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NATIONAL ARCHIVES AND RECORDS ADMINISTRATION
LITTERA SCRIPTA MANET
1985

FEDERAL REGISTER

Vol. 79 Tuesday,
No. 155 August 12, 2014

Part V

Securities and Exchange Commission

17 CFR Parts 240, 241, and 250
Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities; Final Rule; Republication

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 241, and 250

[Release No. 34–72472; File No. S7–02–13]

RIN 3235–AL25

Application of ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities; Republication

Editorial Note: Proposed rule document 2014–15337 was originally published on pages 39067 through 39162 in the issue of Wednesday, July 9, 2014. In that publication the footnotes contained erroneous entries. The corrected document is republished in its entirety.

AGENCY: Securities and Exchange Commission.

ACTION: Final rules; interpretation.

SUMMARY: The Securities and Exchange Commission (''SEC'' or ''Commission'') is adopting rules and providing guidance to address the application of certain provisions of the Securities Exchange Act of 1934 (''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. These rules and guidance in large part focus on the application of the Title VII definitions of ''security-based swap dealer'' and ''major security-based swap participant'' in the cross-border context. The Commission also is adopting a procedural rule related to the submission of applications for substituted compliance. In addition, the Commission is adopting a rule addressing the scope of our authority, with respect to enforcement proceedings, under section 929P of the Dodd-Frank Act.

DATES: Effective September 8, 2014.

FOR FURTHER INFORMATION CONTACT: Richard Gabbert, Senior Special Counsel, Joshua Kans, Senior Special Counsel, or Margaret Rubin, Special Counsel, Office of Derivatives Policy, at 202–551–5870, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–7010.

SUPPLEMENTARY INFORMATION: The Commission is adopting the following rules under the Exchange Act, accompanied by related guidance, regarding the application of Subtitle B of Title VII of the Dodd-Frank Act to cross-border activities: Rule 0–13 (filing procedures regarding substituted compliance requests); Rule 3a67–10 (regarding the cross-border implementation of the ''major security-based swap participant'' definition); Rule 3a71–3 (regarding the cross-border implementation of the *de minimis* exception to the ''security-based swap dealer'' definition); Rule 3a71–4 (regarding the cross-border implementation of the aggregation provisions of the dealer *de minimis* exception); and Rule 3a71–5 (regarding an exception, from the dealer *de minimis* analysis, for certain cleared anonymous transactions). The Commission is not addressing, as part of this release, certain other rules that we proposed regarding the application of Subtitle B of Title VII in the cross-border context. The Commission also is adopting Rule 250.1 to clarify the scope of its antifraud civil law-enforcement authority, with respect to enforcement proceedings, in the cross-border context.

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I. Background

A. Scope of This Rulemaking

The Commission is adopting the first of a series of rules and providing guidance regarding the application of Title VII of the Dodd-Frank Act [1] (''Title VII'') to cross-border security-based swap activities and persons engaged in those activities.[2] This rulemaking primarily focuses on the application of the *de minimis* exception to the definition of ''security-based swap dealer'' in the cross-border context, and on the application of thresholds related to the definition of ''major security-based swap participant'' in the cross-border context. We also are adopting a procedural rule regarding the submission of ''substituted compliance'' requests to allow market participants to satisfy certain Title VII obligations by complying with comparable foreign regulatory requirements.[3]

The rules and guidance we are adopting are based on our May 23, 2013 proposal, which addressed the application of Title VII in the cross-border context.[4] Aside from addressing the definitions and procedural rule noted above, the Cross-Border Proposing Release also addressed a range of other cross-border issues, including issues regarding the requirements applicable to dealers and major participants, and requirements relating to mandatory clearing, trade execution, regulatory reporting, and public dissemination. The Cross-Border Proposing Release stated that it was possible that we would consider final rules and guidance related to some of those issues in the adopting releases related to the relevant substantive rulemakings, and that we would address others in a separate rulemaking.[5]

This rulemaking's focus on the cross-border application of the dealer and major participant definitions reflects the critical and foundational role that those definitions occupy with regard to the implementation of Title VII.[6] We expect to address other matters raised by the Cross-Border Proposing Release as part of subsequent rulemakings, to allow us to consider the cross-border application of the substantive requirements imposed by Title VII—including the economic consequences of that cross-border application—in conjunction with the final rules that will implement those substantive requirements.[7] Market participants are not required to comply with certain of those Title VII requirements pending the publication of final rules or other Commission action, and temporarily are exempt from having to comply with certain other requirements added by or arising from Title VII.[8]

These final rules and guidance do not address one key issue related to the application of the ''security-based swap dealer'' definition in the cross-border context. In the Cross-Border Proposing Release, we proposed that non-U.S. persons must count, against the relevant thresholds of the *de minimis* exemption, their dealing activity involving ''transactions conducted within the United States.'' [9] Commenters raised a number of significant issues related to this proposed requirement, including issues regarding the Commission's authority to impose this requirement and regarding the costs associated with this requirement. While we continue to preliminarily believe that the cross-border application of the security-based

[1] Public Law 111–203, 124 Stat. 1376 (2010). Unless otherwise indicated, references to Title VII in this release are to Subtitle B of Title VII.

[2] Consistent with the scope of the final rules as discussed below, the references in this release to the application of Title VII to ''cross-border activities'' refer to security-based swap transactions involving: (i) A U.S. person and a non-U.S. person, or (ii) two non-U.S. persons conducting a security-based swap transaction that otherwise occurs in relevant part within the United States, including where performance of one or both counterparties under the security-based swap are guaranteed by a U.S. person. For purposes of this release only, ''cross-border activities'' do not indicate activities involving a transaction between two non-U.S. persons where one or both are conducting dealing activity within the United States, because, as discussed below, we anticipate considering this issue in a subsequent release.

[3] The procedural rule addresses only the process for submitting such substituted compliance requests to the Commission. It does not address issues regarding whether substituted compliance would be available in connection with particular regulatory requirements, and, if so, under what conditions. We expect to address those matters as part of later rulemakings.

[4] *See* 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, Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968 (May 23, 2013) (''Cross-Border Proposing Release'').

[5] *See id.* at 30974.

[6] This rulemaking does not address the requirements under section 5 of the Securities Act applicable to security-based swap transactions. Security-based swaps, as securities, are subject to the provisions of the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) (''Securities Act'') and the rules and regulations thereunder applicable to securities. 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 purchase or sale of, a security-based swap to any person who is not an eligible contract participant 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) of the Securities Act, exemptions from this requirement in sections 3 and 4 of the Securities Act are not available.

[7] Those subsequent rulemakings may make use of definitions of ''U.S. person'' and certain other terms that we are adopting today.

[8] *See* Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, Exchange Act Release No. 64678 (Jun. 15, 2011), 76 FR 36287 (Jun. 22, 2011) (clarifying the compliance date for certain requirements added by Title VII, and in some cases providing temporary exemptive relief in connection with those requirements); 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. 71485 (Feb. 5, 2014), 79 FR 7731 (Feb. 10, 2014) (extending exemptive relief from certain Exchange Act provisions in connection with Title VII's revision of the Exchange Act definition of ''security'' to encompass security-based swaps).

[9] *See* proposed Exchange Act rule 3a71–3(b). The proposal further would have defined a ''transaction conducted within the United States'' to encompass transactions that are solicited, executed, or booked within the United States by or on behalf of either counterparty, regardless of either counterparty's location, domicile or residence status, subject to an exception for transactions conducted through the foreign branches of U.S. banks. *See* proposed Exchange Act rule 3a71–3(a)(5).

swap dealer definition should account for activities in the United States related to dealing—even when neither party to the transaction is a U.S. person—we also believe that the final resolution of this issue can benefit from further consideration and public comment. Accordingly, we anticipate soliciting additional public comment regarding approaches by which the cross-border application of the dealer definition appropriately can reflect activity between two non-U.S. persons where one or both are conducting dealing activity within the United States.

B. The Dodd-Frank Act

As discussed in the Cross-Border Proposing Release, the 2008 financial crisis highlighted significant issues in the over-the-counter (''OTC'') derivatives markets, which had experienced dramatic growth in the years leading up to the crisis and are capable of affecting significant sectors of the U.S. economy.[10] 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, including in connection with swaps and security-based swaps.[11]

Title VII provides for a comprehensive new regulatory framework for swaps and security-based swaps. Under this framework, the Commodity Futures Trading Commission (''CFTC'') regulates ''swaps'' while the Commission regulates ''security-based swaps,'' and the Commission and CFTC jointly regulate ''mixed swaps.'' The new framework encompasses the registration and comprehensive regulation of dealers and major participants, as well as requirements related to clearing, trade execution, regulatory reporting, and public dissemination.[12] Security-based swap transactions are largely cross-border in practice,[13] and the various market participants and infrastructures operate in a global market. To ensure that our regulatory framework appropriately reflects and addresses the nature and extent of the potential impact that the global market can have on U.S. persons and the U.S. financial system, it is critically important that we provide market participants with clear rules and guidance regarding how the regulatory framework mandated by Title VII will apply in the cross-border context.

In developing these final rules and guidance, we have consulted and coordinated with the CFTC, the prudential regulators,[14] and foreign regulatory authorities in accordance with the consultation provisions of the Dodd-Frank Act,[15] and more generally as part of our domestic and international coordination efforts.[16] Commission staff has participated in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing the regulation of OTC derivatives.[17] Through these discussions and the Commission staff's participation in various international task forces and working groups,[18] we have gathered information about foreign regulatory reform efforts and the possibility of conflicts and gaps, as well as inconsistencies and overlaps, between U.S. and foreign regulatory regimes. We have taken this information into consideration in developing the final rules and guidance.

C. The Cross-Border Proposing Release and the CFTC Cross-Border Guidance

In expressing our preliminary views regarding the application of Title VII to security-based swap activity carried out in the cross-border context (including to persons engaged in such activities), the Cross-Border Proposing Release recognized that the security-based swap market is global in nature and that it developed prior to the enactment of the Dodd-Frank Act.[19] The proposal further recognized that the rules we adopt and guidance we provide regarding the cross-border application of Title VII could significantly affect the global security-based swap market.[20]

Reflecting the range of regulatory requirements that Title VII imposes upon the security-based swap market,

[10] *See generally* Cross-Border Proposing Release, 78 FR 30972–73.

[11] *See* Pub. L. 111–203, Preamble (stating that 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'').

[12] The Commission has proposed a series of rules regarding these matters. *See* Cross-Border Proposing Release, 78 FR 30972 nn.11–18. Most recently, the Commission proposed rules governing recordkeeping, reporting, and notification requirements for dealers and major participants. *See* Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194 (May 2, 2014).

The Dodd-Frank Act further provides that the SEC and CFTC jointly should further define certain terms, including ''security-based swap dealer'' and ''major security-based swap participant.'' *See* Dodd-Frank Act section 712(d). Pursuant to that requirement, the SEC and CFTC jointly adopted rules to further define those terms. *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''); *see also* Cross-Border Proposing Release, 78 FR 30972 n.9 (discussing joint rulemaking to further define various Title VII terms).

[13] *See* section II.A, *infra,* regarding the preponderance of cross-border activity in the security-based swap market.

[14] 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 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 or major security-based swap participant if the entity is directly supervised by that regulator.

[15] Section 712(a)(2) of the Dodd-Frank Act provides in part that the 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.''

In addition, section 752(a) of the Dodd-Frank Act provides 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 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.''

[16] 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. *See* G20 Leaders' Statement, Pittsburgh, United States, September 24–25, 2009, available at: *http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf. (''G20 Leaders' Pittsburgh Statement'').*

In subsequent summits, the G20 leaders have reiterated their commitment to OTC derivatives regulatory reform. For example, in September 2013, the leaders of the G20 reaffirmed their commitments with respect to the regulation of the OTC derivatives markets, welcoming Financial Stability Board (''FSB'') members' confirmed actions and committed timetables to put the agreed OTC derivatives reforms into practice. *See* the G20 Leaders Declaration (September 2013), para. 71, available at: *https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENGpdf* (''G20 Leaders' St. Petersburg Declaration'').

[17] Senior representatives of authorities with responsibility for regulation of OTC derivatives have met on a number of occasions to discuss international coordination of OTC derivatives regulations. *See, e.g.,* Report of the OTC Derivatives Regulators Group (''ODRG'') on Cross-Border Implementation Issues March 2014 (Mar. 31, 2014), available at: *http://www.cftc.gov/ucm/groups/public/@internationalaffairs/documents/file/odrgreport033114.pdf.*

[18] Commission representatives participate 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. A Commission representative also serves as one of the co-chairs of the IOSCO Task Force on OTC Derivatives Regulation.

[19] *See* Cross-Border Proposing Release, 78 FR 30975–76.

[20] *See id.* at 30975.

the Cross-Border Proposing Release addressed the cross-border application of: (a) The *de minimis* exception to the ''security-based swap dealer'' definition; (b) the entity-level and transaction-level requirements applicable to security-based swap dealers (*e.g.,* margin, capital, and business conduct requirements); (c) the ''substantial position'' and ''substantial counterparty exposure'' thresholds for the ''major security-based swap participant'' definition and the requirements applicable to major participants; (d) the registration of security-based swap clearing agencies and mandatory clearing requirements; (e) the registration of security-based swap execution facilities and mandatory trade execution requirements; and (f) the registration of security-based swap data repositories and regulatory reporting and public dissemination requirements. The proposal also addressed the potential for market participants to satisfy certain of those Title VII requirements by complying with comparable foreign rules as a substitute. This rulemaking establishes a process for submission of such requests.

Following the Commission's proposal, the CFTC issued guidance regarding Title VII's application to cross-border swap activity.[21] The CFTC Cross-Border Guidance differed from the Commission's proposed rules in certain ways, including, as discussed below, with regard to the meaning of ''U.S. person,'' the cross-border application of the *de minimis* exception to the dealer definition, the cross-border application of the major participant definition, and the process for submitting substituted compliance requests.[22]

Certain foreign regulators also have addressed or are in the process of addressing issues related to the cross-border implementation of requirements applicable to OTC derivatives.[23]

D. Comments on the Proposal

The Commission received 36 comments in connection with the proposal.[24] Several of the commenters addressed differences between the SEC's proposed rules and the CFTC Cross-Border Guidance, and urged the Commission to harmonize its rules with the approaches taken by the CFTC and by foreign regulators.[25]

Many of those commenters particularly focused on differences between the two regulators' meanings of the term ''U.S. person,'' with several suggesting that we change our proposed definition to align with the CFTC's approach.[26] A number of commenters also addressed the definition of ''transaction conducted within the United States,'' with several opposing any use of the concept as part of the Commission's rules.[27]

Commenters further raised a number of more general concerns in connection with the proposal, including concerns regarding cost-benefit issues,[28] the clarity of the proposal as a whole,[29] the link between the rules and the location of the associated risk,[30] and perceived concessions to the financial industry.[31]

In addition, commenters addressed issues specific to the cross-border

[21] *See* ''Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations'' (Jul. 17, 2013), 78 FR 45292 (Jul. 26, 2013) (''CFTC Cross-Border Guidance'').

[22] The CFTC Cross-Border Guidance currently is subject to legal challenge. *See* Complaint, *Securities Indus. & Fin. Mkts. Ass'n.* v. *CFTC,* No. 1:13-cv-1916 (D.D.C. filed Dec. 4, 2013).

[23] *See* section III.B, *infra.*

[24] The comment letters are located at: *http://www.sec.gov/comments/s7-02-13/s70213.shtml.* The majority of those commenters addressed, at least in part, the definitional issues that are the subject of this release. A number of commenters also addressed aspects of the proposal that are outside the scope of this release, and a few of those commenters only addressed issues that were outside the scope of this release (for example, addressing only proposed Regulation SBSR). We will consider those comments in connection with the relevant rulemakings.

[25] *See, e.g.,* Managed Funds Assoc. and Alternative Investment Management Assoc. (''MFA/AIMA'') Letter at 3 (''We recognize that there are differences between the Commission's proposed approach and the CFTC Cross-Border Guidance, and we expect that other international regulators will similarly issue proposals related to the cross-border application of their regulations. Thus, in light of the global nature of the derivatives market, we urge continued harmonization with the CFTC and other regulatory authorities with respect to the extraterritorial scope of all these regimes. In particular, we encourage international coordination of substituted compliance regimes to ensure appropriate recognition of comparable regulations, create practical and administrable frameworks, and alleviate duplicative regulation.'' (footnotes omitted)). *See also* letter from six members of the United States Senate at 2 (stating that there should be no gaps or loopholes between the Commission's and the CFTC's rules); Futures and Options Association (''FOA'') Letter at 8 (urging the Commission and the CFTC ''to coordinate, to the extent possible, on their approaches in order to minimise distortions or other unintended consequences for market participants''); letter from Senator Jeffrey A. Merkley, et al., Congress of the United States (Aug. 6, 2013).

Some commenters generally suggested that we harmonize with aspects of the CFTC Cross-Border Guidance, but also expressed preferences for particular elements of our proposed approach. *See, e.g.,* Institute of International Bankers (''IIB'') Letter at 3–4 (generally emphasizing the need for consistency with the CFTC and European Securities and Markets Authority (''ESMA'') approaches, unless the SEC requirement is more flexible than those other requirements). One commenter took the view that the Commission's rules should be at least as strong as the CFTC Cross-Border Guidance, but should go further than the CFTC wherever necessary. *See* Better Markets (''BM'') Letter. *See also* Chris Barnard Letter at 2 (recommending that the Commission and the CFTC propose one set of rules applicable to cross-border activities to avoid duplicative and conflicting rules).

[26] *See* notes 192–224, *infra,* and accompanying text.

[27] As noted above, these final rules and guidance do not address the application of the ''transaction conducted within the United States'' concept to the dealer definition. We instead anticipate soliciting additional public comment regarding the issue.

[28] For example, a few commenters took the view that cost-benefit principles weighed in favor of consistency with the CFTC Cross-Border Guidance. *See* Securities Industry and Financial Markets Association/Futures Industry Association/Financial Services Roundtable (''SIFMA/FIA/FSR'') Letter at 3; PensionsEurope Letter (incorporating by reference SIFMA/FIA/FSR Letter; all references to SIFMA/FIA/FSR Letter incorporate reference to PensionsEurope Letter); IIB Letter at 2, 3. One commenter further took the view that cost-benefit principles merited rejection of the use of the ''transaction conducted within the United States'' concept. *See* SIFMA/FIA/FSR Letter at 3. *See also* Chris Barnard Letter at 2 (suggesting that there is insufficient administrative, legal, or economic rationale for having ''very different rules'' of cross-border application between the SEC and the CFTC); Coalition for Derivatives End-Users (''CDEU'') Letter at 2 (stating that conflicting regulatory regimes will result in increased compliance and regulatory costs and an inefficient financial system); Association of Financial Guaranty Insurers (''AFGI'') Letter, dated August 20, 2013 (''AFGI Letter I'') at 2 (stating that the security-based swap dealer and major security-based swap participant regime would be disruptive and have financial consequences for guaranty insurers and their counterparties who have legacy transactions with a projected run-off date in the near future); AFGI letter, dated July 22, 2013 (''AFGI Letter II'') at 4 (incorporated by reference in AFGI Letter I); AFGI letter, dated February 15, 2013 (''AFGI Letter III'') at 4 (incorporated by reference in AFGI Letter I).

One commenter conversely argued that, in lieu of cost-benefit principles, the Commission instead should be guided by public interest and investor protection principles, as well as the Dodd-Frank Act's intent to increase financial system soundness and prevent another financial crisis. *See* BM Letter at 4, 37–45 (stating, *inter alia,* that ''Congress passed the Dodd-Frank Act knowing full well that it would impose significant costs on industry, yet it determined those costs were not only justified but necessary to stabilize our financial system and avoid another financial crisis'').

One commenter challenged the adequacy—indeed, the existence—of the cost-benefit analysis in the proposing release. *See* CDEU Letter at 6 (''To better understand the negative effects of imposing conflicting rules on the market, the SEC should conduct a direct cost-benefit analysis of the conflicting rule regimes (*e.g.,* with the European Market Infrastructure Regulation and the CFTC's cross-border guidance). Instead, the SEC asks the public to conduct such an analysis for the SEC: 'what would be the economic impact, including the costs and benefits, of these differences on market participants . . . ?' '').

[29] *See* BM Letter at 2–3, 7–8; CDEU Letter at 5.

[30] *See* Americans for Financial Reform (''AFR'') Letter, dated August 22, 2013 (''AFR Letter I'') at 3–4 (criticizing the proposal as having failed to apply the rules based on the geographic location of the entity ultimately responsible for the resulting liabilities, and stating that the rules should apply to transactions engaged in by ''guaranteed foreign subsidiaries of U.S. entities'').

[31] *See* BM Letter at 7–8 (stating that the proposal was the result of unwarranted and inappropriate concessions, such as with regard to the application of the *de minimis* threshold to U.S.-guaranteed entities). *See also* Karim Shariff letter at 1 (stating that the proposal will allow banks to take risks that will lead to an economic collapse).

application of the entity-level and transaction-level requirements for dealers,[32] as well as requirements specific to clearing, trade execution, regulatory reporting and public disclosure.[33] We expect to address those comments regarding the relevant substantive requirements in subsequent rulemakings and guidance regarding the relevant substantive requirements.

Commenters also addressed the proposed availability of substituted compliance.[34] Although today we are adopting a procedural rule regarding requests for substituted compliance, we generally expect to address the potential availability of substituted compliance for specific Title VII requirements in connection with subsequent rulemakings regarding each substantive requirement.

We have carefully considered the comments received in adopting the final rules and providing guidance. Our final rules and guidance further reflect consultation with the CFTC, prudential regulators, and foreign regulatory authorities with regard to the development of consistent and comparable standards. Accordingly, certain aspects of the final rules and guidance—such as, for example, the treatment of guaranteed affiliates of U.S. persons for purposes of the dealer *de minimis* exception—have been modified from the proposal.[35]

II. The Economic, Legal, and Policy Principles Guiding the Commission's Approach to the Application of Title VII to Cross-Border Activities

In this section, we describe the most significant economic considerations regarding the security-based swap market that we have taken into account in implementing the cross-border application of the security-based swap dealer and major security-based swap participant definitions of Title VII. We are sensitive to the economic consequences and effects, including costs and benefits, of our rules, including with respect to the scope of our application of the security-based swap dealer and major security-based swap participant definitions in the cross-border context. We have taken into consideration the costs and benefits associated with persons being brought within one of these definitions through our cross-border application, as well as the costs market participants may incur in determining whether they are within the scope of these definitions and thus subject to Title VII, while recognizing that the ultimate economic impact of these definitions will be determined in part by the final rules regarding the substantive requirements applicable to security-based swap dealers and major security-based swap participants. Some of these economic consequences and effects stem from statutory mandates, while others result from the discretion we exercise in implementing the mandates.

A. Economic Considerations in the Cross-Border Regulation of Security-Based Swaps

1. Economic Features of the Security-Based Swap Market

As noted above, the cross-border implementation of the rules defining security-based swap dealer and major security-based swap participant is the first in a series of final rules that consider the cross-border implications of security-based swaps and Title VII. In determining how Title VII security-based swap dealer and major security-based swap participant definitions should apply to persons and transactions in the cross-border context, the Commission has been informed by our analysis of current market activity, including the extent of cross-border trading activity in the security-based swap market. Several key features of the market inform our analysis.

First, the security-based swap market is a global market. 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, managed, and hedged in still other jurisdictions). The global nature of the security-based swap market is evidenced by the data available to the Commission.[36] Based on market data in the Depository Trust and Clearing Corporation's Trade Information Warehouse (''DTCC–TIW''),[37] viewed from the perspective of the domiciles of the counterparties booking credit default swap (''CDS'') transactions, approximately 48 percent of price forming North American corporate single-name CDS transactions[38] from

[32] *See, e.g.,* BM Letter at 3, 20–21, 28 (stating that transactions conducted through foreign branches of U.S. dealers with non-U.S. persons should be subject to external business conduct requirements, and that margin should be treated as a transaction-level requirement); SIFMA/FIA/FSR Letter at A–22 to A–26 (addressing application of margin, segregation, external business conduct and certain other requirements).

[33] *See, e.g.,* BM Letter at 3, 21–22 (criticizing exceptions from mandatory clearing and trade execution requirements); SIFMA/FIA/FSR Letter at A–38 to A–52 (in part urging that application of regulatory reporting, public dissemination, trade execution and clearing requirements should follow the same rules as external business conduct requirements).

[34] *See, e.g.,* AFR Letter I at 8, 12 (opposing rationale for substituted compliance, and noting need for the Commission to retain discretion to find a lack of comparability based on substantive enforcement issues); AFR letter to CFTC, dated August 27, 2012 (''AFR Letter II'') (stating that CFTC should narrow the scope of substituted compliance) (incorporated by reference in AFR Letter I); Michael Greenberger letter to CFTC, dated February 6, 2013 at 13 (''Greenberger Letter I'') (stating that substituted compliance should be a last resort and that the CFTC regime be enforced vigorously) (incorporated by reference in AFR Letter I); Michael Greenberger letter to CFTC, dated August 27, 2012 at 8, 19–23 (''Greenberger Letter II'') (explaining that international comity does not require that the CFTC exempt foreign subsidiaries from compliance with U.S. financial regulation) (incorporated by reference in AFR Letter I); BM Letter at 3, 26–27 (questioning authority for substituted compliance and suggesting potential for loopholes; also stating that substituted compliance should not be allowed for transactions with U.S. persons or for transactions in the United States and urging limited use of exemptive authority; further stating that the proposal gave only passing reference to foreign supervision and enforcement); SIFMA/FIA/FSR Letter at A–30 to A–38 (in part supporting the approach to focus on similar regulatory objectives rather than requiring foreign rules to be identical, stating that foreign branches should be able to make use of substituted compliance for certain purposes, stating that variations in foreign supervisory practices should not be assumed to be defects, and requesting further clarity regarding substituted compliance assessment factors); ESMA Letter at 1, 3–4 (suggesting particular expansions of the proposed scope of substituted compliance); European Commission (''EC'') Letter (supporting ''holistic'' approach toward substituted compliance based on comparison of regulatory outcomes).

[35] In this regard, the final rules in a number of areas take approaches that are similar to the approaches taken by the CFTC in its own cross-border guidance, although independent considerations have driven our approaches. Moreover, throughout the Cross-Border Proposing Release we recognized and solicited comment on the differences between our proposal and the CFTC's proposed guidance on the cross-border application of swap regulation. As noted above, many commenters urged harmonization with various aspects of the CFTC's guidance. We have taken these comments into account, and in developing final rules we have carefully considered the CFTC's guidance and the underlying policy rationales. Further, where we have determined such policy rationales and approaches are applicable in the context of the market for security-based swaps, we have adopted similar approaches to the CFTC (*see, e.g.,* application of the *de minimis* exception to non-U.S. persons' dealing transactions with foreign branches of U.S. banks).

[36] *See* section III.A.2, *infra* (discussing in detail the global nature of the security-based swap market).

[37] The information was made available to the Commission under an agreement with the DTCC–TIW and in accordance with guidance provided to DTCC–TIW by the OTC Derivatives Regulatory Forum (''ODRF'').

[38] This figure is based on all price-forming DTCC–TIW North American corporate single-name CDS transactions. 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

January 2008 to December 2012 were cross-border transactions between a U.S.-domiciled [39] counterparty and a foreign-domiciled counterparty [40] and an additional 39 percent of such CDS transactions were between two foreign-domiciled counterparties.[41] Thus, approximately 13 percent of the North American corporate single-name CDS transactions in 2008–2012 were between two U.S.-domiciled counterparties.[42] These statistics indicate that, rather than being an exception, cross-border North American corporate single-name CDS transactions are as common as intra-jurisdictional transactions in the security-based swap market.[43]

Second, dealers and other market participants are highly interconnected within this global market. While most market participants have only a few counterparties, dealers can have hundreds of counterparties, consisting of both non-dealing market participants (*e.g.,* non-dealers, including commercial and financial market participants and investment funds) and other dealers.[44] Furthermore, as described in more detail below, the great majority of trades are dealer-to-dealer, rather than dealer-to-non-dealer or non-dealer-to-non-dealer, and a large fraction of single-name CDS volume is between counterparties domiciled in different jurisdictions. This interconnectedness facilitates the use of security-based swaps as a tool for sharing financial and commercial risks. In an environment in which market participants can have diverse and offsetting risk exposures, security-based swap transactions can allow participants to transfer risks so that they are borne by those who can do so efficiently. The global scale of the security-based swap market allows counterparties to access liquidity across jurisdictional boundaries, providing U.S. market participants with opportunities to share these risks with counterparties around the world. As discussed further in section VIII, a broad set of counterparties across which risks can be shared may result in more efficient risk sharing.

However, these opportunities for international risk sharing also represent channels for risk transmission. In other words, the interconnectedness of security-based swap market participants provides paths for liquidity and risk to flow throughout the system, so that it can be difficult to isolate risks to a particular entity or geographic segment. Because dealers facilitate the great majority of security-based swap transactions, with bilateral relationships that extend to potentially hundreds of counterparties, liquidity problems or other forms of financial distress that begin in one entity or one corner of the globe can potentially spread throughout the network, with dealers as a central conduit.

Third, as highlighted in the Intermediary Definitions Adopting Release, dealing activity within the market for security-based swaps is highly concentrated.[45] This concentration in large part appears to reflect the fact that larger entities possess competitive advantages in engaging in OTC security-based swap dealing activities, particularly with regard to having sufficient financial resources to provide potential counterparties with adequate assurances of financial performance.

The security-based swap market developed as an OTC market, without centralized trading venues or dissemination of pre- or post-trade pricing and volume information. In markets without transparent pricing, access to information confers a competitive advantage. In the current 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 non-dealers who, in the absence of pre-trade transparency, observe a smaller subset of the market. Greater private information about order flow enables better assessment of current market values by dealers, permitting them to extract economic rents from counterparties who are less informed.[46] Non-dealers are aware of this information asymmetry, and certain non-dealers—particularly larger entities who transact with many dealers—may be able to obtain access to competitive pricing or otherwise demand a price discount that reflects the information asymmetry. Typically, however, the value of private information (*i.e.,* the economic rent or informational premium) will be earned by those who have the most information. In the case of security-based swap markets, it is predominantly dealers who observe the greatest order flow and benefit from market opacity.

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replacement trades and all bookkeeping-related trades.

''North American corporate single-name CDS transactions'' are classified as such because they use The International Swaps and Derivatives Association, Inc. (''ISDA'') North American documentation. These may include certain transactions involving non-U.S. reference entities. We do not have sufficiently reliable data on reference entity domicile (as opposed to counterparty domicile, which we have sought to identify in the manner described in note 39, *infra*) to limit our analysis to only U.S. single-name CDS. Although the inclusion of transactions involving such non-U.S. reference entities introduces some noise into the data, we do not believe that this noise is sufficiently significant to alter the conclusions we draw from the data.

[39] The domicile classifications in DTCC–TIW are based on the market participants' own reporting and have not been verified by Commission staff. 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. It is also possible that the domicile classifications may not correspond precisely to treatment as a U.S. person under the rules adopted today. Notwithstanding these limitations, we believe that the cross-border and foreign activity presented in the analysis by the Commission's Division of Economic and Risk Analysis demonstrates the nature of the single-name CDS market. *See* section III.A.2, *infra.*

[40] DTCC–TIW classifies a foreign branch or foreign subsidiary of a U.S.-domiciled entity as foreign-domiciled. Therefore, CDS transactions classified as involving a foreign-domiciled counterparty in the DTCC–TIW data may include CDS transactions with a foreign branch or foreign subsidiary of a U.S.-domiciled entity as counterparty.

[41] Put another way, between 2008 and 2012, a vast majority (approximately 87 percent) of North American corporate 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 Economic and Risk Analysis on North American corporate single-name CDS transactions from DTCC–TIW between January 1, 2008, and December 31, 2012. *See* section III.A.2, *infra.*

[42] *See id.*

[43] We note, however, that, in addition to classifying transactions between a U.S. counterparty and a foreign branch of a U.S. bank as cross-border transactions, *see* note 40, *supra,* these statistics characterize as cross-border transactions some transactions 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. That is, a transaction is classified as cross-border if the legal domicile of at least one of the counterparties to the transaction is outside the United States, but if the transaction is classified as cross-border solely on the basis of legal domicile, the risk associated with these transactions may still ultimately be borne by U.S. persons. In this sense, our estimates of the cross-border allocation of security-based swap activity may not precisely reflect the proportion of transactions that are cross-border in nature.

[44] Based on an analysis of 2012 transaction data by staff in the Division of Economic and Risk Analysis, accounts associated with market participants recognized by ISDA as dealers had on average 403 counterparties. All other accounts (*i.e.,* those more likely to belong to non-dealers) averaged four counterparties.

[45] *See* Intermediary Definitions Adopting Release, 77 FR 30639–42.

[46] In this situation, economic rents are the profits that dealers earn by trading with counterparties who are less informed. In a market with competitive access to information, there is no informational premium; dealers only earn a liquidity premium. The difference between the competitive liquidity premium and the actual profits that dealers earn is the economic rent.

Taken together, the need for financial resources and the private information conveyed by order flow suggest that new entrants who intend to engage in security-based swap dealing activity in fact face high barriers to entry. One consequence of the current concentrated market structure is the potential for risk spillovers and contagion, which can occur when the financial sector as a whole (or certain key segments) becomes undercapitalized.[47] 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 counterparty credit risk and market risk until the transaction expires or is terminated.[48] Within this interconnected market, participants may have ongoing bilateral obligations with multiple counterparties, allowing for efficient risk-sharing and access to liquidity throughout the global network. However, a primary risk of the integrated market is the potential for sequential counterparty failure and contagion when one or more large market participants become financially distressed, causing the market participant to default on its obligations to its counterparties.[49] A default by one or more security-based swap dealers or major security-based swap participants, or even the perceived lack of creditworthiness of these large entities, could produce contagion, either through direct defaults and risk spillovers, reduced willingness to extend credit, reduced liquidity, or reduced valuations for financial instruments. As financial distress spreads, the aggregate financial system may become undercapitalized, hindering its ability to provide financial intermediation services, including security-based swap intermediation services.

In other words, the failure of a single large firm active in the security-based swap market can have consequences beyond the firm itself. One firm's default may reduce the willingness of dealers to trade with, or extend credit to, both non-dealers and other dealers. By reducing the availability of sufficient credit to provide intermediation services, and by reducing transaction volume that reveals information about underlying asset values, the effects of a dealer default may, through asset price and liquidity channels, spill over into other jurisdictions and even other markets in which security-based swap dealers participate.

Given that firms may be expected to consider the implications of security-based swap activity only on their own operations, without considering aggregate financial sector risk,[50] 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 during times of market distress. For example, during times of financial distress a dealer's leverage constraints may begin to bind, either because lenders require more collateral or because market declines erode a dealer's capital position, forcing the dealer to de-lever, either by selling assets or raising additional capital. Without adequate capital, the dealer may be unable to intermediate trades, potentially reducing liquidity in the markets it serves. Security-based swap positions replicate leveraged positions in the underlying asset, with a small amount of capital supporting large notional exposures.[51] Given the leveraged nature of swap transactions, and the concentrated structure of the dealer market, in which a large amount of highly leveraged risk exposures may be concentrated in a relatively small number of entities that are responsible for the vast majority of global dealing activity,[52] the potential consequences arising from financial instability in the security-based swap market may be acute.

In sum, the security-based swap market is characterized by a high level of interconnectedness, facilitating risk sharing by counterparties. Further, it is a global market, in which the potential for significant inter-jurisdictional activity and access to liquidity may enhance risk sharing among counterparties. At the same time, channels for risk sharing also represent channels for risk transmission. The global nature of this market, combined with the interconnectedness of market participants, means that liquidity shortfalls or risks that begin pooling in one corner of the market can potentially spread beyond that corner to the entire security-based swap market, with dealers as a key conduit. Because dealers and major participants are a large subset of all participants in the global security-based swap market and facilitate the majority of transactions (and thus reach many counterparties), concerns surrounding these types of spillovers are part of the framework in which we analyze the economic effects of our final rules implementing the security-based swap dealer and major participant definitions in the cross-border context.[53]

2. Context for Regulatory Determinations

In determining how Title VII requirements should apply to persons and transactions in a market characterized by the types of risks we have described, we are aware of the potentially significant tradeoffs inherent in our policy decisions. Our primary economic considerations for promulgating rules and guidance regarding the application of the security-based swap dealer and major participant definitions to cross-border activities include the effect of our choices on efficiency, competition, and

[47] *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 the potential for risk spillovers and sequential counterparty failure, leading to an aggregate capital shortfall and breakdown of financial intermediation in the financial sector.

[48] *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'').

[49] *See* Brunnermeier, Markus K., Andrew Crockett, Charles A. Goodhart, Avinash Persaud, and Hyun Song Shin. ''The Fundamental Principles of Financial Regulation.'' (2009) at 15, available at: *www.princeton.edu/~markus/research/papers/Geneva11.pdf.*

[50] *See* Daron Acemoglu, Asuman Ozdaglar & Alireza Tahbaz-Salehi, Systemic Risk and Stability in Financial Networks (NBER Working Paper No. 18727, Jan. 2013), available at: *http://www.nber.org/papers/w18727.*

[51] *See* Giulio Girardi, Craig Lewis, and Mila Getmansky, ''Interconnectedness in the CDS Market,'' Division of Economic and Risk Analysis White Paper, April 2014, available at *http://www.sec.gov/servlet/sec/dera/staff-papers/white-papers/credit-defaul-swaps-interconnectivity-04-2014.pdf* (describing institutional features of credit default swaps).

[52] The Commission estimates that, of approximately 1,000 transacting agents that participated in single-name CDS transactions in 2012, nearly 80 percent of transactions, by notional volume, can be attributed to the 13 largest entities. *See also* section III.A.2, *infra.*

[53] We have previously noted that, depending on the size of the security-based swap dealer, default by a security-based swap dealer ''could have adverse spillover or contagion effects that could create instability for the financial markets more generally.'' *See* 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, 70304 (Nov. 23, 2012) (''Capital and Margin Proposing Release'').

capital formation,[54] the potential risks of security-based swaps to U.S. market participants that could affect financial stability,[55] the level of transparency and counterparty protection in the security-based swap market, and the costs to market participants.[56]

As noted above, participants may use security-based swaps to manage financial and commercial risks and benefit from a liquid market with broad participation that facilitates risk sharing. We also recognize the possibility that the same channels that enable risk sharing also facilitate the transmission of risks and liquidity problems that begin pooling in one geographic segment of the market to the global security-based swap market. As described more fully in section III.A.1, U.S. entities may take on risk exposures in the security-based swap market by transacting with non-U.S. counterparties through non-U.S. affiliates. This suggests that an approach that applied these Title VII definitions to transactions only where all activity occurs inside the United States would have little effect in addressing the risks associated with security-based swaps, including risks and associated economic consequences flowing from contagion that may originate abroad and reach U.S. market participants through security-based swap activities and the multiple bilateral relationships that may form as a result of those activities. The global reach of security-based swap dealers, including U.S. dealers, participating in the vast majority of trades [57] and extending to upwards of hundreds of counterparties,[58] provides paths for these risks to flow back into the United States.[59]

At the same time, the Commission recognizes that the regulatory requirements we adopt for security-based swap dealers and major participants under Title VII may not reach all market participants that act as dealers or that have positions that pose considerable risk concerns in the global security-based swap markets. These limits to the application of Title VII raise several issues. First, market participants may shift their behavior. Final Title VII requirements may impose significant direct costs on participants falling within the security-based swap dealer and major security-based swap participant definitions that are not borne by other market participants, including costs related to capital and margin requirements, regulatory reporting requirements, and business conduct requirements. The costs of these requirements may provide economic incentive for some market participants falling within the dealer and major participant definitions to restructure their security-based swap business to seek to operate wholly outside of the Title VII regulatory framework by exiting the security-based swap market in the United States and not transacting with U.S. persons, potentially fragmenting liquidity across geographic boundaries.[60] Conversely, such incentives potentially may be mitigated by the fact that capital and margin requirements, counterparty protections, and business conduct standards required by Title VII [61] may promote financial stability and lead to non-dealer market participants exhibiting a preference for transacting with registered dealers and major participants.

Second, to the extent that other jurisdictions may adopt requirements with different scopes or on different timelines, the requirements we adopt may also result in competitive distortions. That is, differences in regulatory requirements across jurisdictions, or the ability of certain non-U.S. market participants to avoid security-based swap dealer regulation under Title VII, may generate competitive burdens and provide incentives for non-U.S. persons to avoid transacting with U.S. persons.

Third, key elements of the rules adopted today—the definition of ''U.S. person,'' as well as rules covering treatment of guaranteed transactions, transactions with foreign branches, transactions conducted through conduit affiliates, and cleared anonymous transactions, and rules covering aggregation standards—all have implications for how U.S. and non-U.S. entities perform their *de minimis* and major participant threshold calculations and may affect the number of participants who ultimately register as security-based swap dealers or major security-based swap participants. The number of persons required to register will affect the costs and benefits of the substantive Title VII requirements that will ultimately be adopted; depending on the final rules, more or fewer entities, and therefore more or fewer security-based swaps, will be subject to Title VII requirements applicable to security-based swap dealers and major security-based swap participants.[62] Title VII requires the Commission to create a new regulatory regime that includes capital, margin, registration and reporting requirements aimed at increasing transparency and customer protections as well as mitigating the risk of financial contagion. Each of these requirements will impose new costs and regulatory burdens on persons that engage in security-based swap dealing activity at levels above the *de minimis* thresholds and on persons whose security-based swap positions are large enough to cause them to be major security-based swap participants.

We expect that these requirements' application to security-based swap

[54] *See* Exchange Act section 3(f).

[55] Title VII imposes financial responsibility and risk mitigation requirements on registered security-based swap dealers and major security-based swap participants. As we noted in proposing rules regarding capital and margin requirements applicable to security-based swap dealers, ''the capital and margin requirements in particular are broadly intended to work in tandem 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.'' *See* Capital and Margin Proposing Release, 77 FR 70304. We also noted that ''[r]equiring particular firms to hold more capital or exchange more margin may reduce the risk of default by one or more market participants and reduce the amount of leverage employed in the system generally, which in turn may have a number of important benefits.'' *Id.*

[56] As we noted in the Cross-Border Proposing Release, 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). *See* Cross-Border Proposing Release, 78 FR 30980 n.97.

[57] *See* note 139, *infra,* and accompanying text.

[58] *See* note 44, *supra.*

[59] As discussed above, the global security-based swaps network, characterized by multiple bilateral relationships between counterparties, has the potential for risk spillovers and sequential counterparty failure. These exposures are not unique to the U.S. financial system. Indeed, the global scope of the security-based swap market suggests that, given our territorial approach to Title VII, there will be the fewest potential gaps in coverage if other jurisdictions also adopt similar comprehensive and comparable derivative regulations. *See* Section III.B for a discussion of global regulatory efforts in this space.

[60] To the extent that registered dealers are ultimately subject to more extensive reporting and public dissemination requirements than other market participants under Title VII, these requirements may also alter the incentives of market participants to transact with registered dealers if, for example, public dissemination requirements reveal information that participants wish to treat as confidential about trading strategies or future hedging needs. Incentives for these participants to avoid registered dealers could potentially isolate liquidity to less transparent corners of the market.

[61] *See, e.g.,* Exchange Act sections 15F(e), (f), (h) (providing that security-based swap dealers and major security-based swap participants be subject to requirements relating to capital and margin, reporting and recordkeeping, and business conduct).

[62] Any forward-looking analysis of the costs and benefits that flow from these Title VII requirements necessarily encompasses uncertain elements, since the final requirements have not been adopted. For example, whether foreign security-based swap dealers will be subject to the full range of Title VII requirements in all of their transactions will be determined in subsequent rulemaking.

dealers and major security-based swap participants subject to Title VII will be associated with a number of benefits to the security-based swap market and security-based swap market participants, including transparency, accountability, and increased counterparty protections.[63] Nevertheless, as we discuss later in this release, the *de minimis* rules for non-U.S. persons could allow certain non-U.S. entities to avoid the costs of dealer registration, which could reduce the number of entities that register as security-based swap dealers, relative to the Commission's estimates in the Intermediary Definitions Adopting Release. Although the number of entities that are not required to register will depend on the availability of the *de minimis* exclusions, we believe that, to the extent that the final rules change the number of eventual registrants, the ultimate programmatic costs and benefits expected from Title VII may differ from those that were described in the Intermediary Definitions Adopting Release.[64]

Finally, the final rules determining how non-U.S. persons must perform their *de minimis* and major participant threshold calculations may face limits as to how precisely they address the risk mitigation goals of Title VII that are reflected in our rules implementing the *de minimis* exception and the ''major security-based swap participant'' definition. On the one hand, the scope of dealer and major participant regulation under Title VII may be subject to limitations on the ability to control risk because the global nature of counterparty interconnections means that it is difficult to prevent risk that pools in one geographic segment of the market from flowing throughout the entire security-based swap network. On the other hand, there is a possibility that the rules defining the scope of dealer and major participant regulation, including the territorial application of the definitions, may capture certain activity that does not represent risk to the U.S. financial system. Because these rules and guidance implementing Title VII regulatory definitions will not capture all transactions and all entities that engage in security-based swap activity, these rules and guidance therefore may create incentives for those entities at the boundaries of the definitions to restructure their business in a way that allows them to operate outside the scope of Title VII. However, as we described in the Intermediary Definitions Adopting Release, we have sought to implement the statutory dealer and major participant definitions in such a way as to impose the substantive rules of Title VII on those entities most likely to contribute to those risks that Title VII is intended to address without imposing unnecessary burdens on those who do not pose comparable risks to the U.S. financial system.[65]

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 to address the potential effects of security-based swap activity on U.S. market participants, the financial stability of the United States, on the transparency of the U.S. financial system, and on the protection of counterparties.[66] The global nature of the security-based swap market and the high proportion of cross-border transactions in that market[67] mean that much of this activity occurs at least in part outside the United States and frequently involves persons that are incorporated, organized, or established in a location outside the United States.[68] In light of these market realities, we noted in the proposal that applying Title VII only to persons incorporated, organized, or established within the United States or only to security-based swap activity occurring entirely within the United States would inappropriately exclude from regulation a majority of security-based swap activity that involves U.S. persons or otherwise involves conduct within the United States, even though such activity raises the types of concerns that we believe Congress intended to address through Title VII.[69]

Because some commenters had, prior to the proposal, argued that section 30(c) of the Exchange Act limited our ability to reach certain types of activity occurring at least in part outside the United States,[70] we discussed in some detail in the proposal our preliminary views on the appropriate approach to determining whether certain security-based swap activity that involves some conduct outside the United States also occurs within the United States for purposes of Title VII.[71] In this subsection, we discuss comments received on this question following publication of our proposal and explain our final views—which remain largely unchanged from the proposal—on the proper approach to determining whether cross-border security-based swap activity occurs, in relevant part, within the United States.[72] We then briefly describe how this framework

[63] Title VII imposes a number of business conduct requirements designed to protect counterparties to security-based swaps, including disclosures about material risks and conflicts of interest, disclosures concerning the daily mark, or value of the position, and segregation of customer assets and collateral from the dealer's assets.

[64] See section IV.I.1 for a discussion of how we expect the cross-border application of the *de minimis* exception to alter the number of entities required to register with the Commission, and how that may affect the programmatic costs and benefits of Title VII.

[65] In adopting the definition of ''security-based swap dealer,'' we intended to determine the set of entities in the security-based swap market for whom regulation ''is warranted due to the nature of their interactions with counterparties, or is warranted to promote market stability and transparency.'' *See* Intermediary Definitions Adopting Release, 77 FR 30726. Similarly, in adopting rules governing the ''major security-based swap participant'' definition, we sought to impose regulations applicable to major security-based swap participants in a way that reflects ''when it would be 'prudent' that particular entities be subject to monitoring, management and oversight of entities that may be systemically important or may significantly impact the U.S. financial system.'' *See id.* at 30666.

Future rulemakings that depend on these definitions are intended to address the transparency, risk, and customer protection goals of Title VII. For example, to further risk mitigation in the security-based swap market, we explained that ''section 15F(e) of the Exchange Act and related rules impose capital and margin requirements on dealers and major participants, which will reduce the financial risks of these institutions and contribute to the stability of the security-based swap market in particular and the U.S. financial system more generally.'' *See id.* at 30723.

[66] *See* note 11, *supra*. *See also* Pub. L. 111–203 sections 701–774 (providing for, among other things, a comprehensive new regulatory framework for security-based swaps, including by: (i) Providing for the registration and comprehensive regulation of security-based swap dealers and major security-based swap participants; (ii) imposing clearing and trade execution requirements on security-based swaps, subject to certain exceptions; and (iii) creating real-time reporting and public dissemination regimes for security-based swaps).

[67] *See* section II.A, *supra* (noting that cross-border activity accounts for the majority of security-based swaps involving U.S. firms).

[68] For example, a single financial firm engaged in dealing activity may utilize two or more entities domiciled in different countries to effectuate a single transaction with a counterparty that may similarly use multiple entities domiciled in different countries.

[69] *See* Cross-Border Proposing Release, 78 FR 30984.

[70] *See id.* at 30983. Exchange Act section 30(c) was added to the Act by Title VII and provides, among other things, 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. *See* section 30(c) of the Exchange Act, 15 U.S.C. 78dd(c), added by section 772(b) of the Dodd-Frank Act.

[71] *See* Cross-Border Proposing Release, 78 FR 30984–87.

[72] We also 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 Exchange Act section 30(c). 15 U.S.C. 78dd(c).

applies to specific types of transactions relevant to the rules we are adopting here.[73]

1. Commenters' Views

Prior to our proposal, several commenters raised concerns about the application of Title VII to security-based swap activity in the cross-border context and specifically about the possibility that we would impose Title VII requirements on ''extraterritorial'' conduct. We received only a few comments on this issue in response to our preliminary views set forth in the proposal, and these generally focused on the application of section 30(c) of the Exchange Act to specific types of activity that we proposed to subject to Title VII rather than the proposed territorial framework more broadly.

One commenter expressed general agreement with our proposed guidance.[74] Three commenters suggested that textual differences between section 30(c) of the Exchange Act and section 2(i) of the Commodity Exchange Act (''CEA'') do not require the Commission to take a different approach to application of Title VII to cross-border security-based swap activity from that taken by the CFTC.[75] Two commenters expressed the view that section 30(c) of the Exchange Act, considered in light of what they described as the risk-based focus of Title VII, prohibited the Commission from imposing Title VII requirements on transactions carried out within the United States but booked in locations outside the United States.[76] One commenter stated that section 30(c) of the Exchange Act prevents us from imposing Title VII requirements on transactions of guaranteed foreign affiliates of U.S. persons.[77] One commenter argued that section 30(c) prevents application of Title VII to certain joint ventures.[78]

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

We continue to believe that a territorial approach to the application of Title VII is appropriate. This approach, properly understood, is grounded in the text of the relevant statutory provisions and is designed to help ensure that our application of the relevant provisions is consistent with the goals that the statute was intended to achieve.

(a) Overview and General Approach

As in our proposal, our analysis begins with an examination of the text of the statutory provision that imposes the relevant requirement. The statutory language generally identifies the types of conduct that trigger the relevant requirement and, by extension, the focus of the statute.[79] Once we have identified the activity regulated by the statutory provision, we can determine whether a person is engaged in conduct that the statutory provision regulates and whether this conduct occurs within the United States. When the statutory text does not describe the relevant activity with specificity or provides for further Commission interpretation of statutory terms or requirements, this analysis may require us to identify through interpretation of the statutory text the specific activity that is relevant under the statute or to incorporate prior interpretations of the relevant statutory text.[80]

As noted above, the Dodd-Frank Act was enacted, in part, with the intent to address the risks to the financial stability of the United States posed by entities engaged in security-based swap activity, to promote transparency in the U.S. financial system, and to protect counterparties to such transactions.[81] These purposes, considered together with the specific statutory requirement, lead us to conclude that it is appropriate to impose the statutory requirements, and rules or regulations thereunder, on security-based swap activity occurring within the United States even if certain conduct in connection with the security-based swap also occurs in part outside the United States.

Contrary to the views expressed by some commenters,[82] we do not agree that the location of risk alone should necessarily determine the scope of an appropriate territorial application of

[73] The following discussion does not reflect a comprehensive analysis of the full range of transactions that may fall within our territorial approach to application of Title VII or of the full range of substantive requirements to which such transactions may be subject under Title VII.

It is important to note that our approach to the application of Title VII security-based swap dealer and major security-based swap participant registration requirements does not limit, alter, or address the cross-border reach or extraterritorial application of any other provisions of the federal securities laws, including Commission rules, regulations, interpretations, or guidance.

[74] *See* BM Letter at 6.

[75] *See* IIB Letter at 4 (noting, *inter alia,* that section 712 of the Dodd-Frank Act requires consultation and coordination between the SEC, CFTC, and prudential regulators, and arguing that differences between Exchange Act section 30(c) and CEA section 2(i) do not require the Commission to take an approach to regulation of cross-border security-based swap activity that is ''fundamentally different'' from that taken by the CFTC); SIFMA/FIA/FSR Letter at A–4 to A–5 (stating that Exchange Act section 30(c) must be read to harmonize with CFTC approach in light of congressional intent that rules be harmonized); FOA Letter at 7 (referring to this element of the SIFMA/FIA/FSR Letter). Section 2(i) of the CEA provides, *inter alia,* that Title VII requirements will not apply to activities outside the United States unless they ''have a direct and significant connection with activities in, or effect on, commerce of the United States.'' 7 U.S.C. 2(i). The CFTC Cross-Border Guidance was adopted as an interpretation of this provision. *See* CFTC Cross-Border Guidance, 78 FR 45295.

[76] *See* SIFMA/FIA/FSR Letter at 4, A–4 to A–6 (acknowledging that proposed application of Title VII to transactions conducted within the United States between two non-U.S. persons is consistent with Commission practice in traditional securities markets but arguing that similar language in sections 30(b) and 30(c) of the Exchange Act should be read differently, given the different nature of security-based swap transactions and focus of Title VII on risk); FOA Letter at 7 (referring to this element of the SIFMA/FIA/FSR Letter). These commenters argue that we should focus on risks to the U.S. financial system and the protection of U.S. counterparties, and that neither concern is raised by transactions between two non-U.S. persons that happen to occur within the United States. *See* SIFMA/FIA/FSR Letter at A–5 to A–6. We continue to believe that this argument does not account for the full range of concerns addressed by Title VII, but, as discussed further below, we are not addressing issues surrounding the proposed ''transaction conducted within the United States'' definition in this release.

Because, as discussed above, we are not adopting ''transaction conducted within the United States'' as part of the final rule, we anticipate considering these comments in connection with soliciting additional public comment.

[77] *See id.* at A–11 (stating that a guarantee may not necessarily import risk into the United States and thus creates ''no nexus for purposes of [s]ection 30(c) of the Exchange Act'').

[78] *See* Mitsubishi UFJ Financial Group (''MUFJ'') Letter at 4–5 (urging the Commission not to require both participants in a foreign joint venture to aggregate the dealing transactions of the joint venture for purposes of the dealer *de minimis* calculation).

[79] *See Morrison* v. *National Australia Bank, Ltd.,* 130 S. Ct. 2869, 2884 (2010) (identifying focus of statutory language to determine what conduct was relevant in determining whether the statute was being applied to domestic conduct).

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. *See* section 30(c) of the Exchange Act. As noted above, some commenters suggest that statutory language requiring us to coordinate and consult with the CFTC also requires us to interpret section 30(c) of the Exchange Act in a manner similar to the CFTC's interpretation of CEA section 2(i). See note 75, *supra.* However, in light of the differences between Exchange Act section 30(c) and CEA section 2(i), we do not find this argument persuasive. As noted above, however, in developing final rules we have carefully considered the CFTC's guidance and the underlying policy rationales, consistent with the statutory requirement that we consult and coordinate with the CFTC.

[80] The Dodd-Frank Act provides that the CFTC and SEC ''*shall* further define'' several terms, including ''security-based swap dealer'' and ''major security-based swap participant.'' Dodd-Frank Act section 712(d) (emphasis added). The Commissions fulfilled this mandate in the Intermediary Definitions Adopting Release. *See* Intermediary Definitions Adopting Release, 77 FR 30973.

[81] *See e.g.,* note 11, *supra. See also* Exchange Act section 15F(h) (establishing business conduct standards for security-based swap dealers and major security-based swap participants).

[82] *See* notes 76–77, *supra.*

every Title VII requirement, given that the definition and the relevant regulatory regime address not only risk but other concerns as well, as just described. For example, neither the statutory definition of ''security-based swap dealer,'' our subsequent further definition of the term pursuant to section 712(d) of the Dodd-Frank Act, nor the regulatory requirements applicable to security-based swap dealers focus solely on risk to the U.S. financial system.[83]

We believe that this approach to territorial application of Title VII provides a reasonable means of helping to 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 potential effects of security-based swap activity on U.S. market participants, on the financial stability of the United States, on the transparency of the U.S. financial markets, and on the protection of counterparties.[84] Persons that engage in relevant conduct, as identified through this analysis, within the United States are not, in our view, ''transact[ing] a business in security-based swaps without the jurisdiction of the United States,'' [85] and thus are properly subject to regulation under Title VII.

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

In determining whether specific transactions should be included in a person's dealer *de minimis* calculation, we begin by looking to the statutory text to identify the type of dealing activity that the statute describes as relevant to a person's status as a security-based swap dealer.[86] Section 3(a)(71) of the Exchange Act [87] 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, or

(iv) engaging in any activity causing oneself to be commonly known in the trade as a dealer in security-based swaps.[88]

In accordance with the authority provided by section 712(d)(1) of the Dodd-Frank Act, which provides that the CFTC and the Commission shall by rule further define, among other things, ''security-based swap dealer,'' [89] we further interpreted the statutory definition by identifying the types of activities that are relevant in determining whether a person is a security-based swap dealer.[90] Pursuant to this further definition, indicia of security-based swap dealing activity include any of 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.[91]

As the foregoing lists illustrate, both the statutory text and our interpretation further defining the statutory term include within the security-based swap dealer definition a range of activities. In the Intermediary Definitions Adopting Release, we stated that transactions arising from dealing activity, as identified by the indicia described above, would generally be subject to relevant Title VII requirements applicable to dealers, including that such transactions be included in a person's calculations for purposes of the dealer *de minimis* calculations. Our territorial approach applying Title VII to dealing activity similarly looks to whether any of the activities described above occur within the United States, and not simply to the location of the risk, as some commenters suggested is required under section 30(c) of the Exchange Act.[92] To the extent that such activity does occur within the United States, the person engaged in such activity, in our view, is transacting a business in security-based swaps within the United States,[93] and therefore applying Title VII to the activity by, among other things, requiring the person to include transactions arising from such activity in its *de minimis* calculation is consistent with a territorial approach, even if some of this activity (or other activity bearing the indicia of dealing activity) relating to the transaction also occurs outside the United States.

This approach is consistent with the purposes of the dealer definition and the *de minimis* exception as they relate to dealer regulation under Title VII. The *de minimis* exception excludes from the dealer registration requirement those entities that may engage in dealing activity but that do so in amounts that may not raise, to a degree that warrants application of security-based swap dealer requirements, the risk, counterparty protection, or other concerns that the dealer registration and regulatory framework were intended to address.[94] On the other hand, dealing activity, as identified by the types of activities described above, carried out within the United States at levels exceeding the *de minimis* threshold is likely to raise these concerns, which would be addressed by requiring persons engaged in that volume of dealing activity to register as security-based swap dealers under Title VII and to comply with relevant requirements applicable to security-based swap dealers. Accordingly, to the extent that a person engages in dealing activity within the United States that results in transactions in a notional amount exceeding the applicable *de minimis* threshold, it is appropriate to require the person to register as a security-based swap dealer.

i. Dealing Activity of U.S. Persons

Under the foregoing analysis and consistent with our proposal, when a U.S. person as defined under this final rule [95] engages in dealing activity, it necessarily engages in such activity within the United States, even when it enters into such transactions through a

[83] *See* note 88, *infra,* and accompanying text (describing elements of statutory definition of ''security-based swap dealer''); note 90, *infra,* and accompanying text (describing elements of the further definition of ''security-based swap dealer'' adopted by the Commission and the CFTC pursuant to section 712(d) of the Dodd-Frank Act); Exchange Act section 15F(h) (establishing business conduct standards for security-based swap dealers).

