosure Detail (include Charge(s)/Charge Description(s), and for each charge provide: 1. number of counts, 2. felony or misdemeanor, 3. plea for each charge, and 4. product type if charge is investment-related):

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

C. Current status of the Event? [ ] Pending [ ] On Appeal [ ] Final

D. Event Status Date (complete unless status is Pending) (MM/DD/YYYY):  [ ] Exact [ ] Explanation

If not exact, provide explanation: \_\_\_\_\_

4. Disposition Disclosure Detail: Include for each charge, A. Disposition Type [e.g., convicted, acquitted, dismissed, pretrial.], B. Date, C. Sentence/Penalty, D. Duration [if sentence-suspension, probation, etc.], E. Start Date of Penalty, F. Penalty/Fine Amount and G. Date Paid.

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

5. Provide a brief summary of the circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct which was the subject of the char(s) occurred. (The information must fit within the space provided.)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

## REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

### GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an  INITIAL **OR**  AMENDED response to report details for affirmative responses to **Items C, D, E, F, or G** of Schedule C of Form SBSE-A;

Check  item(s) being responded to:

- C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:
  - (1) Found the principal to have made a false statement or omission?
  - (2) Found the principal to have been involved in a violation of its regulations or statutes?
  - (3) the principal to have been a cause of an investment-related business having its authorization to do business denied, revoked, or restricted?
  - (4) Entered an order against the principal in connection with investment-related activity?
  - (5) Imposed a civil money penalty on the principal, or ordered the principal to cease and desist from any activity?
- D. Has any other federal regulatory agency, state regulatory agency, or foreign financial regulatory authority:
  - (1) Ever found the principal to have made a false statement or omission or been dishonest, unfair, or unethical?
  - (2) Ever found the principal to have been involved in a violation of investment-related regulations or statutes?
  - (3) Ever found the principal to have been a cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted?
  - (4) In the past ten years, entered an order against the principal in connection with an investment-related activity?
  - (5) Ever denied, suspended, or revoked the principal's registration or license or otherwise, by order, prevented it from associating with an investment-related business or restricted its activities?
- E. Has any self-regulatory organization or commodities exchange ever:
  - (1) found the principal to have made a false statement or omission?
  - (2) found the principal to have been involved in a violation of its rules (other than a violation designated as a "minor rule violation" under a plan approved by the U.S. Securities and exchange Commission)?
  - (3) found the principal to have been the cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted?
  - (4) Disciplined the principal by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?
- F.  Has the principal's authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?
- G.  Is the principal now the subject of any regulatory proceeding that could result in a "yes" answer to any part of C, D, or E?

Use a separate **DRP** for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one **DRP**. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items C, D, E, F or G. Use only one **DRP** to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate **DRP**.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this **DRP**.

If the principal is an organization registered through the CRD, such principal need only complete Part I of the *applicant's* appropriate **DRP** (SBSE). Details of the event must be submitted on the *principal's* appropriate **DRP** (BD) or **DRP** (U-4). If a *principal* is an organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate **DRP** (SBSE). The completion of this **DRP** does not relieve the *principal* of its obligation to update its CRD records.

### PART I

- A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of <i>Principal</i>	<i>Principal's</i> CRD Number
--------------------------	-------------------------------

Registered:  Yes  No

This **DRP** should be removed from the SBS Entity record because the control affiliate(s) are no longer associated with the SBS Entity.

- B. If the *principal* is registered through the CRD, has the *principal* submitted a **DRP** (with Form U-4) or **DRP** (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this **DRP** must be provided: If "No," complete Part II.

Yes  No

**Note:** The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.



# REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE-A) (continuation)

## PART II

1. Regulatory Action initiated by:

SEC     Other Federal     State     SRO     Foreign  
(Full name of regulator, foreign financial regulatory authority, federal, state or SRO)

2. Principal Sanction: (check appropriate item)

<input type="checkbox"/> Civil and Administrative Penalty(ies)/Fine(s)	<input type="checkbox"/> Disgorgement	<input type="checkbox"/> Restitution
<input type="checkbox"/> Bar	<input type="checkbox"/> Expulsion	<input type="checkbox"/> Revocation
<input type="checkbox"/> Cease and Desist	<input type="checkbox"/> Injunction	<input type="checkbox"/> Suspension
<input type="checkbox"/> Censure	<input type="checkbox"/> Prohibition	<input type="checkbox"/> Undertaking
<input type="checkbox"/> Denial	<input type="checkbox"/> Reprimand	<input type="checkbox"/> Other _____

Other Sanctions:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

3.

3. Date Initiated (MM/DD/YYYY)   Exact     Explanation

If not exact, provide explanation: \_\_\_\_\_

4.

Docket/Case Number:

5.

Principal Employing Firm when activity occurred which led to the regulatory action (if applicable):

6.

Principal Product Type: (check appropriate item)

<input type="checkbox"/> Annuity(ies) - Fixed	<input type="checkbox"/> Debt - Municipal	<input type="checkbox"/> Investment Contract(s)
<input type="checkbox"/> Annuity(ies) - Variable	<input type="checkbox"/> Derivative(s)	<input type="checkbox"/> Money Market Fund(s)
<input type="checkbox"/> Banking Products (other than CD(s))	<input type="checkbox"/> Direct Investment(s) – DPP & LP Interest(s)	<input type="checkbox"/> Mutual Fund(s)
<input type="checkbox"/> CD(s)	<input type="checkbox"/> Equity - OTC	<input type="checkbox"/> No Product
<input type="checkbox"/> Commodity Option(s)	<input type="checkbox"/> Equity Listed (Common & Preferred Stock)	<input type="checkbox"/> Options
<input type="checkbox"/> Debt – Asset Backed	<input type="checkbox"/> Futures - Commodity	<input type="checkbox"/> Penny Stock(s)
<input type="checkbox"/> Debt - Corporate	<input type="checkbox"/> Futures - Financial	<input type="checkbox"/> Unit Investment Trust(s)
<input type="checkbox"/> Debt - Government	<input type="checkbox"/> Index Option(s)	<input type="checkbox"/> Other _____
	<input type="checkbox"/> Insurance	

Other Product Type:

7.

