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CFTC ADOPTS CROSS-BORDER RULES TO REPLACE THE CROSS-BORDER GUIDANCE

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On September 14, 2020, the Commodity Futures Trading Commission ("CFTC" or "Commission") published final rules (the "Final Rules") in the Federal Register regarding the cross-border application of certain swap requirements under the Commodity Exchange Act ("CEA").[1] The Final Rules supersede the CFTC's previous Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations published on July 26, 2013 ("Cross-Border Guidance").[2]

The Final Rules also supersede the CFTC Staff Advisory 13-69 ("ANE Staff Advisory") regarding the application of certain compliance obligations to a non-U.S. swap dealer's transactions with other non-U.S. persons that are arranged, negotiated or executed by personnel or agents located in the United States,[3] which the CFTC staff has withdrawn.[4]

Although the Cross-Border Guidance was merely an interpretive statement concerning cross-border application of the CEA's swap provisions, and the ANE Staff Advisory provided staff guidance that was never made effective by virtue of no-action relief, the Final Rules have the force and effect of law. They are effective on November 13, 2020, and the compliance date when market participants must comply with the Final Rules is September 14, 2021.

In many respects, the Final Rules provide greater legal certainty regarding the cross-border application of the CEA's swap provisions and the CFTC's regulations thereunder than the Cross-Border Guidance. Supporters of the Final Rules, including CFTC Chairman Heath Tarbert, emphasized that in addition to providing greater legal certainty, the Final Rules "properly balance[] protection of our national interests with appropriate deference to international counterparts."[5] By contrast, dissenting Commissioner Dan Berkovitz criticized the Final Rules as dangerously paring back the Cross-Border Guidance, which "has helped protect the U.S. financial system from risky overseas swap activity."[6]

This article discusses the Final Rules and how they compare with the Cross-Border Guidance and CFTC Staff Advisory 13-69.

I. KEY DEFINITIONS

The Final Rules adopt narrower definitions of the key terms "U.S. person" and "Guarantee," and add a new term, "Significant Risk Subsidiary," which replaces the "Conduit Affiliate" concept from the Cross-Border Guidance, as discussed below.

A. U.S. PERSON

The definition of the term "U.S. Person" in the Final Rules is narrower in scope than the Cross-Border Guidance definition, and is defined as follows:

- A natural person resident in the United States;
- A partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;[7]
- An account (whether discretionary or non-discretionary) of a U.S. person; or
- An estate of a decedent who was a resident of the United States at the time of death.[8]

Removed from the definition of "U.S. Person" is the prefatory language "including, but not limited to," that was contained in the Cross-Border Guidance, so that the definition in the Final Rules is exhaustive. This should facilitate compliance with the Final Rules, provide greater legal certainty and obviate the need to consider "catch all" considerations. Also removed in the Final Rules is the "unlimited U.S. responsibility" prong of the U.S. person definition from the Cross-Border Guidance. Under that prong, a majority-owned affiliate of a U.S. person would be considered a U.S. person "where one or more U.S. owners has unlimited responsibility for losses or nonperformance by its majority-owned affiliate." While such persons would not be considered U.S. persons under the Final Rules, the CFTC stated that explicit financial support, such as "unlimited U.S. responsibility," is considered to be a guarantee of a U.S. person under the Final Rules.[9]

In a further effort to streamline the U.S. person definition, the Final Rules do not include a commodity pool, pooled account, investment fund, or other collective investment vehicle that is majority-owned by one or more U.S. persons that was included in the Cross-Border Guidance. This change saves collective investment vehicles from costs and practical difficulties of tracking the U.S. person status for their investors. With this change and the other changes noted above, the Final Rules' definition is consistent with the Securities and Exchange Commission's ("SEC's") definition in its cross-border rules, which will make compliance more efficient for registrants dually registered with the CFTC and SEC.[10]

In complying with the Cross-Border Guidance, market participants have relied on representations from their counterparties regarding their status as a U.S. person, which may be made through bilateral agreement or the Cross-Border Representation Letter of the International Swaps and Derivatives Association, Inc. ("ISDA"), published on August 19, 2013 ("Cross-Border Representation Letter"). Because the U.S. person definition in the Final Rules is narrower than that contained in the Cross-Border Guidance, no person or entity that is not a U.S. person under

the Cross-Border Guidance will be a U.S. person under the Final Rules.

Accordingly, the Final Rules permit reliance on prior representations using the Cross-Border Guidance's U.S. person definition until December 31, 2027, if such representations were obtained prior to the effective date of the Final Rules. Similarly, the Final Rules permit reliance on representations using the definition of U.S. person in the cross-border margin rules for uncleared swaps, which is broader than the definition in the Final Rules, until December 31, 2027, if the representations were obtained prior to the effective date.