[84] *See* note 11, *supra.*

[85] Exchange Act section 30(c).

[86] *See* Intermediary Definitions Adopting Release, 77 FR 30616–30619 (further defining ''security-based swap dealer'' by identifying the types of activities that characterize dealing and that would therefore lead a transaction to be required to be included in a person's *de minimis* calculation under Exchange Act rule 3a71–2).

[87] 15 U.S.C. 78c(a)(71).

[88] Exchange Act section 3(a)(71)(A), 15 U.S.C. 78c(a)(71)(A).

[89] *See* Dodd-Frank Act section 712(d)(1).

[90] *See* Intermediary Definitions Adopting Release, 77 FR 30617–18.

[91] *Id.*

[92] *See* notes 76–77, *supra.*

[93] *Cf.* Exchange Act section 30(c) (limiting the application of, among other provisions, Title VII to ''any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States'').

[94] *See, e.g.,* Intermediary Definitions Adopting Release, 77 FR 30629–30 (noting that the *de minimis* threshold is intended to capture firms that engage in a level of dealing activity that is likely to raise the types of concerns that the dealer regulatory framework is intended to address).

[95] *See* Exchange Act rule 3a71–3(a)(4).

foreign branch or office. As discussed in further detail below, the definition of ''U.S. person'' in the final rule is intended, in part, to identify those persons for whom it is reasonable to infer that a significant portion of their financial and legal relationships are likely to exist within the United States and that it is therefore reasonable to conclude that risk arising from their security-based swap activities could manifest itself within the United States, regardless of the location of their counterparties, given the ongoing nature of the obligations that result from security-based swap transactions.[96]

Wherever a U.S. person enters into a transaction in a dealing capacity, it is the U.S. person as a whole that is holding itself out as a dealer in security-based swaps, given that the financial resources of the entire person stand behind any dealing activity of the U.S. person, both at the time it enters into the transaction and for the life of the contract, even when the U.S. person enters into the transaction through a foreign branch or office. Moreover, the U.S. person as a whole seeks to profit by providing liquidity and engaging in market-making in security-based swaps, and the financial resources of the entire person 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, even when the U.S. person enters into the transaction through a 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 and is directly exposed to liability arising from non-performance of the non-U.S. person.[97]

For these reasons, in our view a person does not hold itself out as a security-based swap dealer as anything other than a single person even when it enters into transactions through its foreign branch or office.[98] Because the foreign branch 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 included in the person's *de minimis* threshold calculation.[99]

ii. Dealing Transactions of Non-U.S. Persons That Are Subject to Recourse Guarantees by Their U.S. Affiliates

In the proposing release, we explained that we preliminarily believed that a territorial approach consistent with the text and purposes of the Dodd-Frank Act encompasses transactions involving a non-U.S. person counterparty whose dealing activity is guaranteed by a U.S. person.[100] However, because we proposed to treat non-U.S. persons receiving a guarantee on their security-based swap transactions from a U.S. person like any other non-U.S. person for purposes of the *de minimis* exception (*i.e.,* requiring them to include in their calculations only dealing activity involving U.S.-person counterparties or transactions conducted within the United States), we did not elaborate specifically on how the presence of a guarantee related to a territorial application of the dealer definition, including the *de minimis* exception. Because our final rule requires transactions of non-U.S. persons whose obligations under the security-based swap are subject to recourse guarantees enforceable against their U.S. affiliates to be included in the dealer *de minimis* calculation of the non-U.S. person, we address it here.

In our view, a non-U.S. person engaged in dealing activity, to the extent that one or more transactions arising from such activity are guaranteed by a U.S. person, is engaged in relevant activity for purposes of the security-based swap dealer definition within the United States, with respect to those transactions. By virtue of the guarantee, the non-U.S. person effectively acts together with the U.S. person to engage in the dealing activity that results in the transactions, and the non-U.S. person's dealing activity with respect to such transactions cannot reasonably be isolated from the U.S. person's activity in providing the guarantee. The U.S.-person guarantor together with the non-U.S. person whose dealing activity it guarantees, and not just the non-U.S. person, may seek to profit by providing liquidity and engaging in market-making in security-based swaps, and the non-U.S. person provides liquidity and engages in market-making in connection with security-based swaps by drawing on the U.S. person's financial resources.[101] The non-U.S. person's counterparty, pursuant to the recourse guarantee, looks to both the non-U.S. person and its U.S. guarantor, which is responsible for performance on the transaction that is part of the non-U.S. person's dealing activity. In sum, the non-U.S. person is engaged in the United States in relevant dealing activity identified in the statutory definition and in our jointly adopted further definition of ''security-based swap dealer.''

Moreover, the economic reality of the non-U.S. person's dealing activity, where the resulting transactions are guaranteed by a U.S. person, is identical, in relevant respects, to a transaction entered into directly by the

[96] *See* section IV.C, *infra.* In our view, dealing activity involving such persons is particularly likely to raise the types of concerns Title VII was intended to address, including those related to risk to the U.S. financial system, transparency of the U.S. financial markets, and customer protection.

[97] *Cf.* SIFMA/FIA/FSR Letter at 4, A–5 (stating that main purpose of Title VII is to address risk arising from security-based swap activity).

[98] This is consistent with the view expressed in our proposing release. *See* Cross-Border Proposing Release, 78 FR 30985.

[99] As discussed in further detail below, this interpretation is consistent with the goals of dealer regulation under Title VII. Security-based swap activity that results in a transaction involving a U.S.-person counterparty creates ongoing obligations that are borne by a U.S. person and, as such, is properly viewed as occurring within the United States. See note 186, *infra.*

[100] In our proposal, we noted that 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 person's counterparty recourse to the U.S. person for performance of obligations owed by the guaranteed person under the security-based swap, and the U.S. guarantor exposes itself to the risk of the security-based swap as if it were a counterparty to the security-based swap through the security-based swap activity engaged in by the guaranteed person. *See* Cross-Border Proposing Release, 78 FR 30986–87. This interpretation of guarantee was consistent with our discussion of the application of the major participant tests to guaranteed positions in the Intermediary Definitions Adopting Release, where we, together with the CFTC, noted that a person'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; as we noted in that release, positions are not attributed in the absence of recourse. *See* Intermediary Definitions Adopting Release, 77 FR 30689. In this release, we continue to use the term ''guarantee'' to refer to an arrangement 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. *See* section IV.E.1(b), *infra.*

[101] Even if the U.S. guarantor generally does not hold itself out as a dealer or make a market in security-based swaps, the U.S. guarantor enables the non-U.S. person whose dealing activity it guarantees to engage in dealing activity by providing financial backing. We note that references to ''guarantee,'' ''recourse guarantee,'' or ''rights of recourse,'' as those terms are used in this release, may describe economic relationships that are different from ''guarantee'' under section 2(a)(1) of the Securities Act. We note, however, that, depending on the nature of the ''guarantee,'' ''recourse guarantee,'' or ''rights of recourse'' provided by the guarantor, the transaction at issue may involve not only a security-based swap between two non-U.S. persons but also the offer and sale of a security by a U.S. person, given that a ''guarantee'' of a security-based swap is itself a separate security issued by the U.S. guarantor. *See, e.g.,* Securities Act section 2(a)(1), 15 U.S.C. 77b(a)(1) (including in the statutory definition of ''security'' a guarantee of a security).

U.S. guarantor. By virtue of the guarantee, transactions arising from the non-U.S. person's dealing activity result in risk from the transaction being borne by a U.S. person (the guarantor, which is responsible for the transactions it guarantees in a manner similar to a direct counterparty to the transactions) and potentially the U.S. financial system in a manner similar to a dealing transaction entered into directly by a U.S. person. As with transactions entered into directly by a U.S. person, transactions for which a counterparty has a right of recourse against a U.S. person create risk to a U.S. person and potentially the U.S. financial system regardless of the location of the counterparty.

Our interpretation of the statutory text of the definition, as well as our further definition of the term, as it applies to these entities is consistent with the purposes of Title VII, as discussed above. The exposure of the U.S. guarantor creates risk to U.S. persons and potentially to the U.S. financial system via the guarantor to a comparable degree as if the transaction were entered into directly by a U.S. person. We understand that in some circumstances a counterparty may choose not to enter into a security-based swap transaction (or may not do so on the same terms) with a non-U.S. subsidiary of a U.S. person when that non-U.S. subsidiary is acting in a dealing capacity to the extent that its dealing activity is not subject to a recourse guarantee by a U.S. affiliate, absent other circumstances (*e.g.,* adequate capitalization of the hitherto-guaranteed affiliate).

One commenter noted that U.S. guarantors may provide guarantees for a variety of reasons, including to satisfy regulatory requirements, to ''manage capital treatment across an entity,'' and to ''avoid negative credit rating consequences,'' and argued that a guarantee may therefore not create risk within the United States.[102] Absent the creation of such risk, this commenter further argued that a guarantee creates ''no nexus for purposes of section 30(c) of the Exchange Act.'' [103] However, regardless of the motivation for providing the guarantee, the non-U.S. person's dealing activity still occurs within the United States and creates risk within the United States in the manner described above. The commenter provided no evidence that the motivation for providing a guarantee affects this analysis: It neither alters the risk created within the United States by such a guarantee when it is provided by a U.S. person nor affects the economic reality of the transaction. Moreover, even if a person provides guarantees not in response to counterparty demands but to satisfy regulatory requirements or to avoid negative credit rating consequences, the very reasons for issuing the guarantee suggest that the non-U.S. person would not be able to engage in dealing activity, or to do so on the same terms, without the guarantee.[104]

In sum, the guarantee provided by a U.S. person poses risk to U.S. persons and potentially to the U.S. financial system, and both the non-U.S. person whose dealing activity is guaranteed and its counterparty rely on the creditworthiness of the U.S. guarantor when entering into a security-based swap transaction and for the duration of the security-based swap. The economic reality of this transaction, even though entered into by a non-U.S. person, is substantially identical, in relevant respects, to a transaction entered into directly by a U.S. person. Accordingly, in our view, it is consistent with both the statutory text and with the purposes of the statute to identify such transactions as occurring within the United States for purposes of Title VII.

iii. Dealing Activity of Other Non-U.S. Persons

In our proposal, we stated that non-U.S. persons engaging in dealing activity would be required to count toward their *de minimis* thresholds only transactions arising from their dealing activity with U.S. persons or dealing activity otherwise conducted within the United States. Under the approach described above, and consistent with our proposal, we believe that a non-U.S. person engaged in dealing activity with U.S. persons engages in relevant activity for purposes of the security-based swap dealer definition within the United States.[105]

Dealing activity of non-U.S. persons that involves counterparties who are U.S. persons, as that term is defined in the final rule, necessarily involves the performance by the non-U.S. person of relevant activity under the ''security-based swap dealer'' definition at least in part within the United States. For example, in our view, a non-U.S. person engaging in dealing activity with a U.S. person is holding itself out as a dealer in security-based swaps within the United States.[106] Similarly, by entering into a transaction with a U.S. person in a dealing capacity, it is seeking to profit by providing liquidity within the United States and possibly engaging in market-making in security-based swaps within the United States, given that its decision to engage in dealing activity with U.S. persons, as defined by the rule, affects the liquidity of the security-based swap market within the United States. Particularly at volumes in excess of the *de minimis* threshold, entering into security-based swap transactions in a dealing capacity with U.S. persons likely is the type of activity that would cause a non-U.S. person ''to be commonly known in the trade as a dealer in security-based swaps'' [107] within the United States, that constitutes ''regularly entering into security-based swaps with counterparties as an ordinary course of business for one's own account'' [108] within the United States, and that permits a reasonable inference that it has a regular clientele and actively solicits clients within the United States.[109]

Our application of the statute to non-U.S. persons is consistent with the purposes of Title VII, as discussed

[102] SIFMA/FIA/FSR Letter at A–11.

[103] *Id.*

[104] In addition, this commenter suggested that any risk created by guarantees provided to prudentially regulated foreign entities is adequately addressed by the foreign prudential regulation. *See id.* Although we recognize that foreign prudential regulation may reduce the risk that a guaranteed foreign affiliate's counterparties will seek to enforce the terms of the guarantee against the U.S. guarantor (depending on the quality of prudential regulation in the foreign jurisdiction), it does not eliminate this risk, and the counterparty continues to retain a right of recourse under the guarantee against the guarantor.

Given the role of a foreign person whose activity is guaranteed in creating risk within the United States through its dealing activity, we believe that it is important to ensure that such a foreign person be required to register as a security-based swap dealer to the extent that its guaranteed dealing transactions (together with any dealing transactions with U.S. persons) are included in its *de minimis* threshold calculations. As noted above, our proposal set forth a framework under which substituted compliance potentially would be available for certain Title VII requirements, including for dealer-specific requirements such as capital and margin, which should mitigate concerns about overlapping regulation of such entities.

[105] We continue to believe that security-based swap activity carried out within the United States may also be relevant activity under our territorial approach, even if the resulting transaction involves two non-U.S. counterparties. As discussed below, however, we anticipate soliciting additional public comment regarding the issue.

[106] Given the global nature of the security-based swap market, U.S. persons seeking to access this market may readily do so through both U.S.-person dealers and foreign dealers. That a foreign dealer holding itself out as a dealer to U.S. persons is based in, and operating out of, a foreign jurisdiction does not alter the economic reality of its activity: It is holding itself out as a dealer within the United States in a manner largely indistinguishable from a U.S.-person dealer that ''hangs out its shingle'' in Manhattan.

[107] Exchange Act section 3(a)(71)(A)(iv).

[108] Exchange Act section 3(a)(71)(A)(iii).

[109] *See* Intermediary Definitions Adopting Release, 77 FR 30618.

above. U.S. persons incur risks arising from this dealing activity, which in turn potentially creates risk to other market participants and the U.S. financial system more generally, and transactions with U.S. persons raise counterparty protection and market transparency concerns that Title VII is intended to address. Accordingly, we believe that the dealing activity of a non-U.S. person that involves a U.S.-person counterparty is appropriately characterized as occurring, at least in part, within the United States.[110]

(c) Territorial Approach to Application of Title VII Major Security-Based Swap Participant Registration Requirements

As in our territorial approach to the security-based swap dealer definition (including the *de minimis* exception) described above, our territorial approach to the application of the major security-based swap participant definition looks first to the statutory text to identify the types of activity that are relevant for purposes of the definition. Section 3(a)(67) of the Exchange Act provides that a major security-based swap participant is any person who is not a dealer and who satisfies one or more of the following requirements:

(i) Maintains a substantial position in security-based swaps for any of the major security-based swap categories,[111] excluding certain positions;

(ii) has outstanding security-based swaps that create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or

(iii) is a highly leveraged financial entity that maintains substantial position in outstanding security-based swaps in any major security-based swap category.[112]

The statute directs us to further define, jointly with the CFTC, ''major security-based swap participant'' [113] and separately provides us with authority to ''define . . . the term 'substantial position' 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.'' [114]

Pursuant to these provisions, we further interpreted this definition by, among other things, defining what constitutes a ''substantial position'' and ''substantial counterparty exposure'' for purposes of the major security-based swap participant definition.[115] In doing so, we set forth calculation methodologies and thresholds for each and adopted rules requiring persons that exceeded these thresholds to register as major security-based swap participants.[116] These thresholds were designed to identify persons that were likely to pose counterparty credit risks, as such risks are ''more closely linked to the statutory criteria that the definition focuses on entities that are 'systemically important' or can 'significantly impact' the U.S. financial system.'' [117] We also noted that our definition of ''substantial position'' was intended to address the risk that would be posed by the default of multiple entities close in time and the aggregate risks presented by a person's security-based swap activity, as these considerations reflect the market risk concerns expressly identified in the statute.[118]

The statutory focus of the major security-based swap participant definition differs from that of security-based swap dealer, in that the security-based swap dealer definition focuses on *activity* that may raise the concerns that dealer regulation is intended to address, while the major security-based swap participant definition focuses on *positions* that may raise systemic risk concerns within the United States. Accordingly, a territorial approach to application of the definition of major security-based swap participant involves identifying security-based swap positions that exist within the United States.[119] In our view, and consistent with the approach taken in our proposal, a security-based swap position exists within the United States when it is held by or with a U.S. person, or when it is subject to a recourse guarantee against a U.S. person,[120] as the risks associated with such positions are borne within the United States, and given the involvement of U.S. persons may, at the thresholds established for the major security-based swap participant definition, give rise to the types of systemic risk within the United States that major security-based swap regulation is intended to address. To the extent that a position exists within the United States in this sense, we believe that it is appropriate under a territorial approach to require a market participant, whether a U.S. person or otherwise, that is a counterparty or guarantor with respect to that position, to include that position in its major security-based swap participant threshold calculations, wherever the security-based swap was entered into.

(d) Regulations Necessary or Appropriate To Prevent Evasion of Title VII

Consistent with our proposal, we interpret section 30(c) of the Exchange Act as not requiring us to find that actual evasion has occurred or is occurring to invoke our authority to reach activity ''without the jurisdiction of the United States'' or to limit application of Title VII to security-based swap activity ''without the jurisdiction of the United States'' only to business that is transacted in a way that is purposefully intended to evade Title VII. Section 30(c) of the Exchange Act authorizes the Commission to apply Title VII to persons transacting a business ''without the jurisdiction of the United States'' if they contravene 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 potential evasion of Title VII. In other words, section 30(c) of the Exchange Act permits us to impose prophylactic rules intended to prevent possible purposeful evasion, even though such rules may affect or prohibit

[110] Although at least one commenter suggested that we lack the authority under section 30(c) of the Exchange Act to require non-U.S. person joint-ventures to aggregate relevant dealing transactions with the relevant dealing transactions of multiple investors in the joint-venture, *see* note 78, *supra,* we believe that our limitation on application of the aggregation requirement only to the transactions of such non-U.S. persons that occur within the United States (because they involve U.S.-person counterparties or are subject to a recourse guarantee against a U.S. person) is consistent with our territorial approach.

[111] The statute further provides the Commission with the authority to determine the scope of these categories. *See* Exchange Act section 3(a)(67)(A)(ii)(I).

[112] Exchange Act section 3(a)(67)(A).

[113] Dodd-Frank Act section 712(d)(1).

[114] Exchange Act section 3(a)(67)(B).

[115] *See* Intermediary Definitions Adopting Release, 77 FR 30663–84.

[116] *See id.*

[117] *Id.* at 30666.

[118] *See id.* We defined ''substantial counterparty exposure'' in a similar manner, noting the focus of the statutory test on ''serious adverse effects on financial stability or financial markets.'' *Id.* at 30683. *Cf.* Section 3(a)(67)(A)(ii)(II) of the Exchange Act (encompassing in major security-based swap participant definition persons whose ''outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets'').

[119] *Cf. Morrison,* 130 S. Ct. at 2884 (performing a textual analysis to identify the focus of the statute).

[120] The economic reality of a position subject to such a guarantee, even though entered into by a non-U.S. person, is substantially identical in relevant respects to a position entered into directly by the U.S. guarantor. *See* section II.B.2(b)ii, *supra.*

some non-evasive conduct. Moreover, exercising the section 30(c) authority does not require us to draw a distinction between conduct ''without the jurisdiction of the United States'' that is purposely evasive as opposed to identical conduct that was motivated by some non-evasive purpose. Indeed, to interpret section 30(c) authority otherwise could create a bifurcated regulatory regime where the same conduct is treated differently based on parties' underlying purpose for engaging in it, which could create extraordinary oversight challenges involving difficult subjective considerations concerning parties' true intentions in entering any given transaction or establishing particular business structures, and could create significant competitive advantages for incumbent firms.[121] Thus, we read the statute to permit 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 foreign affiliate whose positions are guaranteed by the market participant, established for valid business purposes, provided the proposed rule or guidance is designed to prevent possibly evasive conduct.[122]

C. Principles Guiding Final Approach To Applying ''Security-Based Swap Dealer'' and ''Major Security-Based Swap Participant'' Definitions in the Cross-Border Context

As in our proposal, our final rules and guidance reflect our careful consideration 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 and other concerns that the dealer and major security-based swap participant definitions were intended to address, as well as the needs of a well-functioning security-based swap market.[123] We also have been guided by the purpose of Title VII[124] and the applicable requirements of the Exchange Act, including the following:

- *Economic Impacts*—The Exchange Act requires the Commission to consider the impact of our rulemakings on efficiency, competition, and capital formation.[125]
- *Counterparty Protection*—The Dodd-Frank Act adds provisions to the Exchange Act relating to counterparty protection, particularly with respect to ''special entities.''[126]
- *Transparency*—The Dodd-Frank Act was intended to promote transparency in the U.S. financial system.[127]
- *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.[128]
- *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.[129]
- *Consultation and Coordination 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 for the purpose of ensuring ''regulatory consistency and comparability, to the extent possible.''[130]
- *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.[131] 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 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 overlaps in the regulatory requirements that apply to market participants under their authority.[132]

At times, these principles reinforce one another; at other times, they may be in tension. For instance, regulating risk posed to the United States may, depending on the final rules, make it more costly for U.S.-based firms to conduct security-based swap business, particularly in foreign markets, compared to foreign firms; it could make foreign firms less willing to deal with U.S. persons; and it could discourage foreign firms from carrying out security-based swap dealing activity through branches or offices located in the United States. On the other hand, providing U.S. persons greater access to foreign security-based swap markets may, depending on the final rules, fail to appropriately address the risks posed to the United States from transactions conducted in part outside the United States or create opportunities for market participants to evade the application of Title VII, particularly until such time as other jurisdictions adopt similar comprehensive and comparable derivative regulations.

Balancing these sometimes competing principles has been complicated by the fact that Title VII imposes a new regulatory regime in a global marketplace. Title VII establishes reforms that will have implications for entities that compete internationally in the global security-based swap market. We have generally sought, in accordance with the statutory factors described above, to avoid creating opportunities for market participants to evade Title VII requirements, whether by restructuring their business or other means, or the potential for overlapping or conflicting regulations. We also have considered the needs for a well-functioning security-based swap market and for avoiding disruption that may

[121] Such an interpretation of our anti-evasion authority, for example, could privilege incumbent firms by allowing them to leverage existing business models that may not be available to new entrants under rules promulgated pursuant to that authority.

[122] As a general matter, the final rules adopted in this release are not being applied to persons who are ''transacting 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* sections II.B.2(a)–(c), *supra.* However, as noted below, the Commission also believes that these rules are necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act and thus help ensure that the particular purposes of the Dodd-Frank Act addressed by the rule are not undermined. *See, e.g.,* section II.B.2(d) and note 186, *infra.*

[123] *See* section II.A, *supra.*

[124] *See* note 11, *supra.*

[125] Specifically, section 3(f) of the Exchange Act provides: ''Whenever pursuant to this title 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 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].''

[126] *See* Exchange Act section 15F(h), as added by section 764(a) of the Dodd-Frank Act, in particular.

[127] *See* note 11, *supra.*

[128] *Id.*

[129] *See* Exchange Act section 30(c), 15 U.S.C. 78dd(c), as discussed in section II.B.2(d), *supra.*

[130] *See* section 712(a)(2) of the Dodd-Frank Act.

[131] *See* section 752(a) of the Dodd-Frank Act.

[132] 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.

reduce liquidity, competition, efficiency, transparency, or stability in the security-based swap market.

III. Baseline

To assess the economic impact of the final rules described in this release, we are using as our baseline the security-based swap market as it exists at the time of this release, including applicable rules we have already adopted but excluding rules that we have proposed but not yet finalized.[133] The analysis includes the statutory and regulatory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act.[134] We acknowledge limitations in the degree to which we can quantitatively characterize the current state of the security-based swap market. As we describe in more detail below, because the available data on security-based swap transactions do not cover the entire market, we have developed an understanding of market activity using a sample that includes only certain portions of the market.

A. 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 CDS market during the period from 2008 to 2012. While other repositories may collect data on transactions in total return swaps on equity and debt, we do not currently have access to such data for these products (or other products that are security-based swaps). We have previously noted that the definition of security-based swaps is not limited to single-name CDS but we believe that the single-name CDS data are sufficiently representative of the market and therefore can directly inform the analysis of the state of the current security-based swap market.[135] Additionally, the data for index CDS encompass both broad-based security indices and narrow-based security indices, and ''security-based swap'' in relevant part encompasses swaps based on single securities or reference entities or on narrow-based security indices. Accordingly, with the exception of the analysis regarding the degree of overlap between participation in the single-name CDS market and the index CDS market (cross-market activity), our analysis below does not include data regarding index CDS.

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. 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;[136] and (ii) are based on non-U.S. reference entities. Notwithstanding this limitation, we believe that the DTCC–TIW data provide sufficient information to identify the types of market participants active in the security-based swap market and the general pattern of dealing within that market.[137]

1. Security-Based Swap Market Participants

A key characteristic of security-based swap activity is that it is concentrated among a relatively small number of entities that engage in dealing activities. In addition to these entities, thousands of other participants appear as counterparties to security-based swap contracts in our sample, and include, but are not limited to, investment companies, pension funds, private (hedge) funds, sovereign entities, and industrial companies. We observe that most non-dealer users of security-based swaps do not engage directly in the trading of swaps, but use dealers, banks, or investment advisers as intermediaries or agents to establish their positions. Based on an analysis of the counterparties to trades reported to the DTCC–TIW, there are 1,695 entities that engaged directly in trading between November 2006 and December 2012.

Table 1, below, highlights that more than 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 approximately 40 percent (about 30 percent of all transacting agents) were registered investment advisers under the Investment Advisers Act of 1940 (''Investment Advisers Act'').[138] Although investment advisers comprise the vast majority of transacting agents, the transactions they executed account for only 10.8 percent 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 (81.9 percent) measured by number of transaction-sides were executed by ISDA-recognized dealers.[139]

[133] We also consider, where appropriate, the impact of rules and technical standards promulgated by other regulators, such as the CFTC and the European Securities and Markets Authority, on practices in the security-based swap market.

[134] As noted above, we have not yet adopted other substantive requirements of Title VII that may affect how firms structure their security-based swap business and market practices more generally.

[135] According to data published by the Bank for International Settlements (''BIS''), the global notional amount outstanding in equity forwards and swaps as of June 2013 was $2.32 trillion. The notional amount outstanding in single-name CDS was approximately $13.14 trillion, in multi-name index CDS was approximately $10.17 trillion, and in multi-name, non-index CDS was approximately $1.04 trillion. *See* Semi-annual OTC derivatives statistics at end-June 2013 (Nov. 2013), Table 19, available at: *http://www.bis.org/statistics/dt1920a.pdf.* As we stated in the Cross-Border Proposing Release, 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* Cross-Border Proposing Release, 78 FR 31120 n.1301; *see also* Exchange Act section 3(a)(68)(A); 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''), 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. Based on those assumptions, single-name CDS appear to constitute roughly 80 percent of the security-based swap market. No commenters disputed these assumptions, and we therefore continue to believe that, although the BIS data reflect the global OTC derivatives market, and not just the U.S. market, these ratios are an adequate representation of the U.S. market.

[136] We note that DTCC–TIW's entity domicile determinations may not reflect our definition of ''U.S. person'' in all cases.

[137] The challenges we face in estimating measures of current market activity stems, in part, from the absence of comprehensive reporting requirements for security-based swap market participants. The Commission has proposed rules regarding trade reporting, data elements, and real-time public reporting for security-based swaps that would provide us with appropriate measures of market activity. *See* Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 34–63346 (Nov. 19, 2010), 75 FR 75208 (Dec. 2, 2010).

[138] *See* 15 U.S.C. 80b1–80b21. Transacting agents participate directly in the security-based swap market, without relying on an intermediary, on behalf of principals. For example, a university endowment may hold a position in a security-based swap that is built up by an investment adviser that transacts on the endowment's behalf. In this case, the university endowment is a principal that uses the investment adviser as its transacting agent.

[139] The 1,695 entities included all DTCC-defined ''firms'' shown in DTCC–TIW as transaction counterparties that report at least one transaction to DTCC–TIW as of December 2012. The staff in the Division of Economic and Risk Analysis classified these firms, which are shown as transaction counterparties, by machine matching names to known third-party databases and by manual classification. This is consistent with the methodology used in the proposal. *See* Cross-Border Proposing Release, 78 FR 31120 n.1304. Manual classification was based in part on searches of the EDGAR and Bloomberg databases, the SEC's Investment Adviser Public Disclosure database, and a firm's public Web site or the public Web site of the account represented by a firm. The staff also referred to ISDA protocol adherence letters available on the ISDA Web site.

TABLE 1—THE NUMBER OF TRANSACTING AGENTS BY COUNTERPARTY TYPE AND THE FRACTION OF TOTAL TRADING ACTIVITY, FROM NOVEMBER 2006 THROUGH DECEMBER 2012, REPRESENTED BY EACH COUNTERPARTY TYPE

Transacting agents	Number	Percent	Transaction share (percent)
Investment Advisers	1,261	74.4	10.9
—SEC registered	*510*	*30.1*	*6.6*
Banks	256	15.1	5.9
Pension Funds	27	1.6	0.1
Insurance Companies	32	1.9	0.3
ISDA-Recognized Dealers [140]	17	1.0	82.1
Other	102	6.0	0.8
Total	1,695	100.0	100.0

Principal holders of CDS risk exposure are represented by ''accounts'' in the DTCC–TIW.[141] The staff's analysis of these accounts in DTCC–TIW shows that the 1,695 transacting agents classified in Table 1 represent over 9,238 principal risk holders. Table 2, below, classifies these principal risk holders by their counterparty type and whether they are represented by a registered or unregistered investment adviser.[142] For instance, 256 banks in Table 1 allocated transactions across 364 accounts, of which 25 were represented by investment advisers. In the remaining 339 instances, banks traded for their own accounts. Meanwhile, 17 ISDA-recognized dealers in Table 1 allocated transactions across 65 accounts.

Among the accounts, there are 1,000 Dodd-Frank Act-defined special entities and 570 investment companies registered under the Investment Company Act of 1940.[143] 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.[144]

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 DECEMBER 2012

Account holders by type	Number	Represented by a registered investment adviser		Represented by an unregistered investment adviser		Participant is transacting agent [145]	
Private Funds	2,696	1,275	47%	1,400	52%	21	1%
DFA Special Entities	1,000	973	97%	7	1%	20	2%
Registered Investment Companies	570	560	98%	8	1%	2	0%
Banks (non-ISDA-recognized dealers)	364	21	6%	4	1%	339	93%
Insurance Companies	205	132	64%	20	10%	53	26%
ISDA-Recognized Dealers	65	0	0%	0	0%	65	100%
Foreign Sovereigns	57	40	70%	2	4%	15	26%
Non-Financial Corporations	55	37	67%	3	5%	15	27%
Finance Companies	8	4	50%	0	0%	4	50%
Other/Unclassified	4,218	2,885	68%	1,146	27%	187	4%
All	9,238	5,927	64%	2,590	28%	721	8%

(a) Dealing Structures

Security-based swap dealers use a variety of business models and legal structures to engage in dealing business with counterparties in jurisdictions all around the world. As we noted in the proposal, both U.S.-based and foreign-based entities use certain dealing structures for a variety of legal, tax, strategic, and business reasons.[146] Dealers may use a variety of structures in part to reduce risk and enhance credit protection based on the particular characteristics of each entity's business.

Bank and non-bank holding companies may use subsidiaries to deal with counterparties. Further, dealers may rely on multiple sales forces to

[140] For the purpose of this analysis, the ISDA-recognized dealers are those identified by ISDA as belonging to the G14 or G16 dealer group during the period: 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, Société Générale, Credit Agricole, Wells Fargo and Nomura. *See, e.g., http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf.*

[141] ''Accounts'' as defined in the DTCC–TIW context are not equivalent to ''accounts'' in the definition of ''U.S. person'' provided by Exchange Act rule 3a71–3(a)(4)(i)(C). They also do not necessarily represent separate legal persons. One entity or legal person may have multiple accounts. For example, a bank may have one DTCC account for its U.S. headquarters and one DTCC account for one of its foreign branches.

[142] 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.

[143] *See* 15 U.S.C. 80a1 through 80a64. There remain over 4,000 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.

[144] Private funds for this purposes encompasses various unregistered pooled investment vehicles, including hedge funds, private equity funds, and venture capital funds.

[145] This column reflects the number of participants who are also trading for their own accounts.

[146] *See* Cross-Border Proposing Release, 78 FR 30976–78.

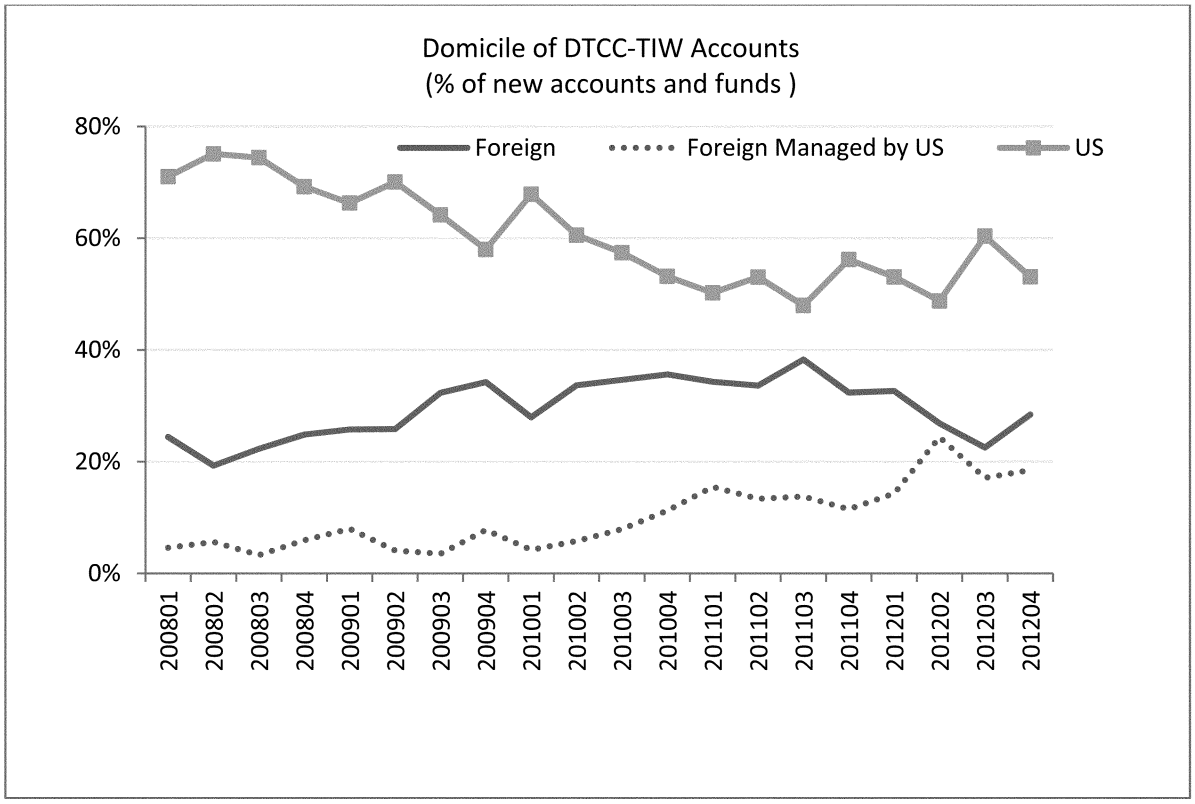
originate security-based swap transactions. For example, a U.S. bank dealer may use a sales force in its U.S. home office to originate security-based swap transactions in the United States and use separate sales forces spread across foreign branches to originate security-based swap transactions with counterparties in foreign markets.

In some situations, an entity's performance under security-based swaps may be supported by a guarantee provided by an affiliate. More generally, guarantees may take the form of a blanket guarantee of an affiliate's performance on all security-based swap contracts, or a guarantee may apply only to a specified transaction or counterparty. Guarantees may give counterparties to the dealer direct recourse to the holding company or another affiliate for its dealer-affiliate's obligations under security-based swaps for which that dealer-affiliate acts as counterparty.

(b) Participant Domiciles

The security-based swap market is global in scope, with counterparties located across multiple jurisdictions. As depicted in Figure 1, the domicile of new accounts participating in the market has shifted over time.

Figure 1: The percentage of (1) new accounts with a domicile in the United States (referred to as "US"), (2) new accounts with domicile outside the United States (referred to below as "Foreign"), and (3) new accounts 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").[147] Unique, new accounts are aggregated each quarter and shares are computed on a quarterly basis, from January 2008 through December 2012.



Over time a greater share of accounts entering the market either have a foreign domicile, or have a foreign domicile while being managed by a U.S. person. The increase in foreign accounts may reflect an increase in participation by foreign accountholders while the increase in foreign accounts managed by U.S. persons may reflect the flexibility with which market participants can restructure their market participation in response to regulatory intervention, competitive pressures, and other stimuli. There are, however, alternative explanations for the shifts in new account domicile we observe in Figure 1. Changes in the domicile of new accounts through time may reflect improvements in reporting by market participants to DTCC–TIW.[148]

[147] 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.

[148] Consistent with the guidance on CDS data access, *see* text accompanying note 37, *supra,* 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. When the fund does not report a registered office location, we assume that the settlement country reported by the investment adviser or

Continued

Additionally, because the data only include accounts that are domiciled in the United States, transact with U.S.-domiciled counterparties, or transact in single-name CDS with U.S. reference entities, changes in the domicile of new accounts may reflect increased transaction activity between U.S. and non-U.S. counterparties.

A U.S.-based holding company may conduct dealing activity through a foreign subsidiary that faces both U.S. and foreign counterparties. Similarly, foreign dealers may choose to deal with U.S. and foreign counterparties through U.S. subsidiaries. Non-dealer users of security-based swaps may participate in the market using an agent in their home country or abroad. An investment adviser located in one jurisdiction may transact in security-based swaps on behalf of beneficial owners that reside in another.

The various layers separating origination from booking by dealers, and management from ownership by non-dealer users, highlights the potential distinctions between the location where a transaction is arranged, negotiated, or executed, the location where economic decisions are made by managers on behalf of beneficial owners, and the jurisdiction ultimately bearing the financial risks associated with the security-based swap transaction that results. As a corollary, a participant in the security-based swap market may be exposed to counterparty risk from a jurisdiction that is different from the market center in which it participates.

(c) Current Estimates of Dealers and Major Participants

In the Intermediary Definitions Adopting Release, we estimated, based on an analysis of DTCC–TIW data, that out of more than 1,000 entities engaged in single-name CDS activity worldwide in 2011, 166 entities engaged in single-name CDS activity at a sufficiently high level that they would be expected to incur assessment costs to determine whether they meet the ''security-based swap dealer'' definition.[149] Analysis of those data further indicated that potentially 50 entities may engage in dealing activity that would exceed the *de minimis* threshold and thus ultimately have to register as security-based swap dealers.[150]

Analysis of more recent data regarding the single-name CDS market using the same methodology suggests comparable results that are consistent with the reduction in transaction volume noted below. In particular, single-name CDS data from 2012 indicate that out of more than 1,000 entities engaged in single-name CDS activity, approximately 145 engaged in single-name CDS activity at a level high enough such that they may be expected to perform the dealer-trader analysis prescribed under the security-based swap dealer definition.[151] These data suggest that, consistent with the Intermediary Definitions Adopting Release analysis, up to approximately 50 entities would engage in dealing activity that would exceed the *de minimis* threshold.[152]

Additionally, in the Intermediary Definitions Adopting Release, we estimated, based on position data from DTCC–TIW for 2011, that as many as 12 entities would be likely to perform substantial position and substantial counterparty exposure tests, and thus incur assessment costs, prescribed

parent entity to the fund or account is the place of domicile.

[149] Based on the *de minimis* threshold of $3 billion for single-name CDS, we estimated that there were 123 entities engaged in engaged in single-name CDS transactions in 2011 that had more than $3 billion in single-name CDS transactions over the previous 12 months. We also estimated that 43 entities with between $2 and $3 billion in transactions over the trailing 12 months may opt to engage in the dealer analysis out of an abundance of caution or to meet internal compliance guidelines, thus leading to the 166 total. *See* Intermediary Definitions Adopting Release, 77 FR 30731–32; *see also* Cross-Border Proposing Release, 78 FR 31139–40. We adopted a phase-in period during which the *de minimis* threshold will be $8 billion and during which Commission staff will study the security-based swap market as it evolves under the new regulatory framework, resulting in a report that will consider the operation of the security-based swap dealer and major security-based swap participant definitions. At the end of the phase-in period, the Commission will take into account the report, as well as public comment on the report, in determining whether to terminate the phase-in period or propose any changes to the rule implementing the *de minimis* exception, including any increases or decreases to the $3 billion threshold. *See* Intermediary Definitions Adopting Release, 77 FR 30640.

[150] In particular, we estimated that 28 entities and corporate groups had three or more counterparties that are not ISDA dealers (which we viewed as a useful proxy for application of the dealer-trader distinction) and that 25 of those entities had trailing notional transactions exceeding $3 billion. *See id.* at 30725 n.1457; SEC Staff Report, ''Information regarding activities and positions of participants in the single-name credit default swap market (''CDS Data Analysis'') (Mar. 15, 2012), available at: *http://www.sec.gov/comments/s7-39-10/s73910-154.pdf* at 14. Our additional estimate of up to 50 potential dealers reflected 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. *See* Intermediary Definitions Adopting Release, 77 FR 30725 n.1457.

In the Cross-Border Proposing Release, we revised those estimates to reflect a more granular analysis of the data. Under this refined approach—which identified the number of entities within a corporate group that may have to register—we estimated that 46 individual firms had three or more non-ISDA dealer counterparties, and that, of those, 31 firms engaged in at least $3 billion of security-based swap activity in 2011. We further estimated that, under the cross-border provisions of proposed Exchange Act rule 3a71–3(b), 27 of those entities engaged in at least $3 billion notional activity that they would have to count against the *de minimis* threshold, and that accounting for the aggregation requirement may result in an additional two firms being required to register, for a total of 29. We also concluded that our original estimate of there being up to 50 dealers was still valid, noting that the revised estimate included individual entities within corporate groups (thus accounting for the possibility that some corporate groups may register more than one dealer), and also accounted for the likely results of the proposed aggregation requirement. *See* Cross-Border Proposing Release, 78 FR 31137–38 n.1407.

[151] Consistent with the earlier analysis, this figure is derived from the fact that 110 transacting agents had total single-name security-based swap activity above the $3 billion *de minimis* threshold, while another 35 transacting agents had activity between $2 and $3 billion and hence out of caution may be expected to engage in the dealer-trader analysis.

In calculating this estimate, Commission staff used methods identical to those used referenced in the Intermediary Definitions Adopting Release, 77 FR 30732 n.1509, aggregating the activity of DTCC accounts to the level of transacting agents and estimating the number of transacting agents with gross transaction notional amounts exceeding $2 billion in 2012. While the analysis contained in the Intermediary Definitions Adopting Release used a sample that ended in December 2011, the sample has been updated through the end of December 2012.

In connection with the economic analysis of the final cross-border dealer *de minimis* rules, we also have estimated the number of entities that may perform the dealer-trader analysis using a more granular methodology that considers data both at the account level and at the transacting agent level. *See* notes 456 through 458, *infra,* and accompanying text.

[152] As discussed below, and consistent with the methodology used in the Cross-Border Proposing Release, 78 FR 31137 n.1407, data from 2012 indicates that 40 entities engaged in the single-name security-based swap market had three or more counterparties that were not identified by ISDA as dealers, and that 27 of those entities had $3 billion or more in notional single-name CDS activity over a 12 month period. Applying the principles reflected in these final rules regarding the counting of transactions against the *de minimis* thresholds suggests that 25 of those entities would have $3 billion or more in notional transactions counted against the thresholds, and that applying the aggregation rules increases that number to 26 entities. Based on this data, we believe that it is reasonable to conclude that up to 50 entities ultimately may register as security-based swap dealers, although the number may be smaller. *See* note 444, *infra.*

In this regard it is important to note that, due to limitations in the availability of the underlying data, this analysis does not include information about transactions involving single-name CDS with a non-U.S. reference entity when neither party is domiciled in the United States or guaranteed by a person domiciled in the United States. This is because for single-name CDS with a non-U.S. reference entity, the data supplied to the Commission by the DTCC–TIW encompasses only information regarding transactions involving at least one counterparty domiciled in the United States or guaranteed by a person domiciled in the United States, based on physical addresses reported by market participants. That data exclusion introduces the possibility that these numbers may underestimate the number of persons that would engage in the dealer-trader analysis (and hence incur assessment costs) or that exceed $3 billion in dealing transactions on an annual basis (and hence would potentially be linked to programmatic costs and benefits).

under the major security-based swap participant definition. Of these 12 firms, we estimated that the number of persons with positions sufficiently large to bring them within the scope of the definition of major security-based swap participant likely would be fewer than five. Although we did not specify how the major security-based swap participant definition would apply to foreign persons in the Intermediary Definitions Adopting Release, our approach in estimating the assessment costs caused by our final definition used available single-name CDS data as a proxy for the market as a whole, and assumed that all potential major security-based swap participants would be required to include in their threshold calculations all positions with all counterparties.

Analysis of more recent data regarding the single-name CDS market suggests comparable results. In particular, single-name CDS data from 2012 indicate that out of over 1,100 DTCC–TIW firms holding positions in single-name CDS activity and not expected to register as security-based swap dealers, nine had worldwide single-name CDS positions at a level high enough such that they may be expected to perform the major security-based swap participant threshold analysis prescribed under the security-based swap dealer definition. Analysis based on these more recent data is consistent with the prior conclusion that five or fewer entities would be likely to register as major security-based swap participants.[153]

2. Levels of Security-Based Swap Trading Activity

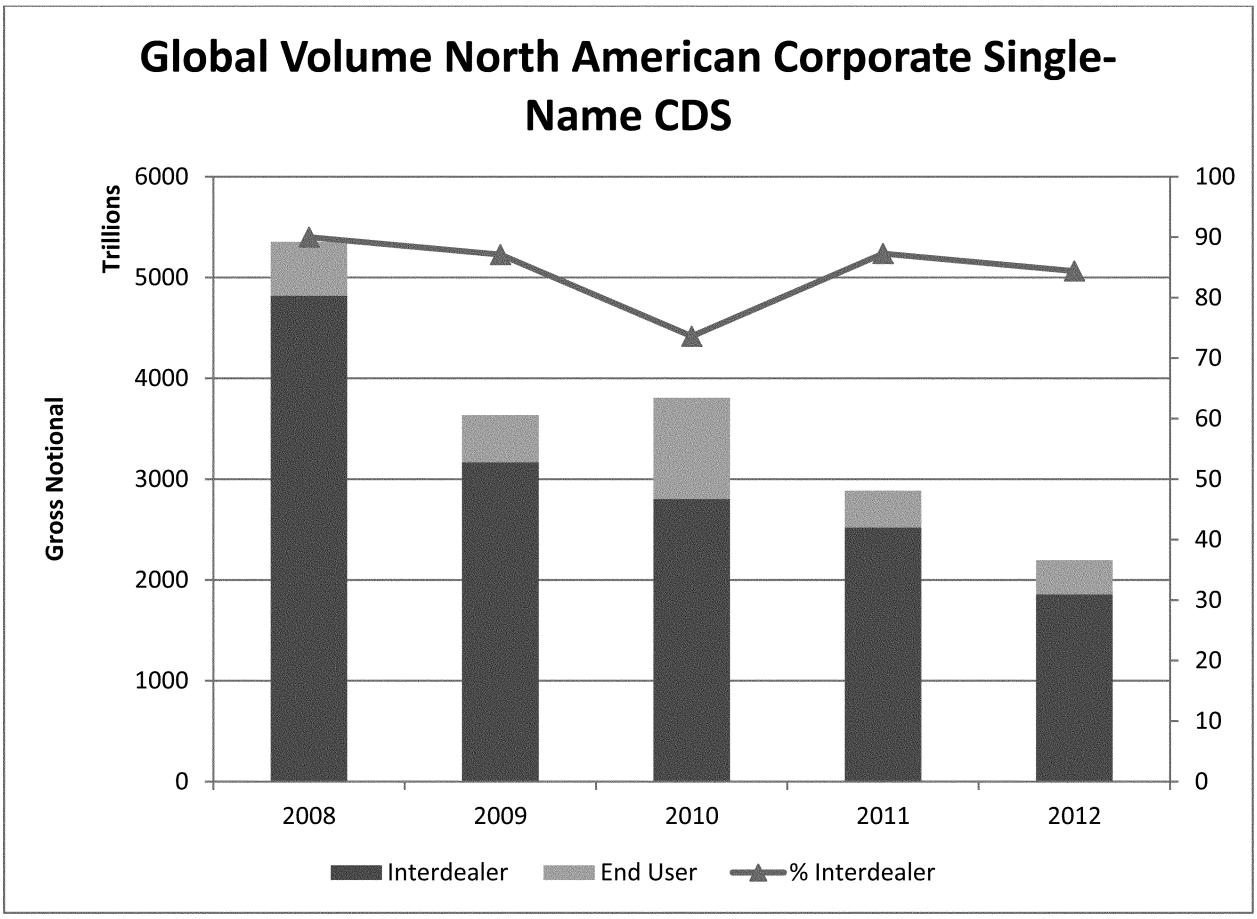
Single-name CDS contracts make up the vast majority of security-based swap products and most are written on corporate issuers, corporate securities, sovereign countries, or sovereign debt (reference entities and reference securities). Figure 2 below describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to the DTCC–TIW between January 2008 and December 2012, separated by whether transactions are between two ISDA-recognized dealers (interdealer transactions) or whether a transaction has at least one non-dealer counterparty.

The level of trading activity with respect to North American corporate single-name CDS in terms of notional volume has declined from more than $5 trillion in 2008 to approximately $2 trillion in 2012.[154] While notional volume has declined over the past five years, the share of interdealer transactions has remained fairly constant and interdealer transactions continue to represent the bulk of trading activity, whether measured in terms of notional value or number of transactions (see Figure 2).

[153] In calculating this estimate, Commission staff used methods identical to those used referenced in the Intermediary Definitions Adopting Release, 77 FR 30734, note 1529, estimating the number of participants with notional positions exceeding $100 billion in 2012. The analysis contained in the Intermediary Adopting Release used a sample that ended in December 2011, aggregated the activity of DTCC accounts to the level of transacting agents, and did not attribute positions to parent companies. For the purposes of analysis of the final rules, the sample has been updated through the end of December 2012 and positions falling short of the $100 billion threshold have been attributed to parent companies.

[154] The start of this decline predates the enactment of the Dodd-Frank Act and the proposal of rules thereunder, which is important to note for the purpose of understanding the economic baseline for this rulemaking. The timing of this decline seems to indicate that CDS market demand shrank prior to the enactment of the Dodd-Frank Act, and therefore the causes of this reduction in trading volume may be related to market dynamics and not directly related to the enactment of statutes and 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 identify the effects of the newly developed security-based swap market regulation apart from changes in trading activity that may be due to natural market forces, or the anticipation of (or reaction to) proposed (or adopted) Title VII requirements or requirements being considered or implemented in other jurisdictions.

Figure 2: Global, notional trading volume in North American corporate single-name CDS by calendar year and the fraction of volume that is interdealer.



Against this backdrop of declining North American corporate single-name CDS activity, about half of the trading activity in North American corporate single-name CDS reflected in the set of data we analyzed was between counterparties domiciled in the United States and counterparties domiciled abroad. Basing counterparty domicile on the self-reported registered office location of the DTCC–TIW accounts, the Commission estimates that only 13 percent of the global transaction volume by notional volume between 2008 and 2012 was between two U.S.-domiciled counterparties, compared to 48 percent entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 39 percent entered into between two foreign-domiciled counterparties (see Figure 3).[155]

When the domicile of DTCC–TIW accounts are instead defined according to the domicile of their ultimate parents, headquarters, or home offices (*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 29 percent, and to 53 percent for transactions entered into between a U.S.-domiciled counterparty and a foreign-domiciled counterparty.

Differences in classifications across different definitions of domicile illustrate the effect of participant structures that operate across jurisdictions. Notably, the proportion of activity between two foreign-domiciled counterparties drops from 39 percent to 18 percent when domicile is defined as the ultimate parent's domicile. As noted earlier, foreign subsidiaries of U.S. parent companies and foreign branches of U.S. banks, and U.S. subsidiaries of foreign parent companies and U.S. branches of foreign banks may transact with U.S. and foreign counterparties. However, this decrease in share suggests that the activity of foreign subsidiaries of U.S. firms and foreign branches of U.S. banks is generally higher than the activity of U.S. subsidiaries of foreign firms and U.S. branches of foreign banks.

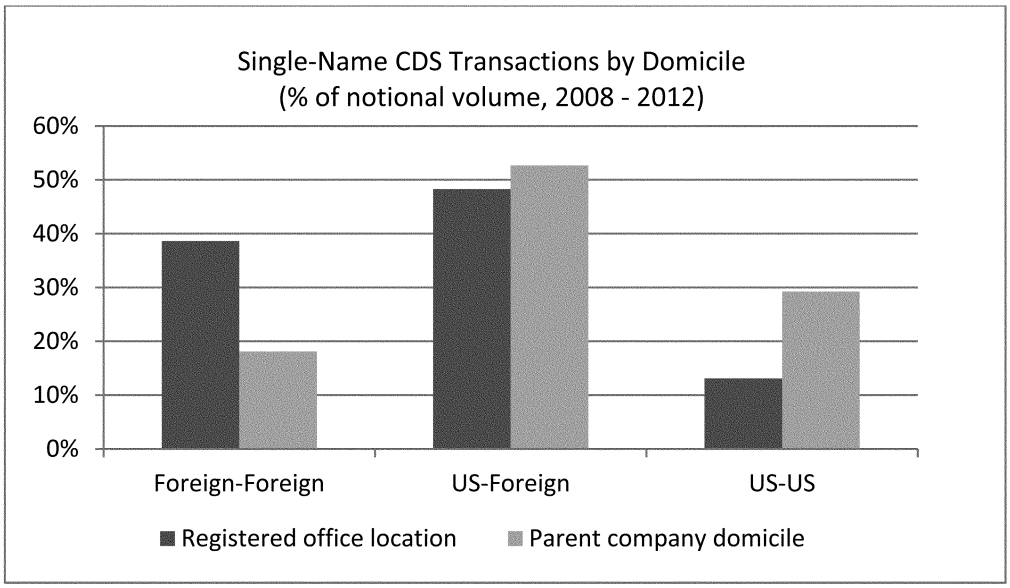
By either of those definitions of domicile, the data indicate that a large fraction of North American corporate single-name CDS transaction volume is entered into between counterparties domiciled in two different jurisdictions or between counterparties domiciled outside the United States. For the purpose of establishing an economic baseline, this observation indicates that a large fraction of security-based swap

[155] Following publication of the Warehouse Trust Guidance on CDS data access, the DTCC–TIW surveyed market participants, asking for the physical address associated with each of their accounts (*i.e.,* where the account is organized as a legal entity). This is designated the registered office location by the DTCC–TIW. When an account 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. For purposes of this discussion, we have assumed that the registered office location reflects the place of domicile for the fund or account.

Changes to these estimates relative to figures presented in the proposing release represent additional data regarding new accounts in the time series as well as the use of a longer sample period.

activity would be affected by the scope of any cross-border approach we take in applying the Title VII requirements. Further, the large fraction of North American corporate 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, both facilitating risk sharing among market participants and allowing for risk transmission between jurisdictions.

Figure 3: The fraction of notional volume in North American corporate single-name CDS between (1) two U.S.-domiciled accounts, (2) one U.S.-domiciled account and one non-U.S.-domiciled account, and (3) two non-U.S.-domiciled accounts, computed from January 2008 through December 2012.



B. Global Regulatory Efforts

Efforts to regulate the swaps market are underway not only in the United States but also abroad. In 2009, leaders of the G20—whose membership includes the United States, 18 other countries, and the EU—called for global improvements in the functioning, transparency, and regulatory oversight of OTC derivatives markets agreeing that ''all standardised OTC derivatives contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties (''CCPs'') by end-2012 at the latest. OTC derivatives contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements.'' [156] In subsequent summits, the G20 leaders have reiterated their commitment to OTC derivatives regulatory reform and encouraged international consultation in developing standards for these markets.[157] The FSB monitors implementation of OTC derivatives reforms and provides progress reports to the G20.[158]

Pursuant to these commitments, jurisdictions with major OTC derivatives markets have taken steps toward substantive regulation of these markets, though the pace of regulation varies. This suggests that many foreign participants will face substantive regulation of their security-based swap activities that is intended to implement the G20 objectives and that may therefore address concerns similar to those addressed by rules the Commission has proposed but not yet adopted.

Foreign legislative and regulatory efforts have focused on five general areas: Requiring post-trade reporting of transactions data for regulatory purposes, moving OTC derivatives onto organized trading platforms, requiring central clearing of OTC derivatives, establishing or enhancing capital requirements, and establishing or enhancing margin requirements for OTC derivatives transactions.

The first two areas of regulation should help improve transparency in OTC derivatives markets, both to regulators and market participants. Regulatory transaction reporting requirements have entered into force in a number of jurisdictions including the EU, Hong Kong SAR, Japan, and

[156] *See* G20 Leaders' Statement cited in note 16, *supra.*

[157] See *e.g.,* G20 Leaders' St. Petersburg Declaration. *See also* G20 Meeting, Los Cabos, Mexico, June 2012, available at: *http://www.treasury.gov/resource-center/international/g7-g20/Documents/Los%20Cabos%20Leaders%27%20Declaration.pdf;* and G20 Meeting, Cannes, France, November 2011, available at: *https://www.g20.org/sites/default/files/g20_resources/library/Declaration_eng_Cannes.pdf* (''G20 Leaders' Cannes Declaration''). In the G20 Leaders' Cannes Declaration, the G20 Leaders agreed to develop standards on margin for non-centrally cleared OTC derivatives.

[158] The FSB has published seven progress reports on OTC derivatives markets reform implementation: FSB Progress Report April 2014 (available at: *http://www.financialstabilityboard.org/publications/r_140408.pdf*); September 2013 (available at: *http://www.financialstabilityboard.org/publications/r_130902b.pdf*), April 2013 (available at: *http://www.financialstabilityboard.org/publications/r_130415.pdf*), October 2012 (available at: *http://www.financialstabilityboard.org/publications/r_121031a.pdf*), June 2012 (available at: *http://www.financialstabilityboard.org/publications/r_120615.pdf*), October 2011 (available at: *http://www.financialstabilityboard.org/publications/r_111011b.pdf*) and April 2011 (available at: *http://www.financialstabilityboard.org/publications/r_110415b.pdf*) (collectively, ''FSB Progress Reports''). The ODWG prepares the FSB Progress Reports. The Commission participates in the ODWG, both on its own behalf and as the representative of IOSCO, which is co-chair of the ODWG.

Singapore, and other jurisdictions are in the process of proposing legislation and rules to implement these requirements.[159] The European Parliament has adopted legislation for markets in financial instruments that addresses trading OTC derivatives on regulated trading platforms.[160] This legislation also should promote post-trade public transparency in OTC derivatives markets by requiring the price, volume, and time of OTC derivatives transactions conducted on these regulated trading platforms to be made public in as close to real time as technically possible.

Regulation of derivatives central clearing, capital requirements, and margin requirements aims to improve management of financial risks in these markets. Japan has rules in force mandating central clearing of certain OTC derivatives transactions. The EU has its legislation in place but has not yet made any determinations of specific OTC derivatives transactions subject to mandatory central clearing. Most other jurisdictions are still in the process of formulating their legal frameworks that govern central clearing. While the EU is the only major foreign jurisdiction that has initiated the process of drafting rules to implement margin requirements for OTC derivatives transactions, we understand that several other jurisdictions anticipate taking steps towards implementing such requirements.