Describe the allegations related to this regulatory action. (The information must fit within the space provided.):

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

8.

Current Status?     Pending     On Appeal     Final

9.

If on appeal, regulatory action appealed to: (SEC, SRO, Federal or State Court) and Date Appeal Filed:



## CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

### GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (BD)] is an  INITIAL **OR**  AMENDED response to report details for affirmative responses to **Item H** of Schedule C of Form BD;

Check  item(s) being responded to:

H(1) Has any domestic or foreign civil judicial court:

(a) in the past ten years, enjoined the principal in connection with any investment-related activity?

(b) ever found that the principal was involved in a violation of investment-related statutes or regulations?

(c) ever dismissed, pursuant to a settlement agreement, an investment-related civil judicial action brought against the principal by a state or foreign financial regulatory authority?

H(2)  Is the principal now the subject of any civil judicial proceeding that could result in a "yes" answer to any part of H?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item H. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *principal* is an individual or organization registered through the CRD, such *principal* need only complete Part I of the *applicant's* appropriate DRP (SBSE-A). Details of the event must be submitted on the *principal's* appropriate DRP (BD) or DRP (U-4). If a *principal* is an organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE-A). The completion of this DRP does not relieve the *principal* of its obligation to update its CRD records.

### PART I

- A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Principal*

CRD NUMBER

Registered:  Yes  No

This DRP should be removed from the SBS Entity's record because the principal is no longer associated with the SBS Entity.

- B. If the *principal* is registered through the CRD, has the *principal* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

Yes  No

**Note:** The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.

## CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

(continuation)

**PART II**

1. Court Action initiated by: (Name of regulator, foreign financial regulatory authority, SRO, commodities exchange, agency, firm, private plaintiff, etc.)

2. Principal Relief Sought: (check appropriate item)

Cease and Desist                       Disgorgement                       Money Damages (Private/Civil Complaint)                       Restraining Order  
 Civil Penalty(ies)/Fine(s)                       Injunction                       Restitution                       Other \_\_\_\_\_

Other Relief Sought:

3. Filing Date of Court Action (MM/DD/YYYY)   Exact     Explanation

If not exact, provide explanation: \_\_\_\_\_

4. Principal Product Type: (check appropriate item)

<input type="checkbox"/> Annuity(ies) - Fixed	<input type="checkbox"/> Debt - Municipal	<input type="checkbox"/> Investment Contract(s)
<input type="checkbox"/> Annuity(ies) - Variable	<input type="checkbox"/> Derivative(s)	<input type="checkbox"/> Money Market Fund(s)
<input type="checkbox"/> Banking Products (other than CD(s))	<input type="checkbox"/> Direct Investment(s) – DPP & LP Interest(s)	<input type="checkbox"/> Mutual Fund(s)
<input type="checkbox"/> CD(s)	<input type="checkbox"/> Equity - OTC	<input type="checkbox"/> No Product
<input type="checkbox"/> Commodity Option(s)	<input type="checkbox"/> Equity Listed (Common & Preferred Stock)	<input type="checkbox"/> Options
<input type="checkbox"/> Debt – Asset Backed	<input type="checkbox"/> Futures - Commodity	<input type="checkbox"/> Penny Stock(s)
<input type="checkbox"/> Debt - Corporate	<input type="checkbox"/> Futures - Financial	<input type="checkbox"/> Unit Investment Trust(s)
<input type="checkbox"/> Debt - Government	<input type="checkbox"/> Index Option(s)	<input type="checkbox"/> Other _____
	<input type="checkbox"/> Insurance	

Other Product Type:

5. Formal Action was brought in (include name of Federal, State or Foreign Court, Location of Court – City or County and State or Country, Docket/Case Number):

6. Control Affiliate Employing Firm when activity occurred which led to the civil judicial action (if applicable):

7. Describe the allegations related to this civil action. (The information must fit within the space provided.):

8. Current Status?     Pending     On Appeal     Final

9. If on appeal, action action appealed to (provide name of court):    Date Appeal Filed (MM/DD/YYYY):

10. If pending, date notice/process was served (MM/DD/YYYY)   Exact     Explanation

If not exact, provide explanation: \_\_\_\_\_

## CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE-A) (continuation)

**If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.**

11. How was matter resolved: (check appropriate item)

- Consent                       Judgement Rendered                       Settled
- Dismissed                       Opinion     Withdrawn                                       Other \_\_\_\_\_

12. Resolution Date (MM/DD/YYYY)   Exact                       Explanation

If not exact, provide explanation:

13. Resolution Detail

A. Were any of the following Sanctions Ordered or Relief Granted? (Check all appropriate items):

- Monetary/Fine                       Revocation/Expulsion/Denial                                       Disgorgement/Restitution
- Amount \$ \_\_\_\_\_                       Censure                       Cease and Desist/Injunction                                       Bar                       Suspension

B. Other Sanctions:

C. Sanction Detail: If suspended, enjoined or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification, by exam/retraining was a condition of the sanction, provide length of time given to re-qualify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against principal, date paid and if any portion of penalty was waived.

14. Provide a brief summary of details related to action(s), allegation(s), disposition(s), and/or finding(s) disclosed above. (The information must fit within the space provided.)

**BANKRUPTCY / SIPC DISCLOSURE REPORTING PAGE (SBSE-A)****GENERAL INSTRUCTIONS**

This Disclosure Reporting Page [DRP (SBSE)] is an an  INITIAL **OR**  AMENDED response to report details for affirmative responses to **Questions I** on Schedule C of Form SBSE;

Check  item(s) being responded to:

- In the past ten years has the *principal* ever been a securities firm or a *control affiliate* of a securities firm that:
- (1) has been the subject of a bankruptcy petition?
- (2) has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

It is not a requirement that documents be provided for each event or *proceeding*. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *principal* is an individual or organization registered through CRD, such *principal* need only complete Part I of the *applicant's* appropriate DRP (SBSE-A). Details of the event must be submitted on the *principal's* appropriate DRP (BD) or DRP (U-4). If a *principal* is an organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE-a). The completion of this DRP does not relieve the *principal* of its obligation to update its CRD records.