B. GUARANTEE

The term "guarantee" is defined in the Final Rules as "an arrangement pursuant to which one party to a swap has rights of recourse against a guarantor, with respect to a counterparty's obligations under the swap."[11] The definition is narrower than the Cross-Border Guidance's interpretation of a guarantee, which included consideration of non-definitive "facts and circumstances" in determining whether a particular arrangement was a "guarantee," and a non-exclusive list of examples, such as keepwells, liquidity puts and certain types of indemnity, liability, loss transfer or sharing arrangements.[12] Similar to the U.S. person definition, "catchall" considerations under the guaranteed definition, which is definitive, have been removed.

The Final Rules provide some clarifications regarding the scope of the term guarantee. For purposes of the definition, a party to a swap "has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the swap."[13] The term guarantee also includes any arrangement pursuant to which the guarantor itself has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from any other guarantor with respect to the counterparty's obligations under the swap.[14]

The Final Rules clarify that a "guarantee" need not be a written instrument or contained in swap documentation, so long as the recipient has a legally enforceable right to receive payments from the guarantor in connection with the non-U.S. person's obligations under a swap.[15] In addition, the Final Rules state that the term guarantee includes any arrangement whereby a swap counterparty has the right of recourse against at least one U.S. person (individually, jointly, and/or severally with others) for the non-U.S. person's obligations under the swap. Thus, an indirect guarantee, such as when a non-U.S. person has a guarantee from another non-U.S. person with respect to its swap obligations that are in turn guaranteed by a U.S. person, would be deemed to have a guarantee from the U.S. person. The definition of guarantee therefore is not dependent upon whether the guarantor is an affiliate of the non-U.S. person.[16]

Another clarification notes that the "guarantee" definition does not apply when a non-U.S. person has a right to be compensated by a U.S. person with respect to the non-U.S. person's own obligations under the swap, or enters into a back-to-back swap with a U.S. person. In this regard, the Final Rule provides the following example:

> Consider a swap between two non-U.S. persons ("Party E" and "Party F"), where Party E enters

> into a back-to-back swap with a U.S. person ("Party G"), or enters into an agreement with Party G to be compensated for any payments made by Party E under the swap in return for passing along any payments received. In such an arrangement, a guarantee does not exist because Party F does not have a right to collect payments from Party G with respect to Party E's obligations under the swap (assuming no other agreements exist).[17]

Thus, transfer of risk from a non-U.S. person to a U.S. person, without a formal guarantee arrangement as defined in the Final Rules, does not create a guarantee.

The CFTC acknowledged in the Final Rules that its streamlined definition of guarantee may result in some transfer of risk back to the United States without being subject to CFTC regulatory oversight. However, the Commission determined that a narrower definition of guarantee than that in the Cross-Border Guidance achieves a more workable framework for non-U.S. persons, particularly because the Final Rule's definition of "guarantee" is consistent with the Cross-Border Margin Rule, and therefore does not require a separate independent assessment. Further, the CFTC stated that the narrower definition does not undermine the protection of U.S. persons and the U.S. financial system.[18]

The CFTC also recognized that the narrower definition of guarantee may lead to certain entities having to count fewer swaps towards their swap dealer or major swap participant thresholds or qualify additional counterparties for exceptions to certain regulatory requirements, discussed below, as compared to the definition in the Cross-Border Guidance. However, the CFTC expressed the view that such concerns could be mitigated to the extent such non-U.S. persons meet the definition of a "significant risk subsidiary," also discussed below, which are required to count certain swaps or swap positions toward their swap dealer or major swap participant registration thresholds.[19]

A non-U.S. person with a guarantee from a U.S. person is referred to in the Final Rules as a "Guaranteed Entity." The Final Rules clarify that a non-U.S. person could be a Guaranteed Entity with respect to some counterparties but not with respect to others, depending upon whether its swaps were guaranteed by a U.S. person.[20]

Notwithstanding the modifications to the definition of "guarantee," the Final Rules permit reliance on guarantee representations under the Cross-Border Guidance or the uncleared swaps margin rules until December 31, 2027, if such representations were obtained prior to the effectiveness of the Final Rules. Accordingly, to the extent that market participants have obtained such representations from counterparties through the Cross-Border Representation Letter or otherwise, those market participants do not need to seek new representations to reflect the requirements of the Final Rules until December 31, 2027.[21]

C. SIGNIFICANT RISK SUBSIDIARY AND CONDUIT AFFILIATE

Under the Cross-Border Guidance, the CFTC did not define the concept of a "conduit affiliate," but only identified non-exclusive factors it believed were relevant to the determination of whether an entity would be considered a conduit affiliate of a U.S. person.[22] Conduit affiliates, like U.S. persons and non-U.S. persons guaranteed by a U.S. person under the Cross-Border Guidance, were required to count all of their swap

transactions, whether or not with U.S counterparties, in their swap dealer *de minimis* calculations.