C. Cross-Market Participation

Persons registered as security-based swap dealers or major security-based swap participants are likely also to engage in swap activity, which is subject to regulation by the CFTC. In the release proposing registration requirements for security-based swap dealers and major security-based swap participants, we estimated, based on our experience and understanding of the swap and security-based swap markets that of the 55 firms that might register as security-based swap dealers or major security-based swap participants, approximately 35 would also register with the CFTC as swap dealers or major swap participants.[161]

This overlap reflects the relationship between single-name CDS contracts, which are security-based swaps, and index CDS contracts, which may be swaps or security-based swaps. A single-name CDS contract covers default events for a single reference entity or reference security. These entities and securities are often part of broad-based indices on which market participants write index CDS contracts. Index CDS contracts and related products make payouts that are contingent on the default of index components and allow participants in these instruments to gain exposure to the credit risk of the basket of reference entities that comprise the index, which is a function of the credit risk of the index components. As a result of this construction, a default event for a reference entity that is an index component will result in payoffs on both single-name CDS written on the reference entity and index CDS written on indices that contain the reference entity. Because of this relationship between the payoffs of single-name CDS and index CDS products, prices of these products depend upon one another. This dependence is particularly strong between index CDS contracts and single-name CDS contracts written on index components.[162]

Because payoffs associated with these single-name CDS and index CDS are dependent, hedging opportunities exist across these markets. Participants who sell protection on reference entities through a series of single-name CDS transactions can lay off some of the credit risk of their resulting positions by buying protection on an index that includes a subset of those reference entities. Participants that are active in one market are likely to be active in the other. Commission staff analysis of approximately 4,400 DTCC–TIW accounts that participated in the market for single-name CDS in 2012 revealed that approximately 2,700 of those accounts, or 61 percent, also participated in the market for index CDS. Of the accounts that participated in both markets, data regarding transactions in 2012 suggest that, conditional on an account transacting in notional volume of index CDS in the top third of accounts, the probability of the same account landing in the top third of accounts in terms of single-name CDS notional volume is approximately 62 percent; by contrast, the probability of the same account landing in the bottom third of accounts in terms of single-name CDS notional volume is only 14 percent.

In an effort to comply with CFTC rules and applicable statutory provisions in the cross-border context, swap market participants, many of whom, as discussed above, likely also participate in the security-based swap market, may have already changed some market practices.[163] Although a commenter suggested that swap market participants have already conformed their business practices to the CFTC's approach to cross-border regulation, the commenter did not supply particular details as to the scope of that operations restructuring.[164] We believe, however, based on these comments, it is likely that all participants who preliminarily believe they may be subject to the CFTC's registration requirements will have expended resources to build systems and infrastructure that will permit them to determine and then record the U.S.-person status of their counterparties consistent with applicable requirements, as interpreted by the CFTC Cross-Border Guidance.

The CFTC's rules and cross-border guidance have likely influenced the information that market participants collect and maintain about the swap transactions they enter into and the counterparties they face. For example, the CFTC's guidance describes a majority-ownership approach for collective investment vehicles that are

[159] Information regarding ongoing regulatory developments described in this section was primarily obtained from the FSB Progress Reports cited in note 158, *supra,* which reflect the input of relevant jurisdictions.

[160] *Id.*

[161] *See* Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 65543 (Oct. 12, 2011), 76 FR 65784, 65808 (Oct. 24, 2011). Based on its analysis of 2012 DTCC–TIW and the list of swap dealers provisionally-registered with the CFTC, and applying the methodology used in the Intermediary Definitions Adopting Release, the Commission estimates that substantially all registered security-based swap dealers would also register as swap dealers with the CFTC. *See also* CFTC list of provisionally registered swap dealers, available at: *http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.*

[162] ''Correlation'' typically refers to linear relationships between variables; ''dependence'' captures a broader set of relationships that may be more appropriate for certain swaps and security-based swaps. *See, e.g.,* Casella, George and Roger L. Berger, ''Statistical Inference'' (2002), at 171.

[163] *See, e.g.,* SIFMA/FIA/FSR Letter at 2–3. We understand that new capabilities have been built by swap market participants following issuance of the CFTC's guidance. To the extent that such capabilities can be transferred to these participants' security-based swap activities (*e.g.,* to the extent that a market participant's assessment practices regarding whether a counterparty would generally be considered a U.S. person for purposes of the CFTC guidance also can help determine the corresponding assessment for purposes of these final rules and guidance), such capabilities may tend to mitigate the costs that market participants otherwise would incur in connection with the Commission's final cross-border rules.

[164] *Id.* at 2–4. The commenter notes the ''technological, operational, legal and compliance systems'' necessary for complying with the Commission's proposed rules, and taking account of the CFTC Cross-Border Guidance, outlining the general categories of changes to practice necessary for compliance. The commenter further indicates a potential need to ''build[] separate systems for a small percentage of the combined swaps and SBS market instead of using the systems already built for compliance with the CFTC's cross-border approach,'' suggesting that market participants have already altered market practices to follow the CFTC Cross-Border Guidance.

offered to U.S. persons, contemplating that managers of these vehicles would assess, on an ongoing basis, the proportion of ownership by U.S. persons. As another example, the CFTC's guidance articulates an approach by which all swap transactions by a non-U.S. person that rely on guarantees from U.S. affiliates would generally count against that non-U.S. person's dealer *de minimis* exception.[165]

Thus, as discussed in more detail in sections IV.I.2 and V.H.2 below, the adoption of rules that would seek similar information from security-based swap market participants as the CFTC seeks from swap market participants, may allow such participants to use infrastructure already in place as a result of CFTC regulation to comply with Commission regulation. Among those entities that participate in both markets, entities that are able to apply to security-based swap activity new capabilities they have built in order to comply with requirements applicable to cross-border swap activity may experience lower costs associated with assessing which cross-border security-based swap activity counts against the dealer *de minimis* exception or towards the major participant threshold, relative to those that are unable to redeploy such capabilities. The Commission remains sensitive to the fact that in cases where its final rules differ from the CFTC approach, additional outlays related to information collection and storage may be required even of market participants that conformed to the CFTC's guidance regarding the applicable cross-border requirements.[166] These costs are discussed in sections IV.I.1 and V.H.1(b).

IV. Cross-Border Application of Dealer De Minimis Exception

A. Overview

The Exchange Act excepts from designation as ''security-based swap dealer'' entities that engage in a '' *de minimis''* quantity of security-based swap dealing activity with or on behalf of customers.[167] Under the final rules adopted in the Intermediary Definitions Adopting Release, a person may take advantage of that exception if, in connection with CDS that constitute security-based swaps, the person's dealing activity over the preceding 12 months does not exceed a gross notional amount of $3 billion, subject to a phase-in level of $8 billion.[168] The phase-in level will remain in place until—following a study regarding the definitions of ''security-based swap dealer'' and ''major security-based swap participant''—the Commission either terminates the phase-in period or establishes an alternative threshold following rulemaking.[169]

To apply the exception to cross-border dealing activity, the Cross-Border Proposing Release would have required that a U.S. person count against the *de minimis* thresholds all of its security-based swap dealing activity, including transactions conducted through a foreign branch of a U.S. bank.[170] Non-U.S. persons, in contrast, would have included only dealing transactions entered into with U.S. persons other than foreign branches of U.S. banks, plus dealing transactions where the transaction is ''conducted within the United States.'' [171] To implement, within the cross-border context, the existing rule that requires a person to aggregate the dealing activity of its affiliates against its own *de minimis* thresholds,[172] the proposal would have required a person to count: (i) dealing transactions by its affiliates that are U.S. persons; and (ii) dealing transactions by non-U.S. affiliates that either are entered into with U.S. persons other than foreign branches, or that are conducted within the United States.[173] The proposal further would have permitted a person to exclude, from the *de minimis* analysis, transactions by affiliates that are registered security-based swap dealers, provided that the person's dealing activity is ''operationally independent'' from the registered dealer's dealing activity.[174] The proposal, moreover, set forth definitions relevant to the application of the *de minimis* exception in the cross-border context, including proposed definitions of the terms ''U.S. person'' and ''transaction conducted within the United States.'' [175]

Commenters raised issues related to various aspects of this proposed approach to application of the *de minimis* exception in the cross-border context. As discussed below, these include issues regarding: the scope of the ''U.S. person'' definition, the proposal to require counting of certain ''transactions conducted within the United States'' between two non-U.S. persons, the treatment of the dealing activity of non-U.S. persons that is guaranteed by U.S. persons, and the application of the exception to non-U.S. persons whose counterparties are foreign branches of U.S. banks. Some commenters also urged us to more closely harmonize particular aspects of our proposal with the CFTC Cross-Border Guidance.

After considering commenters' views regarding the cross-border application of the *de minimis* exception, we are adopting final rules that have been modified from the proposal in certain important respects. While these changes are discussed in more detail below, key elements include:

- Modifications to the proposed definition of ''U.S. person'';
- Provisions to distinguish non-U.S. persons' dealing activity involving security-based swaps that are guaranteed by their U.S. affiliates from such non-U.S. persons' other dealing activity for purposes of the *de minimis* exception, by requiring a non-U.S. person to count against the *de minimis* thresholds all dealing activity involving security-based swaps for which its counterparty has rights of recourse

[165] *See* section IV.I.2(c), *supra,* for a discussion of costs to market participants that may arise from differences between the CFTC approach to guarantees and the Commission's final rules.

[166] We recognize that the CFTC Cross-Border Guidance is the subject of ongoing litigation. Our economic analysis is not intended to draw any conclusions about the ultimate outcome of that litigation; rather, the economic analysis relies on the current practices and operational abilities of firms that are, we understand, either in accordance with the CFTC Cross-Border Guidance or are in the process of adapting their systems to account for the CFTC's approach to cross-border issues.

[167] *See* Exchange Act section 3(a)(71)(D).

[168] *See* Exchange Act rule 3a71–2(a).

[169] *See* Intermediary Definitions Adopting Release, 77 FR 30640–41; *see also* note 149, *supra* (addressing process for termination of phase-in level). Lower thresholds are set forth in connection with dealing activity involving other types of security-based swaps. *See* Exchange Act rule 3a71–2(a)(1)(ii).

[170] *See* proposed Exchange Act rule 3a71–3(b)(1)(i).

[171] *See* proposed Exchange Act rule 3a71–3(b)(1)(ii).

[172] *See* Exchange Act rule 3a71–2(a)(1) (providing that, for purposes of the *de minimis* exception, a person shall count its own dealing activity plus the dealing activity of ''any other entity controlling, controlled by, or under common control with the person'').

[173] *See* proposed Exchange Act rule 3a71–3(b)(2).

[174] *See* proposed Exchange Act rule 3a71–4.

[175] The proposal also set forth definitions of ''foreign branch'' and ''transaction conducted through a foreign branch'' in connection with the *de minimis* exception. *See* proposed Exchange Act rule 3a71–3(a). The proposed definitions of ''U.S. person,'' ''transaction conducted within the United States,'' ''foreign branch,'' and ''transaction conducted through a foreign branch'' also are relevant to the Commission's proposed rules regarding the cross-border application of certain other Title VII requirements. *See, e.g.,* proposed Exchange Act regulation SBSR (regarding regulatory reporting and public dissemination).

Proposed Exchange Act rule 3a71–3 also contained a provision and associated definitions related to the cross-border application of counterparty protection requirements in connection with security-based swap activities. As discussed above, those matters are not the subject of the present rulemaking, and the Commission intends to address those matters as part of a subsequent rulemaking.

against a U.S. guarantor that is affiliated with the non-U.S. person;

- Provisions to distinguish non-U.S. persons that act as conduit affiliates (by entering into certain security-based swap transactions on behalf of their U.S. affiliates) from other non-U.S. persons for purposes of the *de minimis* exception, in that conduit affiliates are required to count all of their dealing activity against the *de minimis* thresholds regardless of counterparty;
- Modifications to the application of the *de minimis* exception to dealing activity by non-U.S. persons when the counterparty is the foreign branch of a U.S. bank.
- The addition of an exclusion related to cleared, anonymous transactions; and
- Modifications of the proposed aggregation provisions, in part by removing the ''operational independence'' condition to excluding dealing positions of affiliates that are registered dealers.

The final rules we are adopting reflect a territorial approach that is generally consistent with the principles that the Commission traditionally has followed with respect to the registration of brokers and dealers under the Exchange Act. Under this territorial approach, registration and other requirements applicable to brokers and dealers generally are triggered by a broker or dealer physically operating in the United States, even if its activities are directed solely toward non-U.S. persons outside the United States. The territorial approach further generally requires broker-dealer registration by foreign brokers or dealers that, from outside the United States, induce or attempt to induce securities transactions by persons within the United States—but not when such foreign brokers or dealers conduct their activities entirely outside the United States.[176]

In the cross-border context, moreover, the application of the ''security-based swap dealer'' definition and its *de minimis* exception remains subject to general principles that we addressed in the Intermediary Definitions Adopting Release. Accordingly, the term ''person'' as used in the ''security-based swap dealer'' definition and in the Commission's rules implementing the *de minimis* exception should be interpreted to refer to a particular legal person, meaning that a trading desk, department, office, branch or other discrete business unit that is not a separately organized legal person will not be viewed as a security-based swap dealer. As a result, a legal person with a branch, agency, or office that is engaged in dealing activity above the *de minimis* threshold is required to register as a security-based swap dealer, even if the legal person's dealing activity is limited to such branch, agency, or office.[177]

Cross-border security-based swap transactions also are subject to the principle that transactions between majority-owned affiliates need not be considered for purposes of determining whether a person is a dealer.[178]

As discussed below, these final rules and guidance do not address the proposed provisions regarding the cross-border application of the dealer definition to ''transactions conducted within the United States,'' as defined in the Cross-Border Proposing Release. We anticipate soliciting additional public comment on potential approaches for applying the dealer definition to non-U.S. persons in connection with activity between two non-U.S. persons where one or both are conducting dealing activity that occurs within the United States.[179]

B. Application of De Minimis Exception to Dealing Activities of U.S. Persons

1. Proposed Approach and Commenters' Views

Under the proposal, a U.S. person would have counted all of its security-based swap dealing activity against the *de minimis* thresholds, including transactions that it conducted through a foreign branch.[180] Although some persons who submitted comments in connection with the Intermediary Definitions Adopting Release expressed the view that dealing activity by foreign branches should not be counted as part of a U.S. person's *de minimis* calculation,[181] we did not propose such an approach.[182] Moreover, commenters to the Cross-Border Proposing Release did not specifically express opposition to this aspect of the proposal, although several commenters addressed related issues regarding the proposed scope of the ''U.S. person'' definition.[183]

2. Final Rule

Consistent with the proposal, the final rules require U.S. persons to apply all of their dealing transactions against the *de minimis* thresholds, including activity they conduct through their foreign branches.[184] Such dealing transactions must be counted regardless of where they are arranged, negotiated, or executed.

As discussed above, it is our view that any dealing activity undertaken by a U.S. person, as defined in this final rule, occurs at least in part within the United States and therefore warrants the application of Title VII regardless of where particular aspects of dealing activity are conducted.[185] Whenever a U.S. person enters into a security-based swap in a dealing capacity, it is the U.S. person as a whole—and not merely any applicable foreign branch or office of that U.S. person—that holds itself out as a dealer in security-based swaps. It is the U.S. person as a whole that seeks to profit by providing liquidity and making a market in security-based swaps, and it is the financial resources of the U.S. person as a whole that enable it to do so. Even if the U.S. person engages in dealing activity through a foreign branch or office, its dealing counterparties will look to the entire U.S. person—and not merely its foreign branch or office—for performance on the transaction, and the U.S. person as a whole assumes and stands behind the obligations arising from the security-based swap, thereby creating risk to the U.S. person and potentially to the U.S. financial system. A dealer that is organized or has its principal place of business in the United States thus cannot hold itself out as anything other than a single person, and generally cannot operate as a dealer absent the financial and other resources of that single person. Accordingly, we conclude that U.S. persons that engage in security-based swap dealing activity through foreign branches or offices should be subject to the regulatory framework for dealers even if those U.S. persons deal exclusively with non-U.S. persons.[186]

[176] *See* Cross-Border Proposing Release, 78 FR 30990; *see generally* section III.B, *supra.*

[177] *See* Intermediary Definitions Adopting Release, 77 FR 30624; *see also* Cross-Border Proposing Release at 30993.

[178] *See* Exchange Act rule 3a71–1(d).

[179] *See* section I.A, *supra.*

[180] *See* proposed Exchange Act rule 3a71–3(b)(1)(i).

[181] *See, e.g.,* ISDA Letter (Feb. 22, 2011) (''Non-U.S. entities (including non-U.S. affiliates and branches of U.S. banks) should not be required to register as Dealers when they are conducting business with non-U.S. counterparties''). This and other comments in connection with the Intermediary Definitions Adopting Release are located at: *http://www.sec.gov/comments/s7-39-10/s73910.shtml.*

[182] We considered these comments in connection with the Cross-Border Proposing Release. *See* Cross-Border Proposing Release, 78 FR 30990, 30994.

[183] We address these comments in the context of our discussion of our final definition of ''U.S. person.'' *See* notes 192–231, *infra,* and accompanying text.

[184] *See* Exchange Act rule 3a71–3(b)(1)(i). Issues regarding how the *de minimis* exception applies to a non-U.S. person whose counterparty is a foreign branch are addressed in section IV.E.2, *infra.*

[185] *See* Cross-Border Proposing Release, 78 FR 30994.

[186] The definition of ''U.S. person'' is addressed below. The definitions of ''foreign branch'' and

C. Definition of ''U.S. Person''

1. Proposed Approach

Consistent with our territorial approach to application of Title VII to cross-border security-based swap activity, our Cross-Border Proposal defined ''U.S. person'' to mean:

- 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 [187] or having its principal place of business in the United States; and
- Any account (whether discretionary or non-discretionary) of a U.S. person.[188]

The Commission also proposed that the term ''U.S. person'' would exclude 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.[189]

This proposed definition of ''U.S. person'' generally followed an approach to defining U.S. person that is similar to that used by the Commission in other contexts,[190] though it was tailored to the specific goals of Title VII. As we noted in the proposal, we sought with the proposed definition to identify those types of individuals or entities whose security-based swap activity is likely to impact the U.S. market even if they transact with security-based swap dealers that are not U.S. persons and to identify those types of individuals or entities that are part of the U.S. security-based swap market and should receive the protections of Title VII.[191]

2. Commenters' Views

We received extensive comments on our proposed definition of ''U.S. person.'' In these comments, many commenters also expressed their views on the interpretation of ''U.S. person'' in the CFTC Cross-Border Guidance. As explained in more detail below, several commenters emphasized that we should minimize divergence from the CFTC's approach, including by adding certain elements to our definition of ''U.S. person'' that we had not proposed. Many commenters also identified specific elements of the CFTC interpretation that we should not adopt in our final rule.

(a) Definition of ''U.S. Person'' Generally

Several commenters expressed the view that our proposed definition of ''U.S. person'' was clear, objective, and territorial in scope.[192] At the same time, many commenters, including some who expressed agreement with our proposed approach, urged us to adopt, in whole or in part, a definition of ''U.S. person'' that is consistent with the interpretation of ''U.S. person'' in the CFTC Cross-Border Guidance.[193] In contrast, two

''transaction conducted through a foreign branch'' are addressed in section IV.E.2, *infra.*

This interpretation, moreover, is consistent with the goals of security-based swap dealer regulation under Title VII. Security-based swap activity that results in a transaction involving a U.S. counterparty creates ongoing obligations that are borne by a U.S. person, and thus is properly viewed as occurring within the United States. The events associated with AIG FP, described in detail in our proposal, illustrate how certain transactions of U.S. persons can pose risks to the U.S. financial system even when they are conducted through foreign operations. *See* Cross-Border Proposing Release, 78 FR 30980–81. Such risks, and their role in the financial crisis and in the enactment of Title VII, suggest that the statutory framework established by Congress and the objectives of Title VII would be undermined by an analysis that excludes from Title VII's application certain transactions involving U.S. persons solely because they involve conduct carried out through operations outside the United States, particularly when those transactions raise concerns about risk to the U.S. person and to the U.S. financial system that are similar or identical to those raised by such conduct when carried out by the U.S. person entirely inside the United States.

For the above reasons, we conclude that our approach does not apply 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(d), *supra.* A contrary interpretation would, in our view, reflect an understanding of what it means to conduct a security-based swaps business within the jurisdiction of the United States that is divorced both from Title VII's statutory objectives and from the reality of the role of U.S. persons within the global security-based swap market. But in any event we also believe that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Otherwise, U.S. persons could simply conduct dealing activities with non-U.S. persons using foreign branches and remain outside of the application of the dealer requirements of Title VII, bringing the same risk into the United States that would be associated with such dealing activity that is conducted out of their U.S. offices.

[187] Proposed Exchange Act rule 3a71–3(a)(9) under the Exchange Act defined ''United States'' as ''the United States of America, its territories and possessions, any States of the United States, and the District of Columbia.''

[188] Proposed Exchange Act rule 3a71–3(a)(7)(i) under the Exchange Act.

[189] *See* proposed Exchange Act rule 3a71–3(a)(7)(ii).

[190] *See, e.g.,* Securities Act Release No. 6863 (''Regulation S Adopting Release'') (April 24, 1990), 55 FR 18306, 18308 (May 2, 1990), 55 FR 18308 (adopting regulation ''based on a territorial approach to [s]ection 5 of the Securities Act''). Although the proposed rule followed the approach to defining ''U.S. person'' in Regulation S in certain respects, we stated that we preliminarily believed that it was necessary to depart from Regulation S in defining ''U.S. person'' in the context of the cross-border application of Title VII. *See* Cross-Border Proposing Release, 78 FR 31007–08 (comparing the proposed definition of ''U.S. person'' with the definition of ''U.S. person'' in Regulation S). For example, Regulation S expressly excludes foreign branches of U.S. banks from the definition of ''U.S. person,'' whereas our proposed definition provided that U.S.-person status would be determined at the entity level, meaning that a foreign branch of a U.S. person would, as part of that U.S. person, share in that U.S.-person status of the entity as a whole. *See* section II.B.2(b)i, *supra.* Thus, under our proposed approach, the term ''U.S. person'' would have been interpreted to include any foreign trading desk, office, or branch of an entity that is organized under U.S. law or that has its principal place of business in the United States. *See* Cross-Border Proposing Release, 78 FR 30996.

The proposed definition of ''U.S. person'' was similar in many respects to the definition provided by CFTC staff in 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/@lrlettergeneral/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). In July 2013, the CFTC issued its cross-border guidance, which modified its interpretation of U.S. person in certain respects, discussed in greater detail below.

[191] *See* Cross-Border Proposing Release, 78 FR 30996.

[192] *See, e.g.,* SIFMA/FIA/FSR Letter at A–6 (stating that the Commission's proposed ''U.S. person'' definition was ''clear, objective and ascertainable''); American Bar Association (''ABA'') Letter at 1–2, 4 (commending the Commission for a ''clear and objective'' approach to the ''U.S. person'' definition that is consistent with its statutory authority and respects principles of comity); IIB Letter at 5 (stating that the Commission's proposed ''U.S. person'' definition is sensible in its jurisdictional scope and is consistent with territorial principles). *But see* EC Letter at 2 (generally supporting the territorial scope of the ''U.S. person'' definition, with the exception of the ''principal place of business'' requirement, arguing that it is inconsistent with the territorial approach); ESMA Letter at 2 (supporting a definition of ''U.S. person'' that covers only persons located or incorporated in the United States).

[193] *See, e.g.,* SIFMA/FIA/FSR Letter at 2–3, A–7 (suggesting that the Commission coordinate with the CFTC in order to provide a ''consistent set of standards for determining an entity's principal place of business''); IIB Letter at 2 (noting that its recommendations are generally intended to emphasize consistency across regimes). *See also* Chris Barnard Letter at 2 (stating belief that the ''U.S. person'' definition should be aligned with the CFTC's definition, specifically with respect to commodity pools, pension plans, estates, and trusts); Japan Financial Markets Council (''JFMC'') Letter at 4 (noting that, even though JFMC does not support all aspects of the CFTC's definition, it believes the Commission should adopt the same definition as the CFTC); Japan Securities Dealers Association (''JSDA'') Letter at 3 (expressing hope

Continued

commenters disagreed with our approach as being underinclusive and urged us to define U.S. person more broadly than the CFTC had interpreted it.[194] Two commenters addressed whether our ''U.S. person'' definition should follow the U.S. person analysis in Regulation S.[195]

(b) Treatment of Investment Vehicles

In response to our questions about whether our proposed definition of ''U.S. person'' provided sufficient guidance to investment vehicles and similar legal persons, commenters generally requested guidance but expressed a range of views as to what guidance we should provide. One commenter requested that we ensure that foreign investment vehicles with a ''U.S. nexus'' be considered U.S. persons.[196] This commenter expressed support for what it described as our ''complementary'' proposed approach that would have required legal persons, including investment vehicles, to perform a principal place of business assessment to determine whether they are U.S. persons, and would have subjected all transactions conducted within the United States to Title VII requirements.[197] One commenter conversely argued that a ''principal place of business'' test for investment vehicles would be inappropriate.[198]

Several commenters requested that we provide additional guidance regarding the application of the ''principal place of business'' test to investment vehicles. Some commenters specifically requested that we avoid diverging from the CFTC's interpretation of ''U.S. person'' in our own final definition.[199] One commenter urged us to help ensure that market participants are able to make rational and consistent determinations regarding the U.S.-person status of investment vehicles, and suggested that an appropriate test would look to the location of the person responsible for the fund's operational management, which the commenter identified as the person that establishes the investment vehicle and selects persons to carry out functions on behalf of the vehicle, as opposed to the person responsible for the fund's investment management activities.[200] Another commenter requested guidance regarding the application of the ''principal place of business'' test, while expressing support for using an approach similar to the CFTC Cross-Border Guidance.[201] One commenter requested that the location of an asset manager retained by a person not be the sole factor used to determine the person's principal place of business or U.S.-person status.[202]

A few commenters responded to our question whether the proposed definition should encompass funds that are majority-owned by U.S. persons, as the CFTC's interpretation does, with two commenters advocating against and three advocating in favor of such an approach.[203] One of the commenters that opposed such a test urged, however, that if we were to adopt such a test, the test be identical to the approach taken by the CFTC.[204]

One commenter suggested that we adopt the CFTC's approach by which collective investment vehicles that are offered publicly only to non-U.S. persons, and not offered to U.S. persons, would not generally be considered ''U.S. persons.'' [205] Another commenter urged that the definition exclude ''non-U.S. regulated funds'' that are offered publicly only to non-U.S. persons but are offered privately to U.S. persons in certain specific circumstances.[206]

(c) Treatment of Legal Persons More Generally

Two commenters urged us to include in the definition of ''U.S. person'' guaranteed subsidiaries and affiliates of U.S. persons.[207] Alternatively, these

that the Commission and the CFTC do not adopt different definitions of U.S. person); Investment Adviser Association (''IAA'') Letter at 3 (noting that, given the finalization of the CFTC Cross-Border Guidance, the Commission should modify its proposal in several respects to be more consistent with the CFTC's definition of ''U.S. person'').

[194] *See* AFR Letter I at 3, 5 (stating that the proposed definition of ''U.S. person'' is overly narrow because it does not include foreign subsidiaries of the seven largest U.S. bank holding companies); BM Letter at 5, 9, 14–15 (stating that the proposed definition of ''U.S. person'' is too narrow because it excludes guaranteed affiliates and other affiliates in a control relationship with a U.S. person; further suggesting that, should such guaranteed entities, whether they are implicitly or explicitly guaranteed, not be considered U.S. persons, they be separately ''ring-fenced'' from their U.S. affiliate in order to ensure that the U.S. affiliate does not cover any of the guaranteed affiliates obligations; further stating that such entities are within the scope of the Commission's broad authority under Exchange Act section 30(c) to regulate cross-border activity).

[195] *See* Citadel Letter at 3 (supporting our proposal to not rely on Regulation S as it would not capture certain foreign funds that the commenter believed should be considered U.S. persons); ICI Letter at 6 (recommending that our analysis be consistent with Regulation S because fund managers are accustomed to that definition). *Cf.* note 190, *supra* (describing elements of ''U.S. person'' definition contained in Regulation S).

[196] *See* Citadel Letter at 2–3 (noting further that such an approach will ensure that these entities will be subject to clearing, reporting, and other transaction-level requirements).

[197] *See id.*

[198] *See* ICI Letter at 4–5 (arguing that a ''principal place of business'' test is inappropriate for investment vehicles because they generally have no employees or offices of their own).

[199] *See* IAA Letter at 3 (urging the Commission to coordinate with the CFTC to develop a consistent definition of principal place of business); SIFMA/FIA/FSR Letter at A–8 (urging harmonization with the CFTC).

[200] *See* IIB Letter at 6. *But see* ICI Letter at 5 n.13 (requesting that the U.S.-person status of an investment vehicle not turn on the location of the vehicle's activities, employees, or the offices of its sponsor or adviser because such considerations are not relevant to whether risk is transferred to the United States).

[201] *See* Citadel Letter at 2. This commenter suggested looking to those senior personnel responsible for implementing the investment vehicle's investment and trading strategy as well as those responsible for ''investment selections, risk management decisions, portfolio management, or trade execution.'' *See id.*

[202] *See* IAA Letter at 4 (suggesting that the Commission follow the CFTC Cross-Border Guidance by specifically providing that non-U.S. persons are not U.S. persons simply by virtue of using a U.S.-person asset manager); SIFMA/FIA/FSA at A–8 (same).

[203] *Compare* ICI Letter at 7 (arguing that a majority-ownership test is not workable for non-U.S. regulated funds that are offered publicly abroad because it may be impossible or inconsistent with local law to identify or reveal investor information) and IAA Letter at 4 (explaining that a majority-ownership test would capture non-U.S. funds with minimal nexus to the United States and present implementation challenges) *with* AFR Letter I at 8 (recommending that the U.S.-person status of investment vehicles be based on majority ownership and/or actual locations of the person, regardless of the location of incorporation), and Greenberger Letter I at 6–7 (making a similar argument with respect to CFTC's interpretation of U.S. person), and BM Letter at 10 (recommending that the ''U.S. person'' definition include collective investment vehicles that are majority-owned by U.S. persons).

[204] *See* IAA Letter at 5.

[205] *See id.* at 3, 5 (noting that the CFTC Cross-Border Guidance has been finalized and urging the Commission to adopt the CFTC approach to permit market participants to operate ''under the certainty and clarity'' of consistent definitions of U.S. persons).

[206] *See* ICI Letter at 5–6 (noting that such investment vehicles have only minimal nexus to the United States and stating that institutional investors that invest in such funds would not expect U.S. law to apply to the vehicles' transactions).

[207] *See* AFR Letter I at 3, 5–7 (stating that proposed definition is too narrow and would allow U.S. entities to avoid regulation and engage in regulatory arbitrage); BM Letter at 9, 11–15 (requesting that the ''U.S. person'' definition be broadened to include any person that is ''indistinguishable'' from a U.S. person, such as by implicit or explicit guarantees from a U.S. person, including any affiliate controlling, controlled by, or under common control with a person that is headquartered, incorporated, or otherwise residing in the United States). These commenters further argued that the acknowledgement in the Cross-Border Proposing Release that guarantees of foreign entities by a U.S. person may subject the U.S. financial system to risk is inconsistent with a definition that does not include such entities in the ''U.S. person'' definition. *See id.* at 5–6; BM letter at 8, 12. *Cf.* AFR Letter II at 2 (urging CFTC to include guaranteed affiliates in of U.S. persons in the interpretation of U.S. person); Greenberger Letter II at 3, 16 (requesting that the CFTC classify foreign subsidiaries of U.S. financial institutions as U.S. persons); AFR letter to CFTC, dated August 13, 2012 (''AFR Letter III'') (stating that the CFTC's Final Exemptive Order Regarding Compliance with Certain Swap Regulation, 78 FR 858, will pose a risk to U.S. taxpayers due to the delay in applying

commenters suggested that we should require dealing transactions with such persons to be included in the dealing counterparty's security-based swap dealer *de minimis* calculation.[208] However, another commenter supported our proposed approach not to look to whether a person's transactions are guaranteed by a U.S. person for purposes of determining that person's U.S.-person status, stating that our proposal to address such risk through major security-based swap participant registration was sufficient.[209]

One commenter suggested that the Commission follow the CFTC in including in its final ''U.S. person'' definition legal persons that are directly or indirectly majority-owned by one or more U.S. persons who bear unlimited responsibility for the obligations of that legal person, stating that such a provision is necessary to prevent evasion of Title VII.[210]

One commenter expressed support for a principal place of business component to the ''U.S. person'' definition as set forth in our proposal.[211] Several commenters requested that the Commission provide additional guidance regarding relevant factors in identifying a legal person's principal place of business.[212] One commenter suggested that the location of a company's headquarters should be determinative and that a particular legal person should have only one principal place of business.[213]

Several commenters suggested that the Commission harmonize its approach to determining a person's principal place of business to the approach in the CFTC Cross-Border Guidance,[214] while at least one commenter suggested that the Commission work with the CFTC to develop a new, common definition.[215] At least two commenters, on the other hand, objected to the use of a ''principal place of business'' test.[216] One commenter suggested an alternative approach that would establish criteria for this determination, such as quantitative thresholds, and would also consider not requiring a principal place of business analysis if the jurisdiction of incorporation has an acceptable regulatory framework.[217] Another commenter stated that a U.S. branch of a person established in another jurisdiction should not be considered to have its principal place of business in the United States.[218] Another suggested that requiring a principal place of business analysis represented a departure from the Commission's stated territorial approach to U.S. person.[219]

Several commenters recommended that, if the Commission were to adopt a ''principal place'' of business test in its ''U.S. person'' definition, market participants be allowed to rely on a counterparty's representations as to the counterparty's principal place of business.[220] Another suggested that the test look to information found in the public filings of a public company or, with respect to a private company, the location of its business.[221]

(d) Accounts

One commenter supported the Commission's proposal for determining the U.S.-person status of an account, which would look to whether the owner of the account itself is a U.S. person,[222] but suggested that the Commission provide bright-line thresholds to clarify that *de minimis* ownership by U.S. persons would not cause the account to be considered a U.S. person.[223] The commenter further requested that the Commission clarify that the ''account'' prong of the ''U.S. person'' definition would not apply to collective investment vehicles but was intended to capture persons that should be considered U.S. persons even though they are conducting trades, as the direct counterparty, through an account.[224]

(e) International Organizations

A number of commenters expressed support for the Commission's proposal to exclude certain international organizations (*e.g.,* multilateral development banks, or ''MDBs'') from the ''U.S. person'' definition.[225] Three

requirements to foreign affiliates of U.S. banks) (incorporated by reference in AFR Letter I); Michael Greenberger letter to CFTC, dated August 13, 2012 (''Greenberger Letter III'') (incorporated by reference in AFR Letter I).

[208] *See* AFR Letter I at 7; BM Letter at 17 (stating that the exclusion from the *de minimis* calculation for guaranteed transactions is ''indefensible'' and ''must be eliminated''). *See also* Chris Barnard Letter at 2 (stating that Title VII should apply to transactions involving a guarantee by a U.S. person).

[209] *See* SIFMA/FIA/FSR Letter at A–11 to A–12 (stating that to treat the existence of a U.S. parent as relevant to determining whether a person is a U.S. person would disregard the legal independence of affiliates and imply that persons within the same corporate group necessarily coordinate their security-based swap activities).

[210] *See* BM Letter at 10. *Cf.* CFTC Cross-Border Guidance, 78 FR 45312.

[211] *See* Citadel Letter at 2 (stating that Commission was correct to incorporate a principal place of business determination into the ''U.S. person'' definition).

[212] *See* IIB Letter at 5 (noting the difficulty of implementing the ''principal place of business'' test without further guidance and requesting the Commission to provide workable criteria); ABA Letter at 2–3 (requesting clarification of ''principal place of business'' test and recommending that the Commission confirm that an entity may rely on its counterparty's written representations regarding the counterparty's principal place of business).

[213] *See* IIB Letter at 5–6. Another commenter suggested that the location of the personnel directing the security-based swap activity of the legal person be determinative. *See* Citadel Letter at 2.

[214] *See* JFMC Letter at 4 (notwithstanding burdensome aspects of the CFTC's interpretation, and the difficulties of the ''principal place of business'' test in particular, urging the Commission to adopt the same definition as the CFTC); SIFMA/FIA/FSR Letter at A–8 (explaining the difficulty in having to determine a counterparty's principal place of business under two different standards); Citadel Letter at 2 (requesting that the Commission provide further guidance ''to parallel the CFTC's guidance'' on principal place of business).

[215] *See* IAA Letter at 3 (urging that, if the Commission adopts a ''principal place of business'' test, it coordinate with the CFTC to develop a consistent and harmonized definition).

[216] *See* ESMA Letter at 2 (arguing that the ''U.S. person'' definition should be limited to entities that are established within the United States and should not in any case extend to an entity, such as a U.S. branch of a foreign bank, whose presence in the United States is ''complementary'' to its principal activity outside the United States and which is already regulated by a non-U.S. jurisdiction); JSDA Letter at 3 (recommending that the Commission and the CFTC eliminate the principal place of business concept from their respective criteria for identifying U.S. persons). *See also* EC Letter at 2 (supporting the territorial approach of the ''U.S. person'' definition, but suggesting that the ''principal place of business'' test is not territorial and suffers from ambiguity);

[217] *See* EC Letter at 2. *See also* ESMA Letter at 2 (requesting that the Commission provide clarity with respect to its proposed ''U.S. person'' definition, particularly the ''principal place of business'' test).

[218] *See* ESMA Letter at 2 (noting that to include such persons would place potentially duplicative and conflicting requirements on the person in the case of European persons that would also be subject to the European Market Infrastructure Regulation).

[219] *See* EC Letter at 2.

[220] *See* ABA Letter at 2–3 (stating that entities should be able to rely on their counterparty's written representations ''absent evidence to the contrary,'' regarding their principal place of business); JSDA Letter at 3 (recommending that, if the Commissions determine to keep a ''principal place of business'' test, they permit entities to rely on counterparty representations); IIB Letter at 5 n.9 (recommending that a counterparty representation as to U.S.-person status be sufficient to fulfill a person's diligence requirements). One of these commenters specifically requested that the reasonable reliance standard be limited to representations regarding principal place of business. *See* ABA letter at 3 n.2.

[221] *See* IIB Letter at 6.

[222] *See* SIFMA/FIA/FSR Letter at A–8.

[223] *See id.* at A–9. *See also* IAA Letter at 4–5 (requesting that, should the Commission adopt an ownership test, it adopt a test consistent with and no more restrictive than the CFTC test for collective investment vehicles).

[224] *See* SIFMA/FIA/FSR Letter at A–8 to A–9. Another commenter expressed disagreement with the Commission's proposed treatment of accounts in the ''U.S. person'' definition, expressing concern that inclusion of accounts in the definition may affect the U.S.-person status of funds. *See* IAA Letter at 4 (explaining that an ownership test applying to accounts would potentially capture non-U.S. funds that may have U.S. investors but whose ''purposeful activities'' such as ''marketing or offering'' are not aimed at U.S. persons, meaning the fund would have ''little nexus to the U.S.'').

[225] *See* SIFMA/FIA/FSR Letter at A–10 (supporting an exclusion for all Foreign Public

Continued

commenters specifically requested that the Commission list all such institutions that would be excluded from the ''U.S. person'' definition, similar to the approach the CFTC took in its guidance,[226] rather than refer to ''other similar international organizations.'' [227] These commenters also argued that certain organizations have absolute immunity under federal law and should be excluded from regulation under Title VII entirely.[228] Three commenters requested that affiliates of MDBs and similar organizations also be excluded from the definition of ''U.S. person.'' [229]

(f) Status Representations

Some commenters requested that a potential dealer expressly be permitted to rely on a counterparty representation to fulfill its diligence requirements in determining whether its counterparty is a U.S. person under the final rule.[230] Several commenters, as discussed above, specifically requested that we permit reliance on representations as to a person's principal place of business.[231] Two commenters requested that market participants be permitted to rely on the representations prepared by counterparties under the CFTC Cross-Border Guidance.[232]

3. Final Rule

Consistent with the proposal, we are adopting a final definition of ''U.S. person'' that continues to reflect a territorial approach to the application of Title VII and is in most respects unchanged from the proposal.[233] In response to comments, the final definition reflects certain changes intended to clarify the scope of the definition. Also in response to comments, we are adopting a general definition of ''principal place of business'' and a specific application of the term to externally managed investment vehicles. We are also adding a prong relating specifically to the U.S.-person status of estates.

The final rule defines ''U.S. person'' to mean:

- Any natural person resident in the United States;
- Any 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;
- Any account (whether discretionary or non-discretionary) of a U.S. person; or
- Any estate of a decedent who was a resident of the United States at the time of death.[234]

The final rule defines ''principal place of business'' to mean ''the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person.'' [235] It also provides that, 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.'' [236]

Also consistent with the proposal, the final definition excludes the following international organizations from the definition of ''U.S. person'': The 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.[237]

To address commenters' requests,[238] the final rule also has been revised from the proposal to provide that a person may rely on a counterparty's representation regarding its status as a U.S. person, unless such person knows,

Sector Financial Institutions (including MDBs) (''FPSFIs'') and their affiliates from the ''U.S. person'' definition); JFMC Letter at 4 (supporting an exclusion from ''U.S. person'' definition for FPSFIs and their affiliates); JSDA letter at 3 (supporting the Commission's proposed exclusion from the ''U.S. person'' definition for certain ''international organizations'' and expressing support for an exclusion for FPSFIs); International Bank for Reconstruction and Development, International Finance Corporation et al. Letter (''WB/IFC Letter'') at 1, 6 (supporting an exclusion for multilateral development institutions and their affiliates from the ''U.S. person'' definition, and noting that such affiliates are excluded under Regulation S as well); IDB Letter at 1 (requesting that MDBs and their affiliates not be considered U.S. persons).

[226] *See* Sullivan and Cromwell (''SC'') Letter at 18 and n.20; WB/IFC Letter at 4–5 (suggesting that to avoid confusion, the Commission expressly include other MDBs that maintain headquarters in Washington, DC and identify those organizations which include IFC, the International Development Association, the Multilateral Investment Guarantee Agency, and the Inter-American Investment Corporation); IIB Letter at 5 (supporting an exclusion from U.S.-person status for ''international organizations'' similar to those already enumerated in the Cross-Border Proposing Release, and stating that such an exclusion would be consistent with the CFTC Cross-Border Guidance and ''well-established'' principles of international law); Inter-American Development Bank (''IDB'') Letter at 2 (stating that it shares the position of the International Finance Corporation and the International Bank for Reconstruction and Development that the Commission's approach to MDB's should be consistent with the CFTC). *See also* Intermediary Definitions Adopting Release, 77 FR 30692 n.1180 (listing international financial institutions for purposes of CFTC requirements); CFTC Cross-Border Guidance, 78 FR 45353 n.531 (incorporating list provided in Intermediary Definitions Adopting Release by reference).

[227] Proposed Exchange Act rule 3a71–3(a)(7)(ii).

[228] *See* SC Letter at 3–4, 7–9, 12–14; WB/IFC letter at 2. *See also* IDB Letter at 1 (requesting confirmation that MDBs will not be subject to Commission's requirements with respect to security-based swaps and indicating that such an approach would respect its privileges and immunities).

[229] *See* SC Letter at 19–22 (requesting that, in response to footnote 301 of the Cross-Border Proposing Release, ''controlled affiliates'' of MDBs not be treated as U.S. persons); IDB Letter at 1 (requesting that affiliates of international organizations not be treated as U.S. persons); WB/IFC Letter at 1, 6 (supporting an exclusion for multilateral development institutions and their affiliates from the ''U.S. person'' definition, and noting that such affiliates are excluded under Regulation S as well). One commenter suggested that this exclusion be made available for a ''controlled affiliate,'' defined as follows: (1) an entity subject to the MDB's governance structure; (2) all of whose activities must be consistent with and in furtherance of the MDB's purpose and mission; (3) whose governing instruments restrict it to engaging in activities in which the MDB could itself engage and provide that it is not authorized to engage in any other activities; and (4) which is under the ''control'' of the MDB as that term is used in securities laws (Securities Act Rule 405). *See also* note 225, *supra*.

[230] *See* IIB Letter at 5 n.9. This commenter suggested that we should permit reliance on a representation ''absent knowledge of facts that would cause a reasonable person to question the accuracy of the representation.'' *See also* JSDA Letter at 3.

[231] *See* note 220, *supra*.

[232] *See* SIFMA/FIA/FSR Letter at A–8 (noting that performing a separate analysis would be burdensome); IIB Letter at 5, note 9 (noting that the CFTC's interpretation of ''U.S. person'' is broader than, and encompasses the three elements of, the Commission's proposed ''U.S. person'' definition).

[233] *Cf.* note 192, *supra* (citing comment letters expressing general agreement with our territorial approach to defining U.S. person).

[234] Exchange Act rule 3a71–3(a)(4)(i). The second prong has been modified from the proposal to include an express reference to ''investment vehicle'' and to clarify that any legal person ''established'' under United States law is a U.S. person, as discussed further below. *See* Exchange Act rule 3a71–3(a)(4)(i)(B). The fourth prong has been added to include an express reference to ''estate.'' *See* Exchange Act rule 3a71–3(a)(4)(i)(D). In the text of the final rule we have made a technical change to the proposal to clarify that the ''U.S. person'' definition is met if any one of the applicable prongs is satisfied (in part by replacing ''and'' with ''or'' in connection with the enumeration of the prongs). *See* Exchange Act rule 3a71–3(a)(4)(i).

Consistent with the proposal, ''special entities,'' as defined in section 15F(h)(2)(C) of the Exchange Act, are 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: A Federal agency; a State, State agency, city, county, municipality, or other political subdivision of a State; any employee benefit plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002; any governmental plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974, 29 U.S.C. 1002; or 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).

[235] Exchange Act rule 3a71–3(a)(4)(ii).

[236] *Id.*

[237] Exchange Act rule 3a71–3(a)(4)(iii).

[238] *See* notes 220, 230, *supra*.

or has reason to know, that the representation is inaccurate.[239]

Although one commenter requested that we use a definition of ''U.S. person'' that is consistent with Regulation S, we are declining to do so for the reasons described in our Cross-Border Proposing Release.[240] We acknowledge that many market participants are accustomed to Regulation S and may find such a definition relatively easy to implement. As we discussed in our proposal, however, Regulation S addresses different concerns from those addressed by Title VII.[241] In light of these differences, the Commission believes that adopting the definition of ''U.S. person'' in Regulation S would not achieve the goals of Title VII and that a definition of U.S. person specifically tailored to the regulatory objectives it is meant to serve, as we are adopting here, is appropriate.

(a) Natural Persons

As in our proposed definition, the final definition of ''U.S. person'' provides that any natural person resident in the United States[242] is a U.S. person. This definition encompasses persons resident within the United States regardless of the individual's citizenship status,[243] but it does not encompass individuals who are resident abroad, even if they possess U.S. citizenship.[244]

As we noted in the proposal, it is consistent with the approach we have taken in prior rulemakings relating to the cross-border application of certain similar regulatory requirements to subject natural persons residing within the United States to our regulatory framework.[245] Moreover, we believe that natural persons residing within the United States who engage in security-based swap transactions are likely to raise the types of concerns intended to be addressed by Title VII, including those related to risk, transparency, and counterparty protection.[246] We believe that it is reasonable to infer that a significant portion of such persons' financial and legal relationships are likely to exist within the United States and that it is therefore reasonable to conclude that risks arising from the security-based swap activities of such persons could manifest themselves within the United States, regardless of the location of their counterparties.

(b) Corporations, Organizations, Trusts, Investment Vehicles, and Other Legal Persons

The final definition of ''U.S. person'' as applied to legal persons has been modified to clarify certain aspects of the rule. Also, in response to comments, we are adopting a definition of ''principal place of business.'' In general, the scope of the definition as applied to legal persons does not differ materially from the scope of our proposal.[247]

i. Entities Incorporated, Organized, or Established Under U.S. Law

As with the proposed rule, the final definition provides that 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 would be a U.S. person.[248] The final definition also includes two changes that are intended to make explicit certain concepts that were implicit in the proposed definition. First, the final rule provides that a legal person ''established'' under the laws of the United States is a U.S. person, just as if it had been ''organized'' or ''incorporated'' under the laws of the United States. This change is intended to clarify the Commission's intention that any person formed in any manner under the laws of the United States will be a U.S. person for purposes of Title VII.

Second, the final rule adds an express reference to ''investment vehicle'' in the non-exclusive list of legal persons to clarify that any such person, however formed, will be treated as a U.S. person for purposes of Title VII if it is organized, incorporated, or established under the laws of the United States or has its principal place of business in the United States.[249] Investment vehicles are commonly established as partnerships, trusts, or limited liability entities and, therefore, fall within the scope of the rule as proposed. However, given the significant role that such vehicles have played and likely will continue to play in the security-based swap market, we believe that the final rule should incorporate an express reference to such vehicles to avoid any ambiguity regarding whether the definition of ''U.S. person,'' including the principal place of business component of that definition, applies to them.

As noted in our proposal, we have previously looked to where a legal person is organized, incorporated, or established to determine whether it is a U.S. person.[250] We continue to believe that place of organization, incorporation, or establishment is relevant in the context of Title VII. In our view, the decision of a corporation, trustee, or other person to organize under the laws of the United States indicates a degree of involvement in the U.S. economy or legal system that warrants subjecting it to security-based swap dealer or major security-based swap participant registration requirements under Title VII if its security-based swap dealing activity or its security-based swap positions exceed the relevant thresholds.[251] We believe that it is reasonable to infer that an entity incorporated, organized, or established under the laws of the United States is likely to have a significant portion of its financial and legal relationships in the United States and that it is therefore reasonable to conclude that the risks arising from its security-based swap activities are likely to manifest themselves in the United States, regardless of the location of its counterparties. Accordingly, the final

[239] Exchange Act rule 3a71–3(a)(4)(iv).

[240] *See* note 195, *supra.*

[241] *See* 17 CFR 230.901(k); Regulation S Adopting Release, 55 FR 18306. *See also* Cross-Border Proposing Release, 78 FR 31007 (describing differences between policy concerns underlying Regulation S and Title VII). For example, 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. *See id.*

[242] Exchange Act rule 3a71–3(a)(5) defines ''United States'' to mean ''the United States of America, its territories and possessions, any State of the United States, and the District of Columbia.''

[243] Exchange Act rule 3a71–3(a)(4)(i)(A).

[244] This approach to treating natural persons as U.S. persons solely based on residence, rather than citizenship, differs from the approach to legal persons, such as partnerships and corporations, discussed below.

Notwithstanding slight differences between the language of our final rule and the CFTC Cross-Border Guidance, we expect that a natural person's U.S.-person status under our final definition would be the same as under the CFTC Cross-Border Guidance. *Cf.* note 193, *supra* (citing commenters urging the Commission to harmonize its definition of ''U.S. person'' with the interpretation set forth by the CFTC).

[245] *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).

[246] *See* Cross-Border Proposing Release, 78 FR 30996.

[247] Moreover, we expect that a legal person's U.S.-person status under the Commission's final definition of ''U.S. person'' and under the definition ''principal place of business'' would as a general matter be the same as under similar prongs on the CFTC Cross-Border Guidance.

[248] *See* Exchange Act rule 3a71–3(a)(4)(i)(B).

[249] *Cf.* Cross-Border Proposing Release, 78 FR 30997 n.296 (using funds and special-purpose investment vehicles as examples of other legal persons that may be U.S. persons).

[250] *See* Regulation S Adopting Release, 55 FR 18316.

[251] *Cf.* EC Letter at 2 (expressing support for this approach); ESMA letter at 1 (same).

rule retains this element of the definition.

As under the proposal, the final definition determines a legal person's status at the entity level and thus applies to the entire legal person, including any foreign operations that are part of the U.S. legal person. Consistent with this approach, a foreign branch, agency, or office of a U.S. person is treated as part of a U.S. person, as it lacks the legal independence to be considered a non-U.S. person for purposes of Title VII even if its head office is physically located within the United States. We continue to believe that there is no basis to treat security-based swap transactions or positions of a foreign branch, agency, or office of a U.S. person differently from similar transactions or positions of the home office for purposes of the dealer *de minimis* or major security-based swap participant threshold calculations, given that the legal obligations and economic risks associated with such transactions or positions directly affect the entire U.S. person.

Under the final definition, the status of a legal person as a U.S. person has no bearing on whether separately incorporated or organized legal persons in its affiliated corporate group are U.S. persons. Accordingly, a foreign subsidiary of a U.S. person is not a U.S. person merely by virtue of its relationship with its U.S. parent. Similarly, a foreign person with a U.S. subsidiary is not a U.S. person simply by virtue of its relationship with its U.S. subsidiary. Although two commenters urged that most foreign affiliates of U.S. persons be treated as U.S. persons themselves,[252] we continue to believe that it is appropriate for each affiliate to determine its U.S.-person status independently, given the distinct legal status of each of the affiliates, and that such status should turn on each affiliate's place of incorporation, organization, or establishment, or on its principal place of business.[253] We recognize that certain foreign persons, including foreign persons whose security-based swap activity is subject to a recourse guarantee against a U.S. person, may create risk to persons within the United States such as counterparties or guarantors.[254] We continue to believe, however, that, to the extent that such persons are established under the laws of a foreign jurisdiction and have their principal place of business abroad, they should not be included in the definition of ''U.S. person.'' [255] As discussed in further detail below, we believe that our final rules regarding application of the dealer *de minimis* exception and the major security-based swap participant thresholds adequately address concerns about the treatment of these persons under the dealer and major participant definitions without categorizing them as U.S. persons.[256]

ii. Entities Having Their Principal Place of Business in the United States

a. In General

Consistent with our proposal, we are defining ''U.S. person'' to include persons that are organized, incorporated, or established abroad, but have their principal place of business in the United States. For purposes of this final rule, and in response to commenters' request for further guidance,[257] we are defining ''principal place of business'' generally to mean ''the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person.'' [258] As

[252] *See* note 194, *supra* (citing AFR and BM Letters). One of these commenters argued that the final definition of ''U.S. person'' should include guaranteed foreign affiliates of U.S. persons, whether the guarantee is explicit or implicit, and that affiliates should be presumed to be receiving guarantees. *See* AFR Letter I at 3, 5–7. The other urged that the final definition of ''U.S. person'' include guaranteed foreign affiliates and ''*de facto* guaranteed'' affiliates of U.S. persons that may not be explicitly guaranteed. *See* BM Letter at 9, 11–15.

[253] *But see* section IV.F, *infra* (discussing the aggregation of affiliate positions for purposes of the *de minimis* calculation).

[254] *See* note 207 (citing AFR and BM Letters).

[255] As we noted above, our ''U.S. person'' definition is intended to identify those persons whose financial and legal relationships are likely to be located in significant part within the United States. The mere fact of an affiliate relationship with, or a guarantee from, a U.S. person does not appear to us to indicate that such person has such relationships within the United States. Similarly, the mere fact that a person's security-based swap activity poses some degree of risk to the United States does not necessarily indicate that the person has the types of financial and legal relationships within the United States that warrant treating it as a U.S. person. However, we recognize that non-U.S. persons may in fact pose risk to the United States, particularly when their security-based swap transactions are subject to a recourse guarantee against a U.S.-person affiliate, and, even though we do not include them in our ''U.S. person'' definition, we do address such risk through our final rules applying the security-based swap dealer *de minimis* exception and the major security-based swap participant thresholds.

One commenter also urged us to follow the CFTC in including within the final definition any legal person that is directly or indirectly majority-owned by one or more U.S. persons that bear unlimited responsibility for the obligations and liabilities of such legal person. *See* note 210, *supra* (citing BM Letter). *Cf.* CFTC Cross-Border Guidance, 78 FR 45312, 45317. Although we recognize that such persons give rise to risk to the U.S. financial system, as with non-U.S. persons whose security-based swap transactions are subject to explicit financial support arrangements from U.S. persons, we do not believe that it is appropriate in the context of security-based swap markets to treat such persons as U.S. persons given that they are incorporated under foreign law, unless their principal place of business is in the United States. *See* Exchange Act rule 3a71–3(a)(4)(i)(B). Moreover, to the extent that a non-U.S. person's counterparty has recourse to a U.S. person for the performance of the non-U.S. person's obligations under a security-based swap by virtue of the U.S. person's unlimited responsibility for the non-U.S. person, the non-U.S. person would be required to include the security-based swap in its own dealer *de minimis* calculations (if the transaction arises out of the non-U.S. person's dealing activity) and its major participant threshold calculations. *See* sections IV.E.1 and V.D.3, *infra.* For example, if a counterparty to a transaction is a general partnership that is not a U.S. person but has a U.S.-person general partner that has unlimited responsibility for the general partnership's liabilities, including for its obligations to security-based swap counterparties, we would view the general partner's obligations with respect to the security-based swaps of the partnership as recourse guarantees for purposes of this final rule, absent countervailing factors.

[256] *See* section IV.E.1 (describing application of *de minimis* exception to transactions of non-U.S. persons that are subject to a recourse guarantee against a U.S. person) and section V.D.3 (describing application of major security-based swap participant threshold calculations to positions of non-U.S. persons that are subject to a recourse guarantee against a U.S. person), *infra.* As discussed above, we will address the application of other Title VII requirements to these persons in subsequent releases.

[257] In the proposing release, we did not provide guidance regarding the meaning of ''principal place of business,'' but we requested comment whether such guidance was desirable, including whether it would be appropriate to adopt a definition similar to that adopted in rules under the Investment Advisers Act. *See* Cross-Border Proposing Release, 78 FR 30999 n.306 (noting that the focus of one possible definition would be similar to that of the definition used in rules promulgated under the Investment Advisers Act, which define principal place of business 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'') (citing 17 CFR 275.222–1(b)). As noted above, several commenters requested that we provide guidance regarding the concept, and some provided suggested interpretations of the phrase with respect to operating companies and investment vehicles. *See, e.g.,* note 213, *supra* (citing IIB Letter). *See also* SIFMA/FIA/FSR letter at A–8; Citadel Letter at 2. Several of these commenters urged us to minimize divergence from the approach taken subsequent to our proposal by the CFTC in its July 2013 guidance (or from likely outcomes under that approach). *See* note 214, *supra* (citing letters from JFMC, SIFMA/FIA/FSR, Citadel, and IAA). Another commenter urged us to work closely with the CFTC in developing guidance regarding the meaning of principal place of business. *See* note 215, *supra* (citing IAA Letter).

[258] Exchange Act rule 3a71–3(a)(4)(ii). *Cf.* 17 CFR 275.222–1(b) (defining principal place of business for investment advisers under the Investment Advisers Act to mean ''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'').

Because the definition of ''principal place of business'' in this final rule is tailored to the unique characteristics of the security-based swap market, it does not limit, alter, or address any guidance regarding the meaning of the phrase ''principal place of business'' that may appear in other provisions of the federal securities laws, including the Investment Advisers Act, Commission rules, regulations, interpretations, or guidance.

with the ''U.S. person'' definition more generally, our definition of ''principal place of business'' is intended to identify the location where a significant portion of the person's financial and legal relationships would be likely to exist, and we think it is reasonable to assume, for purposes of this final rule, that this location also generally corresponds to the location from which the activities of the person are primarily directed, controlled, and coordinated. In our view, to the extent that this location is within the United States, it is reasonable to conclude that the risks arising from that entity's security-based swap activity could manifest themselves within the United States, regardless of location of its counterparties.

This definition is intended to help market participants make rational and consistent determinations regarding whether their (or their counterparty's) principal place of business is in the United States.[259] Under the final rule, the principal place of business is in the United States if the location from which the overall business activities of the entity are primarily directed, controlled, and coordinated is within the United States. With the exception of externally managed entities, as discussed further below, we expect that for most entities the location of these officers, partners, or managers generally would correspond to the location of the person's headquarters or main office.[260]

Although we recognize that several commenters objected to including a ''principal place of business'' test in our definition of ''U.S. person,''[261] we believe that a definition that focused solely on whether a legal person is organized, incorporated, or established in the United States could encourage some entities to move their place of incorporation to a non-U.S. jurisdiction to avoid complying with Title VII, while maintaining their principal place of business—and thus, reasonably likely, risks arising from their security-based swap transactions—in the United States.[262] Moreover, we believe that a definition of ''U.S. person'' that did not incorporate a ''principal place of business'' element potentially would result in certain entities falling outside the Title VII regulatory framework, even though the nature of their legal and financial relationships in the United States is, as a general matter, indistinguishable from that of entities incorporated, organized, or established in the United States.[263] Given that such entities raise the types of concerns that Title VII was intended to address, we believe it is both appropriate under our territorial approach and consistent with the purposes of Title VII to treat such entities as U.S. persons for purposes of the final rule.