**PART I**

- A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Principal*

CRD NUMBER

Registered:  Yes  No

This DRP should be removed from the SBS Entity's record because the principal is no longer associated with the SBS Entity.

- B. If the *principal* is registered through the CRD, has the *principal* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

Yes  No

**Note:** The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.

**PART II**

1. Action Type: (check appropriate item)  
 Bankruptcy  Declaration  Receivership  
 Compromise  Liquidated  Other \_\_\_\_\_
2. Action Date (MM/DD/YYYY) \_\_\_\_\_  Exact  Explanation

If not exact, provide explanation: \_\_\_\_\_





## Form SBSE-BD

OMB Approval
OMB Number: .....3235-_____
Expires:..... Month __, 2016
Estimated average burden hours per response: . . . . . _____.
per amendment: . . . . . _____.

# Application for Registration of Security-based Swap Dealers and Major Security-based Swap Participants that are Registered Broker-dealers

BILLING CODE 8011-01-C

### Form SBSE-BD Instructions

#### A. General Instructions

1. FORM—Form SBSE-BD is the Application for Registration as either a Security-based Swap Dealer or Major Security-based Swap Participant (collectively, “SBS Entities”) by an entity that is registered or registering with the Commission as a broker or dealer. These SBS Entities must file this form to register with the Securities and Exchange Commission. An applicant must also file Schedules F and G, as

appropriate. There are no Schedules A, B, C, D, or E.

2. DEFINITIONS—Form SBSE-BD uses the same definitions as in Form BD.

3. ELECTRONIC FILING—This Form SBSE-BD must be filed electronically with the Commission through the EDGAR system, and must utilize the EDGAR Filer Manual (as defined in 17 CFR 232.11) to file and amend Form SBSE-BD electronically to assure the timely acceptance and processing of those filings.<sup>1981</sup> Additional documents

<sup>1981</sup> As discussed in the release proposing this Form, the Commission is currently developing a

shall be attached to this electronic application.

4. UPDATING—By law, the *applicant* must promptly update Form SBSE-BD information by submitting amendments whenever the information on file becomes inaccurate or incomplete for any reason [17 CFR 240.15Fb2-2]. In addition, the applicant must update any incomplete or inaccurate information contained on Form SBSE-BD prior to filing a notice of withdrawal from

system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.

registration on Form SBSE-W [17 CFR 15Fb3-2(a)].

5. FEDERAL INFORMATION LAW AND REQUIREMENTS—An agency may not conduct or sponsor, and a *person* is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§ 78o–10, 78q and 78w. Filing of this form is mandatory. The principal purpose of this Form is to permit the Commission to determine whether the *applicant* meets the statutory requirements to engage in the security-based swap business. The Commission maintain[s] a file of the information on this form and will make certain information collected via the form publicly available. Any member of the public may direct to the

Commission any comments concerning the accuracy of the burden estimate on this Form, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. § 3507. The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the **Federal Register** the Privacy Act Systems of Records Notice for these records.

*B. Filing Instructions*

1. FORMAT

a. Items 1–4 and the accompanying Schedules must be answered and all fields requiring a response must be completed before the filing will be accepted.

b. Failure to follow instructions or properly complete the form may result in the application being delayed or rejected.

c. *Applicant* must complete the execution screen certifying that Form SBSE-BD and amendments thereto have been executed properly and that the information contained therein is accurate and complete.

d. To amend information, the *applicant* must update the appropriate Form SBSE-BD screens.

e. A paper copy, with original signatures, of the initial Form SBSE-BD filing and Schedules must be retained by the *applicant* and be made available for inspection upon a regulatory request.

The mailing address for questions and correspondence is:

**BILLING CODE 8011-01-P**

FORM SBSE-BD	Application for Registration as a Security-based Swap Dealer and Major Security-based Swap Participant that is Registered as a Broker-Dealer	Official Use	Official Use Only
<b>WARNING:</b>		Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as an SBS Entity, would violate the Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.	
<b>INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.</b>			
[ ] APPLICATION [ ] AMENDMENT			
1. Exact name and CRD number of the <i>applicant</i> :			
A. Full name of the <i>applicant</i> : _____			
B. CRDNo.: _____			
C. Website/URL: _____			
D. Contact Employee:			
Name: _____		Title: _____	
Telephone Number: _____		Email Address: _____	
E. Chief Compliance Officer designated by the <i>applicant</i> in accordance with Exchange Act Section 15F(k):			
Name: _____		Title: _____	
Telephone Number: _____		Email Address: _____	
2. A. The <i>applicant</i> is registering as a security-based swap dealer: [ ] Yes [ ] No			
B. The <i>applicant</i> is registering as a major security-based swap participant: [ ] Yes [ ] No			
Because it: (check all that apply)			
[ ] maintains a substantial security-based swap position			
[ ] has substantial counterparty exposure [ ] is highly leveraged relative to its capital position			
3. A. The <i>applicant</i> is presently registered with the Commodity Futures Trading Commission as a:			
[ ] Swap Dealer [ ] Major Swap Participant			
B. The <i>applicant</i> is registering with the Commodity Futures Trading Commission as a:			
[ ] Swap Dealer [ ] Major Swap Participant			
4. Is the <i>applicant</i> subject to regulation by a prudential regulator, as defined in Sec. 1a(39) of the Commodity Exchange Act.			
[ ] Yes [ ] No If "yes," identify the prudential regulator: _____.			
Briefly describe the <i>applicant's</i> business: _____			
_____			
_____			
_____			
5. Is the <i>applicant</i> registered with a foreign financial regulatory authority? [ ] [ ]			
If "yes," list all such registrations on Schedule F, Page 1, Section II.			
<b>EXECUTION:</b>			
The applicant consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission in connection with the applicant's security-based swap activities, unless the applicant is a nonresident SBS Entity, may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 1E and 1F. If the applicant is a nonresident SBS Entity, it must complete Schedule F to designate a U.S. agent for service of process.			
The undersigned certifies that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including schedules attached hereto, and other information filed herewith are current, true and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended such information is currently accurate and complete.			
Date (MM/DD/YYYY) _____		Name of Applicant _____	
By: _____		Name and Title of Person Signing on <i>Applicant's</i> behalf _____	
Signature			
<b>This page must always be completed in full.</b>			
DO NOT WRITE BELOW THIS LINE – FOR OFFICIAL USE ONLY			

<b>Schedule F of FORM SBSE NONRESIDENT SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS</b>	Applicant Name: _____ Date: _____ Firm SEC No.: _____	<b>Official Use</b>
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**Section I Service of Process and Certification Regarding Access to Records**

Each nonresident security-based swap dealer and non-resident security-based swap participant shall use Schedule F to identify its United States agent for service of process and the certify that it can

- (1) provide the Commission with prompt access to its books and records, and
- (2) submit to onsite inspection and examination by the Commission.