The Final Rules do not include the concept of "conduit affiliate," but replace it with the SRS category.[23] Under the Final Rules, an SRS means any non-U.S. "significant subsidiary"[24] of an "ultimate U.S. parent entity,"[25] where the ultimate U.S. parent entity has more than $50 billion in global consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year. However, excluded from the definition are prudentially regulated subsidiaries of bank holding companies or entities subject to Basel capital standards and oversight and subject to comparable uncleared swaps margin rules.[26]

Market participants likely will favor the new SRS definition with its objective criteria when compared to the "conduit affiliate" concept that, due to its vagueness, was difficult to apply. Critics of the SRS concept note that it is not likely to capture any entities, especially in light of the exclusions from the definition for prudentially regulated entities and those entities subject to Basel capital standards and comparable uncleared swaps margin rules. Further, specifically with respect to the elimination of the conduit affiliate concept, Commissioner Berkovitz in his dissent criticized the Final Rules for not containing any similar provision to prevent the use of conduit affiliates to avoid CFTC regulation, which he believed was an invitation to abuse.[27]

Because the SRS category is new, there is no ISDA protocol or representation letter that addresses it. Accordingly, market participants will be requested to make representations and/or disclosures regarding their SRS status as a condition to future swap trading when compliance with the Final Rules is required.

II. COUNTING CROSS-BORDER SWAPS TOWARD THE *DE MINIMIS* THRESHOLDS

Under the CFTC's rules, a person who engages in swap dealing activity is required to register as a swap dealer,[28] unless the person has engaged in swap dealing activity below the *de minimis* thresholds, which are the aggregate gross notional amount of dealing swaps (calculated over the immediately preceding 12 months) of US$8 billion, or US$25 million in the case of counterparties that are "special entities."[29] The Final Rules address the cross-border application of the swap dealer *de minimis* thresholds as applied to U.S. persons, Guaranteed Entities, SRSs, and "Other Non-U.S. Persons," as described below.[30]

A. U.S. PERSONS, GUARANTEED ENTITIES AND SRSS

Under the Final Rules, a U.S. person must count all of its dealing swaps, whether with non-U.S. persons or U.S. persons, toward the swap dealer *de minim*is threshold. The Final Rules thus do not depart from the Cross-Border Guidance, which treated U.S. persons the same way. A U.S. person must also include in its calculation under the Final Rules all of the dealing swaps of its foreign branches because such branches are part of the same legal person.[31]

Similarly, a Guaranteed Entity and an SRS must count all of their dealing swaps with both U.S. person and non-U.S. person counterparties toward the swap dealer *de minimis* thresholds, as is required of U.S. persons.[32] This approach is generally consistent with that taken in the Cross-

Border Guidance with respect to guaranteed affiliates by a U.S. person and conduit affiliates, which the SRS concept replaces. Note that, as mentioned above, the Guaranteed Entity concept does not require affiliation, only that the entity is guaranteed by a U.S. person.

B. OTHER NON-U.S. PERSONS

Under the Final Rules, an "Other Non-U.S. Person," which refers to a non-U.S. person that is neither a Guaranteed Entity nor an SRS,[33] is required to count the following swaps toward its swap dealer *de minimis* thresholds:

- Dealing swaps with a U.S. person, except for swaps conducted through a foreign branch of a registered swap dealer;[34] and
- Dealing swaps with a Guaranteed Entity, except when: (i) the Guaranteed Entity is registered as a swap dealer; (ii) the Guaranteed Entity's swaps are subject to a guarantee by a U.S. person that is a non-financial entity; or (iii) the Guaranteed Entity is itself below the *de minimis* thresholds and is affiliated with a registered swap dealer.[35]

The above counting requirements are consistent with the Cross-Border Guidance.

An Other Non-U.S. Person is not required to count swaps with SRSs or another other non-U.S. person under the Final Rules. Moreover, an other non-U.S. person is not required to count any swap that has been entered into anonymously on a designated contract market, a registered or exempt swap execution facility, or a registered foreign board of trade where such swaps are also cleared through a registered or exempt derivatives clearing organization.[36] This latter exception represents an expansion from the Cross-Border Guidance insofar as it includes exempt swap execution facilities and exempt derivatives organizations.