We also have considered the suggestion by one commenter that ''principal place of business'' be defined to incorporate certain quantitative thresholds and an exception for firms whose jurisdiction of incorporation has an acceptable regulatory framework in place.[264] However, we do not believe such thresholds are necessary. Because the analysis is applied on an entity-wide basis, consistent with our entity-based approach generally, the ''principal place of business'' analysis generally will not encompass companies incorporated, organized, or established outside the United States merely because they have an office or branch within the United States. Similarly, we do not believe that the determination whether a legal person's jurisdiction of incorporation, organization, or establishment has an acceptable regulatory framework is relevant to the question whether a specific person has its principal place of business in the United States any more than it would be relevant for a person incorporated within the United States but subject to regulation abroad. The question whether such a company should be permitted to fulfill relevant Title VII requirements by complying with the law of the jurisdiction in which it is incorporated, organized, or established is a separate issue that may

[259] *Cf.* IIB Letter at 6 (urging an approach that ''enable[s] market participants to reach rational, consistent U.S. person determinations for funds''). We also believe that our definition of ''principal place of business'' should reduce the potential that a particular entity would have a different U.S.-person status by virtue of the ''principal place of business'' prong under our definition and under the CFTC Cross-Border Guidance.

As discussed in further detail below, we also are including in our definition of ''U.S. person'' a provision permitting persons to rely on representations from a counterparty regarding whether the counterparty's principal place of business is in the United States, unless these persons know or have reason to know that the representation is false. *See* section IV.C.4, *infra. Cf.* note 220, *supra* (citing letters requesting that the Commission's final rule permit reliance on representations regarding principal place of business). This provision should further facilitate consistent application of the ''U.S. person'' to specific entities across market participants. We are not, however, specifically providing that entities may rely solely on representations prepared by counterparties under the CFTC Cross-Border Guidance, *see* note 232, *supra,* given that the CFTC has articulated a facts-and-circumstances approach to the principal place of business determination that is susceptible to significant further development and interpretation. However, depending on how market participants have applied the CFTC's facts-and-circumstances analysis, they may be able to rely on such representations. Because we are permitting persons to rely on counterparty representations, we do not think it necessary to provide guidance regarding specific factors a person may consider in determining its counterparty's principal place of business, as some commenters requested. *Cf.* note 221, *supra* (citing IIB Letter).

[260] *Cf.* note 213, *supra* (citing IIB letter suggesting that an entity's principal place of business should be the location of its headquarters). Our definition of ''principal place of business'' is in this respect similar to the guidance issued by the CFTC regarding the application of ''principal place of business'' to operating companies. *See* CFTC Cross-Border Guidance, 78 FR 45309. We expect that outcomes of our final definition of ''principal place of business'' for such entities would generally be similar to those produced under the CFTC Cross-Border Guidance.

[261] *See* note 216, *supra.*

[262] For this reason, although we believe that the definition of ''principal place of business'' set forth in the final rule is consistent with our territorial approach to application of Title VII, we also believe that it is necessary or appropriate to prevent the evasion of Title VII. *See* Exchange Act section 30(c). The final definition of ''principal place of business'' will help ensure that entities do not restructure their business by incorporating under foreign law while continuing to direct, control, and coordinate the operations of the entity from within the United States, which would enable them to maintain a significant portion of their financial and legal relationships within the United States while avoiding application of Title VII requirements to such transactions.

[263] In addition, some foreign regulators expressed concerns about our proposed inclusion of a ''principal place of business'' element in the ''U.S. person'' definition, *see* notes 216–217, *supra,* and one foreign regulator encouraged us to focus our final ''U.S. person'' definition on where a legal person is established. *See* note 216, *supra.* We note that under the European Market Infrastructure Regulation, a foreign fund is treated identically to a European financial counterparty if it is managed by a European investment manager. *See* Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, CCPs, and trade repositories, Article 2(8) (defining ''financial counterparty'' to include ''an alternative investment fund managed by [alternative investment fund managers] authorised or registered in accordance with Directive 2011/61/EU''). This appears to reflect a recognition that where legal person is established should not be treated as the sole relevant factor in determining whether legal person should be subject to such jurisdiction's rules.

We also note that limiting our definition of ''U.S. person'' to entities incorporated, established, or organized in the United States as some commenters requested would not eliminate the potential that entities would be simultaneously classified as U.S. persons and as local persons under foreign law. Even under such a definition, some persons could be classified both as U.S. persons for purposes of Title VII and as persons established in foreign jurisdictions under a foreign regulatory regime. *Cf.* EC Letter. Although we are adopting a definition of ''U.S. person'' that should mitigate this likelihood, we recognize that such entities may be subject to overlapping regulation, and we intend to address the availability of substituted compliance with respect to specific substantive requirements in subsequent releases, which should mitigate the concerns expressed by these commenters. *Cf.* note 218, *supra* (citing ESMA Letter noting possibility of duplicative and conflicting regulation of certain persons as a result of the Commission's inclusion of a principal place of business element in the ''U.S. person'' definition).

[264] *See* note 217, supra (citing EC Letter); note 216, *supra* (citing ESMA Letter urging the Commission not to include U.S. branches of foreign banks in its ''U.S. person'' definition under a ''principal place of business'' test).

be addressed in a separate substituted compliance determination.[265]

Finally, we recognize that one commenter suggested that a ''principal place of business'' test should look to the location of personnel directing the security-based swap activity of the entity,[266] but we are not convinced that the location of such personnel, without more, would necessarily correspond to the location of a significant portion of the entity's financial and legal relationships, which is the focus of our ''U.S. person'' definition. We also note that a focus on the location of personnel directing the entity's security-based swap activity would provide an incentive for market participants to move such personnel outside the United States while maintaining their executive offices, and the bulk of their operations, within the United States. Such restructuring would allow an entity to avoid application of Title VII to its security-based swap activities while continuing to maintain a significant portion of its financial and legal relationships within the United States, leaving unchanged the likelihood that risks arising from its security-based swap activity could manifest themselves within the United States while avoiding application of Title VII to such activities.[267]

b. Externally Managed Investment Vehicles

Application of the ''principal place of business'' test to externally managed investment vehicles presents certain challenges not present when determining the principal place of business of an operating company or other internally managed legal person. For example, an operating company generally will carry out key functions (including directing, controlling, and coordinating its business activities) on its own behalf and generally will have offices through which these functions are performed. Responsibility for key functions of an externally managed investment vehicle, on the other hand, generally will be allocated to one or more separate persons (such as external managers, or other agents), with few or no functions carried out through an office of the vehicle itself.[268] Further complicating the application of this definition is the organizational and operational diversity of such vehicles.

Notwithstanding these challenges, we also recognize that externally managed investment vehicle are active participants in the security-based swap market[269] and, in our view, should be treated as U.S. persons if their operations are primarily directed, controlled, and coordinated from a location within the United States. For example, we understand that a significant portion of the investment vehicles that participate in the security-based swap market are private funds such as hedge funds. We have observed that such private funds commonly may be organized under non-U.S. law—frequently in the Cayman Islands—but are managed by investment advisers headquartered in the United States.[270] We also understand that those advisers commonly manage or direct the investment activities of these vehicles, including the arrangement of security-based swaps, through locations within the United States. We further understand that a significant portion of the financial and legal relationships of such vehicles, as a general matter, are in the United States, including some combination of equity ownership by managers (or their affiliates) and outside investors, credit relationships with prime brokers and other lenders, and relationships with other market participants and service providers. These vehicles, therefore, raise concerns that are similar to those raised by the security-based swap activities of market participants that are incorporated, established, or organized in the United States. Over the past two decades, failures of investment vehicles of various types organized under foreign law, but directed, controlled, or coordinated from within the United States have had significant negative impact on U.S. financial institutions, potentially threatening the stability of the U.S. financial system more generally.[271] We believe that it is reasonable to expect that the security-based swap activities of such vehicles may pose similar risks.[272]

To address the unique characteristics of externally managed investment vehicles, we are including in our definition of ''principal place of business'' language specifying that an externally managed investment vehicle's principal place of business is ''the office from which the manager[273] of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.'' This definition directs market participants to consider where the activities of an externally managed investment vehicle generally are directed, controlled, and coordinated, even if this conduct is performed by one or more legally separate persons.[274] For

[265] *Cf.* Cross-Border Proposing Release, 78 FR 31085–102 (setting forth proposed substituted compliance framework).

[266] *See* note 206, supra (citing Citadel Letter).

[267] As noted above, we believe that the definition of ''principal place of business'' set forth in the final rule is consistent with our territorial approach to application of Title VII. We also note, however, that for the reasons just discussed the final definition's focus on activity of the person as a whole, as opposed to a focus on the security-based swap activity of the person, is in our view necessary or appropriate to prevent the evasion of Title VII. *See* Exchange Act section 30(c).

[268] Such functions may not even be carried out in the jurisdiction in which the externally managed vehicle is incorporated, organized, or established. Indeed, many private investment funds are incorporated, organized, or established under the laws of a jurisdiction with which they have only a nominal connection.

[269] *See* Tables 1 and 2, *supra* (noting involvement of investment advisers and private funds in the security-based swap market).

[270] This observation is consistent with data reported to us by private fund managers. *See* Staff of the Division of Investment Management, U.S. Securities and Exchange Commission, Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports (July 25, 2013) at Appendix A (providing aggregated, non-proprietary data on percentages of reporting private funds organized under non-U.S. law and on locations of advisers to such funds).

[271] For example, Long Term Capital Management (''LTCM''), a Delaware partnership with its principal place of business in Connecticut, established a master fund, Long-Term Capital Portfolio, L.P. (''LTCP''), in the Cayman Islands. Mine Aysen Doyran, *Financial Crisis Management and the Pursuit of Power: American Pre-Eminience and the Credit Crunch* 83–84 (Ashgate 2011). LTCP attracted investments from both U.S. and foreign investors. *Id.* When it failed in 1998, fourteen domestic and foreign banks and securities firms (''the Consortium'') that were major creditors or counterparties of the fund agreed to recapitalize it. GAO, *Responses to Questions Concerning Long-Term Capital Management and Related Events* 1 n.2, (identifying these fourteen firms); *id.* at 8–9 (stating that ''[t]hese firms contributed about $3.6 billion into [LTCP]'') (available at: *http://www.gao.gov/archive/2000/gg00067r.pdf*). The Federal Reserve Board of New York played a key role in initiating discussion among the banks that ultimately formed the Consortium. *Id.* at 10.

Other, more recent, examples of risks of such entities established under foreign law manifesting themselves within the United States include the failure of two Bear Stearns hedge funds, which had significant repercussions within the United States, and the bailouts of bank-sponsored structured investment vehicles. *See, e.g.,* FCIC Report at 241, 289–90; Henry Tabe, *The Unravelling of Structured Investment Vehicles: How Liquidity Leaked Through SIVs* (2010), at 192–94.

[272] For these reasons, we are declining to follow the suggestion of one commenter that we not include a principal place of business element of the ''U.S. person'' definition for investment vehicles. *See* note 198, *supra.*

[273] Identifying the manager for purposes of this definition will depend on the structure and organizing documents of the investment vehicle under consideration.

[274] Exchange Act rule 3a71–3(a)(4)(ii). At least one commenter also recognized that differences between categories of legal persons may require different tests for determining whether a person has its principal place of business in the United States. *See* IIB Letter at 5–6 (suggesting separate ''principal place of business'' tests for operating companies and investment vehicles). The CFTC Cross-Border Guidance, which provides separate guidance for operating companies, trusts, and investment vehicles, tailored to the characteristics of each,

an investment vehicle, for example, the primary manager is responsible for directing, controlling, and coordinating the overall activity of the vehicle, such that the business of the vehicle, such as its investment and financing activity, is principally carried out at the location of the primary manager. Such an investment vehicle's principal place of business under the final rule would be the location from which the manager carries out those responsibilities.[275]

As noted above, at least one commenter suggested that a ''principal place of business'' test should look to the location of personnel directing the security-based swap activity of the vehicle.[276] Although we believe that the manager responsible for directing, controlling, and coordinating the activities of the externally managed investment vehicle also would generally be responsible for directing, controlling, and coordinating the security-based swap activity of such vehicle, we do not believe that an externally managed vehicle should be excluded from the U.S. person definition merely because the manager that otherwise directs, controls, and coordinates its activity has effectively shifted responsibility for the security-based swap activity of the externally managed vehicle to a non-U.S. person. As noted above, such an approach would provide an incentive to move responsibility for the security-based swap activity of externally managed vehicles outside the United States while retaining control of all other activities relating to management of such vehicles within the United States. As with the ''principal place of business'' definition more generally, and for similar reasons, we believe that the definition of ''principal place of business'' set forth in the final rule with respect to externally managed vehicles is consistent with our territorial approach to application of Title VII. We also note, however, that for the reasons just discussed the final definition's focus on where the activity of the vehicle as a whole is primarily directed, controlled, and coordinated, as opposed to a focus on its security-based swap activity, is in our view necessary or appropriate to prevent the evasion of Title VII.[277]

In our proposal, we stated that we did not think that the U.S.-person status of a commodity pool operator (''CPO'') or fund adviser (as opposed to the fund actually entering into the transaction) was in itself relevant in determining the U.S.-person status of an investment vehicle.[278] Although the definition of ''principal place of business'' we are adopting in this final rule may lead to similar classifications of investment vehicles for purposes of the ''U.S. person'' definition as a test that looked to the U.S.-person status of a CPO or fund adviser, we believe that the definition we are adopting is more appropriately designed to capture externally managed investment vehicles that raise the kinds of concerns that Title VII was intended to address. Moreover, we note that mere retention of an asset manager that is a U.S. person, without more, would not necessarily bring an offshore investment vehicle or other person within the scope of the ''U.S. person'' definition.[279] However, where an asset manager, whether or not a U.S. person, is primarily responsible for directing, controlling, and coordinating the activities of an externally managed vehicle and carries out this responsibility within the United States, we believe that it is reasonable to include the externally managed vehicle in the definition of ''U.S. person'' [280] and to require foreign dealers to include dealing activity with such vehicles in their *de minimis* threshold calculations.

iii. Fund Ownership

Some commenters urged us to include in the definition investment vehicles that are majority-owned by U.S. persons.[281] One of these commenters noted that the CFTC had reasoned that '''passive investment vehicles''' designed to '''achieve the investment objectives of their beneficial owner''' were distinguishable from majority-owned entities that are '''separate, active operating businesses.' '' [282] We are not persuaded, however, that this distinction between investment vehicles and operating companies warrants treating ownership interests in these two types of entities differently for purposes of the ''U.S. person'' definition, particularly given that the exposure of investors in a collective investment vehicle engaging in security-based swap transactions typically is capped at the amount of their investment and such investors generally are unlikely to seek to make the investment vehicle's counterparties whole for reputational or other reasons in the event of a default.[283] We do not believe risks created through ownership interests in collective investment vehicles are the types of risks that Title VII is intended to address with respect to security-based swaps.[284]

Because we are not adopting an ownership test for funds, we are also not following the suggestion of some commenters that we exclude from the ''U.S. person'' definition investment vehicles that are offered publicly only to non-U.S. persons and are not offered to

appears to reflect this distinction. *See* CFTC Cross-Border Guidance, 78 FR 45309–311.

[275] As noted above, one commenter suggested that we adopt a definition of ''principal place of business'' that looked to where the operational management activities of the fund are carried out. *Cf.* note 200, *supra.* We are not convinced, however, that the location of such activities (which the commenter identified as including ''establishing the fund and selecting its investment manager, broker, and underwriter/placement agent''), absent an ongoing role by the person performing those activities in directing, controlling, and coordinating the investment activities of the fund, generally will be as indicative of activities, financial and legal relationships, and risks within the United States of the type that Title VII as the location of a fund manager.

[276] *See* note 213, *supra* (citing Citadel Letter).

[277] *See* Exchange Act section 30(c).

[278] *See* Cross-Border Proposing Release, 78 FR 31144 n.1454.

[279] *Cf.* note 195, *supra* (citing IAA letter urging the Commission to follow the CFTC in clarifying that retention of an asset manager that is a U.S. person alone would not bring a person within the scope of the ''U.S. person'' definition).

[280] We also noted in our proposal that a transaction by an adviser on behalf of a fund could be a ''transaction conducted within the United States'' as defined in the proposal and thus fall within the scope of Title VII. See Cross-Border Proposing Release, 78 FR 31144 n.1454. As noted above, we are not addressing the ''transaction conducted within the United States'' element of our proposal in the final rule and instead intend to address this element of the proposed dealer *de minimis* threshold calculations in a subsequent reproposal.

[281] *See* note 203, *supra* (citing BM Letter and AFR Letter). The CFTC also incorporated a majority-ownership inquiry in its interpretation of ''U.S. person'' as it applies to funds. *See* CFTC Cross-Border Guidance, 78 FR 45313.

[282] BM Letter at 10 (quoting CFTC Cross-Border Guidance, 78 FR 45314).

[283] *See* Cross-Border Proposal, 78 FR 31144 (noting that losses arising from investments in investment vehicles ''are generally limited to their investments in the form of equity or debt securities'' and that these risks are ''addressed by other provisions of U.S. securities law pertaining to issuances and offerings of equity or debt securities'').

[284] Several commenters also argued that a majority-ownership test, including any look-through requirements, may be difficult to implement in this context. *See* note 203, *supra* (citing ICI Letter and IAA Letter). We believe that our definition of ''principal place of business'' with respect to externally managed entities should help to ensure that the ''U.S. person'' definition encompasses investment vehicles that may generally have a significant portion of their financial and legal relationships within the United States and that may therefore raise the types of risk concerns within the United States that Title VII was intended to address.

We note that, because we are not following a majority-ownership approach for collective investment vehicles as part of the ''U.S. person'' definition, the U.S.-person status of accounts investing in such investment vehicles will not affect the U.S.-person status of such vehicles. *Cf.* IAA Letter at 4 (explaining that a majority-ownership test would capture non-U.S. funds with minimal nexus to the United States and present implementation challenges).

U.S. persons.[285] Although we recognize that the CFTC reasoned that such investment vehicles would generally not be within its interpretation of ''U.S. person,'' [286] we do not believe that it would be relevant under our final definition, which does not focus on an investment vehicle's ownership by U.S. persons.[287]

(c) Accounts

The final definition of ''U.S. person'' continues to mean ''any account (whether discretionary or not) of a U.S. person,'' irrespective of whether the person at which the account is held or maintained is a U.S. person.[288] As a general matter, we expect that market participants will determine their U.S.-person status under the prongs of that definition relating to natural persons or to legal persons.[289] This ''account'' prong of the definition is intended to clarify that a person's status for purposes of this rule generally does not differ depending on whether the person enters into security-based swap transactions through an account, or depending on whether the account is held or maintained at a U.S. person or a non-U.S. person intermediary or financial institution.[290]

Consistent with the overall approach to the definition of ''U.S. person,'' our focus under the ''account'' prong of this definition is on the party that actually bears the risk arising from the security-based swap transactions.[291] Accordingly, an account owned solely by one or more U.S. persons is a U.S. person, even if it is held or maintained at a foreign financial institution or other person that is itself not a U.S. person; an account owned solely by one or more non-U.S. persons is not a U.S. person, even if it is held or maintained at a U.S. financial institution or other person that is itself a U.S. person. For purposes of this ''account'' prong of the ''U.S. person'' definition, account ownership is evaluated only with respect to direct beneficial owners of the account. Because the status of an account turns on the status of the account's beneficial owners, the status of any nominees of an account is irrelevant in determining whether the account is a U.S. person under the final rule.

Where an account is owned by both U.S. persons and non-U.S. persons, the U.S.-person status of the account, as a general matter, should turn on whether any U.S.-person owner of the account incurs obligations under the security-based swap.[292] Consistent with the approach to U.S.-person and non-U.S.-person accounts described above, neither the status of the fiduciary or other person managing the account, nor the discretionary or non-discretionary nature of the account, nor the status of the person at which the account is held or maintained are relevant in determining the account's U.S.-person status.

(d) Estates

The final rule incorporates a new prong that expressly includes certain estates within the definition of ''U.S. person.'' Under the final rule any estate of a natural person who was a resident of the United States at the time of death is itself a U.S. person.[293] Our proposed rule did not expressly address estates because we did not believe that they typically engage in security-based swap activity and, to the extent that they do, their U.S.-person status would have been determined under the standard applicable to any legal person under our proposed rule. We received no comments in response to our questions regarding whether we should adopt a final rule that expressly addresses estates or that reflects the CFTC's proposed approach.[294]

We continue to believe that estates are not likely to be significant participants in the security-based swap market, but we also believe that, given the unique characteristics of estates, it is appropriate to include in the ''U.S. person'' definition an express reference to estates of decedents who were residents of the United States at the time of death. This element of our final definition reflects similar considerations to those that informed our inclusion of natural persons who are residents of the United States within the scope of that definition. We noted above that the security-based swap activity of a natural person who is a resident of the United States raises the types of risks that Title VII is intended to address, given that person's residence status and likely financial and legal relationships, and we expect that the estate of a natural person who was a resident of the United States at the time of his or her death is likely to operate within the same relationships that warranted subjecting such transactions to Title VII during the life of the decedent.

(e) Certain International Organizations

As under the proposal, the final rule expressly excludes certain international organizations from the definition of U.S. person.[295] This list includes ''the [IMF], the International Bank for Reconstruction and Development, the Inter-American Development Bank, the

[285] *See* note 205, *supra* (citing IAA Letter). *Cf.* CFTC Cross-Border Guidance, 78 FR 45314, 45317. One commenter suggested that the exclusion apply to funds offered publicly only to non-U.S. persons and are regulated in a foreign jurisdiction. *See* note 205, *supra* (citing ICI Letter, which suggested that funds regulated under foreign law be excluded from the ''U.S. person'' definition if they are (1) offered publicly only to non-U.S. persons; (2) offered publicly only to non-U.S. persons but offered privately to U.S. persons; or (3) authorized to offer publicly within the United States. but elect to offer only privately to non-U.S. institutional investors).

[286] *See* CFTC Cross-Border Guidance, 78 FR 45314.

[287] We also note that our guidance regarding the meaning of ''principal place of business'' is designed to identify, among other entities, investment vehicles that may pose risks to the United States, regardless of where they may be offered.

[288] Exchange Act rule 3a71–3(a)(4)(i)(C). Thus, if a partnership, corporation, trust, investment vehicle, or other legal person is a U.S. person, any account of that person is a U.S. person.

[289] *See* Exchange Act rule 3a71–3(a)(4)(i)(A) and (B).

[290] As we noted in the Cross-Border Proposing Release, this 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.

[291] In other words, the U.S.-person status of an account is relevant under our final rule to the extent that the security-based swap activity is carried out by or through the account. Because our final definition of ''U.S. person'' does not include investment vehicles that are majority-owned by U.S. persons, the underlying ownership of an investment vehicle that engages in security-based swap activity through an account is not relevant in determining the U.S.-person status of an account. *Cf.* note 224, *supra* (citing IAA Letter expressing concern about the relationship between the definition of accounts and treatment of funds).

[292] Two commenters urged us to exclude from the definition of ''U.S. person'' any account with a *de minimis* level of ownership by a U.S. person. *See* note 223, *supra* (citing letters from IAA and SIFMA/FIA/FSR). We, however, do not believe it would be appropriate to incorporate this concept wholesale into the definition of ''U.S. person,'' as a *de minimis* level of ownership by a U.S. person in the account does not necessarily indicate that such a U.S. person incurs only a *de minimis* level of risk or obligations under the security-based swap transactions entered into through the account. For example, the U.S. person may be jointly and severally liable with all of the other account owners for obligations incurred under a security-based swap. We recognize that account ownership may take different forms and that security-based swap transactions may impose risks and obligations on account holders in different ways. The approach we are taking here is intended to take into account the concerns expressed by commenters regarding *de minimis* U.S.-person interests in such accounts, while also recognizing that security-based swap transactions carried out through such accounts may pose risks to U.S. persons and to the U.S. financial system.

[293] *See* Exchange Act rule 3a71–3(a)(4)(i)(D).

[294] The CFTC subsequently issued an interpretation of ''U.S. person'' that expressly incorporates estates. *See* CFTC Cross-Border Guidance, 78 FR 45314.

[295] Exchange Act rule 3a71–3(a)(4)(iii).

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.'' [296] Although these organizations may have headquarters in the United States, the Commission continues to believe that their status as international organizations warrants excluding them from the definition of ''U.S. person.'' [297]

4. Representations Regarding U.S.-Person Status

Our proposed definition of ''U.S. person'' did not expressly provide that parties could rely on representations from their counterparties as to their counterparties' U.S.-person status, although we did anticipate that parties likely would request such representations.[298] On further consideration, we believe that market participants would benefit from an express provision permitting reliance on such representations.[299] Accordingly, under the final rule, a person need not consider its counterparty to be a U.S. person for purposes of Title VII if that person receives a representation from the counterparty that the counterparty does not satisfy the criteria set forth in Exchange Act rule 3a71–3(a)(4)(i), unless such person knows or has reason to know that the representation is not accurate. For purposes of the final rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.[300]

Expressly permitting market participants to rely on such representations in the ''U.S. person'' definition should help mitigate challenges that could arise in determining a counterparty's U.S.-person status under the final rule. It permits the party best positioned to make this determination to perform an analysis of its own U.S.-person status and convey, in the form of a representation, the results of that analysis to its counterparty. In addition, such representations should help reduce the potential for inconsistent classification and treatment of a person by its counterparties and promote uniform application of Title VII.[301]

The final rule reflects a constructive knowledge standard for reliance. Under this standard, a counterparty is permitted to rely on a representation, unless the person knows or has reason to know that the representation is inaccurate. A person would have reason to know the representation is not accurate for purposes of the final rule if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.[302] We believe that this ''know or have reason to know'' standard should help ensure that potential security-based swap dealers and major security-based swap participants do not disregard facts that call into question the validity of the representation.

D. Application of De Minimis Exception to Dealing Activities of Conduit Affiliates

1. Proposed Approach and Commenters' Views

The Cross-Border Proposing Release did not include requirements specific to ''conduit affiliates'' or other non-U.S. persons that enter into security-based swap transactions on behalf of their U.S. affiliates. Instead, the proposal would have treated those entities like other non-U.S. persons, and required them to count, against the *de minimis* thresholds, only their dealing transactions with U.S. persons other than foreign branches, and their dealing transactions conducted in the United States.[303] The proposal also noted that the general rule implementing the *de minimis* exception excludes transactions between majority-owned affiliates from the analysis.[304]

The proposal acknowledged the difference between its approach and the CFTC's approach in its proposed cross-border guidance, which encompassed special provisions for foreign affiliates that act as conduits for U.S. persons.[305] We thus cited the CFTC's proposed approach toward conduit affiliates in requesting comment regarding whether the Commission should follow a similar approach.[306] We also requested comment as to whether the Commission should, consistent with the CFTC's proposed approach, require a person that operates a ''central booking system''—whereby security-based swaps are booked to a single legal person—be subject to applicable dealer registration requirements as if the person had entered into the security-based swaps directly.[307] More generally, we requested comment as to whether foreign affiliates of U.S. persons, such as majority-owned subsidiaries of U.S.

[296] *Id.* Although three commenters requested that we list all such organizations that are excluded from U.S. persons, *see* note 226, *supra,* we do not believe it appropriate to attempt to enumerate an exclusive list of entities that may be eligible for such exclusion.

[297] Although three commenters requested that the final rule also exclude ''controlled affiliates'' of these international organizations from the definition of ''U.S. person,'' *see* note 229, *supra* (citing SC Letter, WB/IFC Letter, and IDB Letter), our final rule does not incorporate such an exclusion, as commenters did not provide us with information that leads us to change our view that we should not treat such affiliates' security-based swap or other activities differently from other persons that are incorporated, organized, or established in the United States or have their principal place of business here.

[298] *See* Cross-Border Proposing Release, 78 FR 31140.

[299] *Cf.* note 230, *supra* (citing IIB Letter requesting the Commission to confirm that, as a general matter, a representation is sufficient to fulfill diligence requirements under these rules).

[300] *See* Exchange Act rule 3a71–3(a)(4)(iii). This provision applies to each prong of the ''U.S. person'' definition, including the principal place of business prong. *Cf.* note 220, *supra.* As noted above, we are not providing that persons may rely solely on representations from counterparties that have been developed for purposes of the CFTC's interpretation of U.S. person. However, depending on how market participants have applied the CFTC's general facts-and-circumstances inquiry, they may be able to rely on such representations.

As we noted in the proposal, 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. *See* Cross-Border Proposing Release, 78 FR 30994 n.264. Any change in a counterparty's U.S.-person status after the transaction is executed would not affect the original 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 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'').

[301] The final rule permitting reliance on representations with respect to a counterparty's U.S.-person status applies only to the definition of ''U.S. person'' as used in this final rule and does not apply to any determinations of a person's U.S.-person status under any other provision of the federal securities laws, including Commission rules, regulations, interpretations, or guidance.

[302] *Cf.* IIB Letter at 5 n.9 (urging the Commission to permit reliance on counterparty representations, ''absent knowledge of facts that would cause a reasonable person to question the accuracy of the representation''). To the extent that a person has knowledge of facts that would lead a reasonable person to believe that a counterparty may be a U.S. person under the final definitions it may need to conduct additional diligence before relying on the representation.

We recognize that one commenter urged us to limit a reasonable reliance standard for such representations to representations concerning whether a person had its principal place of business in the United States. *Cf.* note 220, *supra* (citing ABA Letter). However, we believe that applying a single standard of reliance to all representations regarding a person's U.S.-person status will reduce the potential complexity of establishing policies and procedures associated with identifying the U.S.-person status of counterparties.

[303] *See* proposed Exchange Act rule 3a71–3(b)(1)(ii).

[304] *See* Cross-Border Proposing Release at 31006 (citing Exchange Act rule 3a71–1(d)).

[305] *See id.* at 31006 n.356.

[306] *See id.* at 31024.

[307] *See id.* at 31007.

parents, should be considered to be U.S. persons.[308]

One commenter took the view that the Commission's rules should not make use of the conduit affiliate concept notwithstanding its use in the CFTC Cross-Border Guidance, stating that the concept lacks any statutory or regulatory authority, would not advance efforts to reduce systemic risk, and, if applied to end-users, would interfere with internal risk allocations within a corporate group.[309] In contrast, one commenter depicted conduit affiliates as being a type of person that is subject to a *de facto* guarantee by a U.S. affiliate and that should thus be treated as a U.S. person, and also argued that the dealer registration requirement should apply to other types of entities subject to a *de facto* guarantee.[310]

One commenter further opposed the adoption of an approach that would require a ''central booking system'' or any other affiliate to register as a security-based swap dealer based solely on its inter-affiliate security-based swap transactions, arguing that such an approach would tie registration requirements to firms' internal risk management practices, and would hamper the ability to manage risk across a multinational enterprise.[311]

2. Final Rule

The final rule distinguishes ''conduit affiliates'' from other non-U.S. persons by requiring such entities to count all of their dealing transactions against the *de minimis* thresholds, regardless of the counterparty.[312] As discussed below, for these purposes a ''conduit affiliate'' is a non-U.S. affiliate of a U.S. person that enters into security-based swaps with non-U.S. persons, or with certain foreign branches of U.S. banks, on behalf of one or more of its U.S. affiliates (other than U.S. affiliates that are registered as security-based swap dealers or major security-based swap participants), and enters into offsetting transactions with its U.S. affiliates to transfer the risks and benefits of those security-based swaps.

After careful consideration, we believe that requiring such conduit affiliates to count their dealing transactions against the *de minimis* thresholds is appropriate to help ensure that non-U.S. persons do not facilitate the evasion of registration requirements under Dodd-Frank by participating in arrangements whereby a non-U.S. person engages in security-based swap activity outside the United States on behalf of a U.S. affiliate that is not a registered security-based swap dealer or major security-based swap participant,[313] and the U.S. affiliate assumes economic risks and benefits of those positions by entering into offsetting transactions with the non-U.S. affiliate. Absent such a requirement that conduit affiliates count their dealing transactions for purposes of the *de minimis* exception, a U.S. person may be able to effectively engage in unregistered dealing activity involving non-U.S. persons by having a non-U.S. affiliate enter into dealing transactions with other non-U.S. persons (which would not be counted against the *de minimis* thresholds because both counterparties are non-U.S. persons) or with foreign branches of U.S. banks that are registered as security-based swap dealers (which would not be counted against the *de minimis* thresholds because of an exclusion for dealing transactions with foreign branches of U.S. banks that are registered as security-based swap dealers). The U.S. person could enter into offsetting transactions with those non-U.S. affiliates, and those offsetting transactions would not be counted against the *de minimis* thresholds due to the inter-affiliate exception to the dealer analysis.[314]

Accordingly, in our view, requiring conduit affiliates to count their dealing transactions against the thresholds is necessary or appropriate to prevent the evasion of any provision of the amendments made to the Exchange Act by Title VII for the reasons given above.[315] We believe that this requirement is appropriately tailored to prevent the evasion of the dealer requirements,[316] while preserving participants' flexibility in managing risk exposures through inter-affiliate transactions.[317]

In light of the anti-evasion rationale for this use of the conduit affiliate concept, which is consistent with our statutory anti-evasion authority, we are not persuaded by a commenter's view that the use of the concept is outside of our authority.[318] We also are not persuaded by that commenter's suggestion that the use of the conduit affiliate concept would not advance risk-mitigation goals, given that the concept can be expected to help ensure that the provisions of Title VII

[308] *See id.* at 30998–99.

[309] *See* CDEU Letter at 3–5 (adding that if the conduit concept is not rejected, at a minimum it should exclude non-dealers and should not be applied to security-based swaps in which neither party is a dealer or a major participant).

[310] *See* BM Letter at 3, 14–15.

[311] *See* SIFMA/FIA/FSR Letter at A–16 to A–17 (also stating that the final CFTC cross-border guidance does not include the central booking system concept). *See also* CDEU Letter at 3–5 (raising concerns that the regulation of conduit affiliates may have the potential to interfere with the use of centralized treasury units that corporate groups may use as a market-facing entity for a non-dealer's corporate group).

[312] *See* Exchange Act rule 3a71–3(b)(1)(ii).

[313] As discussed below, the ''conduit affiliate'' definition does not encompass persons that engage in such offsetting transactions solely with U.S. persons that are registered with the Commission as security-based swap dealers or major security-based swap participants because we do not believe that such transactions raise the types of evasion concerns that the conduit affiliate concept is designed to address.

[314] The rule requires that a conduit affiliate count all of its dealing activity, and is not limited to the conduit affiliate's dealing transactions that specifically are linked to offsetting transactions with a U.S. affiliate. This is because there may not be a one-to-one correspondence between dealing transactions and their offsets for reasons such as netting.

[315] *See* Exchange Act section 30(c); section II.B.2(d), *supra.* In noting that this requirement is consistent with our anti-evasion authority under Exchange Act section 30(c), we are not taking a position as to whether such activity by a conduit affiliate otherwise constitutes a ''business in security-based swaps without the jurisdiction of the United States.''

[316] We recognize that not all dealing structures involving conduit affiliates may be evasive in purpose. We believe, however, that the anti-evasion authority of section 30(c) permits us to prescribe prophylactic 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 established for valid business purposes, so long as the rule is designed to prevent possible evasive conduct. *See* Cross-Border Proposing Release, 78 FR 30987; *see also* section II.B.2(d), *supra* (discussion of anti-evasion authority); *Abramski* v. *United States,* No. 12–1493, slip op. at 14 (S. Ct. June 16, 2014) (noting ''courts' standard practice, evident in many legal spheres and presumably known to Congress, of ignoring artifice when identifying the parties to a transaction'').

We also note that while this requirement appears consistent with the views of a commenter that supported the use of the conduit affiliate concept, we take no position on that commenter's view that conduit affiliates represent a type of entity that is subject to a de facto guarantee by a U.S. person. *See* note 310, *supra.* Indeed, in our view the conduit affiliate concept will serve as a useful anti-evasion tool even in the situation where the conduit affiliate's counterparty does not consider the U.S. person's creditworthiness in determining whether to enter into a security-based swap with the conduit affiliate.

[317] For example, one potential alternative anti-evasion safeguard could be to narrow the inter-affiliate exception to counting dealing transactions against the *de minimis* thresholds, such as by making the exception unavailable in the context of transactions between non-U.S. persons and their U.S. affiliates. We believe, however, that such an approach would be less well-targeted than the use of the conduit affiliate concept, as that alternative could impact a corporate group's ability to use specific market-facing entities to facilitate the group's security-based swap activities (given that the market-facing entities would arguably be acting as a dealer on behalf of its affiliates).

[318] *See* CDEU Letter at 3 (''The concept of a conduit affiliate is not based on statutory or regulatory authority, and does not decrease the potential for systemic risk.''). *See also* note 309, *supra.*

applicable to dealers (including risk mitigation provisions such as margin and capital requirements) are implemented, which can be expected to produce risk mitigation benefits.

At the same time, we recognize the significance of commenter concerns that the use of the ''conduit affiliate'' concept or the use of a ''central booking system'' approach to registration could impede efficient risk management practices.[319] The conduit affiliate concept serves as a prophylactic anti-evasion measure, and we do not believe that any entities currently act as conduit affiliates in the security-based swap market, particularly given that a framework for the comprehensive regulation of security-based swaps did not exist prior to the enactment of Title VII, suggesting that market participants would have had no incentives to use such arrangements for evasive purposes.

Moreover, in light of this anti-evasion purpose, the definition of ''conduit affiliate'' does not include entities that may otherwise engage in relevant activity on behalf of affiliated U.S. persons that are registered with the Commission as security-based swap dealers or major security-based swap participants, as we do not believe that transactions involving these types of registered entities and their foreign affiliates raise the types of evasion concerns that the conduit affiliate concept is designed to address.[320]

In addition, in the context of the dealer *de minimis* exception, the relevant rules would require the conduit affiliate to count only its dealing transactions. The rules accordingly distinguish dealing activity by a conduit affiliate from a corporate group's use of affiliates for non-dealing purposes, such as a corporate group's use of a single affiliated person to enter into transactions with the market for risk management not involving dealing activity (accompanied by offsetting inter-affiliate transactions that place the economic substance of the instrument into another person within the group). The requirement we are adopting here—under which a conduit affiliate will count only its dealing transactions against the *de minimis* thresholds—is not expected to impact persons that enter into security-based swaps with affiliates for non-dealing purposes.[321]

Consistent with these goals, the final rule defines ''conduit affiliate'' in part as a non-U.S. person that directly or indirectly is majority-owned by one or more U.S. persons.[322] To be a conduit affiliate, moreover, such a person must in the regular course of business enter into in security-based swaps with one or more other non-U.S. persons or with foreign branches of U.S. banks that are registered as security-based swap dealers,[323] for the purposes of hedging or mitigating risks faced by, or otherwise taking positions on behalf of, one or more U.S. persons [324] (other than U.S. persons that are registered as security-based swap dealers or major security-based swap participants) that control, are controlled by, or are under common control with the potential conduit affiliate, and enter into offsetting security-based swaps or other arrangements with such affiliated U.S. persons to transfer risks and benefits of those security-based swaps.[325]

E. Application of De Minimis Exception to Dealing Activities of Other Non-U.S. Persons

As noted above, the proposal would have required non-U.S. persons to count, against the *de minimis* thresholds, only their dealing transactions involving U.S. persons other than foreign branches, and their dealing transactions conducted within the United States.[326]

Aside from issues related to conduit affiliates, addressed above, commenters discussed other issues regarding the application of the *de minimis* exception to the dealing activities of non-U.S. persons, particularly relating to: (i) Dealing transactions of non-U.S. persons that are guaranteed by their U.S. affiliates; (ii) activities within the United States; and (iii) dealing activities of other non-U.S. persons whose counterparties are U.S. persons (including foreign branches of U.S. banks) or non-U.S. persons guaranteed by U.S. persons. We are addressing those groups of issues separately, given the distinct issues relevant to each.[327] As discussed below, the final rule requires non-U.S. persons (apart from the conduit affiliates addressed above) to count all of their dealing transactions where: (1) The transaction is subject to a recourse guarantee against a U.S. affiliate of the non-U.S. person; or (2) the counterparty to the transaction is a U.S. person, other than the foreign branch of a registered security-based swap dealer.

[319] *See* note 311, *supra* (citing CDEU Letter).

[320] As discussed below, we also are applying the conduit affiliate concept to the major participant analysis to help guard against evasive practices. *See* section V.C, *infra.*

[321] One commenter particularly suggested that the conduit affiliate concept, if implemented, should exclude non-dealers. *See* CDEU Letter. As the requirement related to counting by conduit affiliates for purposes of the *de minimis* dealer exception is relevant only to the extent that a conduit affiliate engages in dealing activity, however, we do not believe that it is necessary to otherwise tailor the requirement to address the possibility that a conduit affiliate is acting on behalf of an affiliated U.S. non-dealer for risk management or other non-dealing purposes.

Moreover, as discussed above, over a recent six-year period, entities that are recognized as dealers are responsible for almost 85 percent of transactions involving single-name CDS. *See* Table 1, section III.A.1, *supra.*

[322] *See* Exchange Act rule 3a71–3(a)(1)(i)(A).

For purposes of the definition, the majority-ownership standard is met if one or more U.S. persons directly or indirectly own a majority interest in the non-U.S. person, where ''majority interest'' is 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* Exchange Act rule 3a71–3(a)(1)(ii). This parallels the majority-ownership standard in the inter-affiliate exclusion from the dealer analysis. *See* Exchange Act rule 3a71–1(d).

[323] The definition does not require a conduit affiliate to exclusively transact with such non-U.S. persons and foreign branches. Accordingly, transactions with other types of U.S. persons would not cause a person to fall outside the ''conduit affiliate' definition.

[324] For these purposes, it would not be necessary that the non-U.S. person transfer the risks and benefits of all of its security-based swaps. It also would not be necessary that the non-U.S. person transfer all of the risks and benefits of any particular security-based swap; for example, the non-U.S. person may retain the credit risk associated with a security-based swap with a non-U.S. counterparty, but transfer to its U.S. affiliate the market risk associated with the instrument.

[325] *See* Exchange Act rule 3a71–3(a)(1)(i)(B).

The reference to ''other arrangements'' to transfer the risks and benefits of security-based swaps, as an alternative to entering into offsetting security-based swaps, may encompass, for example, the use of swaps to transfer risks and benefits of the security-based swaps (for example, two CDS based on slightly different indices of securities could be used to approximately replicate a security-based swap such as a CDS based on a single reference entity).

We note that while the CFTC Cross-Border Guidance also states the view that as a general matter conduit affiliates should count their dealing activity against the *de minimis* thresholds (*see* 78 FR 45318–19), the CFTC's interpretation of what constitutes a ''conduit affiliate'' differs in certain ways from our final rule. For example, the CFTC's approach takes into account whether the conduit affiliate's financial results are consolidated in the U.S. person's financial statements, and the CFTC states that it did not ''intend that the term 'conduit affiliate' would include affiliates of swap dealers.'' *See* CFTC Cross-Border Guidance, 78 FR 45359; *see also id.* at 45318–19 n.258.

In our view, the final rule's definition—including its prerequisite that the conduit affiliate be majority-owned by non-natural U.S. persons—appropriately focuses the meaning of the term ''conduit affiliate'' on persons who may engage in security-based swap activity on behalf of U.S. affiliates in connection with dealing activity (and, as discussed below, *see* section V.C, *infra,* in connection with other security-based swap activity in the context of the major participant definition).

[326] *See* proposed Exchange Act rule 3a71–3(b)(1)(ii).

[327] In addition, some commenters requested an exclusion for transactions that are executed anonymously and cleared. Those comments—and our incorporation of an exception for certain cleared anonymous transactions—are addressed below. *See* section IV.G, *infra.*

1. Dealing Transactions of Non-U.S. Persons That Are Subject to Recourse Guarantees by Their U.S. Affiliates

(a) Proposed Approach and Commenters' Views

Under the proposal, a non-U.S. person's transactions involving security-based swaps guaranteed by its U.S. affiliate would have been treated the same as other transactions of non-U.S. persons for purposes of the *de minimis* exception. In other words, the non-U.S. guaranteed affiliate would have counted, against the *de minimis* thresholds, only its dealing transactions involving U.S. persons other than foreign branches, and its dealing transactions otherwise conducted within the United States.[328]

In the Cross-Border Proposing Release, we solicited comment regarding whether the ''U.S. person'' definition should incorporate foreign entities that are guaranteed by their U.S. affiliates.[329] We also expressed the preliminary view that the primary risk related to such guaranteed transactions of non-U.S. persons was the risk posed to the United States via the guarantee from a U.S. person, rather than the dealing activity occurring between two non-U.S. persons outside the United States, and sought to address this risk via the proposed attribution principles in the ''major security-based swap participant'' definition, and we also expressed the view that the use of the major participant definition effectively would address those regulatory concerns.[330]

Two commenters supported an alternative approach to require such guaranteed non-U.S. persons to count all of their dealing transactions against the thresholds. One commenter stated that non-U.S. persons that receive guarantees from U.S. persons should count all of their dealing transactions toward the *de minimis* thresholds, arguing that the failure to do so would be inconsistent with the resulting flow of risk to the United States and that major participant regulation was not the appropriate means of addressing those risks.[331] Another commenter took the position that the proposed approach would provide a loophole whereby U.S. entities trading in security-based swaps could avoid regulation under the Dodd-Frank Act.[332] Both commenters further suggested that affiliates of U.S. persons be presumed to be beneficiaries of guarantees,[333] with the presumption potentially subject to rebuttal if there is notice that no guarantee would be provided.[334]

One comment letter did not explicitly address this issue, but did support the Commission's proposed approach not to require non-U.S. persons to aggregate the dealing transactions of their U.S.-guaranteed affiliates against the *de minimis* thresholds, stating that this would pose too tenuous a nexus with the U.S. to justify registration.[335]

(b) Final Rule

Under the final rule, a non-U.S. person (other than a conduit affiliate, as discussed above) must count, against the *de minimis* thresholds, any security-based swap transaction connected with its dealing activity for which, in connection with that particular security-based swap, the counterparty to the security-based swap has rights of recourse against a U.S. person that is controlling, controlled by, or under common control with the non-U.S. person.[336] For these purposes, the counterparty would be deemed to have a right of recourse against a U.S. affiliate of the non-U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. affiliate in connection with the non-U.S. person's obligations under the security-based swap.

We understand that such rights may arise in a variety of contexts. For example, a counterparty would have such a right of recourse against the U.S. person if the applicable arrangement provides the counterparty the legally enforceable right to demand payment from the U.S. person in connection with the security-based swap, without conditioning that right upon the non-U.S. person's non-performance or requiring that the counterparty first make a demand on the non-U.S. person. A counterparty also would have such a right of recourse if the counterparty itself could exercise legally enforceable rights of collection against the U.S. person in connection with the security-based swap, even when such rights are conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the security-based swap, and/or are conditioned upon the counterparty first being required to take legal action against the non-U.S. person to enforce its rights of collection.

The terms of the guarantee need not necessarily be included within the security-based swap documentation or even otherwise reduced to writing (so long as legally enforceable rights are created under the laws of the relevant jurisdiction); for instance, such rights of recourse would arise when the counterparty, as a matter of law in the relevant jurisdiction, would have rights to payment and/or collection that may arise in connection with the non-U.S. person's obligations under the security-based swap that are enforceable.[337] We would view the transactions of a non-U.S. person as subject to a recourse guarantee if at least one U.S. person (either individually or jointly and severally with others) bears unlimited responsibility for the non-U.S. person's obligations, including the non-U.S. person's obligations to security-based

[328] *See* proposed Exchange Act rule 3a71–3(b)(1)(ii).

[329] *See* Cross-Border Proposing Release, 78 FR 30998.

[330] *See id.* at 31006. As part of the proposal, we also expressed the preliminary view that dealer regulation of such persons would not materially increase the programmatic benefits of the dealer registration requirement, and that such an approach would impose programmatic costs without a corresponding increase in programmatic benefits to the U.S. security-based swap market. *See id.* at 31146–47. For the reasons discussed below, however, we have concluded that it is appropriate to require non-U.S. guaranteed affiliates of U.S. persons to count, against the *de minimis* thresholds, their dealing transactions that are subject to a right of recourse against a U.S. person. *See* IV.E.1(b) (discussing the final rule's changes to the preliminary view).

[331] *See* BM Letter at 17–18.

[332] *See* AFR Letter I at 7–8, 14.

[333] *See id.* at 14 (''In cases where a guarantee is implicit, the use of a rebuttable presumption of a guarantee will put the burden on the foreign affiliate in question to demonstrate to regulators that it is not guaranteed.''); BM Letter at 14 (suggesting in part that support should be presumed if a foreign affiliate incorporates a ''de facto guarantor's name in its own'').

[334] *See* AFR Letter I at 7 (''This presumption could be rebutted by showing clear evidence that counterparties were informed of the absence of a guarantee.''); BM Letter at 14–15 (suggesting that presumptions of support might be rebutted by explicit statements within trade documentation accompanied by explicit counterparty waivers, and discussing the potential additional use of associated public filing requirements and of possible ''ring-fence'' systems for determining which affiliates should be considered U.S persons).

[335] *See* SIFMA/FIA/FSR Letter at A–17.

[336] *See* Exchange Act rule 3a71–3(b)(1)(iii)(B). Consistent with the rule generally requiring a person to consider its affiliates' dealing activities for purposes of the *de minimis* exception (Exchange Act rule 3a71–2(a)(1)), the Commission interprets control 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. *See* Intermediary Definitions Adopting Release, 77 FR 30631 n.437.

[337] For purposes of the dealer *de minimis* exception, rights of recourse would not be present if legally enforceable rights were to arise by operation of law following the transaction, such as due to later actions that evidence the disregard of corporate form by a party to the transaction and its affiliate. Rights of recourse, in contrast, would encompass rights existing at the time of the transaction but conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the security-based swap or conditioned upon the counterparty first being required to take legal action against the non-U.S. person to enforce its right of collection.

swap counterparties. Such arrangements may include those associated with foreign unlimited companies or unlimited liability companies with at least one U.S.-person member or shareholder, general partnerships with at least one U.S.-person general partner, or entities formed under similar arrangements such that at least one U.S. persons bears unlimited responsibility for the non-U.S. person's liabilities. In our view, the nature of the legal arrangement between the U.S. person and the non-U.S. person—which makes the U.S. person responsible for the obligations of the non-U.S. person—is appropriately characterized as a recourse guarantee, absent countervailing factors. More generally, a recourse guarantee is present if, in connection with the security-based swap, the counterparty itself has a legally enforceable right to payment or collection from the U.S. person, regardless of the form of the arrangement that provides such a legally enforceable right to payment or collection.

Accordingly, the final rule clarifies that for these purposes a counterparty would have rights of recourse against the U.S. person ''if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap.'' [338]

In revising the proposal, we have been influenced by commenter concerns that the proposed approach could allow non-U.S. persons to conduct a dealing business involving security-based swaps that are guaranteed by a U.S. affiliate without being regulated as a dealer, even though the guarantee exposes the U.S. person guarantor to risk in connection with the dealing activity.[339]

This final rule also reflects our conclusion that a non-U.S. person—to the extent it engages in dealing activity involving security-based swaps subject to a recourse guarantee by its U.S. affiliate—engages in dealing activity that occurs, at least in part, within the United States. As discussed above, the economic reality is that by virtue of the guarantee the non-U.S. person effectively acts together with its U.S. affiliate to engage in the dealing activity that results in the transactions, and the non-U.S. person's dealing activity cannot reasonably be isolated from the U.S. person's activity in providing the guarantee. The U.S. person guarantor together with the non-U.S. person whose dealing activity it guarantees jointly may seek to profit by providing liquidity and otherwise engaging in dealing activity in security-based swaps, and it is the U.S. guarantor's financial resources that enable the guarantor to help its affiliate provide liquidity and otherwise engage in dealing activity. It is reasonable to assume that the counterparties of the non-U.S. person whose dealing activity is guaranteed look to both the non-U.S. person and the U.S. guarantor for performance on the security-based swap. Moreover, the U.S. guarantor bears risks arising from any security-based swap between the non-U.S. person whose dealing activity it guarantees and that affiliate's counterparties, wherever located.

This approach is consistent with the purposes of Title VII. The exposure of the U.S. guarantor creates risk to U.S. persons and potentially to the U.S. financial system via the guarantor to a comparable degree as if that U.S. person had directly entered into the transactions that constituted dealing activity by the affiliate. In many cases the counterparty to the non-U.S. person whose dealing activity is guaranteed may not enter into the transaction with that non-U.S. person, or may not do so on the same terms, absent the guarantee. The U.S. guarantor usually undertakes obligations with respect to the security-based swap regardless of whether that non-U.S. person ultimately defaults in connection with the security-based swap.[340]

In requiring non-U.S. persons whose dealing involves security-based swaps that are guaranteed by a U.S. person to apply those dealing transactions against the *de minimis* thresholds, the final rule further reflects the fact that the economic reality of an offshore dealing business using such non-U.S. persons may be similar or identical to an offshore dealing business carried out through a foreign branch. In both cases the risk of the dealing activity has directly been placed into the United States, and non-U.S. counterparties generally may be expected to look to a U.S. person's creditworthiness in deciding whether to enter into the transaction with the guarantor's non-U.S. affiliate or the foreign branch (and on what terms). The final rule thus should help apply dealer regulation in similar ways to differing organizational structures that serve similar economic purposes, and help avoid disparities in applying dealer regulation to differing arrangements that pose similar risks to the United States.[341]

We believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, U.S. persons may have a strong incentive to evade dealer regulation under Title VII simply by conducting their dealing activity via a guaranteed affiliate, while the economic reality of transactions arising from that activity—including the risks these transactions introduce to the U.S. market—would be no different in most respects than transactions directly entered into by U.S. persons. In other words, for example, if a U.S. entity engaged in security-based swap dealing wanted to either avoid registration or otherwise have its security-based swap transactions with foreign counterparties be outside the various Title VII requirements with respect to those transactions, it could establish an overseas affiliate and simply extend a

[338] *See* Exchange Act rule 3a71–3(b)(1)(B). This approach of looking to the presence of rights of recourse to identify guarantees is consistent with our prior views in connection with Title VII implementation. *See generally* Intermediary Definitions Adopting Release, 77 FR 30689 (stating that in connection with the application of the major participant definition, ''positions in general would be attributed to a parent, other affiliate or guarantor for purposes of the major participant analysis to the extent that the counterparties to those positions would have recourse to that other entity in connection with the position''); Cross-Border Proposing Release, 78 FR 30977 (noting that a guarantee would typically give the counterparties to a U.S. non-bank dealer direct recourse to a holding company, as though the guarantor had entered into the transactions directly).

[339] *See* BM Letter at 12, 17–18 (stating that the ''proposed exemption has the potential to create a large loophole for foreign market participants, while leaving the risk with the American taxpayer,'' also stating that ''*de facto* guaranteed affiliates'' should be classified as U.S. persons ''under the SEC's territorial or anti-evasion authority''); AFR Letter I at 5 (suggesting that the proposed treatment of U.S.-guaranteed affiliates, as well as certain other aspects of the proposal, could result in regulatory arbitrage).

[340] We understand that, in practice, a guarantor's obligation to a derivatives counterparty of a person whose security-based swap activity is guaranteed may be based on the same terms as that of the guaranteed person, and that the guarantor's obligation to make payments under the contract may not be contingent upon the guaranteed person's default. Moreover, we understand that margin payments under a contract at times may be made directly by a U.S. guarantor to the counterparty of the guaranteed person, particularly when the corporate group uses a consolidated back office located within a parent guarantor, or when the derivative is denominated in U.S. dollars. We further understand that a counterparty may, for risk management purposes, use a single credit limit for all transactions guaranteed by a parent, regardless of which particular affiliate may be used for booking the transaction with that counterparty.

[341] For the above reasons, we conclude that this final rule 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 Exchange Act section 30(c). *See* section II.B.2(a), *supra.*

payment guarantee. The purpose for doing so would be to evade the requirements of Title VII and the incentives to do so could be high, making it necessary and appropriate to invoke our Title VII authority, because the economic reality of these transactions would be no different in most respects, including the risks these transactions could introduce to the U.S. market. Arrangements between a U.S. person and a non-U.S. person that, as a matter of law in the relevant jurisdiction, make the U.S. person responsible for the non-U.S. person's liabilities may create similarly strong incentives to restructure business operations to avoid the application of Title VII by providing the economic equivalent of an express guarantee through an arrangement that under relevant law provides the non-U.S. person counterparty with direct recourse against the U.S. person. For these reasons, we believe that it is necessary and appropriate to adopt this rule pursuant to our anti-evasion authority under Exchange Act section 30(c).[342]

Compared to the proposal, this approach also more fully accounts for differences between the regulatory regimes applicable to security-based swap dealers and major security-based swap participants. The definition of ''major security-based swap participant'' focuses on systemic risk issues, in that it particularly targets persons that maintain ''substantial positions'' that are ''systemically important,'' or that pose ''substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets.'' [343] The thresholds associated with the major participant definition reflect that systemic risk focus.[344] The dealer definition, in contrast, is activity-focused, addresses the significance of a person's dealing activity only via the *de minimis* exception, and addresses regulatory interests apart from risk.[345] Accordingly, upon further consideration, we believe that availability of major participant regulation does not mitigate the above considerations regarding risk and regulatory treatment of similar business models, and those considerations are better addressed by counting dealing activities guaranteed by U.S. affiliates against the *de minimis* thresholds of the non-U.S. persons whose transactions are subject to the guarantees.[346]

In adopting these provisions, we acknowledge that the final rule does not go as far as some commenters have requested, in that it does not require a non-U.S. person to count its dealing transactions involving security-based swaps that do not grant its counterparty a recourse guarantee against the U.S. affiliate of that non-U.S. person, even if the U.S. affiliate is subject to a recourse guarantee with respect to other security-based swaps of the same non-U.S. person. The final rule also does not incorporate the suggestion from certain commenters that we should treat U.S. entities and their affiliates as equivalent for purposes of the cross-border implementation of Title VII.[347] The final rule further does not incorporate the suggestion that affiliates of a U.S. person should be presumed to be recipients of *de facto* guarantees, which could be rebutted via disclosure.[348]

Those commenters raise important concerns regarding the possibility that, even absent explicit financial support arrangements, U.S. entities that are affiliated with non-U.S. persons for reputational reasons may determine that they must support their non-U.S. affiliates at times of crisis. In those commenters' view, such considerations impose risks upon U.S. markets even absent explicit legal obligations. As a result, the commenters suggest that foreign affiliates of U.S. entities should have to count all their dealing transactions against the *de minimis* thresholds, or that such foreign affiliates should be deemed to be ''U.S. persons'' for purposes of Title VII.[349]

Our modification requiring these non-U.S. persons to count certain of their dealing transactions with non-U.S. persons against the *de minimis* thresholds partially addresses those commenter concerns.[350] We also recognize that there may be circumstances in which a U.S. person provides its foreign affiliate with non-recourse support that is not specifically linked to particular instruments or to derivatives activities generally. Our final rule, however, targets recourse-based arrangements whereby the counterparties to the non-U.S. affiliate would be particularly likely to look to the U.S. person for satisfaction of some or all of the obligations arising under the security-based swap. On balance, we believe that an approach that focuses on the presence of recourse arrangements appropriately addresses dealing activities that have a particularly direct effect on the U.S. market, as well as the ability of a U.S. person to use such guarantees to conduct a security-based

[342] Exchange Act section 30(c) particularly provides 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.

[343] *See* Exchange Act section 3(a)(67).

[344] For example, for cleared security-based CDS, a person would have to write $200 billion notional of CDS protection to meet the relevant $2 billion ''potential future exposure'' threshold that is used as part of the major participant analysis. *See* Intermediary Definitions Adopting Release, 77 FR 30671 n.914.

[345] *See id.* at 30629 (''The statutory requirements that apply to swap dealers and security-based swap dealers include requirements aimed at the protection of customers and counterparties, . . . as well as requirements aimed at helping to promote effective operations and transparency of the swap and security-based swap markets.''; footnotes omitted).

[346] This is consistent with the view of one commenter that highlighted the differences in purpose between dealer and major participant regulation. *See* BM Letter.

[347] *See id.* at 14, 17–18 (''Thus, regardless of whether an affiliate is 'guaranteed' by a U.S. person, that affiliate may be effectively guaranteed, having the same connection with and posing the same risks to the United States.''). *See also* AFR Letter I at 7–8.