1. Service of Process:

A. Name of United States person *applicant* designates and appoints as agent for service of process

B. Address of United States person *applicant* designates and appoints as agent for service of process

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

- (a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the *applicant* may have information; and
- (b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2. Certification regarding access to records:

*Applicant* can as a matter of law;

- (1) provide the Commission with prompt access to its books and records, and
- (2) submit to onsite inspection and examination by the Commission.

*Applicant* must attach to this Form SBSE a copy of the opinion of counsel it is required to obtain in accordance with paragraph (c)(2) or (c)(3) of Exchange Act Rule 15Fb2-4, as appropriate [paragraphs (c)(2) or (c)(3) of 17 CFR 240.15Fb2-4].

Signature: \_\_\_\_\_

Name and Title: \_\_\_\_\_

Date: \_\_\_\_\_

**Section II Registration with Foreign Financial Regulatory Authorities**

**Complete this Section for Registration with Foreign Financial Regulatory Authorities relating to ITEM 5.** Each security-based swap dealer and major security-based swap participant that is registered with a foreign financial regulatory authority must list on Section II of this Schedule F, for each foreign financial regulatory authority with which it is registered, the following information:

1.	_____	Foreign Registration No. (if _____ any)	English Name of Country: _____
	English Name of Foreign Financial Regulatory Authority		
2.	_____	Foreign Registration No. (if _____ any)	English Name of Country: _____
	English Name of Foreign Financial Regulatory Authority		
3.	_____	Foreign Registration No. (if _____ any)	English Name of Country: _____
	English Name of Foreign Financial Regulatory Authority		

If applicant has more than 3 Foreign Financial Regulatory Authorities to report, complete additional Schedule F Page 1s.

<b>Schedule G of FORM SBSE-BD CERTIFICATION ON STATUTORY DISQUALIFICATION</b>	Applicant Name: _____	<b>Official Use</b>
	Date: _____ Firm SEC No.: _____	

Use Schedule G to certify that none of the *applicant's* associated persons is subject to statutory disqualification (as that term is defined in Section 3(a)(39) of the Exchange Act [15 U.S.C. 78c(a)(39)]).

Instructions: This certification must be signed by the *applicant's* Chief Compliance Officer designated pursuant to Exchange Act Section 15F(k) or by his or her designee.  
 For purposes of this Form, the term *associated person* shall have the meaning as specified in Section 3(a)(70) of the Exchange Act [15 U.S.C. 78c(a)(70)].

This is a:  CERTIFICATION  RE-CERTIFICATION

The *applicant* certifies that it has

- (a) performed background checks on all of its *associated persons* who effect or are involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf, and
- (b) determined that no *associated person* who effects or is involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(39)].

Applicant Name:	Date:
Signature of Chief Compliance Officer or Designee:	
Name of Chief Compliance Officer or Designee:	If Designee, Title of Designee:

**BILLING CODE 8011-01-C**

**Appendix D: List of Commenters**

Market participants, foreign regulators, and other interested parties have submitted to the Commission (and the CFTC) numerous written comment letters that address the

application of Title VII to cross-border activities. Because of the interdisciplinary nature of cross-border issues, these comments were filed in connection with several rulemakings and following the joint public roundtable regarding the application of Title VII to cross-border activities held by

the Commission and the CFTC on August 1, 2011. The Commission has provided the legend and table below to facilitate the public's ability to access and review these comment letters.

Abbreviation	Source	Location
Definitions Concept Release (Advanced Joint Notice of Proposed Rulemaking or "ANPR").	Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act.	<a href="http://www.sec.gov/comments/s7-16-10/s71610.shtml">http://www.sec.gov/comments/s7-16-10/s71610.shtml</a> .
Study on International Swap Regulation ("ISR").	Comments on Acceptance of Public Submissions for a Study on International Swap Regulation Mandated by Section 719(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.	<a href="http://www.sec.gov/comments/4-635/4-635.shtml">http://www.sec.gov/comments/4-635/4-635.shtml</a> .
Intermediary Definitions Adopting Release ("IDAR").	SEC Final Rules on the Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant".	<a href="http://www.sec.gov/comments/s7-39-10/s73910.shtml">http://www.sec.gov/comments/s7-39-10/s73910.shtml</a> .
Registration Proposing Release ("RPR").	SEC Proposed Rules on the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants.	<a href="http://www.sec.gov/comments/s7-40-11/s74011.shtml">http://www.sec.gov/comments/s7-40-11/s74011.shtml</a> .
Regulation SBSR Proposing Release ("RSPR").	SEC Proposed Rules on Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information.	<a href="http://www.sec.gov/comments/s7-34-10/s73410.shtml">http://www.sec.gov/comments/s7-34-10/s73410.shtml</a> .