C. AGGREGATION

The Final Rules retain the requirement from the Cross-Border Guidance that a potential swap dealer, whether a U.S. or non-U.S. person, must aggregate all swaps connected with its dealing activity with those of persons controlling, controlled by, or under common control with the potential swap dealer to the extent that these affiliated persons are themselves required to include those swaps in their own *de minimis* threshold calculations, unless the affiliated person is itself a registered swap dealer.[37] For this purpose, the CFTC construes "affiliates under common control" by reference to its Entity Definitions Rule,[38] which defined control as 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. Accordingly, any reference in the CFTC's aggregation interpretation in the Final Rules to "affiliates under common control" with a person includes affiliates that are controlling, controlled by, or under common control with such person.

III. ANE TRANSACTIONS

On November 14, 2013, the CFTC's Division of Swap Dealer and Intermediary Oversight ("DSIO") issued the ANE Staff Advisory mentioned above. Under the ANE Staff Advisory, a non-U.S. swap dealer that regularly uses personnel or agents located in the United States to arrange, negotiate, or execute a swap with a non-

U.S. person ("ANE Transactions") generally was subject to "Transaction-Level Requirements" under the Cross-Border Guidance, although the ANE Staff Advisory never went into effect as a result of staff no-action relief.

The Final Rules eliminate the concept of "Transaction-Level Requirements" from the regulations regarding the categorization and applicability of swaps requirements, as discussed below. Under the Final Rules, ANE Transactions are explicitly exempt from the new classification of "Group B" and "Group C" requirements. Certain requirements, such as swap data reporting, capital adequacy, clearing and trade execution, are not addressed in the Final Rules ("Unaddressed Requirements"). In its discussion of the Final Rules, the CFTC indicated that it intends to consider the application of ANE Transactions to the Unaddressed Requirements in future rulemakings. Further, the Commission states that, until such time, the Commission will not consider, as a matter of policy, a non-U.S. swap dealer's use of their personnel or agents located in the United States to "arrange, negotiate, or execute" swap transactions with non-U.S. counterparties for purposes of determining whether the Unaddressed Requirements apply to such transactions.[39]

Concurrent with the issuance of the Final Rules, DSIO withdrew the ANE Staff Advisory and, along with the CFTC's Division of Clearing and Risk and the Division of Market Oversight, issued a no-action letter that provides relief from the applicability of the Unaddressed Requirements to ANE Transactions.[40] This relief applies until the effective date of any CFTC action addressing whether a particular Unaddressed Requirement is or is not applicable to ANE Transactions.

In addition to the above, the Final Rules state that ANE Transactions will not be considered for purposes of *de minimis* thresholds for swap dealer registration.[41]

As a result of the Final Rules' treatment of ANE Transactions, the CFTC's approach diverges from that of the Securities and Exchange Commission's ("SEC's") with respect to security-based swaps. In that regard, the SEC applies certain security-based swap requirements to ANE Transactions, and also requires that ANE Transactions count towards the security-based swap dealer *de minimis* thresholds.[42] In his supporting statement, CFTC Chairman Tarbert justified this divergence on the basis that, because securities generally are predominantly traded in the jurisdiction where they are issued, and security-based swaps can affect the price and liquidity of an underlying security, the SEC has a greater interest in regulating ANE security-based swap transactions. By contrast, because commodities are traded throughout the world, there is less need for the CFTC to apply its swaps regulations to ANE Transactions.[43] Swap dealers who intend to register with the SEC as security-based swap dealers will need to be mindful of this distinction.

IV. CATEGORIZATION AND APPLICABILITY OF SWAP REGULATORY REQUIREMENTS

The Cross-Border Guidance categorized its regulatory requirements as either "Transaction Level" or "Entity Level." Those categories were in turn sub-divided into further subcategories. The Final Rules eliminate the Transaction-Level and Entity-Level categories and subcategories, and instead recategorize the regulatory requirements into three groups—Groups A, B, and C.

These requirements apply to all Swap Entities, a newly defined term that means a swap dealer or major swap participant registered with the CFTC,[44] unless an exception or substituted compliance is available.

A. GROUP A, B AND C REQUIREMENTS

Group A requirements apply to all swap dealers on an entity-wide basis and are not dependent on the swap counterparty being a U.S. person or not. Group A requirements consist of the following:

- Chief compliance officer;
- Risk management, (monitoring compliance with position limits, conflicts of interest, diligent supervision, business continuity and disaster recovery programs, information availability);
- Swap data recordkeeping, and
- Antitrust considerations.