[348] *See* notes 333 and 334, *supra* and accompanying text. We note that any U.S. person that is subject to the reporting requirements of section 13(a) or section 15(d) of the Exchange Act, 15 U.S.C. 78m(a) or 15 U.S.C. 78o(d) respectively, regardless of whether that person provides a recourse guarantee relating to its non-U.S. affiliates' obligations, must consider whether there are disclosures that must be made in its periodic reports regarding any of its obligations. These disclosures would include any known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on the financial condition or operating performance of the U.S. person that would be required to be disclosed pursuant to Item 303 of Regulation S–K. As required by Item 303 of Regulation S–K, the disclosures are presented with regard to the registrant (the U.S. person) and its subsidiaries on a consolidated basis. *See* Item 303 of Regulation S–K, 17 CFR 229.303, and *Commission's Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations,* Securities Act Release No. 8350 (Dec. 19, 2003), 68 FR 75056 (Dec. 29, 2003). *See also* Item 305 of Regulation S–K, 17 CFR 229.305.

[349] *See* AFR Letter I at 7 (stating that ''[b]oth explicit and implicit guarantees of support from the parent institution should be counted,'' with a rebuttable presumption that a subsidiary of a U.S. entity is guaranteed, and that ''[s]hould the SEC not include guaranteed affiliates and subsidiaries in the definition of 'U.S. person', at the very least SBS with such entities should count toward entities *de minimis* calculation''); BM Letter at 12, 17 (stating that guaranteed affiliate should be defined ''to include those affiliates that are de factor guaranteed, even though not explicitly subject to a guarantee agreement,'' and that transactions with non-U.S. persons that receive guarantees from U.S. persons should be included in the *de minimis* calculation).

[350] This final rule regarding the *de minimis* exception does not encompass non-U.S. persons who receive a guarantee from an *unaffiliated* U.S. person. We do not expect that U.S. persons would use guarantees of unaffiliated persons as a substitute for dealing activity via a foreign branch, and we do not believe such arrangements comprise a significant part of dealing activity in the market. Our final rules do, however, generally require such non-affiliate arrangements to be included in the major security-based swap participant threshold calculations. *See* section V.D.3, *infra*.

swap dealing business as an alternative to using a foreign branch.

This is not to say that more general financial support arrangements do not also pose risks to U.S. persons and potentially to the U.S. financial system, including risks posed by the activity of non-U.S. persons to their U.S. parents or affiliates. However, we believe that this focus on recourse guarantees appropriately addresses the most direct risks posed by such guarantee arrangements to U.S. persons and potentially to the U.S. financial system. We also note that Congress has provided additional regulatory tools apart from Title VII to address such risks. Indeed, in enacting the Dodd-Frank Act, Congress provided general tools—not merely tools focusing on derivatives activities—to address the risks associated with U.S.-based financial groups as a whole, including the risks posed by such groups' non-guaranteed foreign affiliates engaged in financial services business. This holistic approach to risks that could flow back to the United States may reflect the fact that financial services activities apart from security-based swaps constitute the great majority of such groups' overall financial activities outside the United States that can produce such risks. The regulatory tools substantially enhanced by the Dodd-Frank Act to better address these cross-border risks posed by financial services activities other than security-based swaps and such tools include globally consolidated capital requirements (including enhanced capital and leverage standards, group-wide single-counterparty credit limits, and capital surcharges for firms with particularly high levels of risk), and globally consolidated liquidity and risk management standards (including stress testing, debt-to-equity limitations, living will requirement, and timely remediation measures). By accounting for risks at the consolidated level, these tools address risks posed by guaranteed and non-guaranteed subsidiaries within U.S.-based financial groups, regardless of whether the subsidiaries are based in the United States or outside the United States.[351] Our focus on recourse guarantees appropriately targets the concerns raised by security-based swap activity that Title VII was intended to address, recognizing that Congress has established other regulatory tools that are specifically intended, and better suited, to address risks to bank holding companies and financial holding companies, arising from the financial services activities of a foreign affiliate of those holding companies where the foreign affiliate does not engage in security-based swap activity in the United States.

Conversely, one commenter implicitly appeared to oppose any requirement that non-U.S. persons count their guaranteed transactions carried out in a dealing capacity with non-U.S. person counterparties against their *de minimis* thresholds.[352] For the reasons discussed above, however, we believe that the targeted counting required by the final rule is appropriate to reflect activity involving security-based swaps that occurs in the United States and presents risks to U.S. persons and potentially to the U.S. financial system.

Finally, in adopting these provisions we recognize that the CFTC Cross-Border Guidance appears to broadly opine that non-U.S. persons who receive any express guarantee from a U.S. affiliate should, as a general matter, count all of their dealing activity against the *de minimis* thresholds, regardless of whether a counterparty has recourse against the U.S. person in connection with the swap.[353] Our final rule is more targeted than the CFTC approach, in that our final rule requires a non-U.S. guaranteed affiliate to count only those dealing transactions for which the counterparty to the security-based swap has recourse against a U.S. person that is affiliated with the non-U.S. person. This reflects our decision to focus the application of the *de minimis* exception on recourse arrangements involving security-based swaps, while recognizing that some non-recourse arrangements could influence a U.S. person to provide financial support to non-U.S. persons and thereby present risk to the U.S. person and potential risk to the U.S. financial system.

2. Dealing Transactions of Non-U.S. Persons Involving U.S. and Other Counterparties

(a) Proposed Approach and Commenters' Views

Under the proposal, non-U.S. persons also would be required to count their dealing transactions entered into with a U.S. person, other than a foreign branch.[354] As discussed below, this proposed exclusion for transactions in which the counterparty is a foreign branch reflected concerns regarding U.S. banks being limited in their access to foreign counterparties when conducting dealing activity through their foreign branches.

The proposal solicited comment regarding whether non-U.S. persons should be required to count, towards their *de minimis* thresholds, transactions with U.S. persons or with foreign branches of U.S. banks. It also solicited comment regarding whether non-U.S. persons should be required to count the dealing transactions they enter into with registered security-based

[351] *See, e.g.,* Public Law 111–203, sections 165–166 of the Dodd Frank Act, 124 Stat. 1376, 1423–32 (2010). In the Cross-Border Proposing Release, in connection with our preliminary view that the risks posed by guarantees could be adequately addressed via the regulation of major security-based swap participants, we referenced the Bank Holding Company Act of 1956, and the provisions of Title I of the Dodd-Frank Act regarding the regulation of certain nonbank financial companies and bank holding companies that pose a threat to the financial stability of the United States. *See* Cross-Border Proposing Release, 78 FR 31006 n.360.

For the reasons discussed above, however, we have concluded that the presence of those particular regulatory safeguards do not warrant the conclusion that non-U.S. guaranteed affiliates of U.S. persons should not have to count, against the *de minimis* thresholds, their dealing activity involving other non-U.S. persons when the transaction is subject to a right of recourse against the U.S. affiliate. Although those provisions encompass regulatory safeguards that can be expected to address the risks associated with U.S.-based financial groups, upon further consideration we conclude that it is appropriate for the application of the *de minimis* test to directly account for those specific security-based swap transactions that are subject to recourse guarantees, as opposed to more generalized risks arising from the range of activities conducted by non-guaranteed foreign affiliates, given the U.S. person's participation in the security-based swap transaction through the guarantee.

[352] *See* note 335, *supra,* and accompanying text.

[353] *See* CFTC Cross-Border Guidance, 78 FR 45319. For those purposes, the CFTC Cross-Border Guidance interprets guarantees generally to include ''not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations with respect to its swaps,'' and also refers to ''keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements, and any other explicit financial support arrangements'' as being types of guarantees notwithstanding that that they ''may provide for different third-party rights and/or address different risks than traditional guarantees.'' *See id.* at 45319–20.

[354] *See* proposed Exchange Act rule 3a71–3(b)(1)(ii). For those purposes, ''foreign branch'' was defined to mean 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 it is located. *See* proposed Exchange Act rule 3a71–3(a)(1). The proposal also included a definition of ''transaction conducted through a foreign branch'' that encompassed transactions solicited, negotiated, or executed through a foreign branch where the foreign branch is the counterparty to the transaction, and the transaction was not solicited, negotiated, or executed by a person within the United States. *See* proposed Exchange Act rule 3a71–3(a)(4).

Under the CFTC's cross-border guidance, as a general matter non-U.S. persons may exclude their dealing activities involving foreign branches of U.S. persons only if the U.S. person is registered with the CFTC as a swap dealer. *See* CFTC Cross-Border Guidance, 78 FR 45319.

swap dealers, and regarding whether non-U.S. persons should be able to conduct dealing transactions within the United States without registering if their transactions are with a registered security-based swap dealer.[355]

Two commenters took the position that non-U.S. persons should have to count their transactions with foreign branches of U.S. banks against the *de minimis* thresholds, noting that those foreign branches themselves fall within the ''U.S. person'' definition,[356] and stating that excluding those transactions would serve as a loophole from regulation.[357] In contrast, one commenter stated that such transactions should be excluded from the *de minimis* analysis even if U.S. personnel are involved in soliciting, negotiating, executing or booking the transaction.[358]

Commenters also addressed the application of the exception to non-U.S. persons' dealing activities involving counterparties that are guaranteed affiliates of non-U.S. persons. The proposal did not require such transactions to be counted. One commenter expressed support for the fact that our proposal, unlike the CFTC's guidance, did not require non-U.S. persons to count certain transactions with non-U.S. counterparties that are guaranteed by U.S. persons.[359] On the other hand, one commenter stated that non-U.S. persons should count against the thresholds security-based swaps entered into with guaranteed affiliates and subsidiaries of U.S. persons if those affiliates and subsidiaries are not included within the ''U.S. person'' definition.[360] Also, as noted above, that commenter and one other commenter generally suggested that the presence of explicit or implicit guarantees of foreign affiliates should trigger application of the Exchange Act.[361]

(b) Final Rule

The final rule has been modified from the proposal to require non-U.S. persons (other than conduit affiliates[362]) to count, against the *de minimis* thresholds, their dealing transactions with U.S. persons other than certain transactions with the foreign branches of registered security-based swap dealers.[363] The proposal would have excluded all of the non-U.S. person's transactions with a foreign branch (other than ''transactions conducted within the United States'') regardless of the branch's registration status.

The requirement that such non-U.S. persons must count their dealing transactions with U.S. persons against the *de minimis* thresholds reflects the fact that dealing activity involving counterparties who are U.S. persons necessarily involves the performance, at least in part, of dealing activity within the United States. As discussed above, a non-U.S. person engaged in dealing activity with U.S. persons in an amount sufficient to implicate the *de minimis* thresholds reasonably can be concluded to constitute dealing activity within the United States by virtue of indicating that the non-U.S. person is commonly known in the trade as a security-based swap dealer within the United States, and that the non-U.S. person is regularly entering into security-based swaps as an ordinary course of business within the United States.[364] Similarly, that non-U.S. person seeks to profit by, among other things, providing liquidity within the United States and engaging in market making in security-based swaps within the United States, and its decision to engage in dealing activity with U.S. persons affects the liquidity of the security-based swap market within the United States. U.S. persons incur risks arising from this dealing activity, which in turn potentially creates risk to the U.S. financial system more generally. Transactions with U.S. persons further raise market transparency and counterparty protection concerns that Title VII is intended to address. Accordingly, the dealing activity of such a non-U.S. person is best characterized as occurring, at least in part, within the United States to the extent that the dealing activity involves a U.S. person.[365] No commenters to the Cross-

[355] *See* Cross-Border Proposing Release, 78 FR 30995.

[356] *See* AFR Letter I at 6 (supporting the premise that offices and branches of U.S. persons are ''an integral part of the U.S. person'' but arguing that it is inconsistent to treat such foreign branches different from their U.S. parent institutions); BM Letter at 18 (noting that the foreign branch of a U.S. person should be treated no differently than the U.S. person).

[357] *See* AFR Letter I at 6–7 (''With these incentives [related to transactions with foreign branches, offices and guaranteed subsidiaries and affiliates of U.S. persons], it is unlikely that any foreign entities will choose to trade within the United States directly, and quite likely that U.S. financial institutions will simply advise their clients to trade with their foreign branches if they want to avoid Dodd-Frank''); BM Letter at 3, 18–19 (''This exception is no more than a loophole based upon a scare tactic, which will cause U.S. firms to operate their SBS business through offshore branches.'').

[358] *See* SIFMA/FIA/FSR Letter at A–15 to A–16 (supporting the proposed approach and urging the Commission to extend the exclusion to transactions between non-U.S. persons and foreign branches even if they are conducted within the United States).

[359] *See* SIFMA/FIA/FSR Letter at A–17. Under the CFTC's guidance, non-U.S. persons would generally count certain dealing transactions involving counterparties that are guaranteed affiliates of U.S. persons, subject to exceptions. *See* CFTC Cross-Border Guidance, 78 FR 45319.

[360] *See* AFR Letter I at 7–8 and note 28 (stating that the proposal ''incentivizes U.S. institutions to execute SBS indirectly by using foreign affiliates, subsidiaries, branches and offices,'' and thus lead U.S. institutions to incur risks ''by trading with foreign entities without the full regulatory protections of Dodd-Frank''; also acknowledging that U.S. guarantors would count those trades for determining whether the guarantor is a major participant, but adding that major participants are subject to fewer requirements than dealers ''so this is not a satisfactory method for addressing the risks presented by U.S. parent institutions guaranteeing the swaps of foreign subsidiaries and affiliates'').

[361] *See* note 333, *supra.*

[362] The separate counting requirements applicable to conduit affiliates are addressed above. *See* section IV.D, *supra.*

[363] *See* Exchange Act rule 3a71–3(b)(1)(iii)(A). ''Foreign branch'' is defined in Exchange Act rule 3a71–3(a)(2).

[364] *See* section II.B.2(b)iii, *supra.* We also note that the Commission's traditional approach toward the registration of securities brokers and dealers under the Exchange Act generally requires registration of foreign brokers or dealers that, from outside the United States, induce or attempt to induce securities transactions by persons within the United States. *See* Cross-Border Proposing Release, 78 FR 30990 n.213 and accompanying text.

In this regard we recognize that Exchange Act rule 15a-6, which provides an exemption for the activities of certain foreign broker-dealers, includes an exemption for transactions in securities with or for persons ''that have not been solicited by the foreign broker or dealer.'' Exchange Act rule 15a-6(a)(1). In adopting this provision, the Commission stated that it ''does not believe, as a policy matter, that registration is necessary if U.S. investors have sought out foreign broker-dealers outside the United States and initiated transactions in foreign securities markets entirely of their own accord.'' *See* 54 FR 30013, 30017 (Jul. 18, 1989). The Commission further stated that a narrow construction of ''solicitation'' would be inconsistent with the Exchange Act. *See id.* at 30018. We do not believe that a similar unsolicited exception—which reflects a policy decision rather than a matter of statutory scope—would be appropriate in this context, particularly given that situations in which non-U.S. persons engage in dealing activity with U.S. persons in an amount that is significant enough to implicate the *de minimis* thresholds would not appear consistent with a policy allowing non-U.S. persons to accommodate transactions which U.S. persons initiate ''entirely of their own accord.'' Moreover, we note that the definition of ''security-based swap dealer'' includes persons that hold themselves out as security-based swap dealers or that are commonly known in the trade as security-based swap dealers. *See* Exchange Act section 3(a)(71)(A). Such persons may not actively solicit transactions from particular customers, and nothing in the statutory definition suggests that active solicitation on the part of such persons is required for them to fall within the definition of ''security-based swap dealer.''

[365] For the above reasons, we conclude that this final rule 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 Exchange Act section 30(c). *See* section II.B.2(b)iii, *supra.* We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, market participants could engage in dealing activity with persons

Border Proposing Release expressed opposition to generally requiring non-U.S. persons to count their dealing transactions with U.S. persons (other than comments regarding transactions with foreign branches, as discussed below).

The final rule permits such non-U.S. persons not to count certain dealing transactions conducted through a foreign branch of a counterparty that is a U.S. bank as part of the *de minimis* analysis. For this exclusion to be effective, persons located within the United States cannot be involved in arranging, negotiating, or executing the transaction. Moreover—and in contrast to the proposal—the counterparty bank must be registered as a security-based swap dealer,[366] unless the transaction occurs prior to 60 days following the effective date of final rules providing for the registration of security-based swap dealers.[367] Registration of the counterparty U.S. bank would not be required for the exclusion to be effective before then, given that the non-U.S. person would not be able to know with certainty whether the U.S. bank in the future would register with the Commission as a security-based swap dealer.[368]

As we noted in the proposal, although a foreign branch is part of a ''U.S. person,'' and dealing transactions with foreign branches pose risk to the U.S. financial system, requiring non-U.S. persons to count transactions with foreign branches ''could limit 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.''[369] We continue to believe that generally permitting a non-U.S. person not to count those types of transactions that do not involve U.S. personnel against the thresholds thus should help avoid the disparate treatment of foreign branches that engage in security-based swap dealing activity and that seek to access offshore dealing services, compared to other persons that engage in security-based swap dealing activities outside the U.S.

The final rule differs from the proposal in that the final rule permits a non-U.S. person not to count its transactions with a foreign branch of a U.S. person against the *de minimis* thresholds only when the foreign branch is part of a registered security-based swap dealer (or for a temporary period of time prior to 60 days prior to the effectiveness of the dealer registration requirements), rather than transactions with any foreign branch. This tailoring of the proposal seeks to balance the above concerns that the proposed approach would result in disparate treatment of foreign branches and U.S. persons having inadequate access to liquidity located outside the United States, against the purposes of dealer regulation under Title VII. This consideration of competing interests results in an approach that will help to focus the application of the *de minimis* exception in such a way as to ensure that a registered security-based swap dealer is involved in the transaction, and thus that relevant Title VII provisions applicable to dealers (such as margin requirements) will apply to the transaction.[370] This manner of focusing the exclusion also is consistent with the approach taken by the CFTC in its cross-border guidance.[371]

In adopting an exclusion for certain transactions with foreign branches, we recognize that some commenters opposed having any such exclusion for a non-U.S. person's transactions with a foreign branch, stating that the breadth of the proposed exclusion would facilitate the avoidance of the Dodd-Frank Act even while U.S. entities incur the risks of transactions with foreign entities, and that the exclusion would be based on a ''scare tactic.''[372] We nonetheless believe that this approach is justified by concerns about disparate treatment, along with associated liquidity concerns.[373] We also note that the modification of the proposal—such that transactions with foreign branches are excluded only if the foreign branch is part of a registered dealer—should help address concerns that the exclusion would promote evasion of the dealer requirements.[374] Also, as discussed below, a transaction would not constitute a ''transaction conducted through a foreign branch'' if personnel located in the United States were responsible for arranging, negotiating or executing the transaction.

We also recognize that commenters took the view that such an exclusion is inconsistent with the fact that foreign branches fall within the ''U.S. person'' definition.[375] In our view, the exclusion does not disregard the U.S.-person status of foreign branches. Instead, as discussed above, we believe that this exclusion is appropriate to address market concerns regarding disparate treatment of the dealing activity of foreign branches, notwithstanding that U.S.-person status.

We also have considered the view of one commenter that all of a non-U.S. person's transactions with foreign

within the U.S. market, causing the U.S. person counterparties to incur associated risks simply by using non-U.S. persons to engage in those transactions with U.S. counterparties.

[366] *See* Exchange Act rule 3a71–3(b)(1)(iii)(A)(1).

As addressed in the Cross-Border Proposing Release, the ability of U.S. banks to conduct security-based swap activity potentially will be limited by section 716 of the Dodd-Frank Act, which in part prohibits certain federal assistance to security-based swap dealers, and by section 619 of the Dodd-Frank Act, which in part prohibits banking entities from engaging in proprietary trading. *See* Cross-Border Proposing Release, 78 FR 31002 n.326. The prohibitions of section 619 do not extend to certain market making activities. *See* Dodd-Frank Act section 619(d)(1)(B). In December of 2013, the Commission, together with the Office of the Comptroller of Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the CFTC, issued final rules implementing section 619 of the Dodd-Frank Act. *See* 79 FR 5536 (Jan. 31, 2014). In addition, based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches.

[367] *See* Exchange Act rule 3a71–3(b)(1)(iii)(A)(2).

[368] In other words, this provision will help to avoid requiring non-U.S. persons to speculate whether their counterparties would register, and to face the consequences of their speculation being wrong.

[369] Cross-Border Proposing Release, 78 FR 31003.

[370] We note that the mere involvement of a registered dealer in a transaction by itself would not implicate the above concerns regarding disparate treatment and liquidity that balance against the purposes of dealer regulation when it is not acting through a foreign branch, and thus by itself would not be sufficient to justify a more general exception to these counting principles (*e.g.,* an exception for a non-U.S. person's dealing transactions involving any U.S. person that is registered as a security-based swap dealer).

[371] *See* CFTC Cross-Border Guidance, 78 FR 45319.

[372] *See* note 357, *supra.*

[373] In this regard we recognize that dealing activity involving foreign branches of U.S. banks does pose risks to the U.S. bank of which the foreign branch is a part and potentially to the U.S. financial system. Such risks are mitigated in part, however, in that foreign branches of banks that are registered security-based swap dealers will be subject to a number of Title VII regulatory requirements, including capital and margin requirements, that are designed to protect the system against those risks. Furthermore, this limitation is designed to help preserve liquidity throughout the system, given that absent the exclusion non-U.S. dealers may have reasons to favor non-U.S. counterparties to avoid the regulatory requirements of Title VII, which could threaten to fragment liquidity across geographical or jurisdictional lines.

[374] This modification—in conjunction with the fact that dealing transactions conducted through the foreign branch of a U.S. bank will have to be counted against the bank's *de minimis* thresholds regardless of counterparty (as was proposed)—will limit the possibility that U.S. banks could engage in a significant amount of security-based swap business through their foreign branches without either the banks or their non-U.S. counterparties being subject to dealer regulation.

[375] *See* note 356, *supra.*

branches should be excluded from the analysis, even if U.S. personnel are involved in soliciting, negotiating, executing or booking the transaction.[376] As discussed elsewhere, we conclude that a non-U.S. person's dealing transactions within the United States should be counted against the thresholds.[377] More generally, for the reasons addressed above we conclude that the proposed exclusion related to a non-U.S. person's transactions with a foreign branch should be narrowed—not widened.

The final rule retains the proposed definition of ''foreign branch,'' which encompasses any branch of a U.S. bank that is located outside the United States, operates for valid business reasons, and is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where it is located.[378] As discussed in the Cross-Border Proposing Release, we believe these factors appropriately focus on the location of the branch, the nature of its business and its regulation in a foreign jurisdiction.[379]

The final rule modifies the proposed definition of ''transaction conducted through a foreign branch'' to provide that the definition addresses transactions that are arranged, negotiated, and executed by a U.S. person through a foreign branch if both: (a) The foreign branch is the counterparty to the transaction; and (b) the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States.[380] We believe that this definition identifies the functions associated with foreign branch activity in a manner that appropriately focuses the exclusion for non-U.S. person's transactions toward situations in which the branch performs the core dealing functions outside the United States.[381]

Similar to the proposal, the final definition of ''transaction conducted through a foreign branch'' also states that a person need not consider its counterparty's activities in connection with the transaction—*i.e.,* where its counterparty's personnel arranged, negotiated and executed the transaction—if the person received a representation from the counterparty that the transaction is arranged, negotiated, and executed on behalf of the branch solely by persons located outside the United States, unless the person knows or has reason to know that the representation is not accurate. For these purposes a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.[382] This is intended to help address operational difficulties that a non-U.S. person otherwise could face in investigating the activities of its counterparty to ensure compliance with the rule.

Separately, the final rule, consistent with the proposal, does not require such non-U.S. persons to count, against the *de minimis* thresholds, their dealing transactions with non-U.S. persons whose security-based swap transactions are guaranteed by a U.S. person. We recognize the significance of commenter concerns regarding the risk posed to the United States by such security-based swaps, and regarding the potential use of such guaranteed affiliates to evade the Dodd-Frank Act.[383] We nonetheless believe that such concerns are adequately addressed by the requirement that guaranteed affiliates count their own dealing activity against the *de minimis* thresholds when the counterparty has recourse to a U.S. person. Although there can remain residual risk to U.S. markets associated with the security-based swaps involving such non-U.S. guaranteed affiliates, we do not believe that such risk is significant enough to warrant a requirement that non-U.S. persons count all of their dealing activity involving such non-U.S. guaranteed affiliates against their own *de minimis* thresholds. In this regard we note that such a requirement would necessitate certain non-U.S. persons to incur compliance costs associated with assessing whether their counterparties are guaranteed affiliates.[384] For similar reasons, the final rule does not require such non-U.S. persons to count, against the thresholds, their dealing transactions involving non-U.S. persons that are conduit affiliates.

F. Application of the Exception's Aggregation Principles to Cross-Border Dealing Activity

1. Proposed Approach and Commenters' Views

The Cross-Border Proposing Release also addressed the cross-border

[376] *See* note 358, *supra.*

[377] *See* section II.B.2(b)iii, *supra.*

[378] *See* Exchange Act rule 3a71–3(a)(2).

[379] *See* Cross-Border Proposing Release, 78 FR 31002. No commenters specifically addressed the proposed definition of ''foreign branch.''

We are adopting this definition as proposed while recognizing that it differs from the CFTC's interpretation of ''foreign branch'' in its cross-border guidance. *See* CFTC Cross-Border Guidance, 78 FR 45329 (interpreting ''foreign branch'' in part by reference to designation by banking regulators, and by reference to the accounting of profits and losses). However, we believe that any foreign branch of a U.S. bank that would generally be considered a foreign branch under the CFTC Cross-Border Guidance also likely would be a foreign branch under our final rule.

[380] *See* Exchange Act rule 3a71–3(a)(3)(i). No commenters specifically addressed the proposed definition.

[381] The proposed definition would have addressed transactions that are ''solicited, negotiated, or executed'' by persons outside the United States. The final rule refers to ''arranged'' in lieu of ''solicited'' to reflect the fact that a person may engage in dealing activity not only through transactions that the person actively solicits, but also through transactions that result from counterparties reaching out to the person. *See generally* Exchange Act section 3(a)(71)(A)(i) (defining ''security-based swap dealer'' in part to encompass any person who ''holds themselves out as a dealer in security-based swaps'').

Under the proposed rule, ''transaction conducted through a foreign branch'' was defined, in part, to exclude any transaction solicited, negotiated, *or* executed by a person within the United States on behalf of the foreign branch. *See* proposed Exchange Act rule 3a71–3(a)(4)(i)(B). Under the final rule, this element of the definition is set forth in the affirmative and provides that the transaction must be arranged, negotiated, *and* executed on behalf of the foreign branch solely by persons located outside the United States. *See* Exchange Act Rule 3a71–3(a)(3)(i)(B). Consistent with the proposed rule, the final definition requires all relevant activity to be performed outside the United States for a transaction to fall within the definition of ''transaction conducted through a foreign branch.''

[382] *See* Exchange Act rule 3a71–3(a)(3)(ii). This representation provision within the final definition also contains certain clarifying changes from the proposal, in part to reflect the reference to ''arranged'' in lieu of ''solicited.'' *See* note 364, *supra.* The final rule has been modified from the proposal to reflect the change in the definition of ''transaction conducted through a foreign branch'' described above. *See* note 382, *supra.* Also, consistent with the analogous representation provisions of the ''U.S. person'' definition, the final rule also changes the proposal to reflect that the non-U.S. person may not rely on the representation if it knows that the representation is not accurate, or has reason to know that the representation is not accurate; for these purposes a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate. This ''know or have reason to know'' standard should help ensure that potential security-based swap dealers and major security-based swap participants do not disregard facts that may call into question the validity of the representation. *See* note 302, *supra,* and accompanying text. In addition, applying a single standard of reliance to all representations regarding the status of a person or transaction for purposes of the final rule will reduce the potential complexity of establishing policies and procedures associated with reliance on such representations. *See* section IV.C.4, *supra.*

[383] *See* note 360, *supra.*

[384] In taking this position we also recognize that the CFTC takes a different approach in its cross-border guidance, which generally considers it appropriate for such non-U.S. persons to count their dealing transactions with guaranteed affiliate counterparties, subject to certain exceptions. *See* CFTC Cross-Border Guidance, 78 FR 45319, 45324 (stating there generally is no need for non-U.S. persons to count such dealing transactions with a counterparty that is a registered dealer, an affiliate of a registered dealer whose own dealing activities are below the relevant *de minimis* thresholds, or is guaranteed by a U.S. person that is not a financial entity).

implementation of a previously adopted rule requiring a person to count dealing transactions by its affiliates against its own *de minimis* thresholds.[385] Under the proposal, a person engaged in dealing activity would have had to count: (i) Dealing transactions by its U.S. affiliates, including transactions conducted through a foreign branch; and (ii) all dealing transactions of its non-U.S. affiliates where the counterparty is a U.S. person other than a foreign branch, or where the transaction is conducted within the United States.[386]

In the Cross-Border Proposing Release we took the view that the approach would be consistent with the Dodd-Frank Act's statutory focus on the U.S. security-based swap market, in that the dealing of a person's U.S. affiliates would impact the U.S. financial system regardless of the location of the affiliate's counterparty, but that the dealing of a person's non-U.S. affiliates with other non-U.S. persons outside the United States would not impact the U.S. financial system to the same extent. We also took the view that the aggregation approach would minimize the opportunity for a person to evasively engage in large amounts of dealing activity, and that the approach would be in accordance with other aspects of the proposal governing which transactions would be applied against the thresholds.[387]

The proposal separately would have permitted a person not to include, as part of the *de minimis* analysis, transactions by an affiliate that is registered as a security-based swap dealer, so long as the person's dealing activity is ''operationally independent'' of the dealer's activity.[388] For these purposes, the person and its registered dealer affiliate would be considered to be ''operationally independent'' if the two entities maintained separate sales and trading functions, operations (including separate back offices) and risk management.[389]

This aspect of the proposal recognized that any person affiliated with a registered dealer otherwise would have to count the registered affiliate's dealing activity against the person's own *de minimis* thresholds, which likely would require the person to register as a dealer if it engages in any dealing activity. We stated in the Cross-Border Proposing Release that, in our preliminary view, this outcome of preventing all affiliates of a dealer from taking advantage of the *de minimis* exception would not be consistent with the statutory purpose of the exception. We noted, moreover, that this scenario would not appear to raise the anti-evasion concerns at the core of the aggregation provisions, given that it would apply only where a corporate group already included a registered dealer subject to Commission oversight.[390]

A number of commenters opposed the operational independence condition to the proposed exclusion, arguing that it would hinder operational efficiency—including the use of group-wide risk management—without any countervailing benefit,[391] and that the requirement was vague and would impede the growth of different business models.[392] Commenters also pointed out that, in the parallel discussion in the CFTC's cross-border guidance, the CFTC did not interpret its cross-border statute as requiring operational independence.[393] One of these commenters further opposed the use of any aggregation requirement in connection with the *de minimis* exception.[394] One commenter expressed particular concerns regarding the application of aggregation principles in connection with joint venture arrangements involving dealer shareholders.[395] One commenter supported the proposed approach as an anti-evasion safeguard.[396] One commenter suggested we eliminate the ''operationally independent'' requirement but, to prevent evasion of the dealer requirements, prohibit a registered dealer from using an unregistered affiliate as a booking vehicle.[397]

2. Final Rule

The final rule governing aggregation, like the proposal, generally applies the principles that govern the counting of a person's own dealing activity to also determine how the person must count its affiliates' dealing activities for purposes of the *de minimis* exception. Accordingly, the rule has been modified from the proposal to be consistent with changes to the proposed provisions regarding the counting of a person's dealing activity.

Moreover, the final rule modifies the exclusion from having to aggregate the dealing transactions of a person's registered dealer affiliate from the proposal, both to remove the operational independence condition and to address situations in which a person's affiliate has exceeded the *de minimis* thresholds but is in the process of registering as a dealer.

(a) General Provisions Regarding Aggregation of Cross-Border Transactions

The final rule, like the proposal, provides in part that if a person engages in dealing transactions counted against the *de minimis* thresholds, the person also must count all dealing transactions in which any U.S. person controlling, controlled by, or under common control with the person engages, including transactions conducted through a foreign branch.[398] The final rule has been revised from the proposal to further provide that the person should

[385] *See* Exchange Act rule 3a71–2 (requiring that a person count against the thresholds its dealing activity plus that of ''any other entity controlling, controlled by, or under common control with the person'').

[386] *See* proposed Exchange Act rule 3a71–3(b)(2).

[387] *See* Cross-Border Proposing Release, 78 FR 31004.

[388] *See* proposed Exchange Act rule 3a71–4.

[389] *See* Cross-Border Proposing Release, 78 FR 31005.

[390] *See id.*

[391] *See* SIFMA/FIA/FSR Letter at A–13 to A–15 (stating that the operational independence condition is overbroad and unnecessary to achieve the statutory goals in that it ''would have the effect of tying registration requirements to firms' internal risk management strategies or limited efficient leverage of back office functions'' without any regulatory benefit and noting that the requirement would be burdensome for smaller market participants who would need to register solely due to their affiliation with larger entities); IIB Letter at 14–15 (stating that preventing the sharing of group-wide risk management and other resources would have the effect of nullifying the exclusion from the aggregation requirement for affiliates that are registered security-based swap dealers); JSDA Letter at 4–5 (stating that the ''operationally independent'' condition would discourage efficient global management of transactions).

[392] *See* JFMC Letter at 6–7.

[393] *See* SIFMA/FIA/FSR Letter at A–15; JFMC Letter at 6–7; IIB Letter at 14.

[394] *See* SIFMA/FIA/FSR Letter at A–12 to A–13 (stating that the aggregation requirement ''effectively disregards the legal independence of entities'' and that the Commission's existing anti-evasion capabilities are sufficient to guard against abuses; also stating that had the aggregation requirement been proposed as part of the underlying definitional rules SIFMA would have objected to the requirement).

[395] *See* JSDA Letter at 5 (requesting that aggregation not be required of the minority shareholder of a joint venture); *see also* MUFJ Letter at 2–8 (generally opposing aggregation for such joint venture arrangements).

[396] *See* BM Letter at 17 (stating that the condition is a safeguard that addresses evasion concerns while promoting the purpose of the *de minimis* exception).

[397] IIB Letter at 14–15.

[398] *See* Exchange Act rule 3a71–3(b)(2)(i). Consistent with our position in the Intermediary Definitions Adopting Release (*see* 77 FR 30631 n.437) and in the Cross-Border Proposing Release (*see* 78 FR 31004), and with our position regarding the *de minimis* exception when there is a right of recourse against a U.S. person (*see* note 336, *supra*) for purposes of determining whether a person is controlling, controlled by, or under common control with another person (*i.e.,* an affiliate), we interpret control to mean the direct or indirect 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.

count all dealing transactions of its conduit affiliates.[399] Finally, the final rule has been modified from the proposal to provide that the person must count all dealing transactions of non-U.S. person affiliates that: (a) Are entered into with U.S. persons other than the foreign branches of registered dealers; or (b) constitute dealing activity subject to a guarantee giving the non-U.S. person's counterparty rights of recourse against a U.S. person affiliated with the non-U.S. person.[400]

These modifications from the proposal are consistent with similar modifications made to the rules regarding the counting of a person's own transactions for purposes of the *de minimis* exception, and reflect the risk concerns and interests discussed above. The aggregation requirement serves to prevent evasion of the dealer registration requirements by persons that otherwise may seek to avoid dealer registration by simply dividing up dealing activity in excess of the *de minimis* thresholds among multiple affiliates.[401] In keeping with that purpose, in the cross-border context it is appropriate to require a person's affiliates to count the same dealing transactions that the person itself would be required to count for purposes of the *de minimis* exception—unless, as discussed below, the person is registered as a dealer.[402] Because this approach incorporates the direct counting standards discussed above, we believe that the 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.[403]

(b) Application to Dealing Activities of Registered Affiliates

In addition, we are adopting an exception which provides that a person need not count against the *de minimis* thresholds the security-based swap transactions of an affiliate that either is: (1) Registered with the Commission as a dealer; or (2) deemed not to be a dealer pursuant to the provisions of Exchange Act rule 3a71–2(b), which addresses persons who have exceeded the *de minimis* thresholds but are in the process of registering.[404]

In part, this final rule has been modified from the proposal by removing the proposed operational independence condition. After considering the views of several commenters that the proposed operational independence condition would tend to inhibit operational efficiencies,[405] we are persuaded that excluding the condition from the final rule would help facilitate efficiency and avoid deterring beneficial group-wide risk management practices. In this regard we also note that even with the removal of the proposed operational independence condition, the aggregation provisions would prevent a corporate group from cumulatively engaging in aggregate relevant dealing activity—outside of its registered dealers—in excess of the *de minimis* thresholds.[406]

The final rule also has been modified from the proposal to permit a person to rely on this provision if its affiliate is in the process of registering as a dealer. The *de minimis* rule generally provides that a person that is not registered as a dealer but that no longer falls below the applicable *de minimis* thresholds nonetheless will be deemed not to be a dealer until the earlier of the date in which it submits a complete application for registration as a dealer, or two months after the end of the month that it becomes no longer able to take advantage of the exception.[407] That provision was intended to avoid market disruption in conjunction with the registration process.[408] Upon further consideration, we similarly believe that the provision at issue here should allow a person not to count the transactions of its affiliates that are in the process of registering as dealers, to avoid market disruption that may otherwise result due to the prospect of a person intermittently exceeding the *de minimis* thresholds when its affiliates are in the process of registering. Such situations, moreover, would not appear to provide practical opportunities for corporate groups to evade dealer registration by

[399] *See* Exchange Act rule 3a71–3(b)(2)(ii).

[400] *See* Exchange Act rule 3a71–3(b)(2)(iii) (cross-referencing the direct counting provisions of paragraph (b)(1)(iii), applicable to non-U.S. persons other than conduit affiliates); *see also* Sections IV.E, *supra* (addressing counting by non-U.S. persons engaged in dealing activity whose counterparties are U.S. persons); and IV.E.1 (addressing counting by non-U.S. persons engaged in dealing activity when their counterparties have recourse against a U.S. person).

[401] *See* Intermediary Definitions Adopting Release, 77 FR 30631.

[402] As noted above, one commenter questioned whether any aggregation principles should be applied in the *de minimis* context, arguing that the requirement disregards the legal independence of entities and disregards the possibility that two entities under common control may operate independently of each other. The comment further stated that the Commission's existing anti-evasion capacities are sufficient to guard against abuse without requiring aggregation. *See* note 391, *supra.* In our view, however, the aggregation provision is tailored appropriately to prevent evasion of the limits of the *de minimis* exception. *See* Intermediary Definitions Adopting Release, 77 FR 30631 (discussing the use of the aggregation principles in light of the ''increased notional thresholds of the final [definitional] rules, and the resulting opportunity for a person to evasively engage in large amounts of dealing activity if it can multiply those thresholds''; and addressing the use of the common control standard ''as a means reasonably designed to prevent evasion of the limitations of that exception''). We further believe that this aggregation approach would be more effective at implementing the *de minimis* exception than a case-by-case approach, because the aggregation provision would provide upfront objective standards regarding which affiliate transactions must be counted against the thresholds, and thus help avoid uncertainty. Moreover, as discussed below, we are revising the aggregation provisions to allow the exclusion of the positions of affiliates that are registered as dealers (or that are in the process of registering), in response to comments.

[403] In short, we believe that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, corporate groups may engage in dealing activity above the *de minimis* thresholds within the United States while avoiding dealer regulation under Title VII by dividing up the dealing activity among multiple affiliated entities, none of which individually engages in dealing activity above the thresholds.

[404] *See* Exchange Act rule 3a71–4. This exception, when available, applies to all of the dealing of a person's registered dealing affiliate (or affiliate deemed not to be a dealer pursuant to the provisions of Exchange Act rule 3a71–2(b)), regardless of the counterparty or the location of the transaction, and regardless of whether the dealing transaction otherwise implicates cross-border issues.

[405] *See* notes 391 and 392, *supra.*

[406] We recognize that one commenter supported the proposed operational independence condition, stating that the condition would address evasion concerns while promoting the statutory purpose of the *de minimis* exception. *See* note 396, *supra.* After further consideration, however, we believe that the fact that the aggregation provision will still limit cumulative group-wide dealing activity by unregistered entities to no more than the *de minimis* thresholds should suffice as a safeguard against evasive activity. This is particularly true given that those thresholds are significantly below the amounts of dealing typically engaged in by persons above the thresholds. *See* Intermediary Definitions Adopting Release, 77 FR 30636 (noting that, out of 28 potential dealers that had three or more counterparties that themselves were not recognized as dealers by ISDA, 15 of those exceeded a notional transaction threshold of $100 billion and accounted for over 98 percent of the total activity of all 28 entities).

We also note that certain commenters raised concerns about the application of the aggregation provisions generally in the context of joint ventures, particularly in the context of minority shareholders. *See* note 395, *supra.* Those issues regarding the scope of the aggregation provisions that the Commission previously adopted are not unique to the cross-border context, and in our view are outside the scope of this release. We note generally, however, that in the Intermediary Definitions Adopting Release we concluded that a common control standard is more appropriate than a majority-ownership standard in the context of the anti-evasive purposes of the aggregation requirement. *See* Intermediary Definitions Adopting Release, 77 FR 30631 n.437.

[407] *See* Exchange Act rule 3a71–2(b).

[408] *See* Intermediary Definitions Adopting Release, 77 FR 30643.

dividing dealing activities among multiple affiliates.

G. Exception for Cleared Anonymous Transactions

1. Proposed Approach and Commenters' Views

Three commenters expressed the view [409] that the Commission's final rules should include a provision similar to an aspect of the CFTC Cross-Border Guidance, which stated the CFTC's view that certain dealing transactions that are executed anonymously and cleared generally would not be counted against the *de minimis* thresholds.[410] One commenter particularly emphasized that market participants would not have information available regarding a counterparty's identity in an anonymous transaction, and suggested that the prospect of becoming subject to dealer registration could deter non-U.S. liquidity providers from participating on security-based swap markets that provide access to U.S. persons.[411]

2. Final Rule

After considering commenter views we have concluded that this type of exception is appropriate, particularly given that the final *de minimis* rules turn in part on the domicile of the counterparty to the non-U.S. person, and this information would be unavailable to the non-U.S. person that is a counterparty to a cleared anonymous transaction. Absent such an exception, it is possible that execution facilities would exclude U.S. market participants to prevent their non-U.S. members from having to face the prospect of dealer regulation, which could impair market liquidity and increase costs and risks.[412]

For those reasons, the final rule has been revised from the proposal to except, from having to be counted against the *de minimis* thresholds, certain security-based swap transactions that a non-U.S. person enters into anonymously on an execution facility or national securities exchange and that are cleared through a clearing agency.[413]

In particular, the final rule in part provides that a non-U.S. person need not count such cleared anonymous transactions against the threshold, unless the non-U.S. person is a conduit affiliate.[414] In addition, the final rule permits an affiliate (that itself may be a U.S. or non-U.S. person) of such a non-U.S. person not to count such transactions of the non-U.S. person against the affiliate's own thresholds for purposes of the aggregation provisions, unless the non-U.S. person is a conduit affiliate.[415]

The exception is not available when the non-U.S. person is a conduit affiliate because conduit affiliates are required to count all of their dealing transaction against the thresholds regardless of whether their counterparty is a U.S. or a non-U.S. person. As a result, the anonymous nature of the transaction would not cause implementation issues for conduit affiliates.

For purposes of the exception, a transaction would be ''anonymous'' only if the counterparty to the transaction in fact is unknown to the non-U.S. person prior to the transaction. The transaction would not be ''anonymous'' if, for example, a person submitted the transaction to an execution facility after accepting a request for quotation from a known counterparty or a known group of potential counterparties, even if the process of submitting the transaction itself did not involve a named counterparty.

H. Additional Issues

1. Particular Activities and Entities

Commenters to the Cross-Border Proposing Release raised issues regarding the application of the dealer registration requirement to limited security-based swap activities by certain ''run-off'' entities,[416] and in the context of portfolio compression.[417] Those

[409] *See* IIB Letter at 13–14; JSDA Letter at 4; JFMC Letter at 5.

[410] *See* CFTC Cross-Border Guidance, 78 FR 45325 (stating that when a non-U.S. person that is not a guaranteed or conduit affiliate enters in to swaps anonymously on CFTC-registered platforms, and the swaps are cleared, the non-U.S. person would generally not have to count those swaps against the applicable thresholds, noting that, in such circumstances, the non-U.S. person would not have any prior information regarding its counterparty; also interpreting the CFTC's cross-border jurisdiction such that, with respect to such cleared and anonymously executed swaps, the non-U.S. person would generally satisfy certain transaction-level requirements).

The Cross-Border Proposing Release generally requested comment as to whether the proposed *de minimis* approach would place market participants at a competitive advantage or disadvantage, and as to whether there are other measures the Commission should consider to implement the *de minimis* exception. *See* Cross-Border Proposing Release, 78 FR 30996. More generally, the Commission also requested comment regarding the proposals as whole, and regarding consistency with the CFTC's cross-border approach, including comments regarding the impact of differences between the two approaches, and comments regarding whether the Commission's proposed approach should be modified to conform with that taken by the CFTC. *See id.* at 31102.

[411] *See* IIB Letter at 13–14.

[412] The exclusion for cleared anonymous transactions is intended to avoid placing market participants in a position where counterparty-related information needed for compliance would be unavailable, which may in turn lead execution facilities to exclude U.S. persons. We also note that the exclusion would strengthen incentives for shifting activity to transparent trading venues, which is a key goal of Title VII. While these transactions may pose risks to U.S. persons and to the U.S. financial system as a whole, those risks may be offset by the liquidity and transparency benefits that occur due to trading on transparent venues. Furthermore, the characteristics expected to be associated with central clearing (*e.g.,* the daily exchange of mark-to-market margin) have parallels to the capital and margin requirements for registered dealers in terms of helping to protect the financial system against the risks introduced by particular transactions. On the other hand, such risk mitigation may be absent to the extent that the relevant clearing agency—which under the exception is not required to be registered with the Commission—does not follow standards consistent with the Title VII requirements applicable to registered clearing agencies.

[413] *See* Exchange Act rule 3a71–5. This exception solely addresses the issue of whether a particular transaction needs to be counted against the *de minimis* thresholds. It does not address the issue of when a particular execution facility or clearing agency needs to register with the Commission. The Cross-Border Proposing Release separately addressed cross-border issues regarding when an execution facility or clearing agency would have to register with the Commission. *See* Cross-Border Proposing Release, 78 FR 31054–58 (regarding security-based swap execution facility registration), 78 FR 31038–40 (regarding clearing agency registration); *see also* Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (proposed rules regarding registration and other requirements applicable to security-based swap execution facilities).

This exception also does not address the application of section 5 of the Securities Act to such transactions. Rule 239 under the Securities Act (17 CFR 230.239) provides an exemption under the Securities Act for certain security-based swap transactions involving an eligible clearing agency. This exemption does not apply to security-based swap transactions not involving an eligible clearing agency, such as the anonymous transactions entered into on the execution facility or national securities exchange, regardless of whether the security-based swaps subsequently are cleared by an eligible clearing agency. *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).

[414] *See* Exchange Act rule 3a71–5(a). This exception applies regardless of whether the execution facility on which the transaction is entered into, or the clearing agency through which it is cleared, needs to be registered with the Commission. This is because the exclusion of U.S. market participants from an overseas execution or clearing facility—a result this exception is intended to guard against—could impair the markets regardless of whether the facility from which U.S. persons are excluded in fact are registered, and thus lead to increased costs and risks.

[415] *See* Exchange Act rule 3a71–5(a)(2), (b).

[416] *See* SIFMA/FIA/FSR Letter at A–18 (addressing entities that are consolidating U.S.-facing dealing activities worldwide into one or a few registered dealers, but that may not be able to transfer or terminate their legacy security-based swap portfolios and thus may need to enter into new transactions in connection with those legacy portfolios); JSDA Letter at 4 (suggesting that including contract cancellations, alternations and transfers within the *de minimis* calculation ''might invite a rush of cancellation before the enforcement of the proposed rules and make it difficult to cancel or transfer contracts for reducing risks'').

[417] *See* TriOptima Letter at 3–4 (explaining that portfolio compression services do not involve any

Continued

issues are not unique to the cross-border context, and are outside of the scope of this release. We generally note, moreover, that in the Intermediary Definitions Adopting Release we considered and rejected certain requests for categorical exclusions from dealer definition. With regard to issues regarding the relevance of those or other activities to the *de minimis* analysis, we generally note that the dealer registration requirement necessarily distinguishes between a person's dealing and non-dealing activities.[418]

2. Foreign Public Sector Financial Institutions and Government-Related Entities

As discussed above, the final rule defining ''U.S. person'' (like the proposed definition of that term) specifically excludes several foreign public sector financial institutions and their agencies and pension plans, and more generally excludes any other similar international organization and its agencies and pension plans.[419] Certain commenters requested that we take further action to address the application of the dealer definition and its *de minimis* exception to security-based swap activities involving such foreign public sector financial institutions. Those commenters in part stated that such organizations should not be required to register as security-based swap dealers, and that those organizations' affiliates should be considered immune from domestic regulation to the same extent as the organizations themselves.[420] In our view, however, such issues are outside the scope of this release, given that the source of any such privileges and immunities is found outside of the Dodd-Frank Act and the federal securities laws.

Separately, commenters stated that non-U.S. persons should not have to count their dealing transactions involving those organizations against the non-U.S. persons' dealer *de minimis* thresholds, on the grounds that counting such transactions would constitute the impermissible regulation of such organizations even if those were ''transactions conducted within the United States.''[421] As noted below, we have determined not to include the ''transaction conducted within the United States'' provisions in this final rule. With that said, we do not concur with the suggestion that counting a person's dealing transactions with such organizations against the *de minimis* thresholds—when otherwise provided for by the rules—involves the regulation of such organizations. Requiring a person to count, against the *de minimis* thresholds, the person's dealing transactions involving such an international organization as counterparty simply reflects the application of the federal securities laws to that person and its dealing activities, and does not constitute the regulation of the international organization. A person's security-based swap dealing transaction with such an international organization accordingly are considered the same, for purposes of applying the *de minimis* thresholds and other Title VII requirements, as a dealing transaction with some other non-U.S. person counterparty.

Finally, two commenters stated that they should not be subject to the possibility of dealer regulation for comity reasons, on the grounds that they are arms of a foreign government.[422] We believe that such issues best are addressed on a case-by-case basis, but we generally note that the prospect of dealer regulation is relevant only to the extent that a person engages in dealing activity.

I. Economic Analysis of the Final Cross-Border Dealer De Minimis Rule

These final rules and guidance regarding the cross-border implementation of the *de minimis* exception to the ''security-based swap dealer'' definition will affect the costs and benefits of dealer regulation by determining which dealing transactions will be counted against the exception's thresholds.[423] The cross-border rules have the potential to be important in determining the extent to which the risk mitigation and other benefits of Title VII (such as market transparency and customer protection) are achieved, given the core role that dealers play within the security-based swap market and the market's cross-border nature.[424]

Commenters addressed the associated cost-benefit issues from a variety of perspectives. Some directly addressed the link between the cross-border scope of the dealer definition and the associated costs and benefits, by arguing that cost-benefit principles warranted greater harmonization with approaches taken by the CFTC or foreign regulators.[425] Commenters also

of the enumerated factors that the Commission has identified as indicators of dealing activity).

[418] *See generally* Intermediary Definitions Adopting Release, 77 FR 30616–20 (discussing application of the dealer-trader distinction to security-based swap transactions).

[419] *See* section IV.C.2(e), *supra.*

[420] *See, e.g.,* WB/IFC Letter at 2–4, 6–7 (also stating that such organizations should not be required to register as major participants or to clear security-based swaps, and that affiliates of such organizations should be excluded from the ''U.S. person'' definition); SC Letter at 16–24 (contending that the privileges and immunities afforded such organizations would be violated by their direct regulation as dealers or major participants, or by direct regulation equivalents, and that affiliates of such organizations also are immune from regulation); IDB Letter at 5. *See also* notes 225 and 229, *supra.*

[421] *See* SC Letter at 18–19 (stating that the inclusion of such transactions against a counterparty's *de minimis* thresholds would be ''tantamount to regulation of the operations of the World Bank and the IFC, in violation of their privileges and immunities''); WB/IFC Letter (incorporating SC Letter). These comments did not object to the inclusion of transactions between a U.S. person and an FPSFI, because the Commission would have jurisdiction to regulate that ''U.S. person'' for other reasons and it would not be regulated simply because it does business with the FPSFI. *See* SC Letter at note 21.

[422] *See* KfW Letter; FMS–WM Letter.

[423] As we noted in the Intermediary Definitions Adopting Release, because the *de minimis* exception will determine which entities engaged in security-based swap dealing activity ultimately will be regulated as dealers under Title VII, the exception will have an effect on the burdens and benefits associated with dealer regulation. *See* Intermediary Definitions Adopting Release, 77 FR 30628–30. The thresholds used in the *de minimis* exception accordingly were set at a level that sought to meet the goals of Title VII while appropriately minimizing the costs to market participants by providing for the regulation, as dealers, ''of persons responsible for the vast majority of dealing activity within the market.'' *See id.* at 30638–40.

[424] *See* section III.A, *supra.*

[425] *See, e.g.,* IIB Letter (stating that cost-benefit considerations warrant harmonization to the CFTC and foreign regulatory authorities with regard to cross-border rules, and that divergence generally would be warranted only if the Commission's rules are more flexible, and thence would not preclude the voluntary adoption of consistent practices).

Although we have considered those comments that expressed complete or partial support in favor of consistency with the CFTC guidance, these final rules nonetheless follow approaches that differ from those taken by the CFTC in certain regards, generally by taking approaches that are narrower in scope than those adopted by the CFTC. *See supra* note 255 (Commission's definition of ''U.S. person'' differs from the CFTC approach in part by not including investment companies that beneficially are majority-owned by U.S. persons); note 353 and accompanying text (Commission's rules regarding the treatment of guaranteed affiliates of U.S. persons focuses on the presence of recourse against a U.S. guarantor, in contrast to the CFTC approach that more generally accounts for financial support commitments regardless of recourse rights), note 325(Commission's definition of ''conduit affiliate'' differs from the CFTC's approach in part by not considering financial statement treatment); note 379 (discussing expectation that any foreign branch of a U.S. bank that generally would be considered a foreign branch under the CFTC Cross-Border Guidance also likely would be a foreign branch under our final rule).

We also have considered initiatives by foreign regulators related to the regulation of OTC derivatives. In that regard, we note that the regulatory regimes in certain other jurisdictions do not provide for the registration of persons who function as dealers, in contrast to the approach Congress took in Title VII. Also, we expect to take into account the regulatory frameworks followed in other jurisdictions as we assess requests for substituted compliance in connection with the substantive requirements applicable to security-based swap dealers and other market participants.

addressed the need for cost-benefit analysis,[426] or questioned the adequacy of the Cross-Border Proposal's cost-benefit assessment.[427] Other comments that addressed the dealer definition implicate the tradeoff between the costs and benefits associated with the definition's scope, even when the commenters did not directly address the economic analysis in the Cross-Border Proposing Release or otherwise explicitly raise cost-benefit considerations.[428]

We have taken economic effects into account in adopting these final cross-border rules and providing guidance. In doing so, we believe that a narrow application of dealer regulation under Title VII—such as one that is limited to dealing activity that might be viewed as occurring solely within the United States—would not be sufficient to achieve the purposes of Title VII in light of the attributes of the security-based swap market, including the market's global nature, the concentration of dealing activity, the key role played by dealers and the risks posed by dealers via their legal and financial relationships. At the same time, we recognize that the cross-border application of Title VII has the potential to reduce liquidity within the U.S. market to the extent it increases the costs of entering into security-based swaps or provides incentives for particular market participants to avoid the U.S. market by operating wholly outside the Title VII framework.

The cross-border rules applying the ''security-based swap dealer'' definition to cross-border dealing activity implicate two categories of costs and benefits. First, certain current and future participants in the security-based swap market will incur assessment costs in connection with determining whether they fall within the ''security-based swap dealer'' definition and thus would have to register with the Commission.

Second, the registration and regulation of some entities as security-based swap dealers will lead to programmatic costs and benefits arising as a consequence of the Title VII requirements that apply to registered security-based swap dealers, such as the capital, margin, and business conduct requirements.[429] These requirements may be expected to impose certain costs on participants acting as dealers, but also to produce benefits to the market and its participants, including counterparty protections and risk-mitigation benefits.

We discuss the programmatic and assessment costs and benefits associated with the final rules more fully below. We also discuss the economic impact of certain potential alternatives to the approach taken by the final rules.

1. Programmatic Costs and Benefits

(a) Cost-Benefit Considerations of the Final Rules

Exchange Act rules 3a71–3, 3a71–4, and 3a71–5 will permit market participants to exclude certain dealing transactions from their *de minimis* calculations, and thus may cause particular entities that engage in certain dealing activities not to be regulated as security-based swap dealers. The rules accordingly may be expected to affect the programmatic costs and benefits associated with the regulation of security-based swap dealers under Title VII, given that those costs and benefits are determined in part by which persons will be regulated as security-based swap dealers.[430]

This does not mean that there is a one-to-one relationship between a person not being a ''security-based swap dealer'' as a result of these cross-border rules, and the resulting change to programmatic benefits and costs. Indeed, although these rules may determine which particular entities will be regulated as dealers, it does not follow that total programmatic costs and benefits will vary by an amount proportional 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 dealers may be fixed, while others may be variable depending on a particular person's security-based swap dealing activity.[431] In practice, the programmatic benefits associated with the regulation of persons engaged in security-based swap dealing activity—in other words, the expected transparency, customer protection and market efficiency objectives associated with dealer regulation—likely will vary depending on the type and nature of those persons' dealing activity, including the degree to which those persons engage in security-based swap dealing activity within the United States or in a manner likely to give rise to Title VII concerns within the United States.

We believe that the cross-border rules we are adopting today will focus the regulation of security-based swap dealers under Title VII upon those entities that engage in security-based swap transactions that occur in the United States, or on the prevention of evasion. Our definition of ''security-based swap dealer'' seeks to capture those entities for which regulation of security-based swap activity is warranted due to the nature of their activities with other market participants.[432] Specifically, we have focused the rules on those market participants that are likely to have financial and legal relationships within the United States. This set of entities includes those that currently provide liquidity to U.S. persons as market makers in the OTC security-based swap market and those that trade with U.S. persons as market makers for security-based swaps on organized trading venues. Regulation of these entities will

Those substituted compliance assessments are geared to promote Title VII in a way that fairly accounts for other regimes by assessing the requirements of those regimes on a function-by-function basis.

[426] *See* BM Letter, note 28, *supra.* As stated above, the Commission in fact is sensitive to the economic consequences of its rules, and has taken the costs and benefits into account in adopting these rules.

[427] *See* CDEU Letter, note 28, *supra.* This commenter particularly expressed the view that the Commission's proposal had failed to engage in an adequate consideration of cost-benefit principles, and instead stated that the Commission should ''conduct a direct cost-benefit analysis of the conflicting rule regimes (*e.g.,* with the European Market Infrastructure Regulation and the CFTC's cross-border guidance).'' That commenter further expressed the view that, in requesting comment on the proposal's cost-benefit analysis, the Commission actually ''asks the public to conduct such an analysis for the SEC'' in lieu of the Commission having conducted its own analysis. *See id.*

In actuality, our request for comment simply gave the public the opportunity to address our economic analysis. The economic assessment in this release specifically addresses those economic impacts in a context where many entities may have taken steps to follow the CFTC's cross-border guidance, and also recognizes that market participants may seek to structure their activities to avoid Title VII given differences between Title VII regulation and the regulation present in foreign regimes.

[428] For example, one comment in opposition to the proposed ''operational independence'' condition to the exception to the aggregation requirement for positions of affiliates that are registered as security-based swap dealers in part addressed the extra costs that would be associated with such a provision. *See* SIFMA/FIA/FSR Letter, note 391, *supra.* As discussed above, that proposed condition has been removed. *See* section IV.F, *supra.*

[429] *See* Cross-Border Proposing Release, 78 FR 31135.

[430] *See* Intermediary Definitions Adopting Release, 77 FR 30724.

[431] *See id.* (''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.'').