Abbreviation	Source	Location
Regulation SB SEF Proposing Release ("PRsBR").	SEC Proposed Rules on the Registration and Regulation of Security-Based Swap Execution Facilities.	<a href="http://www.sec.gov/comments/s7-06-11/s70611.shtml">http://www.sec.gov/comments/s7-06-11/s70611.shtml</a> .
Product Definitions ("PD") ...	Product Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.	<a href="http://www.sec.gov/comments/s7-16-11/s71611.shtml">http://www.sec.gov/comments/s7-16-11/s71611.shtml</a> .
Public Comments on SEC Regulatory Initiatives Under the Dodd-Frank Act ("PC").	Security-Based Swap Dealers and Major Security-Based Swap Participants: Title VII Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.	<a href="http://www.sec.gov/comments/df-title-vii/swap/swap.shtml">http://www.sec.gov/comments/df-title-vii/swap/swap.shtml</a> .
Roundtable ("T7R") .....	August 1, 2011—Joint Public Roundtable on International Issues Relating to the Implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.	<a href="http://www.sec.gov/comments/4-636/4-636.shtml">http://www.sec.gov/comments/4-636/4-636.shtml</a> .
SDR Proposing Release ("SPR").	Security-Based Swap Data Repository Registration, Duties, and Core Principles.	<a href="http://www.sec.gov/comments/s7-35-10/s73510.shtml">http://www.sec.gov/comments/s7-35-10/s73510.shtml</a> .
CFTC Title VII Definitions ("CFTC-D").	CFTC Proposed Rule 75 FR 51429: Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act.	<a href="http://comments.cftc.gov/PublicPublicCommentList.aspx?id=759">http://comments.cftc.gov/PublicPublicCommentList.aspx?id=759</a> .
CFTC Further Definitions of "Swap Dealer" ("FDSD").	CFTC Proposed Rule 75 FR 80174: Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant".	<a href="http://comments.cftc.gov/PublicComments/CommentList.aspx?id=933">http://comments.cftc.gov/PublicComments/CommentList.aspx?id=933</a> .
CFTC Further Definition of "Swap" ("FDS").	CFTC Proposed Rule 76 FR 29818: Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping.	<a href="http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1032">http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1032</a> .
CFTC Cross-Border Guidance ("CBG").	CFTC Proposed Interpretive Guidance and Policy Statement 77 FR 41214: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act.	<a href="http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1234">http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1234</a> .
Interim Final Rule on Reporting of Security-Based Swap Transaction Data ("IFTR").	Interim Final Temporary Rule for Reporting of Security-Based Swap Transaction Data.	<a href="http://sec.gov/comments/s7-28-10/s72810.shtml">http://sec.gov/comments/s7-28-10/s72810.shtml</a> .
End-User Exception Proposing Release ("EUEPR").	SEC Proposed Rules on the End-User Exception to Mandatory Clearing of Security-Based Swaps.	<a href="http://www.sec.gov/comments/s7-43-10/s74310.shtml">http://www.sec.gov/comments/s7-43-10/s74310.shtml</a> .
Sequencing Policy Release ("SQPR").	SEC Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based-Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act.	<a href="http://www.sec.gov/comments/s7-05-12/s70512.shtml">http://www.sec.gov/comments/s7-05-12/s70512.shtml</a> .

Below is a list of comment letters that we considered in this release.

- "ABC Letter" American Benefits Council, to Elizabeth M. Murphy, Secretary, SEC (Apr. 8, 2011) (available in PRSBR)
- "ACP/AMF Letter" Christian Noyer, Chairman, Autorité de Contrôle Prudential and Jean-Pierre Jouyet, Chairman, Autorité des Marchés Financiers to Mary Schapiro, Chairman, SEC (Feb. 11, 2011) (available in IDAR)
- "AIMA Letter" Mary Richardson, Director of Regulatory and Tax Department, Alternative Investment Management Association to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in IDAR)
- "APG Asset Management Letter" Guus Warringa, Chief Counsel, Legal, Tax, Regulations and Compliance, APG Algemene Pensioen Groep NV/APG Asset Management to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (undated) (available in IDAR)
- "AFGI Letter" Bruce Stern, Chairman, Association of Financial Guaranty Insurers (AFGI) to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Sept. 19, 2011) (available in T7R)
- "Asian-Pacific Regulators Letter" Belinda Gibson, Deputy Chairman, Australian Securities and Investments Commission; Malcolm Edey, Assistant Governor (Financial System), Reserve Bank of Australia; Arthur Yuen, Deputy Chief Executive, Hong Kong Monetary Authority; Keith Lui, Executive Director, Supervision of Markets, Securities and Futures Commission, Hong Kong; Teo Swee Lian, Deputy Managing Director (Financial Supervision), Monetary Authority of Singapore to Gary Gensler, Chairman, CFTC (Aug. 27, 2012) (unavailable online)
- "BaFin Letter" Thomas Happel, Executive Director for Banking Supervision, Bundesanstalt für Finanzdienstleistungsaufsicht to Mary Schapiro, Chairman, SEC and Gary Gensler, Chairman, CFTC (Mar. 25, 2011) (available in IDAR)
- "Better Markets Letter" Dennis M. Kelleher, President & CEO, Stephen W. Hall, Securities Specialist, Wallace C. Turbeville, Derivatives Specialist, Better Markets, Inc., to Elizabeth M. Murphy, Secretary, SEC (Feb. 4, 2011) (available in EUEPR)
- "BIS Letter I" Gunter Pleines, Head of Banking, and Diego Devos, General Counsel, Bank for International Settlements to Ananda Radhakrishnan, Director of Clearing and Intermediary Oversight, CFTC and James Brigagliano, Deputy Director, Division of Trading and Markets, SEC (Mar. 18, 2011) (available in ANPR)
- "BIS Letter II" Günter Pleines, Head of Banking Department, and Diego Devos, General Counsel, Bank for International Settlements to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, SEC (July 20, 2011) (available in PD)
- "BlackRock Letter" Joanne Medero, Richard Prager, and Supurna VedBrat, BlackRock, Inc. to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
- "Bloomberg Letter" Ben Macdonald, Global Head Fixed Income, Bloomberg