Substituted compliance is available under the Final Rules for all Group A requirements, but there are no exceptions to the Group A requirements. Substituted compliance means that a non-U.S. Swap Entity, which is defined as a Swap Entity that is not a U.S. Swap Entity (which in turn is defined as a Swap Entity that is a U.S. person),[45] may follow its home country's rules to comply with any group A requirement if such rules have been determined to be comparable to CFTC rules through the issuance of a comparability determination by the CFTC.

Group B requirements basically track the Transaction-Level Requirements in the Cross-Border Guidance with respect to risk mitigation and recordkeeping requirements. They include:

- Swap trading relationship documentation;
- Portfolio reconciliation and compression;
- Trade confirmation; and
- Daily trading records.

Group B requirements generally apply to all swap entities. However, the Final Rules provide for exceptions from the Group B requirements, and substituted compliance may be separately available, as described below.

The Group C requirements address external business conduct standards (such as counterparty due diligence requirements and disclosures of material information) and segregation of initial margin, except as required under the uncleared swaps margin rules. Substituted compliance is not available for Group C requirements, but the Final Rules provide for certain exceptions from Group C requirements, as described below.

B. EXCEPTIONS

The Final Rules provide exceptions from some or all of the Group B and Group C requirements for non-U.S. Swap Entities or foreign branches of U.S. Swap Entities when transacting in "foreign-based swaps." A "foreign-based swap" means (i) a swap by a non-U.S. Swap Entity, except for a swap booked in a U.S. branch;[46] or (ii) a swap conducted through a foreign branch.[47]

1. EXCEPTION FROM BOTH GROUP B AND C REQUIREMENTS

An exception applies to both Group B and C requirements under the Final Rules in the case of

certain anonymously cleared, exchange-traded, and cleared foreign-based swaps entered into by a non-U.S. Swap Entity or a foreign branch of a U.S. Swap Entity.[48]

2. EXCEPTIONS FROM GROUP C REQUIREMENTS

The Final Rules provide for the following exceptions from Group C requirements.

a. Foreign Counterparties

An exception from Group C requirements applies with respect to any foreign-based swap entered into by a non-U.S. Swap Entity or a foreign branch of a U.S. Swap Entity with a "foreign counterparty." A foreign counterparty is defined to mean a non-U.S. person, except with respect to a swap booked in a U.S. branch of that non-U.S. person, or a foreign branch where the swap is conducted through the foreign branch.[49]

b. Foreign Counterparties but booked in U.S. Branch of a non-U.S. Swap Entity

An additional exception from Group C requirements applies to a non-U.S. Swap Entity with respect to any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch nor a person whose performance under the swap is subject to a guarantee by a U.S. person.[50]

3. EXCEPTIONS FROM GROUP B REQUIREMENTS

The Final Rules provide for the following exceptions from Group B requirements.

a. Non-U.S. Swap Entity and Foreign-Based Swaps with Certain Foreign Counterparties

An exception from Group B requirements applies in the case of foreign-based swaps between a non-U.S. Swap Entity that is neither an SRS nor guaranteed by a U.S. person and a foreign counterparty (other than a foreign branch of a U.S person) that is neither an SRS that is a Swap Entity nor guaranteed by a U.S. person.[51]

b. Swaps Between Foreign Branches of U.S. Swap Entities and Certain Foreign Counterparties

An exception from Group B requirements also applies in the case of foreign-based swaps entered into by foreign branches of a U.S Swap Entity with a foreign counterparty (other than a foreign branch) that is neither a Swap Entity nor subject to a guarantee from a U.S. person. The exception is not available for any swap for which substituted compliance is available and a comparability determination has been issued by the CFTC prior to the execution of the swap. Moreover, there is a cap on the use of this exception. Specifically, in any calendar quarter, the aggregate gross notional amount of swaps conducted by a Swap Entity in reliance on the exception may not exceed 5% of the aggregate gross notional amount of all its swaps in that calendar quarter.[52]

c. Non-U.S. Swap Entity that is an SRS or Guaranteed Entity and Certain Foreign Counterparties

In addition, an exception from Group B requirements is provided for foreign-based swaps between a non-U.S. Swap Entity that is an SRS or a person whose performance under the swap is subject to a guarantee by a U.S. person with a foreign counterparty (other than a foreign branch) that is neither a Swap Entity nor a person whose performance under the swap is subject to a guar-

antee by a U.S. person. However, similar to the exception for foreign-based swaps entered into by foreign branches of U.S. Swap Entities discussed immediately above, this exception is not available for any swap for which substituted compliance is available pursuant to a CFTC issued comparability determination issued before execution of the swap and is subject to a 5% notional cap.[53]

V. SUBSTITUTED COMPLIANCE AND COMPARABILITY DETERMINATIONS

The Final Rules provide for substituted compliance for those non-U.S. Swap Entities and foreign branches of U.S. Swap Entities that are subject to a comparable standards as determined by the CFTC in their respective home jurisdictions.[54] As noted above, substituted compliance is available with respect to Group A and Group B requirements only; substituted compliance is not available for Group C requirements because non-U.S. Swap Entities and foreign branches of U.S. Swap Entities are exempt from Group C requirements with respect to foreign-based swaps with foreign counterparties.