[432] *See id.* at 30617.

mitigate risk and promote stability for U.S. persons and potentially the U.S. financial markets by increasing the likelihood that they are able to meet their obligations under security-based swap contracts against counterparties with ties to the U.S. financial system once they are subject to the final adopted rules regarding the requirements applicable to dealers (rules establishing capital and margin requirements for registered security-based swap dealers). Furthermore, regulation of these entities as dealers may enable them to continue to provide liquidity to their counterparties, particularly in times when the markets are under financial stress and their counterparties may struggle to meet their financial obligations. We also believe that regulation of these entities will further other goals of Title VII, particularly as we consider future substantive regulation of the security-based swap market. In other words, these requirements will direct the application of the *de minimis* thresholds—which themselves are the product of cost-benefit considerations—toward those dealing activities in U.S. financial markets that most directly implicate the purposes of Title VII. As such, these rules reflect our assessment and evaluation of those programmatic costs and benefits:

• *Dealing by U.S. persons*—The ''U.S. person'' definition captures entities whose security-based swap activities pose risks to the United States that may raise the concerns intended to be addressed by Title VII, regardless of the status of their counterparty.[433] The requirement that U.S. persons, including foreign branches, count all of their dealing transactions against the *de minimis* thresholds reflects the domestic nature of their dealing activity, particularly given that it is the financial resources of the entire person that enable it to engage in dealing activity.[434]

• *Dealing by guaranteed affiliates of U.S. persons*—The requirement that non-U.S. persons count all their dealing transactions that are subject to a recourse guarantee by a U.S. affiliate, even when the counterparty is another non-U.S. person, reflects the domestic nature of that activity and the risks that those recourse guarantees pose to U.S. persons and potentially to the U.S. financial system via the U.S. person guarantor.[435]

• *Dealing by other non-U.S. persons with U.S.-person counterparties*—The general requirement that non-U.S. persons count their dealing transactions with counterparties that are U.S. persons reflects the domestic nature of that activity and the concerns raised by the performance of dealing activity within the United States, impacts on U.S. market liquidity, risks that this dealing activity poses to U.S. persons and potentially toward the U.S. financial system as a whole, and counterparty and market transparency concerns.[436] This general requirement is limited, however, as it does not extend to transactions with foreign branches of U.S. banks that are registered as dealers, or to certain cleared anonymous transactions. While those excluded transactions also involve the performance, at least in part, of relevant dealing activity within the United States, implicate Title VII concerns, and import risk into the United States—and their counting against the thresholds thus would be consistent with achieving the programmatic benefits of dealer regulation—their exclusion is nevertheless warranted by considerations regarding market access by U.S. persons (in the case of transactions with certain foreign branches of U.S. banks)[437] and by considerations regarding information availability and market liquidity (in the case of the exclusion for cleared anonymous transactions).[438]

• *Anti-evasion provisions*—The requirement that conduit affiliates count all of their dealing activities against the thresholds, and the cross-border application of the aggregation requirements related to the *de minimis* exception, both reflect targeted efforts to prevent evasion of the security-based swap dealer requirements of Title VII.[439] We are adopting a definition of ''conduit affiliate'' that excludes affiliates of registered security-based swap dealers and major security-based swap participants to avoid imposing costs on registered persons in situations where the types of evasion concerns that the conduit affiliate definition is intended to address are minimal.

In short, these final rules apply the *de minimis* thresholds—which themselves reflect cost-benefit considerations[440]—to cross-border security-based swap activity in a way that directs the focus of dealer regulation toward those entities whose security-based swap dealing activities most fully implicate the purposes of Title VII, or that is reasonably designed to prevent evasion of dealer regulation under Title VII.

In the Cross-Border Proposing Release, we concluded that ''[t]o the extent that an entity engaged in dealing activity wholly outside the United

[433] *See* section IV.C.3, *supra.*

[434] *See* section IV.B.2, *supra.*

[435] *See* section IV.E.1(b), *supra.* In the Cross-Border Proposing Release we preliminarily concluded that the risks associated with such guarantees could be adequately addressed through major participant regulation. We have reconsidered that view for the reasons discussed above.

[436] *See* section IV.E.2(b), *supra.*

[437] *See* section IV.E.2(b), *supra.* Although dealing activity involving foreign branches of U.S. banks does pose risks to the U.S. bank of which the foreign branch is a part and potentially to the U.S. financial system, foreign branches of registered security-based swap dealers will be subject to a number of Title VII regulatory requirements, including capital and margin requirements, that are designed to protect the system against those risks. Furthermore, this limitation is guided in part by the desire to preserve liquidity throughout the system, given that absent the exclusion non-U.S. dealers may have reasons to favor non-U.S. counterparties to avoid the regulatory requirements of Title VII, which could threaten to fragment liquidity across geographical or jurisdictional lines.

[438] *See* section IV.G.2, *supra.* As noted above, *see* note 412, *supra,* the exclusion for cleared anonymous transactions is driven by concerns about counterparty-related information needed for compliance being unavailable, which in turn may lead U.S. persons to be excluded from certain execution facilities. The exclusion for such transactions also would be expected to have the effect of strengthening incentives for shifting activity to transparent trading venues, a key goal of Title VII. While these transactions of non-U.S. persons may pose risks to the U.S. bank of which the foreign branch is a part and potentially to the U.S. financial system as a whole, those risks may be offset by the liquidity and transparency benefits that occur due to trading on transparent venues. Furthermore, certain of the characteristics we expect to be associated with central clearing (*e.g.,* the daily exchange of mark-to-market margin) serve similar functions as the capital and margin requirements for registered dealers in terms of helping to protect the financial system against the risks introduced by particular transactions. Of course, such risk mitigation may be absent to the extent that the relevant clearing agency—which under the exception is not required to be registered with the Commission—does not follow standards consistent with the Title VII requirements applicable to registered clearing agencies. As noted above, moreover, *see* note 413, *supra,* we are not addressing the registration requirements for such clearing agencies in this release.

[439] *See* sections IV.D.2 and IV.F.2, *supra.*

[440] Based on an analysis of dealing activity within the security-based swap market, we concluded that a *de minimis* threshold of $3 billion for dealing activity involving security-based swaps would capture over 99 percent of dealing activity within the single-name CDS market under the ambit of dealer regulation. *See* Intermediary Definitions Adopting Release, 77 FR 30639. We also concluded that this amount constituted a reasonable threshold, though not the only such threshold, for addressing the relevant competing factors—including the fact that the economic benefits provided by dealer requirements in large part will depend on the proportion of security-based swaps that are transacted subject to those requirements, while certain of the costs associated with dealer regulation would include costs that are independent of the amount of a person's dealing activity. *See* Intermediary Definitions Adopting Release, 77 FR 30629, 30639.

As noted above, in application the general *de minimis* threshold currently is subject to an $8 billion phase-in level, and that phase-in level will remain in place until the Commission, following a study, either determines to terminate the phase-in level or adopts a different threshold. *See* part IV.A, *supra.*

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.'' [441] These final rules and guidance regarding which transactions are to be counted against the *de minimis* thresholds are consistent with that principle, although in part they reflect a further assessment of the programmatic benefits resulting from the application of dealer regulation to non-U.S. persons when there is a recourse guarantee against a U.S. affiliate, including the benefits resulting from the application of financial responsibility requirements imposed upon registered security-based swap dealers. In this regard, the final rules and guidance reflect a reconsideration of our earlier conclusion that the risks to U.S. persons arising from such guarantees could adequately be addressed by the regulation of major security-based swap participants. In addition, these final rules and guidance more fully account for anti-evasion concerns associated with the potential for a U.S. person to engage in dealing activity using a guaranteed non-U.S. affiliate that is economically equivalent to the U.S. person itself entering into those dealing transactions.

(b) Evaluation of Programmatic Impacts

In setting the *de minimis* thresholds as part of the Intermediary Definitions Adopting Release, we attempted to identify a level of dealing activity that would identify and capture the entities for which the Title VII dealer requirements are most appropriate, without imposing the costs of Title VII on those entities for which regulation currently may not be justified in light of the purposes of the statute.[442] We particularly took into account data regarding the activities of participants in the security-based swap market, including data regarding activity suggestive of dealing. Based on this analysis, we estimated that up to 50 entities in the security-based swap market might register as security-based swap dealers.[443] Those estimates—made outside of the context the cross-border application of the dealer definition—provide a baseline against which the Commission can analyze the programmatic costs and benefits and assessment costs of the final rules applying the *de minimis* exception to cross-border activities.

We believe the methodology used in the Intermediary Definitions Adopting Release also is appropriate for considering the potential programmatic costs and benefits associated with the final cross-border rules. This methodology particularly can help provide context as to how rules regarding the cross-border application of the *de minimis* exception may change the number of entities that must register as security-based swap dealers, and thus help provide perspective regarding the corresponding impact on the programmatic costs and benefits of Title VII. Applying that methodology to 2012 data regarding the single-name CDS market suggests that under these final rules approximately 50 entities may have to register as dealers—a number that is consistent with our estimates as part of the Intermediary Definitions Adopting Release.[444]

We recognize that there are limitations to using this methodology to consider the potential programmatic impact of the cross-border rules. These include limitations associated with the fact that the available data does not extend to all types of security-based swaps,[445] and challenges in extrapolating transaction data into inferences of dealing activity.[446] Also, the available single-name CDS data in certain regards potentially may lead the impact of these rules to be underestimated or overestimated:

- The Commission's access to data on CDS that are written on non-U.S. reference entities does not extend to data regarding transactions between two counterparties that are not domiciled in the United States, or guaranteed by a person domiciled in the United

[441] *See* Cross-Border Proposing Release, 77 FR 31137.

[442] *See* Intermediary Definitions Adopting Release, 77 FR 30724–25.

[443] *See* section III.A.1, *supra; see also* Intermediary Definitions Adopting Release, 77 FR 30635.

We stated that this was a ''conservative'' estimate. *See* Intermediary Definitions Adopting Release, 77 FR 30725 and n.1457. In establishing the *de minimis* threshold, 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 id.* at 30636. 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 id.* at 30636. Of the 28 firms and corporate groups that satisfied this criterion, 25 also engaged in 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 id.* at 30725 n.1457.

[444] While these revised figures are based on methodology similar to what Commission staff employed in the Intermediary Definitions Adopting Release, they make use of newer data and also account for the final rules' approach to counting dealing transactions against the *de minimis* thresholds.

Consistent with that methodology regarding the use of market data to identify entities that may be engaged in dealing activity pursuant to the dealer-trader distinction (*see id.* 30636 n.478), the data indicated that in 2012, 40 entities engaged in the single-name security-based swap market had three or more counterparties that were not identified by ISDA as dealers. Of those 40 entities, 27 had $3 billion or more in notional single-name CDS activity over a 12 month period. Applying the principles reflected in these final rules regarding the counting of transactions against the *de minimis* thresholds suggests that 25 of those entities would have $3 billion or more in notional transactions counted against the thresholds. Applying the aggregation rules (by aggregating the transactions, that are subject to counting, of other affiliates within a corporate group that individually do not have $3 billion in transactions subject to counting) increases that number to 26 entities. Based on this data, we believe that it is reasonable to conclude that up to 50 entities ultimately may register as security-based swap dealers, although fewer dealers also is possible.

To apply the counting tests of these final rules to the data, Commission staff identified DTCC–TIW accounts associated with foreign branches and foreign subsidiaries of U.S. entities and counted all transaction activity in these accounts against the firm's *de minimis* threshold. Commission staff further counted non-U.S. persons' activity against U.S. persons and foreign branches and subsidiaries of U.S. persons against the *de minimis* thresholds.

[445] In these assessments, we have taken into account data obtained from DTCC–TIW regarding the activity of participants in the single-name CDS market. *See* Intermediary Definitions Adopting Release, 77 FR 30635. The present assessments use data from 2012, rather than the 2011 period used in connection with the Intermediary Definitions Adopting Release.

As part of the Intermediary Definitions Adopting Release we also considered more limited publicly available data regarding equity swaps. *See 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, in that 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. *See id.* at 30724 n.1456. Although the definition of security-based swaps is not limited to single-name CDS, we believe that the single-name CDS data are sufficiently representative of the market to help inform the analysis. *See id.* at 30636.

[446] As we noted in the Intermediary Definitions Adopting Release, the data incorporates transactions reflecting both dealing activity and non-dealing activity, including transactions by persons who may engage in no dealing activity whatsoever. *See id.* at 30635–36. For these purposes we have identified potential dealers based on whether an entity engaged in the single-name security-based swap market had three or more counterparties that were not identified by ISDA as dealers. We recognize that this 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.

States.[447] More generally, the Commission's access to data also does not extend to transactions among affiliated entities. The available data thus does not extend to the activities of non-U.S. conduit affiliates, to the extent that they engage in transactions with non-U.S. persons (that themselves are not the subject of a guarantee), and potentially makes the assessment underinclusive to the extent that conduit affiliates engaged in dealing activity during the relevant period.

- The available data also does not specifically distinguish those transactions of non-U.S. persons that are subject to a guarantee by a U.S. person, and other (non-guaranteed) transactions by such non-U.S. persons. As a result, we have assumed that all foreign subsidiaries of U.S. persons rely on guarantees for all transactions, which potentially overestimates the level of transaction activity that would count toward *de minimis* thresholds for U.S. persons with foreign subsidiaries.

Separately, the programmatic costs and benefits associated with the implementation of these rules cannot be quantified with any degree of precision because the full range of the *de minimis* exception's effects on the programmatic costs and benefits also will reflect final rules—which have yet to be finalized—implementing the Title VII entity-level and transaction-level requirements applicable to security-based swap dealers.

In addition, the programmatic benefits and costs associated with the cross-border application of the *de minimis* exception may change as market participants modify their business structure or practices in response to these rules. To avoid the prospect of being regulated as a security-based swap dealer, some market participants may restructure their businesses or take other steps (such as avoiding engaging in security-based swap activities involving U.S. persons) to avoid having their dealing transactions counted against the *de minimis* thresholds. Other market participants may take similar steps in response to counterparty demands. We understand that some market participants already have taken these types of steps to restructure their derivatives operations in response to the implementation of Title VII requirements related to swaps. More fundamentally, there are inherent challenges associated with attempting to quantify the risk-mitigation and other benefits of financial regulation.[448] The programmatic impact of these rules may further reflect the fact that certain entities that are deemed to be security-based swap dealers, and hence are subject to the applicable Title VII dealer requirements, separately may be subject to other regulatory requirements that are analogous to the security-based swap dealer requirements. For example, we recognize that certain entities that are deemed to be security-based swap dealers pursuant to these rules also may be registered as swap dealers with the CFTC, pursuant to the CEA. Those entities' compliance with CFTC requirements applicable to swap dealers potentially may mitigate the programmatic effect of these rules—in terms of both costs and benefits—to the extent that those CFTC requirements are comparable with the SEC's yet-to-be-finalized substantive rules applicable to security-based swap dealers. The potential availability of substituted compliance, whereby a market participant may comply with a Title VII security-based swap dealer requirement by complying with a comparable requirement of a foreign financial regulator, also may affect the final programmatic impact of these rules.

In general, however, and consistent with our territorial approach, we believe that these rules are targeted appropriately, and do not apply dealer regulation to those entities that have a more limited involvement in the U.S. financial system and hence whose regulation as a security-based swap dealer under Title VII would be less linked to programmatic benefits (*i.e.,* non-U.S. persons that engage in security-based swap dealing activity entirely, or almost entirely, outside the United States with non-U.S. persons or with certain foreign branches), while applying dealer regulation to those entities whose dealing activity would be more likely to produce programmatic benefits under Title VII. The nexus between specific aspects of these requirements and the programmatic costs and benefits also is addressed below in connection with our consideration of various alternatives to the approach taken in the final rules.

Finally, 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 shocks to risk or liquidity arising from a foreign entity's dealing activity outside the United States may spill into the United States. Such spillover risks associated with dealing activity that falls outside the scope of Title VII have the potential to affect U.S. persons and the U.S. financial system either through a 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 that may provide CCP services in the United States or have a U.S. person as a clearing member. We also have considered these spillovers in connection with our analysis of the effects of these final cross-border rules on efficiency, competition and capital formation.[449]

2. Assessment Costs

The analysis of how these cross-border rules will affect the assessment costs associated with the ''security-based swap dealer'' definition and its *de minimis* exception is related to the assessment cost analysis described in the Intermediary Definitions Adopting Release,[450] but must also account for certain issues specific to these cross-border rules. While in certain regards those assessment costs can more readily be estimated than the programmatic effects discussed above, the assessment costs associated with the cross-border application of the Title VII dealer requirements will be considerably smaller in significance than those programmatic effects.

The Intermediary Definitions Adopting Release addressed how certain 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.[451] In that release we

[447] The Commission has more complete access to data regarding transactions involving single-name CDS on U.S. reference entities.

[448] In the Intermediary Definitions Adopting Release, we and the CFTC noted that we are ''not of the general view that the costs of extending regulation to any particular entity must be outweighed by the quantifiable or other benefits to be achieved with respect to that particular entity.'' *See* Intermediary Definitions Adopting Release, 77 FR 30630. We also noted that ''it does not appear possible to demonstrate empirically—let alone quantify—the increase or decrease in the possibility that a financial crisis would occur at a particular future time and with a particular intensity in the absence of financial regulation or as a result of varying levels or types of financial regulation.'' *See id.* at 30630 n.421 (also noting the difficulty of demonstrating empirically ''that the customer protections associated with dealer regulation would increase or decrease the likelihood that any particular market participant would suffer injury (or the degree to which the participant would suffer injury) associated with entering into an inappropriate swap or security-based swap'').

[449] *See* section VIII, *supra.*

[450] *See* Intermediary Definitions Adopting Release, 77 FR 30731–32.

[451] *See id.* at 30731. These assessment costs include costs associated with analyzing a person's security-based swap activities to determine whether those activities constitute dealing activity and the

estimated that 166 entities—out of over one thousand U.S. and non-U.S. entities that engaged in single-name CDS transactions in 2011—had more than $2 billion in single-name CDS transactions over the previous 12 months, and as a result would engage in the dealer analysis.[452] Based on those numbers, and assuming that that all of those entities retain outside counsel to analyze their status under the security-based swap dealer definition, including the *de minimis* exception, we estimated that the legal costs associated with assessing market participants' *potential* status as security-based swap dealers may approach $4.2 million.[453]

Application of these cross-border rules to the *de minimis* exception can be expected to affect the assessment costs that market participants will incur. In part, certain non-U.S. persons may be expected to incur personnel costs and legal costs—beyond the legal costs addressed as part of the Intermediary Definitions Adopting Release—associated with analyzing these cross-border rules and developing systems and procedures to assess which transactions would have to be counted against the *de minimis* thresholds (or with the purpose of avoiding activities within the United States that would be sufficient to meet the applicable thresholds). On the other hand, while certain market participants also would incur additional legal costs associated with the dealer determination (*i.e.,* the assessment of whether particular activities constitute dealing activity for purposes of the analysis) addressed in the Intermediary Definitions Adopting Release, the application of the cross-border rules may reduce the number of entities that incur such legal costs.

In adopting these rules we estimate the assessment costs that market participants may incur as a result. As discussed below, however, these costs in practice may be mitigated in large part by steps that market participants already have taken in response to other regulatory initiatives, including the CFTC Cross-Border Guidance.

(a) Legal Costs

The implementation of these cross-border rules in some circumstances has the potential to change the legal costs identified in the Intermediary Definitions Adopting Release, including by adding new categories of legal costs that non-U.S. persons may incur in connection with applying the *de minimis* exception in the cross-border context.

Legal costs related to application of the dealer-trader distinction—As discussed in the Intermediary Definitions Adopting Release, certain market participants will incur assessment costs relating to performing the analysis as to whether their security-based swap activities constitute dealing. For purposes of that release we assumed 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, and, based on analysis of single-name CDS data, we concluded that there were 166 market participants that would meet those criteria.[454]

In the cross-border context, we believe that some non-U.S. persons that have more than $2 billion in total security-based swap transactions over the previous 12 months nonetheless may be expected to forgo the costs of performing the dealing activity analysis, if only a comparatively low volume of their security-based swap activity involves U.S. counterparties or otherwise potentially needs to be counted against the *de minimis* thresholds. In particular, we believe that it is unlikely that non-U.S. persons would engage in the dealer analysis (and hence would not be likely to incur such legal costs described in the Intermediary Definitions Adopting Release) if over the previous 12 months they have less than $2 billion in security-based swap transactions that potentially would have to be counted against the thresholds.[455]

Available data from 2012 indicates that 218 entities worldwide (147 of which are domiciled in the United States and 71 domiciled elsewhere) had security-based swap activity, with all counterparties, of $2 billion or more. Of those 218 entities 202 had total activity of $2 billion or more that—to the extent it constituted dealing activity—would appear to have to be counted against the *de minimis* thresholds. Those 202 entities consisted of 147 entities domiciled in the United States (which would have to count all of their dealing transactions), and 55 entities domiciled elsewhere that have $2 billion in transactions with U.S. counterparties or that otherwise may have to be counted for purposes of the *de minimis* analysis.[456] To the extent that all 202 of those entities engage in the legal analysis related to which of their security-based swap activities constitutes dealing under the dealer-trader distinction (while recognizing that some such entities may conclude that, based on the nature of their business, they engage in dealing activities and that no such additional analysis is necessary), and assuming that such analyses amount to $30,000 per entity,[457] those 202 entities would incur a total of approximately $6.1 million in such legal costs.[458]

Legal costs related to systems and analysis—As noted above, out of the 218 entities that had total security-based swap activity of $2 billion or more in 2012, 71 are domiciled outside of the United States. Upon further consideration (and in addition to the estimates in the Cross-Border Proposing Release), we also believe that it is

costs of monitoring the volume of dealing activity against the *de minimis* threshold.

[452] *Id.* at 30731–32. As discussed below, a comparable assessment using 2012 data indicates that there were approximately 210 entities in the single-name CDS market with more than $2 billion in transactions over 12 months. That analysis accounts for the aggregation of affiliate activity for purposes of the *de minimis* analysis, by first counting individual accounts with more than $2 billion in activity, and then aggregating any remaining accounts to the level of the ultimate parent and counting those also.

[453] *See 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 reflected the costs that may be incurred by all 166 entities. *See id.*

[454] *See id.* at 30731–32. Using an estimate of $25,000 in legal costs per firm, this led to a total estimate of $4.2 million. *See id.* at 30732.

[455] *See* Cross-Border Proposing Release, 78 FR 31141.

[456] A total of 16 of those 71 entities that are not domiciled in the United States appear to have less than $2 billion in activity that involve U.S. counterparties or that otherwise would appear to potentially have to be counted against the *de minimis* thresholds.

[457] In the Intermediary Definitions Adopting Release, we estimated that such costs may range from $20,000 to $30,000. *See* Intermediary Definitions Adopting Release, 77 FR 30732. For purposes of this analysis, we conservatively are using the upper end of that range.

[458] This analysis of data related to potential assessment costs reflects both the activities of individual DTCC–TIW accounts as well as the activities of transacting agents. The analysis in particular first considers the number of accounts that have $2 billion or more in annual security-based swap activity, and then, after removing those particular accounts, considers activity aggregated at the level of individual transacting agents. This analysis is comparable to the analysis we use to estimate the potential number of dealers under the final rules. *See* note 444, *supra.* This analysis is distinct from the analogous analysis we used in the Intermediary Definitions Adopting Release to estimate the number of entities that may be expected to perform the dealer-trader analysis (*see* notes 149 through 151 and accompanying text, *supra*), which focuses on activity at the transacting agent level, because further experience with the associated data permits us to conduct a more granular analysis of that data. *See generally* Cross-Border Proposing Release, 78 FR 31137 n.1407.

These estimates do not reflect a new category of costs arising from the cross-border rules. They instead are a revision of a category of previously identified costs that market participants may incur in engaging in the dealer-trader analysis, using newer data and reflecting only trades that are counted under the final cross-border rules.

reasonable to conclude that those 71 entities may have to incur one-time legal expenses related to the development of systems and analysis expenses—discussed below—to identify which of their total security-based swap transactions potentially must be counted for purposes of the *de minimis* analysis consistent with these cross-border rules. This additional cost estimate reflects the fact that the development of such systems and procedures must address cross-border rules that require accounting for factors such as whether an entity's security-based swaps are subject to guarantees from affiliated U.S. persons, and whether its counterparties are U.S. persons.[459] We estimate that such legal costs would amount to approximately $30,400 per entity, and that those 60 entities would incur total costs of approximately $2.2 million.[460]

(b) Costs Related to Systems, Analysis, and Representations

Transaction-monitoring systems—The elements introduced by the final cross-border rules may cause certain non-U.S. persons to implement systems to identify whether their dealing transactions exceed the *de minimis* thresholds.[461] Such systems may reflect the need for non-U.S. persons to: (i) identify whether their dealing counterparties are ''U.S. persons''; (ii) determine whether their dealing transactions with a U.S. person constitutes ''transactions conducted through a foreign branch'' (which itself requires consideration of whether their counterparty is a ''foreign branch'') and—of those—determine which transactions involve a foreign branch of a U.S. bank that itself is registered as a security-based swap dealer; (iii) determine whether particular transactions are subject to a recourse guarantee against a U.S. affiliate; (iv) evaluate the applicability of the aggregation principles; and (v) evaluate the availability of the exception for cleared anonymous transactions.[462]

In general, we believe that the costs of such systems 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. In both cases –the assessment of dealer status in the cross-border context and the assessment of major participant status—such systems would have to flag a person's security-based swaps against the specific criteria embedded in the final rules, and then compare the cumulative amount of security-based swaps that meet those criteria against regulatory thresholds.[463] Based on the methodology set forth in the Intermediary Definitions Adopting Release related to systems associated with the major participant analysis, we estimate that such systems would be associated with one-time programming costs of $14,904 and ongoing annual systems costs of $16,612 per entity.[464]

Analysis of counterparty status, including representations—Non-U.S. market participants also would be likely to incur costs arising from the need to assess the potential U.S.-person status of their counterparties, and in some cases to obtain and maintain records related to representations regarding their counterparties' U.S.-person status.[465] We anticipate that non-U.S. persons are likely to review existing information (*e.g.,* information already available in connection with account opening

[459] We would not expect U.S. persons with more than $2 billion in activities to incur such costs, given that U.S. persons would need to count all of their dealing activities against the *de minimis* thresholds.

[460] This estimate of $30,400 reflects an assumption that such efforts would require 80 hours of in-house legal or compliance staff's time. 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 $380.

[461] It is possible that a subset of non-U.S. dealers may reasonably conclude they are above the *de minimis* thresholds and should register with the Commission as security-based swap dealers, without establishing systems to analyze their status under the exception, in light of the nature of their operations and their activity within the United States.

Moreover, in considering the assessment costs associated with the final rules, we continue to hold the expectation, 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. *See* Intermediary Definitions Adopting Release, 77 FR 30732. These systems cost estimates for non-U.S. persons are provided in recognition of the fact that non-U.S. persons will likely need to distinguish those transactions that must be counted against their *de minimis* thresholds and those that do not need to be included.

[462] In considering the assessment costs associated with the final rules, we believe that a potential dealer assessment of whether it is a ''conduit affiliate'' would not require the use of any systems. A conduit affiliate must count all of its dealing transactions, making transaction-specific tracking unnecessary. Moreover, the question of whether a person acts as a conduit affiliate would turn upon whether it engages in certain security-based transactions on behalf of a U.S. affiliate, accompanied by back-to-back transactions with that affiliate. That analysis fundamentally is different from the transaction-specific assessments that are more likely to require the development of new systems for monitoring the attributes of particular transactions.

[463] As discussed in the Cross-Border Proposing Release, we would expect that market participants would be aware of the notional amount of their security-based swap activity as a matter of good business practice. *See* Cross-Border Proposing Release, 78 FR 31140.

[464] 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 $334/hour, the figure for a Compliance Manager is $283/hour, the figure for a Programmer Analyst is $220/hour, and the figure for a Senior Internal Auditor is $209/hour, each from SIFMA's Management & Professional Earnings in the Securities Industry 2013, 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, with a revised figure of $500/hour, for a Chief Financial Officer with five years of experience in New York, that is from *http://www.payscale.com,* modified by 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. *See http://www.payscale.com* (last visited Apr. 16, 2014). 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 $334 per hour for 2 hours) + (Compliance Manager at $283 per hour for 8 hours) + (Programmer Analyst at $220 per hour for 40 hours) + (Senior Internal Auditor at $209 per hour for 8 hours) + (Chief Financial Officer at $500 per hour for 3 hours) = $14,904, and the annual ongoing costs would be $16,612 per entity, *i.e.,* ((Senior Internal Auditor at $209 per hour for 16 hours) + Compliance Attorney at $334 per hour for 4 hours) + (Compliance Manager at $283 per hour for 4 hours) + (Chief Financial Officer at $500 per hour for 4 hours) + (Programmer Analyst at $220 per hour for 40 hours) = $16,612).

[465] Non-U.S. market participants potentially may also assess and seek representations related to whether their security-based swap activity with a particular counterparty constitutes transactions conducted through a foreign branch of a U.S. bank (including representations regarding the non-involvement of U.S. personnel) that is registered as a security-based swap dealer. Based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in this market through their foreign branches. Also, as noted above, other regulatory provisions may limit the ability of U.S. banks to conduct security-based swap activity. *See* note 366, *supra.* Accordingly, we do not believe that it is likely that non-U.S. market participants will independently assess, and seek representations related to, the foreign branch status of their counterparties. Instead, we believe that it is likely that such non-U.S. persons will focus on assessing the U.S.-person status of the bank for which the foreign branch is a part.

materials and ''know your customer'' practices) to assess whether their counterparties are U.S. persons. Non-U.S. persons at times may also request and maintain representations from their counterparties to help determine or confirm their counterparties' status. Accordingly, in our view, such assessment costs primarily would encompass one-time costs to review and assess existing information regarding counterparty domicile, principal place of business, and other factors relevant to potential U.S.-person status, as well as one-time costs associated with requesting and collecting representations from counterparties.[466] The Commission believes that such one-time costs would be approximately $732 thousand per firm.[467]

Monitoring of counterparty status—In addition, market participants may be expected to adapt the systems described above to monitor the status of their counterparties for purposes of their future security-based swap activities. Such refinements would permit these systems to maintain records of counterparty status for purposes of conducting the *de minimis* assessments (*e.g.,* representations regarding a counterparty's U.S.-person status, or whether a counterparty's transaction through a foreign branch involve U.S. personnel), such as by monitoring for the presence of existing representations, to obviate the need to request representations on a transaction-by-transaction basis.[468] Market participants also may need to monitor for the presence of information that may indicate that the representation they have received are outdated or otherwise are not valid.[469] We estimate that this would require one-time costs of approximately $12,436 per firm.[470]

Summary of system, analysis and representation costs—In sum, we estimate that the costs that certain non-U.S. market participants would incur in connection with systems, analysis of counterparty status and representations in connection with these cross-border rules would be approximately $759 thousand in one-time costs,[471] and their estimated annual ongoing costs would be $16,612. The available data provided by the DTCC–TIW, subject to the limitations associated with the use of data analysis discussed above, suggests that such costs may be incurred by 71 non-U.S. domiciled entities with total annual activity of at least $2 billion. Assuming that each of these 71 entities concludes it has a need to monitor the above categories of information in connection with its security-based swap activities, we estimate that the total one-time industry-wide costs associated with establishing such systems would amount to approximately $54 million, and total annual ongoing costs would amount to approximately $1.2 million.

(c) Overall Considerations Related to Assessment Costs

In sum, we believe that the effect of these final cross-border rules would be an increase over the amounts that otherwise would be incurred by certain non-U.S. market participants, both in terms of additional categories of legal costs and in terms of the need to develop certain systems and procedures.

Requiring certain non-U.S. persons to incur such assessment costs is an unavoidable adjunct to the implementation of a set of rules that are appropriately tailored to apply the ''security-based swap dealer'' definition under Title VII to a global security-based swap market in a way that yields the important transparency, accountability, and counterparty protection benefits associated with dealer regulation under Title VII. The alternative—avoiding application of the

[466] We expect that an assessment of whether a particular counterparty is a U.S. person—once properly made—generally will not vary over time, given that the components of the ''U.S. person'' definition generally would not be expected to vary for a particular counterparty absent changes such as a corporate reorganization, restructuring or merger. With that said, we believe market participants will likely monitor for the presence of information that may indicate that the representations they have received in connection with a person's U.S.-person status are outdated or otherwise are no longer accurate (*e.g.,* information regarding a counterparty's reorganization, restructuring, or merger).

We also believe that such non-U.S. persons will likely obtain the relevant information regarding the U.S.-person status of their new accounts as part of the account opening process, as a result of these and other regulatory requirements.

[467] In part, this estimate is based on each firm incurring an estimated one-half hour compliance staff time and one-half hour of legal staff time—per counterparty of the firm—to review and assess information regarding the counterparty, and potentially to request and obtain representations regarding the U.S.-person status of their counterparties. These are in addition to the assessment cost estimates we made in the Cross-Border Proposing Release, and reflect further consideration of the issue in light of industry experience in connection with the CFTC Cross-Border Guidance. For these purposes, we conservatively assume that each of those non U.S. firms will have 2400 single-name CDS counterparties (based on data indicating that the 60 non-U.S. persons with total single-name CDS transactions in 2012 of $2 billion or less all had fewer than 2400 counterparties in connection with single-name CDS), which produces an estimate of 1200 hours of compliance staff time and 1200 hours of legal staff time per firm. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2013 (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 a senior compliance examiner is $217 and that the average national hourly rate for an in-house attorney is $380; this leads to a cumulative estimate of approximately $716 thousand per firm for such costs.

Consistent with the Cross-Border Proposing Release, moreover, this estimate is further based on estimated 40 hours of in-house legal or compliance staff's time (based on the above rate of $380 per hour for an in-house attorney) to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be incorporated into standardized trading documentation used by market participants. This leads to an estimate of $15,200 per firm for such costs.

[468] The exclusion for a non-U.S. person's dealing transactions conducted through the foreign branch of a counterparty that is a registered security-based swap dealer is predicated on U.S.-based personnel of the counterparty not being involved in arranging, negotiating or executing the transaction at issue. Notwithstanding the potentially transaction-specific nature of that assessment, we believe that parties may structure their relationships in such a way that the non-U.S. person may rely on general representations by its counterparty, without the need for a separate representation in conjunction with each individual transaction.

[469] It is possible that the need to monitor for information inconsistent with existing representations would be more significant in the context of representations regarding whether a transaction has been conducted through a foreign branch of a U.S. bank, than they would be in the context of representations regarding the U.S.-person status of a counterparty. This is because a counterparty's potential status as a U.S. person would not be expected to vary on a transaction-by-transaction basis. At the same time, we believe that few, if any, U.S. persons currently may participate in this market through their foreign branches. *See* note 465, *supra.*

[470] In part, this is based on an estimate of the time required for a programmer analyst to modify the software to track whether the counterparty is a U.S. person (including whether it is a foreign branch of a U.S. bank that is not registered as a security-based swap dealer), and to record and classify whether a transaction constitutes dealing activity conducted through a foreign branch of a registered dealer This includes time associated with consultation with internal personnel, and an estimate of the time such personnel would require to ensure that these modifications conformed to those aspects of the final rule. Using the estimated hourly costs described above, we estimate the costs as follows: (Compliance Attorney at $334 per hour for 2 hours) + (Compliance Manager at $283 per hour for 4 hours) + (Programmer Analyst at $220 per hour for 40 hours) + (Senior Internal Auditor at $209 per hour for 4 hours) + (Chief Financial Officer at $500 per hour for 2 hours) = $12,436. *See* note 464, *supra* (for source of the estimated per-hour costs).

As noted above, we generally would not expect a counterparty's U.S.-person status to vary over time absent changes such as reorganization, restructuring or merger. *See* note 466, *supra.*

[471] Consistent with the above discussion, the estimated one-time costs of $759 thousand represent: the costs to establish a system to assess the status of their dealing activities under the definitions and other provisions specific to these cross-border rules ($14,904); the costs related to the assessment of counterparty status, including costs of assessing existing information and of requesting and obtaining representations, as well as costs of related procedures ($732 thousand), and the costs for monitoring the status of their counterparties for purposes of their future security-based swap activities ($12,436).

Title VII dealer requirements to non-U.S. persons—would be inappropriate because, in our view, the dealing activity of non-U.S. persons required to count their dealing activity under these final rules constitutes part of the U.S. financial system. The benefits that arise from Title VII regulatory requirements, including risk management and transparency benefits associated with dealer regulation accordingly could be undermined if a significant portion of U.S. dealing activity by non-U.S. persons were excluded from the Title VII framework. In certain respects, however, decisions embedded in these final rules are designed to avoid imposing assessment costs upon market participants.[472]

It is important to recognize that our estimates of the assessment costs associated with these rules in practice may tend to overestimate that costs that market participants actually will incur as a result of these rules. This is because in practice, the assessment costs associated with the cross-border scope of the dealer definition (like the potential programmatic effects of that cross-border scope) may be tempered to the extent that the assessments that market participants conduct in connection with their security-based swap activities correspond to the assessments they otherwise would follow due to other regulatory requirements or business practices. Significantly, we understand that a substantial number of market participants already have engaged in assessment activities—including activities to determine whether their counterparties are U.S. persons—conforming to the requirements applicable to swaps. Given our expectation that persons that are not ''U.S. persons'' under the CFTC's policy (as set forth in its cross-border guidance) generally also would not be ''U.S. persons'' under our rules, certain market participants may reasonably determine that as part of the implementation of the rules we are adopting today they need not duplicate work already done in connection with implementing the CFTC's swaps regulations. In this regard we recognize the significance of commenter views emphasizing the importance of harmonization with the CFTC to control the costs associated with assessments under Title VII.[473] We acknowledge that, to the extent our final rules differ from the CFTC's approach—especially if they were to require counting of transactions that would not be captured by the requirements applicable to swaps in the cross-border context, or were to require the collection and/or consideration of information that is materially different from that collected under the CFTC's approach—market participants may face higher costs than if regulations were identical.[474] As discussed in connection with the specific aspects of these rules, however, we believe that such differences are justified, as are any associated assessment (or programmatic) costs.

Finally, we also anticipate that certain market participants that wish to limit the possibility of being regulated as a dealer under Title VII, including the programmatic and assessment costs associated with the dealer definition, may choose to structure their business to avoid engaging in dealing transactions with U.S. persons (other than foreign branches of banks registered with the Commission as dealers).

3. Alternative Approaches

As discussed above, the final rules incorporate a number of provisions designed to focus Title VII dealer regulation upon those persons that engage in the performance of security-based swap dealing activity within the United States in excess of the *de minimis* thresholds, taking into account the mitigation of risks to U.S. persons and potentially to the U.S. financial markets, as well as other purposes of Title VII.

In adopting these final rules we have considered alternative approaches suggested by commenters, including the economic effects of following such alternative approaches. In considering the economic impact of potential alternatives, we have sought to isolate the individual alternatives to the extent practicable, while recognizing that many of those alternatives are not mutually exclusive.

We further have considered such potential alternatives in light of the methodologies discussed above, by assessing the extent to which following particular alternatives would be expected to increase or decrease the number of entities that ultimately would be expected to be regulated as dealers under the final rules, as well as the corresponding economic impact. As discussed below, however, analysis of the available data standing alone would tend to suggest that various alternative approaches suggested by commenters would not produce large changes in the numbers of market participants that may have to be regulated as security-based swap dealers. These results are subject to the above limitations, however, including limitations regarding the ability to quantitatively assess how market participants may adjust their future activities in response to the rules we adopt or for independent reasons. Accordingly, while such analyses provide some context regarding alternatives, their use as tools for illustrating the economic effects of such alternatives is limited.

(a) Dealing Activity by Foreign Branches of U.S. Banks

The final rules require U.S. banks to count all dealing transactions of their foreign branches against the *de minimis* thresholds, even when the counterparty is a non-U.S. person or another foreign branch of a U.S. person. Certain commenters to the rules addressed in the Intermediary Definitions Adopting Release had expressed the view that such transactions by foreign branches should not have to count their dealing transactions involving non-U.S. persons.[475] For the reasons discussed above, we believe that it is appropriate for the analysis to include dealing transactions conducted through foreign branches to the same extent as other dealing transactions by U.S. persons.[476]

Adopting such an alternative approach potentially could provide market participants that are U.S. persons with incentives to execute higher volumes through their foreign branches. Such an outcome may be expected in part to reduce the programmatic and assessment costs associated with dealer regulation under Title VII. Such an outcome also would be expected to reduce the programmatic benefits associated with dealer regulation, given that those U.S. banks (and potentially the U.S. financial

[472] For example, the final rules incorporate an express representation provision in the ''U.S. person'' definition, to help the parties best positioned to make the U.S.-person determination and convey the results of that analysis to its counterparty. *See* section IV.C.4, *supra.*

[473] For example, one commenter urged the Commission to exempt from the definition of U.S. person collective investment vehicles that are publicly offered only to non-U.S. persons, consistent with the CFTC's interpretation, on account of the costs that would be required for collective investment vehicles that transact in both swaps and security-based swaps to develop separate compliance systems and operations for swaps and security-based swaps.

[474] In this regard we also note that in certain areas the Commission has taken an approach that is narrower than the CFTC analogue.

[475] *See* note 181, *supra,* and accompanying text. This issue—regarding whether a foreign branch of a U.S. bank should count all of its dealing activity against the *de minimis* thresholds—is distinct from the issue regarding the extent to which a non-U.S. person should count its dealing activity involving a foreign branch of a U.S. bank as a counterparty. That latter issue is addressed below. *See* section IV.I.3(d), *supra.*

[476] *See* section IV.B, *supra.*

system) would incur risks via their foreign branches equivalent to the risk that might arise from transactions of U.S. banks that are not conducted through foreign branches, but without the additional oversight (including risk mitigation requirements such as capital and margin requirements) that comes from regulation as a dealer.

Using the 2012 data to assess the impact associated with this alternative does not indicate a change to our conservative estimate that up to 50 entities potentially would register as security-based swap dealers.[477] This assessment, as well as the other assessments of alternatives discussed below, is subject to the limitations discussed above, including limitations regarding the ability to assess how market participants would change their activities in response to the final rules.

(b) Dealing Activity by Guaranteed Affiliates of U.S. Persons

The final rules require a non-U.S. person to count, against the *de minimis* thresholds, dealing transactions for which the non-U.S. person's performance in connection with the transaction is subject to a recourse guarantee against a U.S. affiliate of the non-U.S. person. Although the proposal instead would have treated such guaranteed affiliates like any other non-U.S. persons, we believe that this provision is appropriate for the reasons discussed above, including that such recourse guarantees pose risks to U.S. persons and potentially to the U.S. financial system via the U.S. guarantor.

This aspect of the final rules reflects a middle ground between commenter views, given that some commenters opposed any consideration of guarantees as part of the dealer analysis, while others expressed the view that all affiliates of a U.S. person should be assumed to be the beneficiary of a *de facto* guarantee from the U.S. person and, absent a showing otherwise, should have to count all of their dealing activity against the thresholds.[478] This diversity of commenter views suggests a range of potential alternatives to the final rules—including one alternative in which the final rules do not address guarantees at all, as well as alternatives in which (based on the concept of a *de facto* guarantee) all affiliates of a U.S. person, or at least all affiliates within a U.S.-based holding company structure, should have to count their dealing activity against the thresholds (with a potential exception if they demonstrate to the market that there will be no guarantee). For the reasons discussed above, we believe that the approach taken by the final rules is appropriate.[479]

Following such alternative approaches could be expected to lead to disparate economic effects depending on which approach is followed. On the one hand, an approach that does not require counting against the thresholds of a non-U.S. person's transactions with non-U.S. counterparties that are guaranteed by their U.S. affiliates would help provide incentives for greater use of guarantees by U.S. persons, with an increase of the associated risk flowing to the United States.[480] On the other hand, an approach that requires the conditional or unconditional counting of transactions by all affiliates of U.S. persons could provide incentives for certain non-U.S. holding companies to limit or eliminate relationships with U.S.-based affiliates, even if these affiliates perform functions unrelated to security-based swap activity. Additionally, a more limited approach that requires counting by non-U.S. subsidiaries of U.S. holding companies could reduce liquidity in the security-based swap market even if such a subsidiary's participation does not depend on the financial position or backing of its parent.

Data assessment of the first alternative does not indicate a change to our estimate that up to 50 entities may be expected to register with the Commission as security-based swap dealers.[481] The available data does not permit us to assess the other approaches, whereby all affiliates within a U.S.-based holding company, or all affiliates of any U.S. person generally, should have to count their dealing activity against the thresholds.[482]

(c) Dealing by Conduit Affiliates

The final rules require that conduit affiliates of U.S. persons count all of their dealing transactions against the *de minimis* thresholds. The available data does not permit us to identify which market participants currently engage in security-based swap dealing activity on behalf of U.S. affiliates, and hence would be deemed to be conduit affiliates. Accordingly, we are limited in our ability to quantify the economic impact of this anti-evasion provision.

The economic effects of not including these provisions—and instead treating conduit affiliates the same as other non-U.S. persons—has the potential to be significant, as it would remove a tool that should help to deter market participants from seeking to evade dealer regulation through arrangements whereby U.S. persons effectively engage in dealing activity with non-U.S. persons via back-to-back transactions involving non-U.S. affiliates.[483] Following that alternative thus may partially impair the effective

[477] The DTCC–TIW data permits us to separately consider dealing activity involving accounts of foreign branches of U.S. banks from other accounts of U.S.-domiciled persons. As a result, it is possible to consider the potential impact of a requirement under which—in contrast to the final rules—dealing activity conducted through a foreign branch only needs to be counted against the thresholds when the counterparty is a U.S.-domiciled person. Under such an alternative approach, the U.S. person would not have to count dealing transactions in which the counterparty is a non-U.S. person or another foreign branch of a U.S. bank.

As discussed above, current data indicates that there are 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period. Screening those entities against a cross-border test that is identical to the one we are adopting, except that it does not count foreign branches of U.S. banks as U.S. persons, leads to an estimate of 25 market entities that have $3 billion or more in activity that must be counted against the thresholds (rather than the 26 estimated in connection with the test we are adopting). That difference does not appear to warrant a change in the conservative estimate that up to 50 entities may register as security-based swap dealers.

[478] *See* note 310, *supra.*

[479] *See* section IV.E.1(b), *supra.*

[480] In the Cross-Border Proposing Release, we expressed the preliminary view that dealer regulation of such persons would not materially increase the programmatic benefits of the dealer registration requirement, and that such an approach would impose programmatic costs without a corresponding increase in programmatic benefits to the U.S. security-based swap market. *See* Cross-Border Proposing Release, 78 FR 31146–47. For the reasons discussed above, we have reached a different conclusion in conjunction with these final rules. *See* section IV.E.1(b), *supra.*

[481] Although the data available to the Commission includes data regarding transactions of non-U.S. persons that are guaranteed by their U.S. affiliates, the data does not allow us to identify which individual transactions of those non-U.S. persons are subject to guarantees by their U.S. affiliates, or to distinguish the guaranteed and non-guaranteed transactions of such non-U.S. persons. As a result, the assessment of the final rule presumed that all transactions of foreign subsidiaries of U.S. persons for which we have data available constitute guaranteed transactions.

Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period, with a revised *de minimis* test that does not include any transactions with non-U.S. person counterparties entered into by a foreign subsidiary of a U.S. person produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold—a number that is identical to the number associated with the test we are adopting.

[482] The available data does not include information about the single-name security-based swap transactions of non-U.S. domiciled persons (including non-U.S. affiliates of U.S.-domiciled persons) for single-name CDS involving a non-U.S. reference entity.

[483] *See* note 314, *supra,* and accompanying text.

functioning of the Title VII dealer requirements, and lead risk and liquidity to concentrate outside of the U.S. market.

Another potential alternative approach to addressing such evasive activity could be to narrow the inter-affiliate exception to having to count dealing transactions against the *de minimis* thresholds, such as by making the exception unavailable when non-U.S. persons transact with their U.S. affiliates. Such an alternative approach may be expected to reduce the ability of corporate groups to use central market-facing entities to facilitate the group's security-based swap activities, and as such may increase the costs faced by such entities (*e.g.,* by requiring additional entities to directly face the market and hence negotiate master agreements with dealers and other counterparties). We believe that the more targeted approach of incorporating the conduit affiliate concept would achieve comparable anti-evasion purposes with less cost and disruption.

(d) Dealing Activity by Non-U.S. Counterparties With Foreign Branches of U.S. Banks and Certain Other Counterparties

The final rules require non-U.S. persons to count, against the thresholds, their dealing transactions involving counterparties that are foreign branches of U.S. banks unless the U.S. bank is registered as a security-based swap dealer and unless no U.S.-based personnel of the counterparty are involved in arranging, negotiating and executing the transaction. This reflects a change from the proposal, which would have excluded all such transactions with a foreign branch regardless of whether the U.S. bank was registered as a dealer. The change appropriately takes into consideration the benefits of having relevant Title VII provisions applicable to dealers apply to the transaction against the liquidity and disparate treatment rationales underlying the exclusion.[484]

This aspect of the final rules reflects a middle ground between commenter views regarding transactions with foreign branches, given that some commenters expressed the view that all transactions with foreign branches should be counted against a non-U.S. person's *de minimis* threshold, while another commenter took the view that no such transaction should be counted.[485] This suggests at least two possible alternatives to the final rule—one in which all transactions with foreign branches are excluded from being counted against the thresholds, and one in which all transactions with foreign branches are counted against the thresholds (just like other transactions with U.S. person counterparties).

The effect of adopting the first alternative—whereby all transactions with foreign branches are excluded from being counted—could provide U.S. market participants that are not registered as dealers with incentives to execute higher volumes of security-based swaps through their foreign branches, resulting in higher amounts of risk being transmitted to the United States without the risk-mitigating attributes of having a registered dealer involved in the transaction.[486] Adopting the second alternative—whereby all of a non-U.S. person's transactions with foreign branches are counted regardless of the registration status of the U.S. counterparty—would raise the potential for disparate impacts upon U.S. persons trading with foreign branches, along with associated concerns about liquidity impacts.

The available data allows for estimates related to both potential alternatives subject to the limitations discussed above, and neither alternative would be expected to indicate a change to our assessment that up to 50 entities may be expected to register with the Commission as security-based swap dealers.[487]

The final rules also incorporate definitions of ''foreign branch'' and ''transaction conducted through a foreign branch'' that potentially could be modified to reflect alternative approaches. While we do not believe that the economic impact of following such alternatives is readily quantifiable given the available data, we generally believe that any such effects would be limited, particularly in light of our understanding that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches.

Separately, the final rules do not require non-U.S. persons to count their dealing transactions with non-U.S. counterparties. Potential alternatives to that approach could be to require non-U.S. persons to count their dealing transactions with counterparties that are guaranteed affiliates of U.S. persons (at least with regard to transactions subject to the guarantees), or their dealing transactions with counterparties that are conduit affiliates.[488] The alternative approach of requiring non-U.S. persons to count dealing transactions with either or both of those types of non-U.S. counterparties potentially would increase the programmatic benefits associated with Title VII dealer regulation, by applying the risk mitigating aspects of dealer regulation (such as capital and margin requirements) to the dealer counterparties of persons whose security-based swap activities directly affect the United States, while recognizing that such risk mitigating benefits would be more attenuated than those that are associated with the final rules' approach of directly counting dealing transactions of such guaranteed and conduit affiliates. On the other hand, requiring non-U.S. persons to count such transactions would be expected to increase assessment costs by requiring such persons to evaluate and track whether their non-U.S. counterparties are guaranteed or conduit affiliates. Also, to the extent such an alternative approach causes non-U.S. dealers to avoid entering into transactions with affiliates of U.S. persons to avoid the need to conduct such assessments, the approach could reduce the liquidity available to corporate groups with U.S. affiliates, and further could provide an incentive for such corporate groups to move their security-based swap activity entirely outside the United States (which could impair the transparency goals of Title VII).

As we discussed in the Cross-Border Proposing Release, another potential approach related to the treatment of non-U.S. persons' dealing activities would be to not require the registration of non-U.S. persons that engage in

[484] *See* note 370, *supra,* and accompanying text.

[485] *See* notes 359 through 361, *supra,* and accompanying text.

[486] In practice, based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches. Also, as noted above, we recognize that other regulatory provisions may limit the ability of U.S. banks to conduct security-based swap activities. *See* note 366, *supra.*

[487] Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period, with the two revised *de minimis* tests addressed above produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold—a number identical to the number associated with the test we are adopting.

[488] For the reasons discussed above, we do not believe that it is necessary to require non-U.S. persons to count their dealing transactions with such non-U.S. counterparties. *See* section IV.E.2, *supra.*

Also, as discussed above, we anticipate soliciting additional public comment regarding counting of dealing transactions between two non-U.S. persons towards the *de minimis* exception when activities related to the transaction occur in the United States. *See* section I.A, *supra.*

dealing activity with U.S. person counterparties through an affiliated U.S. person intermediary.[489] In our view, such an approach would reduce the programmatic benefits associated with dealer regulation under Title VII, and would raise particular concerns related to financial responsibility and counterparty risk, as well as create risk to U.S. persons and potentially to the U.S. financial system.

(e) ''U.S. Person'' Definition

The ''U.S. person'' definition used by the final rules seeks to identify those persons for whom it is reasonable to infer that a significant portion of their financial and legal relationships are likely to exist within the United States and for whom it is therefore reasonable to conclude that risks arising from their security-based swap activities could manifest themselves within the United States, regardless of location of their counterparties. Because the definition incorporates decisions regarding a range of issues, the definition potentially is associated with a number of alternative approaches that could influence the final rules' economic impact.[490]

A particularly significant element of this definition addresses the treatment of investment vehicles. Under the final rule, a fund is a ''U.S. person'' if the vehicle is organized, incorporated or established within the United States, or if its principal place of business is in the United States, which we are interpreting to mean that the primary locus of the investment vehicle's day-to-day operations is within the United States. One potential alternative approach to this element would be to make use of a narrower definition that does not use a principal place of business test for investment vehicles, and hence does not encompass vehicles that are not established, incorporated, or organized within the United States, even if the primary locus of their day-to-day operations is located here. Another potential approach would be to focus the meaning of ''principal place of business'' on the location where the operational management activities of the fund are carried out, without regard to the location of the fund's managers.

Similarly, another potential alternative approach to the ''U.S. person'' definition would be for the definition not to incorporate a principal place of business test for operating companies. Under such an alternative approach, an operating company would not fall within the ''U.S. person'' definition if it is not organized, incorporated or established within the United States, even if the officers or directors who direct, control and coordinate the operating company's overall business activities are located in the United States.

Following an alternative approach whereby the ''U.S. person'' definition did not encompass a ''principal place of business'' test, or whereby the definition followed a narrower such test with regard to particular types of market participants, may be expected to reduce the programmatic costs and benefits associated with dealer regulation, in that it may lead certain non-U.S. persons not to have to register as dealers notwithstanding dealing activities with such counterparties above the *de minimis* thresholds. Such an alternative approach also may promote market participants' use of such counterparties that are closely linked to the United States but that are not organized, incorporated or established within the United States, or that do not have operational management activities within the United States, in lieu of entering into security-based swaps with U.S. persons. While such an approach may be expected to reduce programmatic costs, it also would reduce the programmatic risk mitigation and other benefits of dealer regulation under Title VII given that the ''principal place of business'' test helps to identify persons for which the risks associated with their security-based swap activities can manifest themselves within the United States.[491] Such an alternative approach may also be expected to reduce assessment costs incurred by non-U.S. persons, although such assessment costs in any event would be reduced by the ability of non-U.S. persons to rely on a counterparty's representation that the counterparty is not a U.S. person.

Aside from those issues related to the use of a ''principal place of business'' test, other aspects of the ''U.S. person'' definition also may affect the programmatic costs and benefits and assessment costs associated with dealer regulation. For example, the final rules do not encompass funds that are majority-owned by U.S. persons, although two commenters supported such an approach.[492] Also, the final ''U.S. person'' definition does not exclude investment vehicles that are offered publicly only to non-U.S. persons and are not offered to U.S. persons, although some commenters also supported this type of exclusion.[493]

For the reasons detailed above, we believe that including majority-owned funds within the definition of ''U.S. person'' would be likely to increase programmatic costs (by causing more investment funds to be subject to Title VII requirements) as well as assessment costs, while not significantly increasing programmatic benefits given our view that the composition of a fund's beneficial owners is not likely to have significant bearing on the degree of risk that the fund's security-based swap activity poses to the U.S. financial system. Moreover, for the reasons discussed above, we also believe that an exclusion for publicly offered funds that are offered only to non-U.S. persons and not offered to U.S. persons, while likely to reduce programmatic costs, would also reduce programmatic benefits, by excluding certain funds from the definition of U.S. person based on factors that we do not believe are directly relevant to the degree of risk a fund's security-based swap activities are likely to pose to U.S. persons and potentially to the U.S. financial system.

Apart from those potential alternatives regarding the treatment of majority-owned funds and of investment vehicles offered only to non-U.S. persons, an additional alternative approach would be for the Commission simply to adopt the CFTC's interpretation of ''U.S. person.'' We do not believe that following that alternative approach would be expected to have a significant effect on programmatic costs and benefits, given the substantive similarities between the CFTC's interpretation and our final rule. Adopting such an alternative approach, however, could have an impact on assessment costs. We particularly are mindful that some commenters requested that we adopt a consistent definition notwithstanding their views regarding specific features of the definition, in part because they believed that differences between our definition of ''U.S. person'' and the CFTC's interpretation of that term would significantly increase costs associated with determining whether they or their counterparties are U.S. persons for purposes of Title VII. We recognize that differences between the two definitions could lead certain market participants to incur additional costs that they would

[489] *See* Cross-Border Proposing Release, 78 FR 31146.

[490] The issues regarding the treatment of foreign branches of U.S. banks—as potential dealers or as counterparties to non-U.S. persons that engage in dealing activity—that are addressed above also implicate the status of those foreign branches as ''U.S. persons.''

[491] *See* section IV.C.3(b)(ii), *supra.*

[492] *See* section IV.C.3(b)(iii), *supra.* The CFTC Cross-Border Guidance follows such an approach.

[493] *See* note 285 through 287, *supra,* and accompanying text. Here too, the CFTC Cross-Border Guidance follows such an approach.

not incur in the presence of identical definitions. At the same time, we are adopting definitions of ''U.S. person'' and ''principal place of business'' that should be relatively simple and straightforward to implement, which should mitigate commenters' concerns about the costs associated with different approaches to these terms. More generally, for the reasons discussed above we believe that the definitions we are adopting are the appropriate definitions for the cross-border implementation of Title VII in the security-based swap context.[494]

In addition, as discussed above, the final ''U.S. person'' definition does not follow an approach similar to the one used in Regulation S.[495] Because such an alternative approach would treat certain foreign branches of U.S. persons as non-U.S. persons, notwithstanding the entity-wide nature of the associated risks, following such an approach would be expected to reduce programmatic benefits by causing Title VII dealer regulation not to apply to certain dealing activities that occur in the United States and pose direct risks to U.S. persons. Although such an alternative approach potentially could impact assessment costs, given that certain market participants may already be familiar with the parameters of such a Regulation S approach, in our view the ''U.S. person'' definition we are adopting is more appropriate and simpler than an approach based on Regulation S.

Another potential alternative approach for addressing the ''U.S. person'' definition would be for the definition not to include the exclusion we are adopting with regard to specified international organizations. The alternative approach of not explicitly excluding such organizations from the definition could be expected to increase assessment costs—as counterparties to such organizations would have to consider those organizations' potential status as U.S. persons, which would implicate analysis of the privileges and immunities granted such persons under U.S. law—without likely countervailing programmatic benefits.[496]

The available data suggests that an alternative in which offshore funds managed by U.S. persons are excluded from *de minimis* calculations by non-U.S. persons would not be expected to indicate a change to our assessment that up to 50 entities may be expected to register with the Commission as security-based swap dealers.[497] We do not believe that other alternative approaches to the ''U.S. person'' definition are readily susceptible to quantitative analysis that would illustrate their potential programmatic and assessment effects.[498]

(f) Aggregation Requirement

The final rules apply the *de minimis* exception's aggregation requirement to cross-border activities in a way that reflects the same principles that govern when non-U.S. persons must directly count their dealing activity against the thresholds. The final rules thus have been revised from the proposal to incorporate other aspects of the way that the final rules require counting of particular transactions against the thresholds. The final rules further have been modified from the proposal to remove the proposed ''operational independence'' condition to the exclusion that permits a person not to count transactions of its affiliates that are registered as security-based swap dealers.[499] These rules—like the incorporation of the aggregation requirement as part of the Intermediary Definitions Adopting Release—are intended to avoid evasion of the Title VII dealer requirements.