- LP to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
13. "CEB Letter" Jacques Mirante-Peré, Chief Financial Officer, and Jan De Bel, General Counsel, Council of Europe Development Bank to Elizabeth M. Murphy, Secretary, SEC, and David A. Stawick, Secretary, CFTC (July 22, 2011) (available in PD)
14. "China Investment Letter" Wang Jianxi, Executive Vice President, China Investment Corp. to David A. Stawick, Secretary, CFTC and Elizabeth Murphy, Secretary, SEC (Feb. 22, 2011) (available in IDAR)
15. "Citadel Letter" Adam C. Cooper, Senior Managing Director and Chief Legal Officer, Citadel LLC, to Elizabeth M. Murphy, Secretary, SEC (Aug. 13, 2012) (available in SQPR)
16. "Citigroup Letter" James A. Forese, Chief Executive Officer, Securities & Banking, Citigroup Inc. to David A. Stawick, Secretary, CFTC (Aug. 27, 2012) (available in CBG)
17. "Cleary Letter I" Edward Rosen, Cleary Gottlieb Steen & Hamilton, LLP to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Sept. 21, 2010) (available in ANPR)
18. "Cleary Letter II" Edward Rosen, Cleary Gottlieb Steen & Hamilton, LLP, for Bank of America, BNP Paribas, Citi, Credit Agricole, Credit Suisse (USA), Deutsche Bank AG, Morgan Stanley, Nomura Securities International, Inc., PNC Bank, National Association, Société Générale, UBS Securities LLC, and Wells Fargo & Co. to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Feb. 14, 2011) (available in RSPR)
19. "Cleary Letter III" Edward J. Rosen, Partner, Cleary Gottlieb Steen & Hamilton LLP, for Bank of America, Merrill Lynch, Barclays Capital, BNP Paribas, Citi, Crédit Agricole Corporate and Investment Bank, Credit Suisse Securities (USA), Deutsche Bank AG, HSBC, Morgan Stanley, Nomura Securities International, Inc., Société Générale, UBS Securities LLC, and Wells Fargo & Co. to Elizabeth M. Murphy, Secretary, SEC and David A. Stawick, Secretary, CFTC (April 5, 2011) (available in PRSBR)
20. "Cleary Letter IV" Edward Rosen, Cleary Gottlieb Steen & Hamilton, LLP, for Bank of America, Barclays Capital, BNP Paribas, Citi, Credit Agricole, Credit Suisse (USA), Deutsche Bank AG, HSBC, Morgan Stanley, Nomura Securities International, Inc., Société Générale, and UBS Securities LLC to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corp., Gary K. Van Meter, Director, Office of Regulatory Policy, Farm Credit Administration, and Alfred Pollard, General Counsel, Federal Housing Finance Agency (Sept. 20, 2011) (available in T7R)
21. "CME Letter" Craig S. Donohue, Chief Executive Officer, CME Group Inc., to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
22. "Davis Polk Letter I" Lanny Schwartz, Arthur Long, Bob Colby, and Courtenay Myers, Davis Polk & Wardwell, for Barclays Bank PLC, BNP Paribas S.A., Deutsche Bank AG, Royal Bank of Canada, The Royal Bank of Scotland Group PLC, Société Générale, and UBS AG to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, and Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Jan. 11, 2011) (available in IDAR)
23. "Davis Polk Letter II" Lanny Schwartz, Arthur Long, Bob Colby, and Courtenay Myers, Davis Polk & Wardwell, for Barclays Bank PLC, BNP Paribas S.A., Credit Suisse AG, Deutsche Bank AG, HSBC, Nomura Securities International, Inc., Rabobank Nederland, Royal Bank of Canada, The Royal Bank of Scotland Group PLC, Société Générale, The Toronto-Dominion Bank, and UBS AG to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, and Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Feb. 17, 2011) (available in IDAR)
24. "Deutsche Bank Letter" Ernest C. Goodrich, Jr., Managing Director—Legal Department, and Marcelo Riffaud, Managing Director—Legal Department, Deutsche Bank AG to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC (Nov. 5, 2010) (available in IFTR)
25. "DTCC Letter I" Larry E. Thompson, General Counsel, Depository Trust & Clearing Corporation to Mary Schapiro, Chairman, SEC and Gary Gensler, Chairman, CFTC (Nov. 15, 2010) (available in SPR)
26. "DTCC Letter II" Larry E. Thompson, General Counsel, Depository Trust & Clearing Corporation to Elizabeth M. Murphy, Secretary, SEC (Jan. 18, 2011) (available in RSPR)
27. "DTCC Letter III" Larry E. Thompson, General Counsel, Depository Trust & Clearing Corporation to Elizabeth M. Murphy, Secretary, SEC (Jan. 24, 2011) (available in SPR)
28. "DTCC Letter IV" Larry E. Thompson, General Counsel, Depository Trust & Clearing Corporation to Mary Schapiro, Chairman, SEC and Gary Gensler, Chairman, CFTC (June 3, 2011) (available in RSPR and SPR)
29. "ECB Letter I" Daniela Russo, Director General, Directorate General Payments and Market Infrastructure, and Antonio Sainz de Vicuna, General Counsel, European Central Bank to Ananda Radhakrishnan, Director of Clearing and Intermediary Oversight, CFTC and James Brigagliano, Deputy Director, Division of Trading and Markets, SEC (May 6, 2011) (available in CFTC-D; not available on SEC Web site, but accessible via CFTC Web site)
30. "ECB Letter II" Daniela Russo, Director General, Directorate General Payments and Market Infrastructure, European Central Bank to Natalie Markman Radhakrishnan, Office of International Affairs, CFTC, and Babbak Sabahi, Office of International Affairs, SEC (Sep. 29, 2011) (available in ISR)
31. "EDF Letter" Eric Dennison, Sr. Vice President and General Counsel, Stephanie Miller, Assistant General Counsel-Commodities, Bill Hellinghausen, Director of Regulatory Affairs, EDF Trading North America, LLC to David A. Stawick, Secretary, CFTC (Feb. 22, 2011) (available in IDAR)
32. "EIB Letter" A. Querejeta, Secretary General and General Counsel, and B. de Mazières, Director General, European Investment Bank to Ananda Radhakrishnan, Director of Clearing and Intermediary Oversight, CFTC, and James Brigagliano, Deputy Director, Division of Trading and Markets, SEC (July 22, 2011) (available in PD)
33. "ESMA Letter" Carlos Tavares, Vice-Chairman, European Securities and Markets Authority to Mary Schapiro, Chairman, SEC (Jan. 17, 2011) (available in SPR)
34. "European Commission Letter I" Michel Barnier, European Commissioner for Internal Markets and Services, European Commission to Mary Schapiro, Chairman, SEC and Gary Gensler, Chairman, CFTC (July 19, 2011) (unavailable online)
35. "European Commission Letter II" Michel Barnier, European Commissioner for Internal Markets and Services, European Commission to Mary Schapiro, Chairman, SEC and Gary Gensler, Chairman, CFTC (Oct. 24, 2011) (unavailable online)
36. "European Financial Markets Letter" Antonio Sainz de Vicuna, European Financial Markets Lawyers Group to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Mar. 24, 2011) (available in PC)
37. "Financial Services Roundtable Letter" Richard M. Whiting, Executive Director and General Counsel, Financial Services Roundtable to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in IDAR)
38. "GFI Letter" Scott Pintoff, General Counsel, GFI Group Inc., to Elizabeth Murphy, Secretary, SEC (July 12, 2011) (available in PRSBR)
39. "GIC Letter" Lee Ming Chua, General Counsel, Government of Singapore Investment Corp. Pte Ltd. to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in ANPR)
40. "ICI Letter" Karrie McMillan, General Counsel, Investment Company Institute to Elizabeth M. Murphy, Secretary, SEC, dated (Jan. 18, 2011) (available in RSPR)
41. "IIB Letter" Sarah A. Miller, Chief Executive Officer, Institute of International Bankers to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Jan. 10, 2011) (available in IDAR)
42. "ISDA Letter I" Robert Pickel, Executive Vice Chairman, International Swaps and