For Group A requirements, which apply entity-wide and not on a transaction-by-transaction basis, a non-U.S. Swap Entity would be allowed to comply solely with its local, comparable regulations that have been the subject of a CFTC comparability determination without regard to whether it is transacting with U.S. or non-U.S. counterparties.[55]

For Group B requirements, which can be applied on a transaction-by-transaction or relationship-specific basis, the Final Rules provide that, where substituted compliance is available, and subject to any conditions specified in any comparability determination issued by the CFTC:

- A non-U.S. Swap Entity and the Foreign Branch of a U.S. Swap Entity may satisfy any Group B requirement through substituted compliance when entering into foreign-based swaps with any foreign counterparty; and
- A non-U.S. Swap Entity may satisfy any Group B requirement for any swap with a foreign counterparty that is neither a foreign branch nor a Guaranteed Entity that is booked in a U.S. branch.[56]

The Final Rules also set forth a standard of review for the Commission when making substituted compliance determinations.[57] Specifically, the Final Rules provide that the CFTC may issue a comparability determination if it determines that some or all of a foreign jurisdiction's standards are comparable to the CFTC's corresponding requirements or group of requirements, or would result in comparable outcomes to the CFTC's requirements, after taking into account such factors as the CFTC determines are appropriate. These factors may include: (i) the scope and objectives of the relevant foreign jurisdiction's regulatory standards; (ii) whether the foreign jurisdiction's regulatory standards, despite differences, achieve comparable regulatory outcomes to the CFTC's requirements; (iii) the ability of the relevant regulatory authorities to supervise and enforce compliance with the relevant foreign jurisdiction's regulatory standards; and (iv) whether the relevant foreign jurisdiction's regulatory authorities have entered into a memorandum of understanding or other arrange-

ment with the CFTC regarding the oversight, examination and supervision of Swap Entities.

The Final Rules state that this standard of review is designed to reflect a flexible, outcomes based approach where the CFTC may find a foreign jurisdiction's standards comparable if, viewed holistically, those standards achieve a regulatory outcome that adequately serves the same regulatory purposes as the Group A or B requirements as a whole. It also permits the CFTC to base its comparability determination on a foreign jurisdiction's regulatory standards instead of regulatory requirements, where such standards are not embodied in regulations.[58]

VI. CONCLUSION

For market participants, the Final Rules provide a number of helpful provisions that will provide legal certainty and facilitate compliance. These include the definitive, streamlined definitions of U.S. person and guarantee and the elimination of the vague conduit affiliate concept in favor of the objective criteria in the SRS definition. Because the Final Rules have the force and effect of law, it should be expected that the Commission will bring actions to enforce them and, therefore, these clear standards should put market participants on notice of what is expected so that they can order their affairs accordingly. However, areas where the CFTC did not harmonize with the SEC, such as in the case with ANE transactions, may lead to compliance headaches down the road for dually-registered firms, although the Final Rules generally reflect harmonization with the SEC.

Overall, the Final Rules rely heavily on the Cross-Border Guidance, but reflect greater deference to foreign regulators as a result of the more narrow, streamlined definitions and a flexible approach to substituted compliance. This does not seem surprising given that many more foreign jurisdictions have enacted similar Dodd-Frank reforms than was the case when the Cross-Border Guidance was issued. Critics of the Final Rules note that they may result in greater risks being transferred back to the United States than under the Cross-Border Guidance in light of the narrower definition of guarantee. The SRS concept, which likely will not capture any entities particularly in light of its exclusions, appears to be a regulatory dead letter and could potentially lead to U.S. banks de-registering their overseas non-guaranteed swap dealer affiliates in the long term. Whether these concerns are significant remains to be seen. But given the importance of cross-border transactions to the derivatives market, it does not seem unlikely that the Final Rules will be revisited by a future Commission, and in any event the Unaddressed Requirements will need to be considered.

ENDNOTES:

[1]*See Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants*, 85 Fed. Reg. 56,924 (Sept. 14, 2020).

[2]*See Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations*, 78 Fed. Reg. 45,292 (Jul. 26, 2013).

[3]*See Applicability of Transaction-Level Requirements to Activity in the United States*, Division of Swap Dealer and Intermediary Oversight, CFTC Staff Advisory No. 13-69 (Nov. 14, 2013).