The final rules regarding the aggregation provision represent a middle ground between commenter views. One commenter specifically supported the proposal's ''operational independence'' condition that would limit when a person could exclude the dealing transactions of affiliates that are registered as dealers.[500] On the other hand, other commenters opposed any application of the aggregation provisions in the cross-border context (as well as more generally).[501] This suggests at least two alternatives—one in which the ''operational independence'' condition is retained, and one in which the aggregation requirement is further limited to only require U.S. persons to count dealing activities of affiliated U.S. persons.

The economic impact of retaining the proposed operational independence condition potentially would reduce efficiencies and deter beneficial group-wide risk management practices. Conversely, the impact of the alternative approach of further limiting the aggregation requirement, such that it addresses only affiliated U.S. persons, would facilitate market participants' evasion of the dealer regulation requirement by dividing their dealing activity among multiple non-U.S. entities.

The economic impact of the alternative approach of retaining the ''operational independence'' condition is not readily susceptible to quantification, given the lack of data regarding the extent to which affiliates that engage in security-based swap activities jointly make use of back office, risk management, sales or trades, or other functions. Analysis of data related to the alternate approach under which the requirement would be further limited to aggregating transactions of affiliated U.S. persons would not be expected to indicate a change to our assessment that up to 50 entities may be expected to register with the Commission as security-based swap dealers, subject to the limitations discussed above.[502]

[494] *See* section IV.C, *supra.*

[495] *See* section IV.C.3, *supra.*

[496] Separately, as discussed above, we do not concur with the view of some commenters that a person's dealing activities involving such international organizations as counterparty should be excluded from having to be counted under the final rules. *See* section IV.3(e), *supra.* An alternative approach that followed those views would reduce the programmatic benefits of dealer regulation under Title VII, such as by permitting dealers that are U.S. persons to escape dealer regulation, notwithstanding the risk such U.S. dealers pose to the U.S. market, simply by focusing their dealing activities toward transactions with such international organizations.

[497] Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12 month period, with a revised *de minimis* test that does not count non-U.S. persons' dealing transactions involving offshore funds managed by U.S. persons produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold—a number identical to the number associated with the test we are adopting.

[498] We note generally, however, that similarities between the definition of ''U.S. person'' in the final rules and the CFTC's interpretation of that term would help mitigate the assessment costs associated with the ''U.S. person'' determination. We do not believe that there are any significant differences, whereby a person that is a ''U.S. person'' for purposes of our final rules would generally not be a ''U.S. person'' for purposes of the CFTC Cross-Border Guidance, that may tend to increase assessment costs.

[499] By removing the proposed ''operational independence'' condition, the final rule provides that a person need not count the transactions of its registered dealer affiliate regardless of whether the person and the registered dealer affiliate are operationally independent.

The final rule also has been revised from the proposal to make the exclusion for registered dealer affiliates also available when an affiliate is in the process of registering as a dealer.

[500] *See* note 396, *supra.*

[501] *See* note 391 through 395, *supra.*

[502] Screening the 27 market participants that have three or more counterparties that are not recognized as dealers by ISDA, and that have $3 billion or more in notional single-name CDS transactions over a 12-month period, with a revised *de minimis* test that limits aggregation to U.S. affiliates within a corporate group produces 26 entities that would have more than $3 billion in notional transactions over 12 months counted against the threshold—a number identical to the number associated with the test we are adopting.

(g) Exception for Cleared Anonymous Transactions

The final rules include an exception whereby non-U.S. persons need not count, against the thresholds, transactions that are entered into anonymously and are cleared. This exception reflects limits on the potential availability of relevant information to non-U.S. persons, as well as potential impacts on liquidity that may result absent such an exception.

The likely impact of the alternative approach of not including such an exception could be to deter the development of anonymous trading platforms, or to reduce U.S. persons' ability to participate in such platforms. In this regard the alternative can be expected to help reduce the programmatic benefits of Title VII. The impact of the alternative approach of not including this type of exception is not readily susceptible to quantification.[503]

V. Cross-Border Application of Major Security-Based Swap Participant Thresholds

A. Overview

The statutory definition of ''major security-based swap participant'' encompasses persons that are not dealers but that nonetheless could pose a high degree of risk to the U.S. financial system.[504] The statutory focus of the ''major security-based swap participant'' definition differs from that of the ''security-based swap dealer'' definition, in that the latter focuses on *activity* that may raise the concerns that dealer regulation is intended to address, while the former focuses on *positions* that may raise systemic risk concerns within the United States.[505] The definition focuses on systemic risk issues by targeting persons that maintain ''substantial positions'' that are ''systemically important,'' or whose positions create ''substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets.'' [506] The statute further directed us to define the term ''substantial position'' 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.'' [507]

In the Intermediary Definitions Adopting Release, we, together with the CFTC, adopted rules defining what constitutes a ''substantial position'' and ''substantial counterparty exposure.'' [508] In doing so, we concentrated on identifying persons whose large security-based swap positions pose market risks that are significant enough that it is prudent to regulate and monitor those persons.[509] The definition incorporates a current exposure test and a potential future exposure test designed to identify such persons.[510]

We addressed the application of the major participant definition to cross-border security-based swaps in the Cross-Border Proposing Release, proposing that a U.S. person consider all security-based swap positions entered into by it, and also proposing that a non-U.S. person consider only its positions with U.S. persons but not its positions with other non-U.S. counterparties, even if the positions are entered into within the United States or the non-U.S. counterparties are guaranteed by a U.S. person.[511]

In the proposal, we also explained our preliminary view on the application in the cross-border context of the general principles regarding attribution, which were set forth in guidance in the Intermediary Definitions Adopting Release. Specifically, we stated that a person's security-based swap positions must be attributed to a parent, affiliate, or guarantor for purposes of the major security-based swap participant analysis to the extent that the counterparties to those positions have recourse to that parent, affiliate, or guarantor in connection with the position.[512] This treatment was intended to reflect the risk focus of the major security-based swap participant definition by providing that entities will be regulated as major security-based swap participants when the guarantees they provide pose a sufficiently high level of risk to the U.S. financial system.[513]

Commenters raised several issues related to the proposed approach for applying the major security-based swap participant definition to cross-border security-based swaps. As discussed below, these include issues regarding: the treatment of a non-U.S. person's positions with foreign branches of U.S. banks, the treatment of guarantees, and the treatment of entities with legacy positions. Commenters also requested that the Commission generally harmonize its rules and guidance with the CFTC's Cross-Border Guidance.

After considering commenters' views, we are adopting final rules that have been modified from the proposal in certain important respects. As addressed in further detail below, key changes to the proposal include:

- A requirement that a conduit affiliate, as defined above, must include in its major security-based swap

[503] Based on our understanding of the market, transactions in security-based swaps in general currently would not be eligible for the exception because transactions currently are not anonymous.

[504] As discussed in the Intermediary Definitions Adopting Release, the major security-based swap participant definition employs tests incorporating 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. That discussion also noted that the link between the major participant definitions and risk was highlighted during the congressional debate on the statute. *See id.* (citing 156 Cong. Rec. S5907 (daily ed. July 15, 2010) (citing colloquy between Senators Hagen and Lincoln, discussing how the goal of the major participant definitions was to ''focus on risk factors that contributed to the recent financial crisis, such as excessive leverage, under-collateralization of swap positions, and a lack of information about the aggregate size of positions.'')).

[505] *See* section II.B.2(c), *supra.*

[506] *See* section 3(a)(67) of the Exchange Act. The statute defines a ''major security-based swap participant'' as a person that satisfies any one of three alternative statutory tests: a person that maintains a ''substantial position'' in swaps or security-based swaps for any of the major swap categories as determined by the Commission; a person whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the U.S. banking system or financial markets; or a person that is a ''financial entity'' that is ''highly leveraged'' relative to the amount of capital it holds (and that is not subject to capital requirements established by an appropriate Federal banking agency) and maintains a ''substantial position'' in outstanding security-based swaps in any major category as determined by the Commission.

[507] *See* Exchange Act section 3(a)(67)(B).

[508] *See* Intermediary Definitions Adopting Release, 77 FR 30663–84.

[509] *See id.* at 30661, 30666.

[510] *See id.* at 30666 (noting the use of such tests in context of ''substantial position'' definition); *id.* at 30682 (noting use of such tests in context of ''substantial counterparty exposure'' definition). We also noted that our definition of ''substantial position'' was intended to address default-related credit risks, the risk that would be posed by the default of multiple entities close in time, and the aggregate risks presented by a person's security-based swap activity, as these considerations reflect the market risk concerns expressly identified in the statute. We interpreted ''substantial counterparty exposure'' in a similar manner, noting the focus of the statutory test on ''serious adverse effects on financial stability or financial markets.'' Id. at 30683. *Cf.* section 3(a)(67)(A)(ii)(II) of the Exchange Act (encompassing as major security-based swap participants persons ''whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets'').

[511] *See* proposed Exchange Act rule 3a67–10(c); Cross-Border Proposing Release, 78 FR 31030.

[512] *See* Cross-Border Proposing Release, 78 FR 31031 and n.625. *Cf.* Intermediary Definitions Adopting Release, 77 FR 30689 (describing same attribution treatment in context of domestic security-based swap activities).

[513] *See* Cross-Border Proposing Release, 78 FR 31032.

participant threshold calculations all of its security-based swap positions;

- A requirement that a non-U.S. person other than a conduit affiliate must include in its major security-based swap participant threshold calculations all of its security-based swap positions for which its counterparty has rights of recourse against a U.S. person; and
- A modification to the proposed requirement that a non-U.S. person must include in its major security-based swap participant threshold calculations security-based swap positions with foreign branches of U.S. banks.[514]

Our approach to the application of the major security-based swap participant definition in the cross-border context incorporates certain principles that also apply in the context of the dealer definition and that are set forth in the Intermediary Definitions Adopting Release.[515] First, as in the Intermediary Definitions Adopting Release, we interpret the term ''person'' to refer to a particular legal person, meaning that we view a trading desk, department, office, branch, or other discrete business unit that is not a separately organized legal person as a part of the legal person that enters into security-based swap positions.[516] Thus, a legal person with a branch, agency, or office that exceeds the major security-based swap participant thresholds is required to register as a major security-based swap participant as a legal person, even if the legal person's positions are limited to such branch, agency, or office.[517] In addition, consistent with rules adopted in the Intermediary Definitions Adopting Release, cross-border security-based swap positions between majority-owned affiliates will not be considered for purposes of determining whether the person as a whole is a major security-based swap participant.[518]

B. Application of the Major Security-Based Swap Participant Definition to U.S. Persons

1. Proposed Approach and Commenters' Views

Under the proposal, a U.S. person would have considered all of its security-based swap positions for purposes of the major participant analysis.[519] Commenters did not comment on this aspect of the proposed approach, although, as discussed above, several commenters addressed the proposed scope of the ''U.S. person'' definition.[520]

2. Final Rule

Consistent with the proposal, the final rules require a U.S. person to consider all of its security-based swap positions in its major security-based swap participant threshold calculations.[521] The final rule incorporates the definition of ''U.S. person'' used in the context of a security-based swap dealer's *de minimis* calculation.[522]

As discussed above, in our view, the security-based swap positions of a U.S. person exist in the United States and raise, at the thresholds set forth in our further definition of major security-based swap participant, risks to the stability of the U.S. financial system or of U.S. entities, including those that may be systemically important.[523] As noted above, it is the U.S. person as a whole and not merely a foreign branch or office that bears the risk of the security-based swap. Accordingly, it is consistent with our territorial approach to require a U.S. person to include all of its security-based swap positions in its major security-based swap participant threshold calculations.

C. Application of the Major Security-Based Swap Participant Definition to Conduit Affiliates

1. Proposed Approach and Commenters' Views

The proposal would have treated non-U.S. persons acting as ''conduits'' for their U.S. affiliates the same as any other non-U.S. person for purposes of the major participant analysis, and, as such would have required those persons to include in their major participant threshold calculations only positions with U.S. persons.[524]

The proposal solicited comment regarding whether a non-U.S. person's major participant analysis should incorporate security-based swaps other than those entered into with U.S. persons.[525] Also, as discussed above, the proposal requested comment on the use of the conduit affiliate concept and the treatment of entities that operate a ''central booking system''.[526]

As discussed above, two commenters opposed applying the ''conduit affiliate'' definition to entities that serve as ''central booking systems'' for a corporate group, noting that the ''central booking systems'' are used to manage internal risk.[527] The commenters argued that applying the conduit affiliate definition in this manner would tie regulatory requirements to firms' internal risk management practices, and would hamper the firms' ability to manage risk across a multinational enterprise.[528] Another commenter suggested that conduit affiliates are the recipients of a *de facto* guarantee from their U.S. affiliates and thus should be treated as U.S. persons.[529]

2. Final Rule

The final rule modifies the proposal to require conduit affiliates to include all of their security-based swap positions in their major participant threshold calculations.[530] Consistent with the dealer *de minimis* rules, a ''conduit affiliate'' is a non-U.S. affiliate of a U.S. person that enters into security-based swaps with non-U.S. persons, or with foreign branches of U.S. banks that are registered security-based swap dealers, on behalf of one or more of its U.S. affiliates (other than

[514] In addition to the changes listed above, the final rules do not include certain provisions that were included in proposed Exchange Act rule 3a67–10 because those provisions, which defined ''foreign major security-based swap participant,'' and addressed the application of business conduct requirements to registered foreign major security-based swap participants, were relevant to proposed rules regarding substantive requirements that were included in the Cross-Border Proposing Release. As this release only addresses various definitional rules and not those substantive requirements that were proposed, those provisions are not relevant to this release and are not addressed. Those provisions may, however, be relevant to matters addressed in subsequent rulemakings.

The final rules applying the major security-based swap participant definition also incorporate a conforming change by referring to such person's ''positions'' rather than ''transactions.'' This is consistent with the use of the term ''positions'' in the statutory definition of major security-based swap participant and the rules further defining that term.

[515] *See* Intermediary Definitions Adopting Release, 77 FR 30624 (discussing our guidance regarding the meaning of the term ''person'' as used in security-based swap dealer definition). *Cf.* section IV.A, *supra.*

[516] *See* section IV.A. *Cf.* Intermediary Definitions Adopting Release, 77 FR 30624.

[517] *Cf.* Intermediary Definitions Adopting Release, 77 FR 30624; *see also* Cross-Border Proposing Release, 78 FR 30993.

[518] *See* Exchange Act rule 3a67–3(e); Intermediary Definitions Adopting Release, 77 FR 30687.

[519] *See* proposed Exchange Act rule 3a–67–10(c)(1).

[520] *See* section IV.C.2(a) and notes 192–194 (citing comment letters regarding ''U.S. person'' definition generally), *supra.*

[521] *See* Exchange Act rule 3a67–10(b)(1).

[522] *See* Exchange Act rule 3a67–10(a)(4) (defining ''U.S. person'' by referring to rule 3a71–3(a)(4)).

[523] *See* section II.B.2(c); *Cf.* Exchange Act section 3(a)(67)(B).

[524] Cross-Border Proposing Release, 78 FR 31006. *See id.* at 31006 n.356 (acknowledging that such treatment differed from the CFTC's proposal and citing CFTC's proposed cross-border guidance).

[525] *Id.* at 31036.

[526] *See* section IV.D.1, *supra.*

[527] *See id.*

[528] *See* section IV.D.1, *supra,* notes 309 and 311 (citing SIFMA/FIA/FSR Letter and CDEU Letter).

[529] *See* section IV.D.1, note 310, *supra* (citing BM Letter).

[530] Exchange Act rule 3a67–10(b)(2).

U.S. affiliates that are registered as security-based swap dealers or major security-based swap participants [531]), and enters into offsetting transactions with its U.S. affiliates to transfer risks and benefits of those security-based swaps.[532]

After careful consideration and as discussed in the context of the dealer *de minimis* exception, we believe that requiring such conduit affiliates to include their positions in their major participant threshold calculations is consistent with our statutory anti-evasion authority and necessary or appropriate to help ensure that non-U.S. persons do not facilitate the evasion of major participant regulation under the Dodd-Frank Act. Absent a requirement that conduit affiliates include their positions in the threshold calculations, a U.S. person may be able to evade registration requirements under the Dodd-Frank Act by participating in arrangements whereby a non-U.S. person engages in security-based swap activity outside the United States on behalf of a U.S. affiliate that is not a registered security-based swap dealer or major security-based swap participant. The U.S. person could enter into offsetting transactions with the non-U.S. affiliate, thereby assuming the risks and benefits of those positions.[533] Requiring conduit affiliates to include their positions in their major participant threshold calculations will help guard against evasion of major participant regulation and the risk that such entities could pose to the U.S. financial system.[534]

In this context, as in the dealer context, we recognize the significance of commenters' concerns that the ''conduit affiliate'' concept may impede efficient risk management procedures, such as the use of central booking entities.[535] As in the context of the *de minimis* exception to the dealer analysis, the ''conduit affiliate'' definition serves as a prophylactic anti-evasion measure, and we do not believe that any entities currently act as conduit affiliates in the security-based swap market, particularly given that a framework for the comprehensive regulation of security-based swaps did not exist prior to the enactment of Title VII, suggesting that market participants would have had no incentives to use such arrangements for evasive purposes.

Moreover, we believe that commenter concerns may be mitigated by certain features of the major participant analysis and that, to the extent risk mitigation procedures such as ''central booking systems'' are impacted by the final rules on conduit affiliates, such anticipated impact is appropriate given the purpose of the major participant definition to identify entities that may pose significant risk to the market. As discussed in the Intermediary Definitions Adopting Release, we believe the major participant thresholds are high enough that they will not affect entities, including centralized hedging facilities, of any but the largest security-based swap users.[536] We would not expect that centralized hedging facilities would generally hold positions at the level of the major participant thresholds.[537] Further, the first test in the major security-based swap participant definition, which calculates whether a person maintains a ''substantial position,'' excludes positions held for hedging or mitigating commercial risk.[538] In the Intermediary Definitions Adopting Release, we explained that the exclusion includes hedging on behalf of a majority-owned affiliate, such as a centralized hedging facility.[539] We believe this exclusion in the first test of the major participant definition is likely to lessen the impact that the conduit affiliate rules will have on centralized hedging facilities.[540]

In addition to these features of the major security-based swap participant definition that we anticipate will mitigate the impact of the conduit affiliate rules on risk mitigation practices, we believe the focus of the major participant definition on the degree of risk to the U.S. financial system justifies regulation of certain entities that perform this function if they maintain positions at a level that may pose sufficient risk to trigger the major participant definition, regardless of the nature of their security-based swap activity.

For the foregoing reasons, we believe that the final rules regarding conduit affiliates are necessary or appropriate to prevent the evasion of any provision of the amendments made to the Exchange Act by Title VII and appropriately target potentially evasive scenarios that present the level of risk that the major security-based swap participant definition is intended to address.[541]

D. Application to Other Non-U.S. Persons

The proposed rules would have required a non-U.S. person to include in its major security-based swap participant analysis all positions with U.S. persons, including foreign branches of U.S. banks.[542] A non-U.S. person

[531] As noted in the discussion of conduit affiliate in the context of the application of dealer *de minimis* exception, the ''conduit affiliate'' definition does not encompass persons that engage in such offsetting transactions solely with U.S. persons that are registered with the Commission as security-based swap dealers or major security-based swap participants because we believe the registered status of the U.S. person mitigates evasion concerns. *See* note 313, *supra.*

[532] *See* section IV.D.2, *supra;* Exchange Act section 3a67–10(a)(1) (incorporating the ''conduit affiliate'' definition used in the dealer *de minimis* rule).

[533] *See* Exchange Act section 30(c); section II.B.2(d), *supra.* In noting that this requirement is consistent with our anti-evasion authority under section 30(c), we are not taking a position as to whether such activity by a conduit affiliate otherwise constitutes a ''business in security-based swaps without the jurisdiction of the United States.'' *See* note 315, *supra.*

We recognize that not all structures involving conduit affiliates may be evasive in purpose. We believe, however, that the anti-evasion authority of Exchange Act section 30(c) permits us to prescribe prophylactic 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 established for valid business purposes, so long as the rule is designed to prevent possible evasive conduct. *See* Cross-Border Proposing Release, 78 FR 30987; *see also* section II.B.2(d) and note 316, *supra* (discussion of anti-evasion authority).

[534] Consistent with the approach we are taking in the dealer context, the rule under the major participant analysis requires a conduit affiliate to count all of its positions. *See* section IV.D.2 and note 312, *supra.* It is not limited to the conduit affiliate's positions that are specifically linked to offsetting positions with its U.S. affiliate because the correspondence between positions and their offsets may not be one-to-one, such as due to netting.

[535] *See* note 311, *supra* (citing SIFMA/FIA/FSR Letter and CDEU Letter).

[536] *See* Intermediary Definitions Adopting Release, 77 FR 30671–72 and n.914 (explaining that, for cleared security-based CDS, a person would have to write $200 billion notional of CDS protection to meet the relevant $2 billion threshold for potential future exposure).

[537] We note that of the five non-U.S. domiciled entities that we expect to perceive the need to engage in the major security-based swap participant calculation threshold analysis (*see* section V.H.2(a), *infra*), none appear to have any U.S.-based affiliates.

[538] *See* Exchange Act rule 3a67–1(a)(2)(i).

[539] *See* Intermediary Definitions Adopting Release, 77 FR 30675–76.

[540] We also note that the third test of the major participant definition, rule 3a67–1(a)(2)(iii), which only applies to ''highly leveraged financial entities,'' excludes centralized hedging facilities acting on behalf of a non-financial entity from the definition of financial entity. To the extent commenters expressed concern that the conduit affiliate rules would affect financial entities and their risk mitigation procedures, this exclusion for centralized hedging facilities is designed to limit that impact. However, to the extent that an entity is not able to use the exclusion and falls within the definition of a highly leveraged financial entity, we believe that requiring such positions to be included is consistent with the focus of the major participant definition. *Cf.* CDEU Letter at 1 (stating that financial and non-financial end-users should be subject to the same cross-border requirements); IIB Letter at 22 (noting that many financial institutions that do not enter into CDS for dealing purposes still enter into them for hedging purposes).

[541] *See* section IV.D.2, *supra.*

[542] *See* Cross-Border Proposing Release, 78 FR 31031 (explaining that the ''U.S. person'' definition

Continued

would not have had to include its security-based swap positions with non-U.S. person counterparties, even if such positions were guaranteed by another person.[543] A few commenters criticized the proposed requirement that a non-U.S. person include its positions with foreign branches of U.S. banks in its calculation thresholds.[544] Regarding the treatment of a non-U.S. person whose positions with non-U.S. persons are guaranteed by a U.S. person, one commenter supported our proposed approach not to require the person whose position is guaranteed to include such guaranteed positions in its calculation,[545] while other commenters requested that such entities be treated as U.S. persons.[546] The final rules applying the major participant definition to non-U.S. persons are tailored to address the market impact and risk that we believe a person's security-based swap positions would pose to the U.S. financial system.

1. Positions With U.S. Persons Other Than Foreign Branches of U.S. Banks

(a) Proposed Approach and Commenters' Views

As noted above, the proposed rules would have required a non-U.S. person to include in its major security-based swap participant threshold calculations all positions with U.S. persons, including foreign branches of U.S. banks.[547] The proposal stated that requiring non-U.S. persons to include their positions with U.S. persons, as defined in the proposal, would ''provide an appropriate indication of the degree of default risk proposed by such non-U.S. person's security-based swap positions to the U.S. financial system,'' by accounting for such non-U.S. person's outward exposures to U.S. persons.[548] One commenter objected to the proposal's approach to look to the U.S.-person status of a clearing agency when a non-U.S. person enters into a security-based swap that is cleared and novated through a clearing agency.[549] In the proposal, we explained that we would consider the clearing agency as the non-U.S. person's counterparty and because the clearing agency is a U.S. person we would require such novated security-based swap to be included in the non-U.S. person's major security-based swap participant calculation threshold calculations.[550] The commenter objected, arguing that the location of clearing should be irrelevant for purposes of determining major security-based swap participant status.[551] Although some commenters took issue with the scope of the ''U.S. person'' definition, as described above, commenters did not otherwise address this specific requirement within the application of the major security-based swap participant definition.

(b) Final Rule

The final rule, like the proposal, generally requires that non-U.S. persons (apart from the conduit affiliates, which are addressed above) [552] include in their major security-based swap participant threshold calculations their positions with U.S. persons.[553]

Generally requiring non-U.S. persons to consider their security-based swap positions with U.S. persons (except for positions with foreign branches of registered security-based swap dealers, as discussed below) will help ensure that persons whose positions are likely to pose a risk to the U.S. financial system at the relevant thresholds are subject to regulation as a major security-based swap participant.[554] Security-based swap positions involving a U.S.-person counterparty exist within the United States by virtue of being undertaken with a counterparty that is a U.S. person. For these reasons, positions entered into with U.S. persons are likely to raise, at the thresholds set forth in our further definition of major security-based swap participant, risks to the stability of the U.S. financial system or of U.S. entities, including those that may be systemically important.[555]

While we considered one commenter's concern that the location of clearing should not be relevant for purposes of determining a non-U.S. person's major security-based swap participant status,[556] we continue to believe that, as such positions are cleared through a U.S.-person clearing agency, they exist within the United States and create risk in the United States of the type the major security-based swap participant definition is intended to address.[557] We note, in response to commenters' opinions about the risk-mitigating effects of central clearing, and the additional level of rigor that clearing agencies may have with regards to the process and procedures for collecting daily margin, that the final rules further defining ''substantial position'' provide that the potential future exposure associated with positions that are subject to central clearing by a registered or exempt clearing agency is equal to 0.1 times the potential future exposure that would otherwise be calculated.[558] This treatment reflects our view that clearing the security-based swap substantially mitigates the risk of such positions but cannot eliminate such risk.[559] We believe that this previously adopted provision may provide additional incentives for market participants to clear their positions through registered or exempt clearing agencies, and that the requirement to include such positions in the major security-based swap participant threshold calculations should not discourage market participants from clearing positions through U.S.-based clearing agencies.

2. Positions With Foreign Branches of U.S. Banks

(a) Proposed Approach and Commenters' Views

As noted above, the proposal would have required non-U.S. persons to include their positions with U.S.

applies to the entire person, including its branches and offices that may be located in a foreign jurisdiction and, as such, the potential impact in the United States due to a non-U.S. counterparty's default would not differ depending on whether the non-U.S. counterparty entered into the security-based swap transaction with the home office of a U.S. bank or with a foreign branch of a U.S. bank).

[543] *See* proposed Exchange Act rule 3a67–10(c)(2).

[544] *See* SIFMA/FIA/FSR Letter at A–19 to A–20 (noting that the requirement may provide an incentive for non-U.S. persons to limit trading with foreign branches of U.S. persons and differs from the CFTC guidance); IIB Letter at 12 (noting that the requirement that non-U.S. person include its positions with foreign branches of U.S. persons in its major participant calculation is inconsistent with the proposed requirement in the *de minimis* context and the CFTC guidance).

[545] *See* SIFMA/FIA/FSR Letter at A–10 to A–11 (stating that a guaranteed non-U.S. person does not have the necessary ''requisite jurisdictional nexus'' to be classified as a U.S. person, and thereby supporting the Commission's proposal to address the risk of such guarantees through the attribution process in the major security-based swap participant requirements); note 209, *supra.*

[546] *See* note 207 (citing AFR Letter I and BM Letter).

[547] *See* Cross-Border Proposing Release, 78 FR 31031.

[548] *See id.* at 31030 n.612.

[549] *See* CME Letter at 2–3.

[550] *See* Cross-Border Proposing Release, FR 78 31030 n.612.

[551] CME Letter at 3 (explaining that the requirement will discourage market participants from clearing through a clearing agency in the United States).

[552] *See* section V.C, *supra.*

[553] *See* Exchange Act rule 3a67–10(b)(3)(i).

[554] *See* Cross-Border Proposing Release, 78 FR 31030 (explaining that the risk to the U.S. financial system would be measured by calculating a non-U.S. person's aggregated outward exposures to U.S. persons, meaning what such non-U.S. person owes, or potentially could owe, on its security-based swaps with U.S. persons).

[555] *Cf.* section 3(a)(67)(B) of the Exchange Act.

[556] *See* CME Letter, *supra,* note 549.

[557] *See* section II.B.2(c), *supra.*

[558] This results in a 90 percent discount on the notional exposure under the security-based swap. *See* Exchange Act rule 3a67–3(c)(3)(i)(A); Intermediary Definitions Adopting Release, 77 FR 30670.

[559] *See* Intermediary Definitions Adopting Release, 77 FR 30670.

persons in their threshold calculations. This requirement would have extended to positions with foreign branches of U.S. banks.[560] Two commenters criticized the proposal's requirement that a non-U.S. person would need to include positions with foreign branches of U.S. banks.[561] One of these commenters suggested that the Commission adopt the CFTC policy, which set forth an exception generally permitting a non-U.S. person that is a non-financial entity to exclude from its calculation positions with foreign branches of U.S. banks that are registered swap dealers.[562] One of the commenters suggested that if the Commission did not allow all non-U.S. persons to exclude transactions with foreign branches of U.S. banks from their calculation, the Commission should at least adopt the approach taken by the CFTC in its cross-border guidance of allowing a non-U.S. person that is a financial entity to exclude transactions, subject to certain additional conditions, with foreign branches of U.S. banks that are registered security-based swap dealers.[563]

(b) Final Rule

The final rule has been modified from the proposal to require non-U.S. persons (other than conduit affiliates, as discussed above) to count, against their major security-based swap participant threshold calculations, their positions with U.S. persons other than positions with foreign branches of registered security-based swap dealers.[564] The proposal would have required non-U.S. persons to all include their positions with U.S. persons in their threshold calculations, including any positions with foreign branches of U.S. banks.[565]

The final rule permits non-U.S. persons not to count certain positions that arise from transactions conducted through a foreign branch of a counterparty that is a U.S. bank.[566] For this exclusion to be effective, persons located within the United States cannot be involved in arranging, negotiating, or executing the transaction.[567] Moreover, the counterparty bank must be registered as a security-based swap dealer,[568] unless the transaction occurs prior to 60 days following the effective date of final rules providing for the registration of security-based swap dealers.[569] Registration of the counterparty U.S. bank would not be required for the exclusion to be effective before then, given that the non-U.S. person would not be able to know with certainty whether the U.S. bank in the future would register with the Commission as a security-based swap dealer.[570]

We believe that the revision to the proposal allowing for an exclusion from counting positions that arise from transactions conducted through foreign branches of registered security-based swap dealers appropriately accounts for the risk in the U.S. financial system created by such positions. In our view, the risk of such positions is lessened when the U.S. bank itself is registered with the Commission as a security-based swap dealer because the U.S. bank, and its transactions, will be subject to the relevant Title VII provisions applicable to security-based swap dealers (for example, margin and reporting requirements).[571] The exception is also consistent with our application of the dealer *de minimis* exception in our final rule, which requires non-U.S. persons, other than conduit affiliates, to include in their *de minimis* threshold calculations dealing transactions with U.S. persons other than the foreign branch of a registered security-based swap dealer (or for a temporary period of time prior to 60 days prior to the effectiveness of the dealer registration rules).[572]

The final rule should help mitigate concerns that non-U.S. persons will limit or stop trading with foreign branches of U.S. banks for fear of too easily triggering major security-based swap participant registration requirements under Title VII. Moreover, the inclusion of this exception in our final rule addresses comments expressing concern that non-U.S. persons would have to include positions with foreign branches of U.S. banks in their major security-based swap participant threshold calculations.[573] We also note that the exception reduces divergence between our major participant threshold calculation and that outlined in the CFTC's guidance, as requested by commenters.[574]

[560] *See* proposed rule 3a67–10(c)(2).

[561] *See* SIFMA/FIA/FSR Letter at A–19 to A–20 (stating that the proposal would result in disparate treatment of foreign branches of U.S. banks because non-U.S. persons could exclude such transactions from their dealer *de minimis* threshold calculations but not from their major security-based swap participant threshold calculations, and noting that the proposal differs from the CFTC Cross-Border Guidance, which takes the approach that non-U.S. person financial entities generally should exclude swaps with foreign branches of U.S. swap dealers, subject to certain conditions); IIB Letter at 12 (stating that the same rationale that applies to excluding transactions with foreign branches of U.S. banks in the dealer context should apply in the major security-based swap participant context and that the proposed approach is inconsistent with the CFTC Cross-Border Guidance).

[562] *See* IIB Letter at 12–13 (suggesting that the CFTC's general policy of not counting non-financial entities' swaps with guaranteed affiliates that are swap dealers or foreign branches that are swap dealers reflects an understanding that non-financial entities present less risk than financial entities). *Cf.* CFTC Cross-Border Guidance at 45324–25.

[563] *See* SIFMA/FIA/FSR Letter at A–20 (stating that the proposal to include transactions with foreign branches in a non-U.S. person's major security-based swap participant threshold calculations may cause non-U.S. persons that would otherwise be considered major security-based swap participants to limit or stop trading with foreign branches of U.S. banks); *id.* at A–20 to A–21 (noting that the approach differs from the CFTC Cross-Border Guidance with respect to counting such transactions towards the major swap participant threshold); *see also* IIB Letter at 12–13 (stating that the proposal is inconsistent with the CFTC Cross-Border Guidance, whose exceptions demonstrate an understanding that the risk to the U.S. financial system can be addressed through different means and noting that the proposal may cause non-U.S. counterparties to stop transacting with foreign branches of U.S. banks).

[564] *See* Exchange Act rule 3a67–10(b)(3)(i). Exchange Act rule 3a67–10(a)(2) defines ''foreign branch'' by referring to Exchange Act rule 3a71–3(a)(2). We note for clarification that the rule described here uses the defined term ''transactions conducted through a foreign branch'' (as defined in Exchange Act rule 3a71–3(a)(3)) to describe the manner in which the U.S.-person must enter into the position in order for the non-U.S. person counterparty to avail itself of this exception. The non-U.S. person counterparty that is calculating its major security-based swap participant calculation thresholds is entering into the position with the foreign branch of the U.S. person.

[565] Proposed Exchange Act rule 3a67–10(c)(2).

[566] *See* Exchange Act rule 3a67–10(b)(3)(i). *See also* IV.E.2(b) (discussing similar exception in the context of the *de minimis* analysis).

[567] *See* Exchange Act rule 3a67–10(b)(3)(i) (using the term ''transaction conducted through a foreign branch,'' which requires that ''the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States,'' as defined in Exchange Act rule 3a71–3(a)(3)(i)(B)).

[568] *See* Exchange Act rule 3a67–10(b)(3)(i)(A).

A non-U.S. person would still have to count such positions for purposes of calculating its major security-based swap participant calculation thresholds if the non-U.S. person's counterparty (*i.e.,* the U.S. bank) has rights of recourse against a U.S. person in the position with the non-U.S. person. *See* Exchange Act rule 3a67–10(b)(3)(ii).

[569] *See* Exchange Act rule 3a67–10(b)(3)(i)(B).

[570] In other words, this provision will help to avoid requiring non-U.S. persons to speculate whether their counterparties would register, and to face the consequences of their speculation being wrong.

[571] *See* section IV.E.2(b) and note 373 (discussing that the risk of such positions is mitigated in part because the foreign branch of a registered security-based swap dealer will be subject to a number of Title VII regulatory requirements).

[572] *See* Exchange Act rule 3a71–3(b)(1)(iii)(A); section IV.E.2(b), *supra.*

[573] *See* note 561, *supra.*

[574] *See* notes 562 and 563, *supra.* Although our inclusion of this exception brings us closer to the general policy set forth by the CFTC, our approaches are not entirely identical, as the CFTC includes certain additional inputs for non-U.S. persons that are financial entities that we have determined not to incorporate in our final rule. *See* CFTC Cross-Border Guidance, 78 FR 45326–27.

3. Positions of Non-U.S. Persons That Are Subject to Recourse Guarantees by a U.S. Person

(a) Proposed Approach and Commenters' Views

The proposal would have not required a non-U.S. person to count towards its major security-based swap participant calculation thresholds, those positions that it entered into with non-U.S. persons, regardless of whether the counterparty to the position has a right of recourse against a U.S. person under the security-based swap.[575] To address the risk posed by the existence of a recourse guarantee against a U.S. person, the proposal would have required that 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. person guarantor's major security-based swap participant status.[576]

As noted above, one commenter supported the Commission's proposed approach not to require a non-U.S. person whose positions with other non-U.S. persons are subject to a recourse guarantee from a U.S. person, to include such guaranteed positions in its own major participant threshold calculations, expressing support for using the major security-based swap participant attribution requirements to address the risk posed to the U.S. markets by such guarantees.[577] Two commenters argued that non-U.S. persons whose positions are guaranteed by U.S. persons should be treated as U.S. persons for purposes of the major participant threshold calculations, which would require them to include all their positions in their major participant threshold calculations.[578] Additionally, although commenters did not refer specifically to the application of the major security-based swap participant definition, some commenters requested that the Commission generally harmonize its approach to cross-border activities with that of the CFTC.[579]

(b) Final Rule

We are adopting a final rule that requires a non-U.S. person to include in its major security-based swap participant threshold calculations those positions for which the non-U.S. person's counterparty has rights of recourse against a U.S. person.[580] We believe that when a U.S. person guarantees a position, the position exists within the United States and poses risk to the U.S. person guarantor,[581] and the non-U.S. person that enters directly into the position should be required to include the position in its major security-based swap participant threshold calculations. The final rule will also help to apply major participant regulation in a consistent manner to differing organizational structures that serve similar economic purposes, and help avoid disparities in applying major participant regulation to differing arrangements that pose similar risks to the United States.

Accordingly, the final rule modifies the proposal by requiring a non-U.S. person to include in its major security-based swap participant threshold calculations security-based swap positions for which a counterparty to the security-based swap has legally enforceable rights of recourse against a U.S. person, even if a non-U.S. person is counterparty to the security-based swap.[582] For these purposes, and as addressed in the context of *de minimis* exception to the ''security-based swap dealer'' definition, the counterparty would be deemed to have a right of recourse against a U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, a U.S. person in connection with the non-U.S. person's obligations under the security-based swap.

We understand that such rights may arise in a variety of contexts. For example, a counterparty would have such a right of recourse against the U.S. person if the applicable arrangement provides the counterparty the legally enforceable right to demand payment from the U.S. person in connection with the security-based swap, without conditioning that right upon the non-U.S. person's non-performance or requiring that the counterparty first make a demand on the non-U.S. person. A counterparty also would have such a right of recourse if the counterparty itself could exercise legally enforceable rights of collection against the U.S. person in connection with the security-based swap, even when such rights are conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the security-based swap, and/or are conditioned upon the counterparty first being required to take legal action against the non-U.S. person to enforce its rights of collection.

The terms of the guarantee need not necessarily be included within the security-based swap documentation or even otherwise reduced to writing (so long as legally enforceable rights are created under the laws of the relevant jurisdiction); for instance, such rights of recourse would arise when the counterparty, as a matter of law in the relevant jurisdiction, would have rights to payment and/or collection that may arise in connection with the non-U.S. person's obligations under the security-based swap that are enforceable. We would view the positions of a non-U.S. person as subject to a recourse guarantee if at least one U.S. person (either individually or jointly and severally with others) bears unlimited responsibility for the non-U.S. person's obligations, including the non-U.S. person's obligations to security-based swap counterparties. Such arrangements may include those associated with foreign unlimited companies or unlimited liability companies with at least one U.S.-person member or shareholder, general partnerships with at least one U.S.-person general partner, or entities formed under similar arrangements such that at least one U.S. persons bears unlimited responsibility for the non-U.S. person's liabilities. In our view, the nature of the legal arrangement between the U.S. person and the non-U.S. person—which makes the U.S. person responsible for the obligations of the non-U.S. person—is appropriately characterized as a recourse guarantee, absent countervailing factors. More generally, a recourse guarantee is present if, in connection with the security-based swap, the counterparty itself has a legally enforceable right to payment or collection from the U.S. person, regardless of the form of the

[575] *See* Cross-Border Proposing Release, 78 FR 31031 and n.622; *see also* proposed Exchange Act rule 3a67–10(c)(2). In the proposal, we stated that the non-U.S. person counterparties of a non-U.S. person would bear the risk of loss if that non-U.S. person was unable to pay what it owes, and therefore, that the non-U.S. person need not include in its major participant threshold calculations positions with a non-U.S. counterparty, even if its obligations under the security-based swap are guaranteed by a U.S. person. *See* Cross-Border Proposing Release, 78 FR 31031.

[576] *See id.* at 31032.

[577] *See* note 545, *supra* (citing SIFMA/FIA/FSR Letter).

[578] *See* note 207, *supra* (citing AFR Letter I and BM Letter).

[579] *See* note 25, *supra.*

[580] *See* Exchange Act rule 3a67–10(b)(3)(ii). *Cf.* note 350, *supra* (noting that this final rule encompasses non-U.S. persons who receive a guarantee from an unaffiliated U.S. person, whereas the final rule under the *de minimis* exception only encompasses non-U.S. persons who receive a guarantee from a U.S. affiliate).

We note that we have retained the requirement in the proposal that the U.S. guarantor also attribute to itself, for purposes of its own major security-based swap participant threshold calculations, all security-based swaps entered into by a non-U.S. person that are guaranteed by the U.S. person. *See* Cross-Border Proposing Release, 78 FR 31032; section V.E.1, *infra.*

[581] *See* section II.B.2(c), *supra.*

[582] Exchange Act rule 3a67–10(b)(3)(ii).

arrangement that provides such an enforceable right to payment or collection.[583]

In light of comments received and upon further consideration, we believe that the revised approach addresses, in a targeted manner, the risk to the U.S. financial system posed by entities whose counterparties are able to turn to a U.S. person for performance of the non-U.S. person's obligations under a security-based swap position.[584] We believe our final approach strikes an appropriate balance by directly regulating a non-U.S. person that enters into a position with a counterparty that has a recourse guarantee against a U.S. person, while not treating that non-U.S. person as a U.S. person.[585]

The final rule reflects our conclusion that a non-U.S. person—to the extent it enters into security-based swap positions subject to a recourse guarantee by a U.S. person—enters into security-based swap positions that exist within the United States.[586] The economic reality of such positions is that by virtue of the guarantee the non-U.S. person effectively acts together with a U.S. person to engage in the security-based swap activity that results in the positions, and the non-U.S. person's positions cannot reasonably be isolated from the U.S. person's engagement in providing the guarantee.[587] Both the guarantor and guaranteed entity are involved in the position and may jointly seek to profit by engaging in such security-based swap positions.[588] The final rule echoes our approach, consistent with our approach to regulation of security-based swap dealers that, to the extent that a single non-U.S. person is responsible for positions within the United States (whether by entering into positions with U.S.-person counterparties or for which its non-U.S. person counterparties have recourse against a U.S. person) that rise above the major participant thresholds, the entity that directly enters into such positions should be required to register as a major security-based swap participant and should be subject to direct regulation as a major security-based swap participant.

The final rules regarding positions for which a counterparty to the position has rights of recourse against a U.S. person aim to apply major participant regulation in similar ways to differing organizational structures that serve similar economic purposes, such as positions entered into by a non-U.S. person that are subject to a recourse guarantee by a U.S. person and security-based swap positions carried out through a foreign branch of a U.S. person.[589] These two differing organizational structures serve similar economic purposes and thus should be treated similarly.

As discussed below, we have maintained the proposed approach requiring a U.S. person to attribute to itself any position of a non-U.S. person for which the non-U.S. person's counterparty has rights of recourse against the U.S. person. This attribution requirement further reflects the focus of the major security-based swap participant definition on positions that may raise systemic risk concerns within the United States.[590] Such positions exist within the United States by virtue of the U.S. person's guarantee, which transmits risk to the U.S. financial system to the extent obligations are owed under the security-based swap by the guaranteed non-U.S. person because the non-U.S. person's counterparty may seek recourse from the U.S. person guaranteeing the position.[591] Additionally, the economic reality of this position, even though entered into by a non-U.S. person, is substantially identical, in relevant respects, to a transaction entered into directly by the U.S. guarantor, because a U.S. person is participating directly in the transaction.[592] For these reasons the attribution requirement, which is consistent with our territorial approach and the approach taken in the proposal, reflects the focus of the major security-based swap participant definition.

We note that, consistent with our proposal, we are not requiring non-U.S. persons to include in their major security-based swap participant threshold calculations positions for which they (as opposed to their counterparties) have a guarantee creating a right of recourse against a U.S. person. As we noted in the proposal, non-U.S. persons with a right of recourse against a U.S. person pursuant to a security-based swap do not pose a direct risk to the person providing a guarantee, as that person's failure generally will not trigger any obligations under the guarantee.[593]

E. Attribution

The Cross-Border Proposing Release stated the preliminary view that a person's security-based swap positions in the cross-border context would be attributed to a parent, other affiliate, or guarantor for purposes of the major participant analysis to the extent that the person's counterparties in those positions have recourse to that parent, other affiliate, or guarantor in connection with the position. Positions

[583] Consistent with the rule implementing the dealer de *minimis* exception, this final rule clarifies that for these purposes a counterparty would have rights of recourse against the U.S. person ''if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap.'' *See* Exchange Act rule 3a67–10(b)(3)(ii).

[584] We are not requiring a non-U.S. person whose performance with respect to one or more security-based swap positions is subject to a recourse guarantee to include all of its positions with non-U.S. persons towards its major security-based swap participant threshold calculations. We recognize that the CFTC Cross-Border Guidance uses the term ''guaranteed affiliate'' and states the view that such entities should include all of their swap positions in their major swap participant threshold calculations. *See* CFTC Cross-Border Guidance, 78 FR 45319. We believe that our final rule, which requires a non-U.S. person to include only those positions with non-U.S. persons where the counterparty has rights of recourse to a U.S. person, appropriately in the context of the security-based swap markets reflects the risk that such positions may create within the United States.

[585] *Cf.* notes 577 and 578 (discussing comment letters).

[586] *See* section II.B.2(c), *supra.*

[587] *See* section IV.E.1(b), *supra* (discussing the same point in the context of the application of the *de minimis* exception).

[588] *Cf.* section IV.E.1(b), *supra* (discussing a non-U.S. person's dealing activity that is subject to a recourse guarantee).

[589] *See* section IV.E.1(b) and note 341, *supra.* For the above reasons, we conclude that this final rule 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.* We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, U.S. persons would be able to evade major participant regulation under Title VII simply by conducting their security-based swap positions via a guaranteed non-U.S. person, while still being subject to risks associated with those positions.

[590] *See* section II.B.2(c), *supra.*

[591] *See* section V.E.1(b), *infra.*

[592] *See* section V.E, *infra.*

[593] *See* Cross-Border Proposing Release, 78 FR 31031 and n.622. We recognize that the CFTC Cross-Border Guidance does set forth the concept that non-U.S. persons should generally include in their major swap participant analysis positions with entities that fall within the CFTC's description of a ''guaranteed affiliate,'' subject to certain exceptions. *See* CFTC Cross-Border Guidance, 78 FR 45326–27. We continue to believe, however, consistent with the proposal, that it is not necessary that such non-U.S. person that has rights of recourse against a U.S. person include that position in its major participant threshold calculations because the inability of that non-U.S. person counterparty to pay what it owes pursuant to a security-based swap will generally not pose risk to the U.S. financial system because it will not trigger the obligation of the U.S. guarantor. *See* Cross-Border Proposing Release, 78 FR 31031.

would not be attributed in the absence of recourse.[594]

The final rules codify the proposed guidance related to attribution of guaranteed positions to provide clarity to market participants. We continue to believe that a U.S. person should attribute to itself any positions of a non-U.S. person for which the non-U.S. person's counterparty has rights of recourse against the U.S. person, as the position exists within the United States by virtue of the U.S. person guarantor's involvement in the position.[595] Similarly, a non-U.S. person should attribute to itself any positions of a U.S. person for which that U.S. person's counterparty has rights of recourse against the non-U.S. person.[596] We also continue to believe that when a non-U.S. person guarantor has extended a recourse guarantee on the obligations of a U.S. person, those positions exist within the United States by virtue of the guaranteed U.S. person's involvement in the positions as a direct counterparty to the transaction and therefore the positions should be attributed to the non-U.S. person guarantor that is participating in that position through providing its guarantee. The final rules requiring attribution also aim to apply major participant regulation in similar ways to differing organizational structures that serve similar economic purposes, thus helping to ensure that the relevant purposes of the Dodd-Frank Act are not undermined.

1. Positions Attributed to U.S. Person Guarantors

(a) Proposed Approach and Commenters' Views

Our preliminary view was that a U.S. person would attribute to itself all security-based swap positions for which it provides a guarantee for performance on the obligations of a non-U.S. person, other than in limited circumstances.[597] We noted that the proposed approach did not alter the guidance regarding attribution that was adopted in the Intermediary Definitions Adopting Release, but proposed an approach in the cross-border context applying the principles set forth in the Intermediary Definitions Adopting Release.[598] This attribution standard was based on our preliminary view that, when a U.S. person acts as a guarantor of a position of a non-U.S. person, the guarantee creates risks within the United States whether the underlying security-based swaps that they guarantee are entered into with U.S. persons or with non-U.S. persons.[599] One commenter argued that attribution is beyond the scope of section 30(c) of the Exchange Act.[600] One commenter argued that our preliminary view regarding attribution for entities guaranteed by U.S. persons would result in ''double-counting'' and that security-based swap positions should only be attributed to a U.S. guarantor where the direct counterparty to the security-based swap is not otherwise required to count those positions toward its own calculation.[601]

(b) Final Rule

We are adopting rules that codify the preliminary views set forth in our proposal: A U.S. person is required to attribute to itself any security-based swap position of a non-U.S. person for which the non-U.S. person's counterparty to the security-based swap has rights of recourse against that U.S. person.[602] Although we considered commenters' objections to our proposed attribution requirement, we continue to believe that this approach is necessary because, as stated in the Intermediary Definitions Adopting Release, attribution is intended to reflect the risk posed to the U.S. financial system when a counterparty to a position has recourse against a U.S. person.[603] The final rule also includes a note to clarify that a U.S. person is still expected to attribute to itself positions of other U.S. persons for which the counterparty to that U.S. person has a recourse guarantee against the U.S.-person guarantor, as explained in interpretation in the Intermediary Definitions Adopting Release.[604]

We believe that attribution of positions to guarantors is consistent with Exchange Act section 30(c), notwithstanding the argument by one commenter that attribution to a guarantor ''extends beyond the intended limits of [s]ection 30(c) of the Exchange Act.''[605] As we discuss in more detail above, the major security-based swap participant definition focuses on positions that may raise systemic risk concerns within the United States.[606] It is our view that a security-based swap position exists within the United States when it is held by or with a U.S. person, or when a counterparty to the security-based swap has recourse against a U.S. person, as the risks associated with such positions are borne within the United States, and given the involvement of U.S. persons may, at the thresholds established for the major security-based swap participant definition, give rise to the types of systemic risk within the United States that major security-based swap participant regulation is intended to address.[607]

As discussed above, the final rules regarding positions for which a counterparty to the position has rights of recourse against a U.S. person aim to apply major participant regulation to in similar ways to differing organizational structures that serve similar economic purposes, including structures such as security-based swap positions entered into by a non-U.S. person that are subject to a recourse guarantee by a U.S. person and security-based swap positions carried out through a foreign branch.[608]

[594] *See id.* 31032 and n.625 (noting that we were not proposing to alter the approach with respect to attribution of guarantees that was adopted by the Commission and the CFTC in the Intermediary Definitions Adopting Release, but rather proposing to apply the same principles in the cross-border context).

[595] As discussed above in section V.D.3(b), the economic reality of this position, even though entered into by a non-U.S. person, is substantially identical, in relevant respects, to a transaction entered into directly by the U.S. guarantor.

[596] The economic reality of the non-U.S. person's position is substantially identical, in relevant respects, to a position entered into directly by the non-U.S. person.

[597] Cross-Border Proposing Release, 78 FR 31032 and n.628. *See also* Cross-Border Proposing Release, 78 FR 31033 and section V.E.3, *infra* (discussing limited circumstances where attribution of guaranteed security-based swap positions do not apply).

[598] *See* Cross-Border Proposing Release, 78 FR 31032 n.624; *see also* Intermediary Definitions Adopting Release, 77 FR 30689 n.1132.

[599] Cross-Border Proposing Release, 78 FR 31032.

[600] SIFMA/FIA/FSR Letter at A–20 to A–21 (asserting that only the guaranteed entity, which is the direct counterparty to the security-based swap transactions, should include the positions and that to require the guarantor to include the positions goes ''beyond the intended limits of Section 30(c) of the Exchange Act'').

[601] *See id.* at A–20 to A–21.

[602] Exchange Act rule 3a67–10(c)(1)(i).

[603] *See* Intermediary Definitions Adopting Release, 77 FR 30689 n.1135 (stating that the type of attribution addressed at that time may also be expected to raise special issues in the context of guarantees involving security-based swap positions of non-U.S. entities). As noted in the Cross-Border Proposing Release, these risk concerns are the same regardless of whether the underlying security-based swap positions of the non-U.S. person that the U.S. person guarantees are entered into with U.S. persons or non-U.S. persons. *See* Cross-Border Proposing Release, 78 FR 31032.

[604] *See* Intermediary Definitions Adopting Release, 77 FR 30689.

[605] *See* SIFMA/FIA/FSR Letter at A–21.

[606] *See* section II.B.2(c), *supra.*

[607] *See id.*

[608] *See* section V.D.3(b), *supra.* For the above reasons, we conclude that this final rule 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 Exchange Act section 30(c). *See* section II.B.2(a), *supra.* We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, U.S. persons would be able to evade major participant regulation under Title VII simply by conducting their security-based

While we recognize one commenter's concern that attribution would require ''double counting'' certain positions, we do not agree with that commenter's assertion that the final rule constitutes double-counting, given that both entities assume the risk of the position by either entering into it directly or by guaranteeing it. Because both entities are involved in the position that poses risk to the U.S. financial system, both entities are required to include it in their respective major participant threshold calculations, at least until the entity whose position is guaranteed is required to register as a major security-based swap participant.[609]

2. Positions Attributed to Non-U.S. Person Guarantors

(a) Proposed Approach and Commenters' Views

In the proposal, we expressed our preliminary view that a non-U.S. person that provides a recourse guarantee for performance on the obligations of a U.S. person should attribute to itself the security-based swap positions of the U.S. person that are subject to guarantees by the non-U.S. person.[610] However, when a non-U.S. person provides a guarantee to another non-U.S. person, the non-U.S. person providing the guarantee would have been required to attribute to itself only those positions for which a U.S. person counterparty has rights of recourse against the non-U.S. person guarantor under the security-based swap. As noted above, one commenter argued that attribution is beyond the scope of section 30(c) of the Exchange Act.[611]

(b) Final Rule

Consistent with our preliminary view, the final rule requires a non-U.S. person to attribute to itself any security-based swap positions of a U.S. person that are subject to a guarantee by the non-U.S. person.[612] In other words, the non-U.S. person guarantor will attribute to itself all security-based swap positions of the U.S. person for which a counterparty of the U.S. person has rights of recourse against the non-U.S. person guaranteeing the position.[613] The rule reflects our view that the guarantee may enable the U.S. person to enter into significantly more security-based swap positions with both U.S.-person and non-U.S. person counterparties than it would be able to absent the guarantee, increasing the risk that such persons could incur, amplifying the risk of the non-U.S. person's inability to carry out its obligations under the guarantee.[614]

Under the final rule, if a U.S. person in a transaction with a non-U.S. person counterparty has rights of recourse against another non-U.S. person under the security-based swap, the non-U.S. person guaranteeing the transaction must attribute the security-based swap to itself for purposes of its major security-based swap participant threshold calculations.[615] We note that, consistent with the rule requiring non-U.S. persons to count positions entered into with U.S. persons, a non-U.S. person that attributes a position of another non-U.S. person to itself does not need to attribute to itself positions arising from a transaction conducted through a foreign branch of the U.S.-person counterparty when the counterparty is a registered security-based swap dealer or positions arising from a transaction conducted through a foreign branch of a U.S.-person counterparty, when the transaction is entered into prior to 60 days following the earliest date on which registration of security-based swap dealers is first required.[616]

As explained above, we believe that attribution of positions to guarantors is consistent with Exchange Act section 30(c), notwithstanding the argument by one commenter that attribution to a guarantor ''goes beyond the intended limits of section 30(c) of the Exchange Act.'' [617] As we discuss in more detail above, the major security-based swap participant definition focuses on positions that may raise systemic risk concerns within the United States.[618] It is our view that a security-based swap position exists within the United States when it is held by or with a U.S. person, or when it is guaranteed by a U.S. person, as the risks associated with such positions are borne within the United States, and given the involvement of U.S. persons may give rise, at the thresholds established for the major security-based swap participant definition, to the types of systemic risk within the United States that major security-based swap participant regulation is intended to address.[619]

The final rules requiring non-U.S. persons to attribute certain positions to themselves for purposes of calculating their own major security-based swap participant calculation thresholds aims to apply major participant regulation in similar ways to differing organizational structures that serve similar economic purposes. For example, when a U.S. person has rights of recourse against a non-U.S. person, the economic reality of the position is substantially identical, in relevant respects, to a position entered into directly by the non-U.S. person with the U.S. person. The relevant attribution requirements reflect that a non-U.S. person would need to include such positions were it to enter into them directly.[620]

3. Limited Circumstances Where Attribution of Guaranteed Security-Based Swap Positions Does Not Apply

(a) Proposed Approach and Commenters' Views

The proposal stated our preliminary view that a guarantor would not be required to attribute to itself the security-based swap positions it guarantees, and, therefore, may exclude those positions from its threshold calculations, if the person whose positions it guarantees is already subject to capital regulation by the Commission or the CFTC (for example, by virtue of being regulated as a swap dealer, security-based swap dealer, major swap participant, major security-based swap participant, FCMs, brokers, or dealers),

swap positions via a guaranteed non-U.S. person, while still being subject to the risks associated with those positions.

[609] *See* Exchange Act rule 3a67–10(c)(2)(i).

[610] *See* Cross-Border Proposing Release, 78 FR 31032–33.

[611] *See* note 600, *supra.*

[612] Exchange Act rule 3a67–10(c)(1)(ii)(A).

[613] Exchange Act rule 3a67–10(c)(1)(ii)(A) may be broader than the CFTC Cross-Border Guidance in this context because the final rule requires the non-U.S. person to attribute to itself all the positions of the U.S. person that are guaranteed by the non-U.S. person, whereas the CFTC Cross-Border Guidance states that the non-U.S. person would generally not attribute to itself positions of the U.S. person that it guarantees where the counterparty is another non-U.S. person that is not guaranteed by a U.S. person. *See* CFTC Cross-Border Guidance at 45326 (stating that a non-U.S. person would generally consider in its own calculation (*i.e.,* attribute to itself) any swap position (of a U.S. or non-U.S. person) that it guarantees in which the counterparty is a U.S. person or a guaranteed affiliate).

[614] *See* Cross-Border Proposing Release, 78 FR 31032–33.

[615] Exchange Act rule 3a67–10(c)(ii)(B).

[616] *See* section V.D.2 (describing exception for transaction conducted through a foreign branch of a registered security-based swap dealer), *supra;* Exchange Act rule 3a67–10(c)(ii)(B) (incorporating Exchange Act rule 3a67–10(b)(3)(i)(A) and (B)).

[617] *See* SIFMA/FIA/FSR Letter at A–20 to A–21.