- Derivatives Association, Inc. to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in IDAR)
43. "ISDA Letter II" Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, Inc. to Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in IFTR)
44. "ISDA/SIFMA Letter I" Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, Inc. and Kenneth Bentsen, Jr. Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, SEC (Jan. 18, 2011) (available in RSPR)
45. "ISDA/SIFMA Letter II" Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, Inc. and Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
46. "Japanese Banks Letter" Bank of Tokyo-Mitsubishi UFJ, Ltd., Mizuho Corporate Bank, Ltd., and Sumitomo Mitsui Banking Corp. to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, and Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (May 6, 2011) (available in RSPR)
47. "JFSA Letter I" Katsunori Mikuniya, Commissioner and Chief Executive, Financial Services Agency, Government of Japan to Gary Gensler, Chairman, CFTC; copy recipients include Chairman Mary Schapiro and Commissioners Luis Aguilar, Kathleen Casey, Troy Parades, and Elisse Walter, SEC (Apr. 1, 2011) (unavailable online)
48. "JFSA Letter II" Chikahisa Sumi, Deputy Commissioner for International Affairs, Financial Services Agency, Government of Japan to Jill Sommers, Commissioner, CFTC; copy recipients include Chairman Mary Schapiro and Commissioners Luis Aguilar, Kathleen Casey, Troy Parades, and Elisse Walter, SEC (June 3, 2011) (unavailable online)
49. "Jones Day Letter" Joel Telpner, Jones Day to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in IDAR)
50. "KfW Letter" Dr. Lutz-Christian Funke, Sr. Vice President, and Dr. Frank Czichowski, Sr. Vice President and Treasurer, KfW Bankengruppe to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, SEC (Mar. 20, 2012) (available in PD)
51. "MFA Letter I" Stuart J. Kaswell, Executive Vice President, Managing Director, and General Counsel, Managed Funds Association to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, SEC (Jan. 24, 2011) (available in SPR)
52. "MFA Letter II" Stuart J. Kaswell, Executive Vice President and Managing Director, General Counsel, Managed Funds Association to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in IDAR)
53. "MFA Letter III" Stuart J. Kaswell, Executive Vice President, Managing Director & General Counsel, Managed Funds Association, to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
54. "MFA Letter IV" Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association to Elizabeth M. Murphy, Secretary, SEC (Aug. 13, 2012) (available in SQPR)
55. "MarketAxess Letter" Richard M. McVey, Chairman and Chief Executive Officer, MarketAxess Holdings Inc. to Elizabeth M. Murphy, Secretary, SEC (April 4, 2011) (available in PRSBR)
56. "Markit Letter" Kevin Gould, President, Markit North America, Inc. to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Sept. 19, 2011) (available in T7R)
57. "MarkitSERV Letter I" Jeff Gooch, Chief Executive Officer, MarkitSERV to Elizabeth M. Murphy, Secretary, SEC (Jan. 24, 2011) (available in RSPR and SPR)
58. "MarkitSERV Letter II" Jeff Gooch, CEO, MarkitSERV to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC (Sept. 19, 2011) (available in T7R)
59. "Milbank Tweed Letter" Winthrop N. Brown, Milbank, Tweed, Hadley & McCloy, LLP to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, SEC (Feb. 22, 2011) (available in IDAR)
60. "Multiple Associations Letter I" Financial Services Forum, Futures Industry Association, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association to David A. Stawick, Secretary, CFTC, and Elizabeth M. Murphy, Secretary, SEC (May 4, 2011) (available in ANPR)
61. "Multiple Associations Letter II" Futures Industry Association, the Financial Services Roundtable, Institute of International Bankers, Insured Retirement Institute, International Swaps and Derivatives Association, Securities Industry and Financial Markets Association, and U.S. Chamber of Commerce to Elizabeth M. Murphy, Secretary, SEC (May 31, 2011) (available in ANPR)
62. "Multiple Associations Letter III" Conrad Voldstad, CEO, International Swaps and Derivatives Association; T. Timothy Ryan, Jr., President and CEO, Global Financial Markets Association; Guido Ravoet, CEO, Alternative Investment Management Association; Anthony Belchambers, CEO, Futures and Options Association; Jane Lowe, Director, Markets, Investment Management Association; and Alex McDonald, CEO, Wholesale Market Brokers' Association and London Energy Brokers' Association to Michel Barnier, Commissioner for the Internal Market and Services, The European Commission, and Timothy Geithner, Secretary, The Department of the Treasury; copy recipients include Chairman Mary Schapiro and Commissioners Luis Aguilar, Kathleen Casey, Troy Parades, and Elisse Walter, SEC (July 5, 2011) (available in ISR)
63. "Multiple Associations Letter IV" ABA Securities Association; American Council of Life Insurers; Financial Services Roundtable; Futures Industry Association; Institute of International Bankers; International Swaps and Derivatives Association; and Securities Industry and Financial Markets Association to David A. Stawick, Secretary, CFTC; Elizabeth M. Murphy, Secretary, SEC; Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System; Office of the Comptroller of the Currency; Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation; Alfred M. Pollard, General Counsel, Federal Housing Finance Agency; Gary K. Van Meter, Director, Office of Regulatory Policy, Farm Credit Administration (Sept. 8, 2011) (available in ANPR)
64. "Newedge Letter" Gary DeWaal, Senior Managing Director and General Counsel, Newedge Group to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Feb. 24, 2011) (available in IDAR)
65. "NIB Letter" Heikki Cantell, General Counsel, and Lars Eibeholm, Vice President, Chief Financial Officer, Head of Treasury, and Pernelle de Klauman, Deputy Chief Counsel, Nordic Investment Bank to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Aug. 2, 2011) (available in PD)
66. "Norges Bank Letter" Yngve Slyngstad, CEO, and Marius Nygaard Haug, Global Head of Legal, Norges Bank Investment Management to David A. Stawick, Secretary, CFTC and Elizabeth M. Murphy, Secretary, SEC (Feb. 18, 2011) (available in IDAR)
67. "Phoenix Letter" Nicholas J. Stephan, Chief Executive Officer, Phoenix Partners Group LP, to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
68. "Rabobank Letter" William R. Mansfield, Managing Director, Head of Global Financial Markets Americas, Rabobank Nederland to David A. Stawick, Secretary, CFTC, and Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Apr. 5, 2011) (available in FSDS; not available on SEC Web site, but accessible via CFTC Web site)
69. "SDMA Letter I" Michael Hisler, Swaps & Derivatives Market Association, to Elizabeth M. Murphy, Secretary, SEC (Feb. 18, 2012) (available in PRSBR)
70. "SDMA Letter II" Michael Hisler, Swaps & Derivatives Market Association, to Elizabeth M. Murphy, Secretary, SEC (Apr. 21, 2012) (available in PRSBR)
71. "SIFMA Letter I" Kenneth Bentsen, Executive Vice President, Public Policy