[4]*See* CFTC Staff Letter No. 20-21 (July 23, 2020).

[5]Statement of CFTC Chairman Heath P. Tarbert in Support of Final Cross-Border Swap Rule 85 Fed. Reg. at 57,001 (July 23, 2020)

[6]Dissenting Statement of CFTC Commissioner Dan M. Berkovitz on the Final Rule for Cross-Border Swap Activity of Swap Dealers and Major Swap Participants 85 Fed. Reg. at 57,003 (July 23, 2020).

[7]For this purpose, "principal place of business" "means the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person. With respect to an externally managed investment vehicle, this location is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle. 17 C.F.R. § 23.23(a)(23)(ii)."

[8]17 C.F.R. § 23.23(a)(23)(i).

[9]The Final Rules do not change the "unlimited U.S. responsibility" prong contained in the CFTC's cross-border rules governing margin for uncleared swaps.

[10]*Compare* 17 C.F.R. § 3a71-3(a)(4) *with* 17 C.F.R. § 23.23(a)(23). In an additional change consistent with the SEC's cross-border rules, the Final Rules provide that the U.S. person definition 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, and their agencies and pension plans. See 17 C.F.R. § 23.23(a)(23)(iii).

[11]17 C.F.R. § 23.23(a)(9).

[12]*See* Cross-Border Guidance, 78 Fed. Reg. at 45,320.

[13]Final Rules, 85 Fed. Reg. at 56,939.

[14]*See id.*

[15]*See id.* at 56,940.

[16]*See id.*

[17]*Id.*

[18]*See id.* at 56,941.

[19]Commissioner Berkovitz in his dissent criticized the effect of the Final Rules' "legalistic" definition of guarantee, arguing that it "permits banks to craft financing arrangements for their overseas swap activities that bring risks back into the U.S. parent organization without triggering the application of Dodd-Frank requirements for those activities." *See supra* n.6.

[20]*See* 85 Fed. Reg. at 56,941-942.

[21]*See id.* at 56,941.

[22]*See* Cross-Border Guidance, 78 Fed. Reg. at 45,359. The conduit affiliate factors include: (i) the non-U.S. person is a majority-owned affiliate of a U.S. person; (ii) the non-U.S. person is controlling, controlled by or under common control with the U.S. person; (iii) the financial results of the non-U.S. person are included in the consolidated financial statements of the U.S. person; and (iv) the non-U.S. person, in the regular course of business, engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliate(s), and enters into offsetting swaps or other arrangements with its U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third-party(ies) to its U.S. affiliates. *Id.*

[23]*See* 17 C.F.R. § 23.23(a)(13).

[24]The term "significant subsidiary" means a subsidiary, including its subsidiaries, which meets any of the following conditions: (i) The three year rolling average of the subsidiary's equity capital is equal to or greater than 5% of the three year rolling average of the ultimate U.S. parent entity's consolidated equity capital, as determined in accordance with U.S. GAAP as of the end of the most recently completed fiscal year; (ii) The three year rolling average of the subsidiary's total revenue is equal to or greater than 10% of the three year rolling average of the ultimate U.S. parent entity's total consolidated revenue, as determined in accordance with U.S. GAAP as of the end of the most recently completed fiscal year; or (iii) The three year rolling average of the subsidiary's total assets is equal to or greater than 10% of the three year rolling average of the ultimate U.S. parent entity's total consolidated assets, as determined in accordance with U.S. GAAP as of the end of the most re-

cently completed fiscal year. *See* 17 C.F.R. § 23.23(a)(14). A "subsidiary" means an affiliate of a person controlled by such person directly, or indirectly through one or more intermediaries. *See* 17 C.F.R. § 23.23(a)(15). An "affiliate" or a "person affiliated with a specific person," means a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified. *See* 17 C.F.R. § 23.23(a)(1).

[25]An "ultimate U.S. parent entity" means the U.S. parent entity that is not a subsidiary of any other U.S. parent entity. *See* 17 C.F.R. § 23.23(a)(19).

[26]*See* 17 C.F.R. § 23.23(a)(13).

[27]*See supra* n.6.

[28] A swap dealer is defined as any person who (i) holds themself out as a dealer in swaps, (ii) makes a market in swaps, (iii) regularly enters into swaps with counterparties as an ordinary course of business for their 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 swaps. *See* 7 U.S.C.A. § 1a(49)(A).