- and Advocacy, Securities Industry and Financial Markets Association to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, John Walsh, Acting Comptroller, Office of the Comptroller of the Currency, Administrator of National Banks, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corp., Edward DeMarco, Acting Director, Federal Housing Finance Agency, and Gary Van Meter, Acting Director, Farm Credit Administration (Feb. 3, 2011) (available in IDAR)
72. "SIFMA Letter II" Kenneth E. Bentsen, Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, SEC (Dec. 16, 2011) (available in RPR)
73. "SIFMA AMG Letter I" Timothy W. Cameron, Managing Director, Asset Management Group, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, SEC (Jan. 18, 2011) (available in RSPR)
74. "SIFMA AMG Letter II" Timothy W. Cameron, Managing Director, Asset Management Group, Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
75. "Société Générale Letter I" Laura J. Schisgall, Managing Director and Senior Counsel, Société Générale to Ananda Radhakrishnan, Director of Clearing and Intermediary Oversight, CFTC, John M. Ramsay, Deputy Director, Division of Trading and Markets, SEC, and Mark E. Van Der Weide, Senior Associate Director, Division of Supervision and Regulation, Board of Governors of the Federal Reserve System (Nov. 23, 2010) (available in PC)
76. "Société Générale Letter II" Laura J. Schisgall, Managing Director and Senior Counsel, Société Générale to David A. Stawick, Secretary, Commodity Futures Trading Commission, Elizabeth M. Murphy, Secretary, SEC (Feb. 18, 2011) (available in IDAR)
77. "Sullivan & Cromwell Letter" Kenneth Raisler, Sullivan & Cromwell LLP, on behalf of Bank of America Corp., Citigroup Inc., and JP Morgan Chase & Co. to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, and Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Feb. 22, 2011) (available in IDAR)
78. "TCX Letter" Joost Zuidberg, Managing Director, Chief Executive Officer and Brice Ropion, Director and Chief Operating Officer, TCX Investment Management Company B.V. to Marcia Blase, Counsel, Office of Commissioner Jill E. Sommers, CFTC (Dec. 15, 2011) (available in FDS; not available on SEC Web site, but accessible via CFTC Web site)
79. "Thomson Letter" Nancy C. Gardner, Executive Vice President and General Counsel, Thomson Reuters Markets to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
80. "TradeWeb Letter" Lee H. Olesky, Chief Executive Officer, and Douglas L. Friedman, General Counsel, Tradeweb Markets LLC to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
81. "UBS Letter" David Kelly, Managing Director, and Paul Hamill, Executive Director, UBS Securities LLC, to Elizabeth M. Murphy, Secretary, SEC (Nov. 2, 2011) (available in PRSBR)
82. "Vanguard Letter" Gus Sauter, Managing Director and Chief Investment Officer, and John Hollyer, Principal and Head of Risk Management and Strategy Analysis, Vanguard to Elizabeth M. Murphy, Secretary, SEC (Jan. 18, 2011) (available in RSPR)
83. "WMBAA Letter" Stephen Merkel, Chairman, Shawn Bernardo, Vice Chairman, Christopher Ferreri, Board Member, J. Christopher Giancarlo, Board Member, and Julian Harding, Board Member, Wholesale Market Brokers' Association, Americas to Elizabeth M. Murphy, Secretary, SEC (Apr. 4, 2011) (available in PRSBR)
84. "World Bank Letter I" John Gandolfo, Acting Vice President and Treasurer, The World Bank to Jill Sommers, Commissioner, CFTC (Apr. 5, 2011) (available in ANPR)
85. "World Bank Letter II" Vincenzo La Via, World Bank Group CFO, Anne-Marie Leroy, Senior Vice President and Group General Counsel, and Rachel Robbins, Vice President and General Counsel of International Finance Corp. to David A. Stawick, Secretary, CFTC (July 22, 2011) (available in FDS; not available on SEC Web site, but accessible via CFTC Web site)

By the Commission.

Dated: May 1, 2013.

**Elizabeth M. Murphy,**  
*Secretary.*

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