[29]*See* 17 C.F.R. § 1.3 (definition of the term "swap dealer"). A special entity is defined in 17 C.F.R. § 23.401(c) to mean (i) A Federal agency; (2) A State, State agency, city, county, municipality, other political subdivision of a State, or any instrumentality, department, or a corporation of or established by a State or political subdivision of a State; (iii) Any employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974 (29 U.S.C.A. 1002)("ERISA"); (iv) Any governmental plan, as defined in Section 3 of the ERISA; (v) Any endowment, including an endowment that is an organization described in Section 501(c)(3) of the Internal Revenue Code of 1986 (26 U.S.C.A. 501(c)(3)); or (vi) Any employee benefit plan defined in Section 3 of ERISA, not otherwise defined as a Special Entity, that elects to be a Special Entity by notifying a swap dealer or major swap participant of its election prior to entering into a swap with the particular swap dealer or major swap participant.

[30]A similar approach is taken with respect to the major swap participant registration tests. For the sake of simplicity and given that there are no major swap participants registered with the CFTC at this time, we discuss only swap dealers.

[31]*See* 85 Fed. Reg. at 56,951.

[32]*Id.*

[33]*Id.* at 56,942.

[34]A "swap conducted through a foreign branch" is defined to mean a swap entered into by a foreign branch where: (i) The foreign branch or another foreign branch is the office through which the U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the U.S. persons is such foreign branch; (ii) the swap is entered into by such foreign branch in its normal course of business; and (iii) the swap is reflected in the local accounts of the foreign branch. 17 C.F.R. § 23.23(a)(17). A "foreign branch" is defined as "any office of a U.S. bank that: (i) is located outside the United States; (ii) operates for valid business reasons; (iii) maintains accounts independently of the home office and the accounts of other foreign branches, with the profit and loss accrued at each branch determined as a separate item for each foreign branch; and (iv) is engaged in the business of banking and is subject to substantive regulation in banking or financing in the jurisdiction where it is located." 17 C.F.R. § 23.23(a)(3). A "foreign branch" is a branch office and not a separate legal entity.

[35]*Id.* at 56,953-54. The Final Rules do not require a U.S. branch of an other non-U.S. person to count all of its swaps toward the de minimis threshold, but rather only the swaps required to be counted by other non-U.S. persons, consistent with the CFTC's general approach that a branch is not a separate legal entity.

[36]*Id.* at 56,955-56

[37]*Id.* at 56,954-95.

[38]*See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"*

77 Fed. Reg. 30,596 (May 23, 2012).

[39]*See* 85 Fed. Reg. at 56,963.

[40]*See* CFTC Staff Letter No. 20-21 (July 23, 2020).

[41]*See* 85 Fed. Reg. at 56,963.

[42]*See Cross-Border Application of Certain Security-Based Swap Requirements*, SEC Release No. 34-87780 (Dec. 18, 2019).

[43]*See supra* n.5.

[44]*See* 17 C.F.R. § 23.23(a)(18).

[45]*See* 17 C.F.R. §§ 23.23(a)(11) and 23.23(a)(24).

[46]A "swap booked in a U.S. branch" is defined to mean a swap entered into by a U.S. branch where the swap is reflected in the local accounts of the U.S. branch. 17 C.F.R. § 23.23(a)(16). A U.S. branch is defined to mean a branch or agency of a non-U.S. banking organization where such branch or agency: (i) Is located in the United States; (ii) Maintains accounts independently of the home office and other U.S. branches, with the profit or loss accrued at each branch determined as a separate item for each U.S. branch; and (iii) Engages in the business of banking and is subject to substantive banking regulation in the state or district where located. 17 C.F.R. § 23.23(a)(21). Note that unlike the definition of swaps conducted through a foreign branch, *see supra* n.31, the definition of swap booked in a U.S. branch does not require that payments or deliveries to be made to and from the branch outside the U.S. or that the swap is entered into by the U.S. branch in the normal course of business.

[47]*See* 17 C.F.R. § 23.23(a)(4)(definition of the term "foreign based swap"). *See supra* n.34 regarding definitions of "foreign branch" and "swap conducted through a foreign branch."

[48]*See* 17 C.F.R. § 23.23(e)(1)(i).

[49]*See* 17 C.F.R. § 23.23(e)(1)(ii).

[50]*See* 17 C.F.R. § 23.23(e)(2).

[51]*See* 17 C.F.R. § 23.23(e)(3).

[52]*See* 17 C.F.R. § 23.23(e)(4).

[53]*See* 17 C.F.R. § 23.23(e)(5).

[54]*See* 17 C.F.R. § 23.23(f).

[55]See 17 C.F.R. § 23.23(f)(1).

[56]*See* 17 C.F.R. §§ 23.23(f)(2) and (3).

[57]*See* 17 C.F.R. § 23.23(g)(4).

[58]*See* 85 Fed. Reg. at 56,978