[618] *See* section II.B.2(c), *supra.*

[619] *See id.*

[620] *See* section V.D.3(b), *supra.* For the above reasons, we conclude that this final rule 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.* We also believe, moreover, that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provisions of the Exchange Act that were added by the Dodd-Frank Act, and thus help ensure that the relevant purposes of the Dodd-Frank Act are not undermined. Without this rule, non-U.S. persons would be able to evade major participant regulation under Title VII simply by conducting their security-based swap positions by guaranteeing another entity that would then enter into the positions.

is regulated as a bank in the United States, or is subject to capital standards adopted by its home country supervisor that are consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision (''Basel Accord'').[621] This preliminary view applied both to U.S. persons and non-U.S. persons that are subject to registration and regulation in the enumerated categories.[622] Our preliminary view was that such consistent foreign regulatory capital requirements would adequately address the risks arising from such positions, making it unnecessary to separately address the risks associated with guarantees of those same positions.[623] We noted that this approach was 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.[624]

One commenter supported our preliminary view that a non-U.S. person's guaranteed positions would not be attributed to the guarantor if the guaranteed non-U.S. person is subject to capital regulation by the Commission, the CFTC, or capital standards in its home jurisdiction that are consistent with the Basel Accord.[625] Another commenter sought clarification that a U.S. guarantor will not be required to attribute transactions of guaranteed entities while the guaranteed person's registration as a major security-based swap participant is pending.[626]

(b) Final Rules

Although the final rules require, in some circumstances, both the guarantor and the guaranteed person to include guaranteed positions in their respective major security-based swap participant threshold calculations, the final rules do not require a guarantor to attribute guaranteed positions to itself when the guaranteed person is subject to capital regulation by the Commission or the CFTC (including, but not limited to regulation as a swap dealer, major swap participant, security-based swap dealer, major security-based swap participant, futures commission merchant, broker, or dealer).[627] This codifies our preliminary view.[628] The final rule, moreover, does not require a guarantor to attribute to itself positions that it guarantees when the guaranteed person is regulated as a bank in the United States, or is subject to capital standards adopted by its home country supervisor that are consistent in all respects with the Basel Accord.[629] Consistent with our preliminary view, we believe that consistent foreign regulatory capital requirements would adequately address the risks arising from such positions, making it unnecessary to separately address the risks associated with guarantees of those same positions.[630] We continue to view such regulatory treatment as adequate to address the risks that the attribution requirement is intended to address. We also note that this approach 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.

As noted above, one commenter requested that a U.S. guarantor not be required to attribute to itself a person's positions for which it provides a guarantee while that person's registration as a major security-based swap participant is pending.[631] Upon further consideration, we believe that it is appropriate to permit a guarantor not to attribute the positions of such entities to itself. This change will mitigate market disruption that may otherwise result due to the prospect of a person intermittently exceeding the major participant threshold when a person that it guarantees is in the process of registering as a major security-based swap participant. This approach is also consistent with the approach under the application of the *de minimis* exception that allows a person not to count the transactions of its affiliates that are in the process of registering as dealers.[632]

F. Other Issues Related to the Application of the Major Security-Based Swap Participant Definition

1. Threshold for Registration as a Major Security-Based Swap Participant

One commenter commented generally that the threshold for having to register as a major-security-based swap participant is too high.[633] This threshold, however, was adopted in the Intermediary Definitions Adopting Release and is not under consideration in this rulemaking. In addition, the Intermediary Definitions Adopting Release provided that the Commission staff will prepare a report subsequent to the effectiveness of the security-based swap reporting requirements that will examine a number of aspects of our definitional rules and related interpretations, including relevant major security-based swap participant thresholds.[634]

2. Entities That Maintain Legacy Portfolios

The Cross-Border Proposing Release did not address the treatment of legacy portfolios, but we stated in the Intermediary Definitions Adopting Release that ''the fact that these entities no longer engage in new swap or security-based swap transactions does not overcome the fact that entities that are major participants will have portfolios that are quite large and could pose systemic risk to the U.S. financial system.'' [635] Based on this

[621] *See* Cross-Border Proposing Release, 78 FR 31033 (explaining that the non-U.S. person must be subject to capital standards that are consistent with the capital standards such non-U.S. person would have been subject to if it was a bank subject to the prudential regulators' capital regulation, *i.e.,* the Basel Accord); *see also* Intermediary Definitions Adopting Release, 77 FR 30689 (stating that it is not necessary to attribute a person's positions to a parent or other guarantor if the person already is subject to capital regulation by the CFTC or SEC or if the person is a U.S. person regulated as a bank in the United States). Thus, once the person whose position is guaranteed registers as a major security-based swap participant, attribution would no longer be required.

[622] *See* Cross-Border Proposing Release, 78 FR 31033 at n.636.

[623] *See id.* at 31033–34.

[624] *See id.* at 31033 (citing § 225.2(r)(3) of Regulation Y, which states that ''[f]or 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 Basel Accord may calculate its capital ratios under the home country standard . . .'').

[625] *See* SIFMA/FIA/FSR Letter at A–21 to A–22; *see also* Cross-Border Proposing Release, 78 FR 31033.

[626] *See* AFGI Letter I at 3 (stating that this clarification would be within the spirit and language of the proposed rules).

[627] *See* Exchange Act rule 3a67–10(c)(2)(i).

[628] *See* Cross-Border Proposing Release, 78 FR 31032–33, notes 629, 632, and 634.

[629] Exchange Act rule § 240.3a67–10(c)(2)(ii) and (iii). *See* Cross-Border Proposing Release, 78 FR 31033 (explaining that the non-U.S. person must be subject to capital standards that are consistent with the capital standards such non-U.S. person would have been subject to if it were a bank subject to the prudential regulators' capital regulation, *i.e.,* the Basel Accord); Intermediary Definitions Adopting Release, 77 FR 30689. This approach generally is consistent with the CFTC Cross-Border Guidance. *See* CFTC Cross-Border Guidance, 78 FR 45326 (stating that ''where a subsidiary is subject to Basel-compliant capital standards and oversight by a G20 prudential supervisor, the subsidiary's positions would generally not be attributed to a parental guarantor in the computation of the parent's outward exposure under the MSP definition'').

[630] *See* Cross-Border Proposing Release, 78 FR 31033–34.

[631] *See* note 626, *supra.*

[632] *See* Exchange Act rule 3a67–10(c)(2)(iv) (referring to rule 3a67–8(a)); *see also* Exchange Act rule 3a71–4 (addressing persons who have exceeded the *de minimis* thresholds but are in the process of registering); section IV.F.2, *supra.*

[633] BM Letter at 15–16 (stating that the excessively high major participant threshold excludes most market participants, thus leaving large, non-U.S. entities that are active in the market subject only to dealer requirements).

[634] *See* Intermediary Definitions Adopting Release, 77 FR 30697–30699.

[635] *Id.* at 30691.

understanding, the Commissions jointly determined that such entities should not be excluded from major participant regulation but explained that the Commissions would pay particular attention to special issues raised by the application of substantive rules to those legacy portfolios.[636]

In the Commission's proposed capital and margin requirements, we proposed exceptions from certain account equity requirements, such as collection of margin, for non-bank security-based swap dealers' and non-bank major security-based swap participants' accounts holding legacy security-based swaps and we requested comment on these proposals.[637] As explained in the Intermediary Definitions Adopting Release, we may entertain requests for relief or guidance on a case-by-case basis.[638] One commenter requested that, at a minimum, the Commission provide flexibility in any requirements that require a person to register as a major security-based swap participant solely due to activity related to its legacy portfolios.[639] With respect to the activities of financial guaranty insurers, one commenter suggested that amendments made to an existing insured security-based swap or entry into a new security-based swap with the same or a substituted counterparty in connection with loss mitigation or risk reduction efforts, should receive the same regulatory treatment given to legacy portfolio security-based swaps because such security-based swaps do not increase notional exposure.[640]

In the context of the cross-border application of the major security-based swap participant definition, we are maintaining our approach to legacy portfolios as described in the Intermediary Definitions Adopting Release and are not excluding entities that maintain legacy portfolios from the major security-based swap participant definition.[641] Given the foregoing, we are not adopting an exclusion from the cross-border application of the major security-based swap participant definition for entities that maintain legacy portfolios.

G. Foreign Public Sector Financial Institutions and Government-Related Entities

In the Cross-Border Proposing Release, we did not propose to specifically address the treatment of entities such as foreign central banks, international financial institutions, multilateral development banks, and sovereign wealth funds in the context of the major security-based swap participant definition and instead sought comment regarding the types, levels, and natures of security-based swap activity that such organizations regularly engage in in order to allow us to better understand the roles of these organizations in the security-based swap markets.[642]

The final rule defining ''U.S. person'' (like the proposed definition of that term) specifically excludes several foreign public sector financial institutions and their agencies and pension plans, and more generally excludes any other similar international organization and its agencies and pension plans.[643] As explained in the context of the *de minimis* exception, certain commenters requested that we take further action to address the application of the dealer definition and its *de minimis* exception to security-based swap activities involving such organizations.[644] Additionally, we noted that two commenters stated that they should not be subject to the possibility of dealer regulation for comity reasons, on the grounds that they were arms of a foreign government.[645] Commenters did not make arguments specific to the application of the major security-based swap participant definition but articulated their arguments in conjunction with their arguments related to the application of the dealer definition. However, one commenter explained that, though it understands that multilateral development banks do not currently engage in security-based swap at the level that would trigger major security-based swap participant registration, even if they did, regulation would violate their privileges and immunities.[646]

As discussed in the context of the *de minimis* exception, it is our view that such issues are outside the scope of this release given that the source of any such privileges and immunities is found outside of the Dodd-Frank Act and the federal securities laws.[647]

Similar to the discussion in the context of the *de minimis* exception, commenters also stated that non-U.S. persons should not have to count their security-based swap positions involving these organizations against their major security-based swap participant threshold calculations on the basis that counting such positions would constitute the impermissible regulation of such organizations.[648] As discussed in the context of the *de minimis* exception, we do not agree with the suggestion that counting a person's positions with such organizations against the major participant calculation thresholds—when otherwise provided for by the rules—involves the regulation of such organizations.[649] Requiring a person to count, against their major participant calculation thresholds, the person's positions involving such an international organization as counterparty simply reflects the application of the federal securities laws to that person and its positions, and does not constitute the regulation of the international organization.[650] A person's security-based swap positions with such an international organization are

[636] *Id.* at 30691 and n.1170.

[637] *See* Exchange Act proposed rules 18a-3(c)(1)(iii)(D) and 18a-3(c)(2)(iii)(C); *see also* Capital and Margin Proposing Release, 77 FR 70214, 70247, 70265, 70269–70, 70271–72 (proposed capital, margin and segregation requirements for security-based swap dealers and major security-based swap participants).

[638] Intermediary Definitions Adopting Release, 77 FR 30691.

[639] AFGI Letter I at 2 (suggesting that the Commission consider providing an exemption from major security-based swap participant registration for entities that will be required to register solely due to their legacy portfolios, if their legacy positions are expected to decline below the major security-based swap participant threshold within 12 to 14 months of the effective date due to projected run-off or terminations); AFGI Letter II at 2–5; AFGI letter, dated February 18, 2011 (''AFGI Letter V'') at 11 (stating that attribution to a financial guaranty insurer is not appropriate when the insurer guarantees a security-based swap obligation of an unaffiliated entity) (incorporated by reference in AFGI Letter I).

[640] AFGI Letter I at 3 (stating that such activities, like activities related to legacy swaps, do not constitute new business and that regulators should implement consistent regulatory treatment in this area to reduce exposure resulting from these legacy transactions); AFGI Letter II at 2–3. *See also* AFGI Letter III at 5 (arguing that an amendment to a legacy account for loss mitigation or credit strengthening without increasing notional exposure should still be considered the legacy account instead of a new security-based swap); AFGI letter, dated July 20, 2011 (''AFGI Letter IV'') at 2–4 (supporting exclusion for state-regulated insurers) (incorporated by reference in AFGI Letter I); AFGI Letter V at 3 (same).

[641] *See* Intermediary Definitions Adopting Release, 77 FR 30691.

[642] *See* Cross-Border Proposing Release, 78 FR 31034–35. *See* section IV.C.2(e) and Exchange Act rule 3a71–3(a)(4)(iii) (listing the international organizations that are excluded from the definition of ''U.S. person'').

[643] *See* section IV.C.2(e), *supra.*

[644] *See, e.g.,* WB/IFC Letter at 2–4, 6–7 (also stating that such organizations should not be required to register as major participants or to clear security-based swaps, and that affiliates of such organizations should be excluded from the ''U.S. person'' definition); SC Letter at 16–24 (contending that the privileged and immunities afforded such organizations would be violated by their direct regulation as dealers or major participants, or by direct regulation equivalents, and that affiliates of such organizations also are immune from regulation); IDB Letter at 5. *See* note 420, *supra.*

[645] *See* note 422, *supra.*

[646] *See* SC Letter at 16.

[647] *See* section IV.H.2, *supra.*

[648] *See* section IV.H.2, *supra;* SC Letter at 18–19; WB/IFC Letter (incorporating SC Letter).

[649] *See* IV.H.2, *supra.*

[650] *See id.*

considered the same, for purposes of applying the major participant calculation thresholds and other Title VII requirements, as a position with some other non-U.S. person counterparty.

H. Economic Analysis of Final Rules Regarding ''Major Security-Based Swap Participants''

These final rules and guidance regarding the cross-border implementation of the application of the definition of major security-based swap participants will affect the costs and benefits of major security-based swap participant regulation by determining which positions will be counted against a market participant's major security-based swap participant calculation thresholds.[651] The cross-border rules have the potential to be important in determining the extent to which the risk mitigation and other benefits of Title VII are achieved, by identifying those market participants with sufficiently large exposures to raise the types of systemic risk concerns that the major security-based swap participant definition was intended to address.[652]

As discussed in the context of the cost-benefit analysis of the application of the *de minimis* exception in the cross-border context, commenters addressed cost-benefit issues from a variety of perspectives, including arguing that cost-benefit principles warranted greater harmonization with the approaches taken by the CFTC or foreign regulators.[653] Commenters, however, did not separately address cost-benefit issues related to the application of the major security-based swap participant definition.

We have taken economic effects into account in adopting these final cross-border rules and providing guidance. Because security-based swap contracts are associated with complex risks and the markets are highly interconnected, we believe that positions that exist within the United States, which are most likely to expose the U.S. financial system to financial risk, should generally be included in the major security-based swap participant threshold calculations. At the same time, we recognize that the cross-border application of Title VII has the potential to reduce liquidity within the U.S. market to the extent it increases the costs of entering into security-based swaps or provides incentives for particular market participants to avoid the U.S. market to operate wholly outside the Title VII framework.[654]

As addressed in the analysis of the costs and benefits of our application of the *de minimis* rule, the application of the major security-based swap participant definition implicates two types of costs and benefits: assessment costs and programmatic costs and benefits.[655] First, certain current and future participants in the security-based swap market will incur assessment costs in connection with determining whether they fall within the ''major security-based swap participant'' definition and thus would have to register with the Commission.

Second, the registration and regulation of some entities as major security-based swap participants will lead to programmatic costs and benefits arising as a consequence of the Title VII requirements that apply to registered major security-based swap participants.[656]

We discuss these costs and benefits associated with the final rules more fully below. We also discuss the economic impact of certain potential alternatives to the approach taken in the final rules.

1. Programmatic Costs and Benefits

(a) Cost-Benefit Considerations of the Final Rules

Exchange Act rule 3a67–10 will permit market participants to exclude certain of their positions from their major security-based swap participant threshold calculations, and thus may cause particular entities that engage in security-based swap transactions not to be regulated as major security-based swap participants. The rules accordingly may be expected to affect the programmatic costs and benefits associated with the regulation of major security-based swap participants under Title VII, given that those costs and benefits are determined in part by which persons will be regulated as major security-based swap participants.[657]

As discussed in the context of the application of the *de minimis* exception, this does not mean that there is a one-to-one relationship between a person not being a ''major security-based swap participant'' as a result of these cross-border rules, and the resulting change to programmatic benefits and costs.[658] In practice, we believe that these rules will focus the regulation of major security-based swap participants on those market participants whose security-based swap positions may expose the U.S. financial system to the levels of risk we identified as warranting regulation as a major security-based swap participant in the Intermediary Definitions Adopting Release, or on the prevention of evasion. To the extent that a person's positions within the United States remain below these thresholds, we believe that regulating it as a major security-based swap participant under Title VII would be less likely to produce the types of programmatic benefits that Title VII was intended to address. In other words, these requirements will direct the application of the major security-based swap participant definition—which itself is the product of cost-benefit considerations—towards those entities whose security-based swap positions are most likely to pose the type and level of risk to the U.S. financial system that Title VII was intended to mitigate.

As such, the rules reflect our assessment and evaluation of programmatic costs and benefits:

- *Positions of U.S. persons*—Requiring U.S. persons, as defined in the final rules (including the foreign branches of such persons), to include all of their positions in their major participant threshold calculations, addresses risks that these positions pose to the U.S. financial system.
- *Positions guaranteed by U.S. persons*—Requiring non-U.S. persons to include in their major security-based swap participant threshold calculations all their positions that are guaranteed by a U.S. person, where their counterparties have recourse to the guarantor, reflects both the economic reality of the position—that the position exists within the United States—and addresses the risks posed to the U.S. financial system by the positions of such persons that are guaranteed by U.S. persons.[659]
- *Positions with U.S.-person counterparties*—Requiring non-U.S. persons to include their positions with counterparties that are U.S. persons, unless the positions are with a foreign branch of a registered security-based swap dealer, addresses risks to the U.S.

[651] *See* section IV.I, *supra; see also* Intermediary Definitions Adopting Release, 77 FR 30666 (explaining that in developing the rules further defining ''substantial position,'' we were mindful of the costs associated with regulating major participants and considered cost and benefit principles as part of that analysis).

[652] *See* section III.A, *supra.*

[653] *See* section IV.I, *supra.*

[654] *See id., supra.*

[655] *See id., supra.*

[656] *See* Cross-Border Proposing Release, 78 FR 31139.

[657] *See* Intermediary Definitions Adopting Release, 77 FR 30727.

[658] *See* section IV.I.1(a) and note 431, *supra* (discussing various fixed and variable costs).

[659] *See* Exchange Act rule 3a67–10(b)(3)(ii); section V.D.3, *supra.*

financial system arising from positions entered into with U.S. persons.[660]

• *Attribution of certain positions to guarantors of performance under a security-based swap*—Requiring guarantors of performance under security-based swaps to attribute to themselves, for purposes of their own major security-based swap participant threshold calculations, positions that they guarantee, addresses risks that guarantees pose to the U.S. financial system. To the extent that the guarantee involves a position within the United States or brings a position within the United States, our final rules would typically require attribution to the guarantor. These requirements are intended to help ensure that positions that pose risks to the U.S. financial system are included in the guarantor's major participant threshold calculations.[661]

• *Positions subject to anti-evasion provisions*—Requiring conduit affiliates to include all of their positions in their major participant threshold calculations addresses, in a targeted manner, the potential for evasion of the major security-based swap participant requirements of Title VII.[662] As noted above we are adopting a definition of ''conduit affiliate'' that excludes affiliates of registered security-based swap dealers and major security-based swap participants to avoid imposing costs on registered persons in situations that would not appear to implicate the types of evasion concerns that the conduit affiliate definition is intended to address.

In short, these final rules apply the major security-based swap participant definition—which itself reflects cost-benefit considerations[663]—to cross-border security-based swap positions in a way that directs the focus of major participant regulation toward those entities whose security-based swap positions may expose the U.S. financial system to the levels of risk we identified as warranting regulation as a major security-based swap participant.

(b) Evaluation of Programmatic Impacts

In defining ''substantial position'' and ''substantial counterparty exposure'' as part of the Intermediary Definitions Adopting Release, we sought to capture persons whose security-based swap positions pose sufficient risk to counterparties and the markets generally that regulation as a market participant was warranted, without imposing costs of Title VII on those entities for which regulation currently may not be justified in light of the purposes of the statute.[664] As discussed above in the context of the dealer analysis, we estimated in the Intermediary Definitions Adopting Release that, under those rules, approximately 12 entities had outstanding positions large enough that they would likely carry out threshold calculations and that fewer than five entities, and potentially zero, would ultimately be required to register as major security-based swap participants.[665] Those estimates provide a baseline against which the Commission can analyze the programmatic costs and benefits and assessment costs of the final rules applying the major security-based swap participant definition to cross-border activities.

We believe the methodology used in the Intermediary Definitions Adopting Release also is appropriate for considering the potential programmatic costs and benefits associated with the final cross-border rules. This methodology particularly can help provide context as to how rules regarding the cross-border application of the definition of major security-based swap participant may change the number of entities that must register as major security-based swap participants, and thus help provide perspective regarding the corresponding impact on the programmatic costs and benefits of Title VII. Applying that methodology to 2012 data regarding the single-name CDS market suggests that under these final rules five or fewer entities may have to register as major security-based swap participants—a number that is consistent with our estimates in the Intermediary Definitions Adopting Release.[666]

The factors that are described in more detail in section IV.I.1(b) regarding the application of the *de minimis* exception are also relevant to and may impact the programmatic benefits and costs associated with the implementation of the cross-border application of the major security-based swap participant definition. Those factors include limitations of the methodology and data used, the impact of the not yet finalized rules implementing Title VII entity-level and transaction-level requirements applicable to major security-based swap participants, market participants' modifications to their business structure or practices in response to the final rules, and the impact on market participants of other regulatory requirements that are analogous to the major security-based swap participant requirements.[667]

In general, however, and consistent with our territorial approach, we believe that these rules are targeted

[660] *See* Exchange Act rule 3a67–10(b)(3)(i); section V.D.1; *see also* note 437, *supra* (discussing rationale for this limitation in context of *de minimis* exception).

[661] *See* Exchange Act rule 3a67–10(c); section V.E, *supra.*

[662] *See* Exchange Act rule 3a67–10(b)(2); section V.C, *supra.*

[663] *See* Intermediary Definitions Adopting Release, 77 FR 30666 (explaining that in developing the rules further defining ''substantial position,'' we were mindful of the costs associated with regulating major participants and considered cost and benefit principles as part of that analysis).

[664] *See id.* at 30724–25.

[665] *See id.* at 30727 and note 1529; section III.A.2.

That methodology determined that an entity that margins its positions would need to have security-based swap positions approaching $100 billion to reach the levels of potential future exposure required to meet the substantial position threshold, even before accounting for the impact of netting, while an entity that clears its security based swaps generally would need to have positions approaching $200 billion. We believed that it was reasonable to assume that most entities that will have security-based swap positions large enough to potentially cause them to be major participants in practice will post variation margin in connection with those positions that they do not clear, making $100 billion the relevant measure. The available data from 2011 showed that only one entity had aggregate gross notional positions (*i.e.,* aggregate buy and sell notional positions) in single-name CDS exceeding $100 billion, and three other entities had aggregate gross notional positions between $50 and $100 billion. We explained, however, that an entity's positions reflecting single-name credit protection sold to its counterparties, as opposed to purchased, may be expected to be a more key determinant of potential future exposure under those rules. The data showed that zero entities had more than $100 billion in positions arising from selling single-name credit protection and that only two entities had between $50 and $100 billion arising from such positions. *See id.* at 30727, 30734 and note 1529.

In the Intermediary Definitions Adopting Release, we noted that to the extent that an entity's security-based swap positions are not cleared or associated with the posting of variation margin, security-based swap positions of $20 billion may lead to sufficient potential future exposure to cause the entity to be a major participant, though we believed that few, if any, entities would have a significant number of such positions. The data indicated that only 32 entities have notional CDS positions in excess of $10 billion. *See id.* at note 1529.

[666] *See* note 444, *supra* (noting that the data on which the methodology is based has been updated).

Consistent with the methodology used in the Intermediary Definitions Adopting Release, the 2012 data indicated that two entities had aggregate gross notional positions (*i.e.,* aggregate buy and sell notional positions) in single-name CDS exceeding $100 billion. Applying the principles reflected in these final rules regarding the counting of positions against the major security-based swap participant thresholds suggests that two entities would have aggregate gross notional positions in single name CDS exceeding $100 billion. No additional entities would be required to register as a result of aggregation. Based on this data, we believe that it is reasonable to conclude that five or fewer entities ultimately may register as major security-based swap participants.

[667] *See* section IV.I.1(b), *supra.*

appropriately and do not apply major security-based swap participant regulation to those entities whose positions have a more limited impact on the U.S. financial system and hence whose regulation as a major security-based swap participant under Title VII would be less linked to programmatic benefits (*i.e.,* non-U.S. persons that engage in security-based swap transactions entirely, or almost entirely, outside the United States with non-U.S. persons or with certain foreign branches), while applying major participant regulation to those entities whose positions would be more likely to produce programmatic benefits under Title VII. The nexus between specific aspects of these requirements and the programmatic costs and benefits also is addressed below in connection with our consideration of various alternatives to the approach taken in the final rules.

Finally, as discussed in the context of the *de minimis* exception, we recognize that the U.S. market participants and positions regulated under Title VII are a subset of the overall global security-based swap market and that shocks to risk or liquidity arising from a foreign entity's positions outside the United States may spill into the United States.[668] We also have considered these spillovers in connection with our analysis of the effects of these final cross-border rules on efficiency, competition, and capital formation.[669]

2. Assessment Costs

The analysis of how these cross-border rules will affect the assessment costs associated with the ''major security-based swap participant'' definition is related to the assessment cost analysis described in the Intermediary Definitions Adopting Release,[670] but must also account for certain issues specific to these cross-border rules. While in certain regards those assessment costs can more readily be estimated than the programmatic effects discussed above, the assessment costs associated with the cross-border application of the Title VII major participant requirements will be considerably less significant than those programmatic effects.

The Intermediary Definitions Adopting Release addressed how certain market participants could be expected to incur costs in connection with their determination of whether they have a ''substantial position'' in security-based swaps or pose ''substantial counterparty exposure'' created by their security-based swaps, which is necessary for determining whether they are major security-based swap participants.[671] In that release we estimated that as many as 12 entities would likely perceive the need to perform these calculations, given the size of their security-based swap positions.[672] We preliminarily believed that entities that perceive the need to perform the threshold calculations as a result of the proposed rules and guidance set forth in the Cross-Border Proposing Release would incur only relatively minor incremental costs to those described in the Intermediary Definitions Adopting Release.[673] Based on the estimate that no more than 12 entities would perceive the need to engage in the analysis of whether they are a major security-based swap participant, we estimated that the total legal costs associated with evaluating the various elements of the definition may approach $360,000.[674]

As discussed in the context of the *de minimis* exception, application of these cross-border rules can be expected to affect the assessment costs that market participants will incur. In part, certain non-U.S. persons may be expected to incur personnel costs and legal costs—beyond the legal costs addressed as part of the Intermediary Definitions Adopting Release—associated with analyzing these cross-border rules and developing systems and procedures to assess which transactions would have to be counted against the major security-based swap participant calculation thresholds (or with the purpose of avoiding positions that pose risk to the United States financial system that would be sufficient to meet the applicable thresholds). On the other hand, while certain market participants also would incur additional legal costs associated with the major security-based swap participant determination (*i.e.,* the assessment of whether particular positions should be included in the major participant threshold calculations) addressed in the Intermediary Definitions Adopting Release, the application of the cross-border rules may reduce the number of entities that incur such legal costs.[675]

In adopting these rules we estimate the assessment costs that market participants may incur as a result. As discussed below, however, these costs in practice may be mitigated in large part by steps that market participants already have taken in response to other regulatory initiatives, including compliance actions taken in connection with the requirements applicable to swaps.

(a) Legal Costs

The implementation of these cross-border rules in some circumstances has the potential to change the legal costs identified in the Intermediary Definitions Adopting Release, including by adding new categories of legal costs that non-U.S. persons may incur in connection with applying the major security-based swap participant definition in the cross-border context.

Legal costs related to the cross-border application of major security-based swap participant definition—As discussed in the Intermediary Definitions Adopting Release, certain market participants will incur assessment costs related to the analysis of whether their positions rise to the levels set by the major security-based swap participant definition. For purposes of that release, we assumed that entities with aggregate gross notional single-name CDS positions exceeding $25 billion may identify a need to perform the major participant analysis.[676] Based on that figure, we estimated that 12 entities would perceive the need to perform the major participant analysis.[677]

Under the final rules described above, available data from 2012 indicates that approximately nine persons will have relevant positions exceeding $25 billion, and we continue to believe that firms whose positions exceed this amount will be likely to perform the major participant threshold analysis.[678] Of those nine, five entities are not

[668] *See* section IV.I.1(b), *supra* (describing spillover risks).

[669] *See* section VIII.B, *infra.*

[670] *See* Intermediary Definitions Adopting Release, 77 FR 30733–36.

[671] *See id.* at 30734–36.

[672] *See id.* at 30734.

[673] *See* Cross-Border Proposing Release, 77 FR 31141.

[674] *See* Intermediary Definitions Adopting Release, 77 FR 30736. We also noted in that release that if 32 entities were to perform the analysis, the market wide legal costs would total $960,000. *See id.* at 30736 n. 1539; *see also* note 665, *supra* (noting that if an entity did not clear or post variation margin, $20 billion in notional CDS positions may be sufficient exposure to cause the entity to be a major participant and that 32 entities have notional CDS positions exceeding $10 billion).

[675] *See* section IV.I.2, *supra.*

[676] *See* Intermediary Definitions Adopting Release, 77 FR note 1529.

[677] Based on data as of December 2011, in that release we found that 1 entity had aggregate gross notional positions from bought and sold credit protection exceeding $100 billion, 4 entities had aggregate gross notional single-name CDS positions exceeding $50 million, and 12 entities had aggregate gross notional CDS positions exceeding $25 billion. *See id.* at 30734 n. 1529.

[678] *See* section III.A.1, *supra.* The difference between this and our previous estimate of 12 entities reflects changes in security-based swap activity since the Intermediary Definitions Adopting Release and the final rules' treatment of positions between non-U.S. persons in the absence of guarantees from U.S. persons.

domiciled in the United States. Consistent with our view in the proposing release, we expect that non-U.S. firms in this set will incur additional costs beyond those described in the Intermediary Definitions Adopting Release. These additional costs would arise due to information that non-U.S. market participants would have to collect and maintain in order to calculate the size of positions that count towards the major participant thresholds. Consistent with our analysis in the Intermediary Definitions Adopting Release, we believe that it is reasonable to conclude that at least some entities with security-based swap positions approaching the major participant thresholds are likely to seek legal counsel for interpretation of various aspects of the rules pertaining to the major participant definition.[679] Though the costs associated with obtaining such legal services would vary depending on the facts and circumstances regarding an entity's positions, we believe that $40,000 is a reasonable estimate of the upper end of the range of the costs of obtaining the services of outside counsel in undertaking the legal analysis of the entity's status as a major security-based swap participant.[680]

Legal costs related to systems analysis—As noted in the assessment cost analysis related to the *de minimis* exception (and in addition to the estimates in the Cross-Border Proposing Release), we believe that it is reasonable to conclude that those five entities not domiciled in the United States may have to incur one-time legal expenses related to the development of systems and analysis expenses—discussed below—to identify which of their security-based swap positions potentially must be counted for purposes of the major security-based swap participant analysis, consistent with these cross-border rules. As in the dealer context, this additional cost estimate reflects the fact that the development of such systems and procedures must address cross-border rules that require accounting for factors such as whether an entity's security-based swaps are subject to guarantees from U.S. persons, whether its counterparties are U.S. persons, and, specific to the major security-based swap participant analysis, whether the entity must attribute the position to itself pursuant to the attribution rules. As in the analysis of assessment costs related to the dealer definition, we estimate that such legal costs would amount to approximately $30,400 per entity, and that those five entities would incur total costs of approximately $152,000.[681]

(b) Costs Related to New Systems, Analysis, and Representations

Transaction-monitoring systems—The elements introduced by the final cross-border rules may cause certain non-U.S. persons to implement systems to identify whether their positions exceed the major security-based swap participant calculation thresholds. Such systems may reflect the need for non-U.S. persons to: (i) identify whether their counterparties are ''U.S. persons''; (ii) determine whether their positions with U.S. persons arise from transactions conducted through a foreign branch (which itself requires consideration of whether their counterparty is a ''foreign branch'') and—of those—determine which positions involve a foreign branch of a U.S. bank that itself is a registered security-based swap dealer; (iii) determine whether particular positions are subject to a recourse guarantee against a U.S. person; and (iv) evaluate the applicability of the attribution rules.[682] Our estimates for the required systems are the same in the major participant analysis as they are in the dealer analysis: one-time programming costs of $14,904 and ongoing annual systems costs of $16,612 per entity.[683]

Analysis of counterparty status, including representations—As discussed in the context of the *de minimis* exception, non-U.S. market participants would be likely to incur costs arising from the need to assess the potential U.S.-person status of their counterparties, which we would typically expect to be dealers, and in some cases to obtain and maintain records related to representations regarding their counterparty's U.S.-person status.[684] We anticipate that non-U.S. persons are likely to review existing information about their counterparties to assess whether those counterparties are U.S. persons.[685] Non-U.S. persons at times may also request and maintain representations from their dealer and non-dealer counterparties to help determine or confirm their counterparties' status.[686] Accordingly, as in the discussion of dealer assessment costs, in our view, such assessment costs primarily would encompass one-time costs to review and assess existing information regarding counterparty domicile, principal place of business, and other factors relevant to potential U.S.-person status, as well as one-time costs associated with requesting and collecting representations from counterparties.[687] The costs associated with representations in the context of the major participant analysis would be one-time costs of approximately $24,200 per firm.[688]

[679] *See* Intermediary Definitions Adopting Release, 77 FR 30735.

[680] The average cost incurred by such entities in connection with outside counsel is based on staff experience in undertaking legal analysis of status under federal securities laws. The staff believes that costs associated with obtaining outside legal counsel relating to such determinations range from $20,000 to $40,000 depending on the complexity of the entity. *See id.* at 30735–36 n. 1537 (estimating the upper bound of such costs at $30,000). We note that the additional $10,000 added to the estimate in the Intermediary Definitions Adopting Release is intended to account for the additional complexity that non-U.S. persons may face in performing the analysis.

These estimates do not reflect a new category of costs arising from the cross-border rules. They instead are a revision of a category of previously identified costs that market participants may incur in obtaining legal services to assist in performing the major participant analysis, using newer data and reflecting only positions that are counted under the final cross-border rules.

[681] *See* section IV.I.2(a) and note 460 (addressing calculations of costs), *supra.*

[682] We do not believe that a potential major security-based swap participant will need to use any systems to determine if it is a ''conduit affiliate.'' *See* note 462, *supra.*

[683] *See* section IV.I.2(b) and note 464, *supra.*

[684] *See* Exchange Act rule 3a67–10(a)(4) and (3) (incorporating the definitions of ''U.S. person'' ''transaction conducted through a foreign branch,'' including provisions permitting reliance on representations); *see also* section IV.I.2(b) and note 465, *supra* (noting that non-U.S. market participants may seek representations as to whether positions arise from transactions conducted through a foreign branch of a U.S. bank that is registered as a security-based swap dealer and also noting our understanding that few, if any, U.S. persons may participant in the single-name CDS market through their foreign branches).

[685] *See* section IV.I.2(b), *supra.*

[686] *See id.*

[687] *See* section IV.I.2(b) and note 466, *supra* (explaining that determination of U.S.-person status generally will not vary over time absent changes involving corporate reorganizations).

[688] *See* section IV.I.2(b), *supra.* The cumulative estimate is based on the same methodology and SIFMA Management & Professional Earnings in the Securities Industry 2013 data that we used to estimate these one-time costs for dealers. *See* note 467, *supra.* With respect to major security-based swap participants, we conservatively assume that each of the non-U.S. firms will have 30 single-name CDS counterparties (based on data indicating that the five non-U.S. firms persons with total single-name CDS positions in 2012 exceeding $25 billion all had fewer than 45 counterparties in connection with single-name CDS, which produces an estimate of 15 hours of compliance staff time and 15 hours of legal staff time per firm. Based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2013 (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 a senior compliance examiner is $217 and that the average national hourly rate for an in-house attorney is $380; this leads to a cumulative estimate of $9,000 per firm for such costs.

Continued

Monitoring of counterparty status—Also as addressed in the context of the *de minimis* exception, market participants may be expected to adapt their systems to monitor the status of their counterparties for purposes of future security-based swap activities, which would allow market participants to maintain records of counterparty status for purposes of conducting the major participant assessment.[689] Market participants also may need to monitor for the presence of information that may indicate that the representations they have received are outdated or otherwise are not valid.[690] The costs associated with adapting the systems described above to monitor the status of their counterparties for purposes of their future security-based swaps would be the same as the costs in the dealer analysis: one-time costs of approximately $12,436.[691]

Summary of systems, analysis, and representation costs—The summary of costs that certain non-U.S. market participants would incur in connection with systems, analysis of counterparty status and representations in connection with these cross-border rules would be approximately $51,500 in one-time costs[692] and $16,612 in estimated annual ongoing costs.[693] Based on our estimate, subject to the limitations associated with the use of data analysis discussed above, that five non-U.S. domiciled entities will incur these assessment costs, we estimate that the total one-time industry-wide costs associated with establishing such systems would amount to approximately $257,500 and total ongoing costs would amount to approximately $83,100.

(c) Overall Considerations Related to Assessment Costs

In sum, we believe that the effect of these final cross-border rules would be an increase over the amounts that otherwise would be incurred by certain non-U.S. market participants, both in terms of additional categories of legal costs and in terms of the need to develop certain systems and procedures. As discussed in the context of the assessment costs applicable to the dealer analysis, we believe that requiring certain non-U.S. persons to incur such assessment costs is an unavoidable adjunct to the implementation of a set of rules that are appropriately tailored to apply the ''major security-based swap participant'' definition under Title VII to a global security-based swap market in a way that yields the relevant benefits associated with the regulation of major participants and achieves the benefits of Title VII.[694] The benefits of Title VII's regulatory requirements applicable to major security-based swap participants could be undermined if a significant portion of positions held by non-U.S. persons that impose risk on the U.S. financial system were excluded from the Title VII framework. In certain respects, however, decisions embedded in these final rules are designed to avoid imposing assessment costs upon market participants.[695]

As explained in the context of the analysis for dealers, we recognize that our estimates of assessment costs may result in an overestimation as such costs may be tempered to the extent that market participants' assessments correspond to the assessments they otherwise would follow due to other regulatory requirements or business practices, particularly with respect to assessments they may have made regarding the U.S.-person status of their counterparties.[696]

Also as noted in the dealer discussion, we acknowledge that certain aspects of the final rules may differ from those of the CFTC, which may result in higher costs for market participants, but we believe that such differences are justified and we discuss those differences in the substantive discussions of the specific rules.[697] We also recognize other factors that may impact the assessment costs for potential major security-based swap participants, such as the possibility that certain market participants will choose to restructure their business to avoid major security-based swap participant regulation.[698]

3. Alternative Approaches

As discussed above, the final rules incorporate a number of provisions designed to focus Title VII major security-based swap participant regulation upon those persons whose security-based swap positions may raise the risks within the United States that the major participant definition was intended to address.[699]

In adopting these final rules we have considered alternative approaches suggested by commenters, including the economic effects of following such alternative approaches. In considering the economic impact of potential alternatives, we have sought to isolate the individual alternatives to the extent practicable, while recognizing that many of those alternatives are not mutually exclusive.[700]

We further have considered such potential alternatives in light of the methodologies discussed above, by assessing the extent to which following particular alternatives would be expected to increase or decrease the number of entities that ultimately would be expected to be regulated as major security-based swap participants under the final rules, as well as the corresponding economic impact. Analysis of the available data would tend to suggest that various alternative approaches suggested by commenters would not produce any changes in the numbers of market participants that may have to be regulated as major security-based swap participants. These results are subject to the above limitations, however, including limitations regarding the ability to quantitatively assess how market participants may adjust their future activities in response to the rules we adopt or for independent reasons. Accordingly, while such analyses provide some context regarding alternatives, their use as tools for

Consistent with the Cross-Border Proposing Release, moreover, this estimate is further based on estimated 40 hours of in-house legal or compliance staff's time (based on the above rate of $380 per hour for an in-house attorney) to establish a procedure of requesting and collecting representations from trading counterparties, taking into account that such representation may be incorporated into standardized trading documentation used by market participants. This leads to an estimate of $15,200 per firm for such costs. *See* section IV.I.2(b) and note 467, *supra.*

[689] We also recognize that the final rules requiring attribution may impose certain additional monitoring costs on market participants whose position in a security-based swap is guaranteed by another entity and on the entities that provide the guarantee. We anticipate that the guarantors may receive reports from the market participants whose position is guaranteed in order to allow the guarantors to monitor the amount of such positions for purposes of determining whether the positions attributed to the guarantor rise to the level that would require them to register as a major security-based swap participant.

[690] *See* section IV.I.2(b) and note 469, *supra.*

[691] *See* section IV.I.2(b) and note 468 (noting that parties may structure their relationships in a way that will not require a separate representation in conjunction with each individual position) and 470, *supra* (describing calculations for this estimate).

[692] Consistent with the above discussion, the estimated one-time costs of $51,500 represent: the costs to establish a system to assess the status of their positions under the definitions and other provisions specific to these cross-border rules ($14,904); the costs related to the assessment of counterparty status, including costs of assessing existing information and of requesting and obtaining representations, as well as costs of related procedures ($24,200); and the costs for monitoring the status of their counterparties for purposes of their future security-based swap activities ($12,436). *See* section IV.I.2(b) and note 471, *supra.*

[693] *See* section IV.I.2(b), *supra.*

[694] *See* section IV.I.2(c), *supra.*

[695] *See id.*

[696] *See id.*

[697] *See id.*

[698] *See id.*

[699] *See* section V.A, *supra.*

[700] *Cf.* section IV.I.3, *supra.*

illustrating the economic effects of such alternatives is limited.

(a) Security-Based Swap Positions Held by Foreign Branches of U.S. Banks

As with the final rules in the context of the *de minimis* exception, the final rules applying the major security-based swap participant definition require U.S. banks to count all positions of their foreign branches against the major participant calculation thresholds, even when the counterparty is a non-U.S. person or another foreign branch of a 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, directly affecting which positions a person must include in its major security-based swap participant threshold calculations and ultimately, the number of entities that will register as major security-based swap participants. An alternative approach would permit U.S. persons not to include the positions of their foreign branches in their major security based swap participant calculation thresholds. As discussed above, we believe our approach to U.S. persons as described above, is consistent with our overall territorial approach to the application of Title VII requirements to the cross-border security-based swap market, because it requires that major security-based swap participant calculation thresholds include the positions of such persons that are most likely to cause risk to the U.S. financial system at the threshold levels set in the major security-based swap participant definition.[701] For the reasons discussed above, we believe that it is appropriate for a U.S. person to include in its calculation thresholds positions conducted through foreign branches to the same extent as other positions held by U.S. persons.[702]

As in the dealer analysis, using the 2012 data to assess the impact associated with this alternative does not indicate a change to our estimate that up to five entities potentially would register as major security-based swap participants, and the analysis is subject to the limitations discussed in the context of the dealer analysis.[703] Adopting an alternative approach that does not require foreign branches to count their positions with non-U.S. persons could incentivize U.S. persons to execute higher volumes through their branches.[704]

(b) Positions of Non-U.S. Persons for Which the Counterparty Has Rights of Recourse Against a U.S. Person

The final rules require a non-U.S. person to count, against its major security-based swap participant calculation thresholds, positions for which the non-U.S. person's performance in connection with the transaction is subject to a recourse guarantee against a U.S. person. Although the proposal instead would have treated such guaranteed affiliates like any other non-U.S. persons, we believe that this provision is appropriate for the reasons discussed above, including the fact that such recourse guarantees pose risks to the U.S. financial system via the guarantor.[705]

This aspect of the final rules reflects a middle ground between commenter views, as is discussed above regarding the approach taken in the dealer analysis.[706] The same two alternatives that are presented in the analysis of alternatives to the approach to the dealer final rules are relevant to the discussion of the application of the major security-based swap participant definition—one alternative in which the final rules do not address guarantees at all, and one in which (based on the concept of a *de facto* guarantee) all affiliates of a U.S. person should have to count their security-based swap positions against the calculation thresholds, with a potential exception if they demonstrate to the market that there will be no guarantee.[707] A third alternative and the approach taken in the proposal would require the non-U.S. person to include in its threshold calculations only those positions with U.S. persons that are not guaranteed but would require those positions that are guaranteed to be attributed to the U.S. person guarantor for purposes of its own threshold calculations.

The analysis of the first two alternatives discussed in the context of the application of the dealer requirements above also applies in the context of applying the major security-based swap participant definition.[708] The third alternative, which is the approach taken in the proposal, may have reduced programmatic benefits by increasing the likelihood that, even when a person exceeds the thresholds by virtue of its own positions, which exist within the United States by virtue of the U.S. person guarantor, it will not be subject to direct regulation as a major participant.[709] Under the proposed approach, only the U.S. person guarantor would have counted the positions for which the non-U.S. person's counterparty had rights of recourse against the U.S. person, meaning that such positions would not be accounted for in the major participant threshold calculations of the entity that directly enters into the positions. The economic reality of such positions is that by virtue of the guarantee the non-U.S. person effectively acts together with a U.S. person to engage in the security-based swap activity that results in the positions, and the non-U.S. person's positions cannot reasonably be isolated from the U.S. person's engagement in providing the guarantee.[710] The final rule reflects this economic reality by requiring the non-U.S. person whose position is guaranteed to include such positions in its major security-based swap participant threshold calculations.[711]

For the foregoing reasons, we believe that the approach taken in the final rules is appropriate. We note that an assessment of the data regarding the first alternative does not indicate a change in the number of entities that may be expected to register as major security-based swap participants.[712] Due to data limitations that prevent us from identifying which individual transactions of non-U.S. persons are subject to guarantees by U.S. persons and data limitations preventing us from obtaining information about the single-name security-based swap transactions of non-U.S. domiciled persons for single-name CDS involving a non-U.S. reference entity, the available data does not enable us to assess the second and third alternatives.[713]

(c) Positions of Conduit Affiliates

The final rules require conduit affiliates to count all of their security-based swap positions in their major security-based swap participant threshold calculations. The available

[701] *See* section II.B.2(c), *supra.*

[702] *See* section V.B.2, *supra.*

[703] *See* section IV.I.3(a) and note 477, *supra.*

[704] *See* section IV.I.3(a), *supra* (discussing the same issue in the dealer context).

[705] *See* section IV.I.3(b), *supra* (addressing similar discussion in the context of the dealer analysis).

[706] *See id., supra.*

[707] *See id.*

[708] *See* section IV.I.3(b), *supra* (explaining that not requiring non-U.S. persons to include positions for which their counterparty has a recourse guarantee against a U.S. person could incentivize U.S. persons to use such guarantees, whereas an approach that requires an affiliate of a non-U.S. person to include all of its positions in its major security-based swap participant calculation thresholds may negatively impact liquidity).

[709] *See* section II.B.2(c), *supra.*

[710] *See* section V.D.3(b), *supra.*

[711] *See id.*

[712] *See* section IV.I.3(b) and note 481 (explaining that the data does not enable us to identify which positions of non-U.S. persons are subject to guarantees by U.S. persons).

[713] *See* section IV.I.3(b) and notes 481 and 482, *supra.*

data does not permit us to identify which market participants would be deemed conduit affiliates.[714] As explained in the corollary discussion in the dealer analysis, we believe the alternative of not requiring such entities to count their positions would remove a tool that should help to deter market participants from seeking to evade regulation.

As addressed in the dealer analysis another alternative to address such evasive activity could be to narrow the inter-affiliate exception, such as by making the exception unavailable when non-U.S. persons enter into positions with their U.S. affiliates.[715] While this alternative may be expected to reduce costs to such entities, we believe the final rules will achieve comparable anti-evasion purposes with less cost and disruption.[716]

(d) Positions of Non-U.S. Persons With Foreign Branches of U.S. Banks and Certain Other Counterparties

The final rules require non-U.S. persons to include their positions arising from transactions conducted through foreign branches of U.S. banks unless the U.S. bank is registered as a security-based swap dealer. This reflects a change from the proposal, which would have required non-U.S. persons to include all positions with foreign branches of U.S. banks without exception. The final approach, as in the context of the dealer analysis, reflects a middle ground between commenter views, which provided two alternatives: that all positions arising from transactions conducted through foreign branches be counted or that no such position be counted against a non-U.S. person's major security-based swap participant calculation thresholds.[717] Adopting the first alternative requiring non-U.S. persons to include all positions with foreign branches would raise the potential for disparate impacts upon U.S. persons with foreign branches, along with associated concerns about liquidity impacts.[718] Adopting the second alternative excluding all such positions from being counted, could incentivize U.S. market participants that are not registered as dealers to execute higher volumes of security-based swaps through their foreign branches, resulting in higher levels of risk being transmitted to the United States without the risk-mitigating attributes of having a registered dealer involved in the position.[719]

The available data related to these alternatives is subject to the limitations discussed above and does not indicate a change to our assessment of the number of entities that may be expected to register as major security-based swap participants.[720]

Another alternative approach would require non-U.S. persons to include in their major security-based swap participant threshold calculations those positions for which they have rights of recourse against a U.S. person or their positions with counterparties that are conduit affiliates.[721] We believe that the positions of such non-U.S. persons do not transmit risk to the United States in the same way as if the potential major security-based swap participant is the entity whose performance is guaranteed by a U.S. person because the default of the non-U.S. person who holds the right of recourse against the U.S. person guarantor will not impact the outward exposure of the U.S. person or the non-U.S. person whose position is guaranteed. While these alternatives may potentially increase programmatic benefits associated with Title VII major participant regulation, they would also likely increase assessment costs by requiring such non-U.S. persons to evaluate and track whether they have a right of recourse against a U.S. person, potentially reducing liquidity available to U.S. corporate groups that provide guarantees to non-U.S. persons.[722] We note that, under the final rules regarding guaranteed positions, the entity involved in the position with the closest connection to the United States, the non-U.S. person whose position is guaranteed, as well as the U.S. guarantor itself, will already be including the position in each of their calculations. Thus we believe such benefits would be more attenuated than those associated with the final rules' approach of directly counting the positions of such guaranteed non-U.S. persons. Accordingly, we do not believe these alternatives would generate significant additional programmatic benefits.

(e) Attribution

i. Attribution to U.S. Persons

Our final attribution approach requires U.S. persons to include, for purposes of their major security-based swap participant calculation thresholds, those positions for which a non-U.S. person's counterparty has rights of recourse against the U.S. person.

An alternative approach would not require a U.S. person to include such positions in its threshold calculations. This alternative potentially reduces the programmatic costs and benefits of major participant regulation because it would reduce the number of positions that U.S. guarantors would include in their calculations. By reducing the costs associated with providing guarantees, such an alternative could reduce the barriers to participation in the security-based swap market faced by participants who might benefit from risk sharing afforded by security-based swap positions but cannot credibly provide sufficient information for their counterparties to assess creditworthiness. We further believe that such an approach would only reduce the assessment costs associated with major participant regulation to the extent that U.S. guarantors do not have private incentives in place to collect information about positions they guarantee.

As noted in section V.D.3, however, we believe it is important to account for the risk to the U.S. financial system transmitted by such guaranteed positions. Ensuring that a U.S. person counts positions of potentially several entities whose counterparties have rights of recourse against it, where each of those entities may be individually below the major participant threshold, will generate the types of benefits that Title VII was intended to produce. The benefits of including these positions are significant because, through the U.S. guarantor, these positions expose the U.S. financial system to the type of risk that the definition of major security-based swap participant is intended to address.

ii. Attribution to Non-U.S. Persons

Under the final rules a non-U.S. person must include security-based swap positions of a U.S. person for which that person's counterparty has rights of recourse against the non-U.S. person, and security-based swap positions of another non-U.S. person that are with a U.S.-person counterparty who has rights of recourse against the non-U.S. person that is the potential major security-based swap participant.

An alternative approach to these requirements would be to not require non-U.S. persons to include such positions, even when those positions are entered into by U.S. persons or when a U.S. person has a right of recourse against them under those positions. Not requiring these positions to be attributed

[714] *See* section IV.I.3(c), *supra.*

[715] *See id.*

[716] *See id.*

[717] *See* section IV.I.3(d), *supra.*

[718] *See id.*

[719] *See id.*

[720] *See id.*

[721] *See* note 576 (describing CFTC approach) and note 189 (describing comments suggesting to treat guaranteed entities as U.S. persons), *supra.*

[722] *See* section IV.I.3(d).

to the non-U.S. person could reduce assessment costs for non-U.S. persons and potentially result in fewer non-U.S. persons ultimately registering as major security-based swap participants. This alternative potentially improves risk sharing by U.S. persons who must rely on guarantees in order to participate in the security-based swap market by reducing the costs incurred by non-U.S. person guarantors. It likely would, however, also reduce programmatic benefits to the extent that non-U.S. persons that guarantee positions within the United States of multiple entities, each of which is below the major participant threshold, are not required to include such positions in their own calculations.

Such non-U.S. persons who provide guarantees ultimately bear the risk of positions they guarantee, and the aggregate risk exposure of the U.S. financial system to a non-U.S. person guarantor varies more directly with the notional amount of positions involving U.S. persons that are guaranteed than with the number of entities to which it provides guarantees. As a result, the Commission believes it is appropriate to apply attribution requirements that treat non-U.S. person guarantors of positions to which U.S. persons are counterparties as if they were direct counterparties. With respect to guarantees provided by non-U.S. persons to U.S. persons, the Commission believes it is appropriate to attribute guaranteed positions because U.S. persons bear the risk that non-U.S. person guarantors will be unable to fulfill obligations under the guarantees they provide.

(f) Positions Cleared Through a Clearing Agency in the United States

The final approach requires non-U.S. persons to include in their major participant threshold calculations those positions that are entered into with U.S. persons, including positions that are cleared through a registered clearing agency in the United States. An alternative raised by a commenter suggested that the location of clearing not be relevant for purposes of determining whether a non-U.S. person is a major security-based swap participant.[723] This alternative would ignore the risk that is posed to the U.S. financial system by positions cleared through a U.S.-person clearing agency, and would be inconsistent with the general approach that all positions with U.S. counterparties should be counted towards the major security-based swap participant threshold calculation. For this reason, we believe the alternative would ignore important programmatic benefits that are incorporated in the final approach.

(g) Foreign Government-Related Entities

Several commenters suggested that foreign government-related entities, such as sovereign wealth funds and MDBs, should be excluded from the U.S. person, security-based swap dealer, and major security-based swap participant definitions.[724] 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 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,[725] 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. To the extent that such entities do enter into security-based swaps with U.S. persons, however, we believe such requiring such entities to include those positions in their major participant threshold calculations will generate programmatic benefits, as such positions introduce risk into the United States of the type title VII intended to address.

VI. Substituted Compliance Procedural Rule

A. Proposed Approach and Commenters' Views

The Cross-Border Proposing Release addressed a range of substantive issues regarding the potential availability of substituted compliance, whereby a market participant could satisfy certain Title VII obligations by complying with comparable foreign requirements. These included issues regarding which requirements might be satisfied via substituted compliance, and regarding the showings necessary to obtain a substituted compliance order from the Commission.

The release also proposed to amend the Commission's Rules of General Application to establish procedures for considering substituted compliance requests, similar to the procedures that the Commission uses to consider exemptive order applications under section 36 of the Exchange Act.[726] Among other aspects, proposed Exchange Act rule 0–13 would require that substituted compliance applications be in writing and include any supporting documentation necessary to make the application complete—''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''—and that applications cite applicable precedent.[727] The proposed rule also stated that the Commission may choose to publish requests in the **Federal Register**, and stated that requestors may seek confidential treatment.[728] We preliminarily concluded that those proposed procedures would provide sufficient guidance regarding the submission process.[729] We also solicited comment regarding the sufficiency of the guidance provided by the proposed rule,

[723] *See* section V.B.2 and note 549, *supra. See also* section VIII.A, *infra.*

[724] *See* section IV.H.2 and note 420 (addressing comments in *de minimis* context and citing WB/IFC Letter SC Letter and IDB Letter at 5), *supra.*

[725] *See* section V.G, *supra.*

[726] *See generally* Cross-Border Proposing Release, 78 FR 31087–88.

[727] *See* proposed Exchange Act rule 0–13(a), (e). Proposed Exchange Act rule 0–13 further would provide that applications must comply with Commission rule 0–3 (regarding the filing of materials with the Commission). Under the proposal, all applications would be submitted to the Commission's Office of the Secretary electronically or in paper format, and in the English language. If an application is incomplete, the Commission may request that the application be withdrawn unless the applicant can justify why supporting materials have not been submitted and undertakes to submit promptly the omitted materials. The Commission would not consider hypothetical or anonymous requests for a substituted compliance order. The proposed rule further addressed issues regarding contact information, amendments to the application, the review process, and potential hearings regarding the application. *See* proposed Exchange Act rule 0–13; *see also* Cross-Border Proposing Release, 78 FR 31087–88.

[728] *See* proposed Exchange Act rule 0–13(a), (h). The proposal stated that requests for confidential treatment would be permitted to the extent provided under 17 CFR 200.81. *See* proposed Exchange Act rule 0–13(a); Cross-Border Proposing Release, 78 FR 31087–88. Under 17 CFR 200.81, persons submitting exemptions and related relief may also request that it be accorded confidential treatment for a specified period of time not exceeding 120 days. If the Commission staff determines that the request is reasonable and appropriate it will be granted and the letter or other communication will not be made available for public inspection or copying until the expiration of the specified period. If the staff determines that the request for confidential treatment should be denied, the staff shall advise the person making the request and the person may withdraw the letter or other communication within 30 days.

[729] *See* Cross-Border Proposing Release, 78 FR 31088.

and regarding whether foreign regulatory authorities should be able to submit substituted compliance requests.[730]

One commenter raised concerns that the proposed availability of confidential treatment ''would foreclose any public comment, debate or analysis of the applicant's claims about the foreign regulatory regime, leading to an industry-led process.'' That commenter urged us to disallow confidential treatment of applications, and to invite public comment as foreign jurisdictions are considered for comparability.'' [731]

Commenters also asked for greater clarity regarding the information to be provided in connection with substituted compliance requests.[732] Commenters also asked that the Commission coordinate with the CFTC and foreign regulators in making substituted compliance determinations.[733]

Other commenters addressed a related issue regarding whether foreign regulators could submit substituted compliance requests. Proposed Exchange Act rule 3a71–5, regarding substituted compliance for foreign security-based swap dealers, specified that such requests may be filed by a foreign security-based swap dealer or group of dealers. A number of commenters took the contrasting position that foreign regulators should be able to submit substituted compliance requests.[734] Some commenters further stated that such requests solely should be submitted by foreign regulators.[735] Two commenters particularly emphasized the importance of the Commission's substituted compliance assessments taking into account foreign enforcement and supervisory practices.[736]

B. Final Rule

In large part, we expect to address issues regarding the availability of substituted compliance as part of future rulemakings, in conjunction with considering the cross-border application of the relevant substantive rules. As discussed above, we believe that it is appropriate to address issues regarding the cross-border application of the substantive requirements under Title VII in conjunction with considering the final rules to implement those substantive requirements, as substituted compliance potentially will constitute an integral part of the final approach toward cross-border application.

At this time, however, we believe that it is appropriate to adopt a final rule to address the procedures for submitting substituted compliance requests. Using the same general procedural requirements would facilitate the efficient consideration of substituted compliance requests. Proposed Exchange Act rule 0–13, moreover, is sufficiently flexible to accommodate requests related to a range of regulatory requirements, even when the requirements necessitate different approaches toward substituted compliance.

Accordingly, we are adopting Exchange Act rule 0–13 largely as proposed. In response to commenter input, however, the final rule has been modified from the proposal to provide that a request for a substituted compliance order may be submitted either by a party that potentially would comply with requirements under the Exchange Act pursuant to a substituted compliance order, or by a relevant foreign financial regulatory authority or authorities.[737] We are persuaded that allowing foreign regulators to submit such requests would promote the completeness of requests and promote efficiency in the process for considering such requests, in light of foreign regulators' expertise regarding their domestic regulatory system, including the effectiveness of their compliance and enforcement mechanisms, and to allow for a single point of contact to facilitate the consideration of substituted compliance requests associated with the jurisdiction. We are not, however, foreclosing the ability of a market participant itself to submit a request that it be able to comply with Exchange Act requirements pursuant to a substituted compliance order.[738]

The final rule further revises the proposal to provide that applications should include supporting documentation regarding the methods that foreign financial regulatory authorities use to enforce compliance with the applicable rules.[739] This type of information—which we expect would be best provided by the relevant foreign regulator—is consistent with the fact that our substituted compliance assessments will not be limited to a comparison of applicable rules and their underlying goals, but also will take into account the capability of a foreign financial regulatory authority to monitor compliance with its rules and take appropriate enforcement action in response to violations of such rules.[740]

[730] *See id.*

[731] *See* AFR Letter I at 11–12.

[732] *See* FOA Letter at 4 (stating that the proposed requirement that an application include supporting documentation that the applicant believes necessary for the Commission to make the determination ''puts the burden of interpretation wholly on the applicant''; requesting additional guidance regarding the information needed to accompany requests, and greater specificity to ensure ''that the applications it receives address a similar range of compliance issues and contain a similar amount of supporting detail''); SIFMA/FIA/FSR Letter at A–38 (urging the Commission ''to provide a more granular and detailed framework regarding the considerations relevant to evaluating substituted compliance requests'').

[733] *See, e.g.,* FOA Letter at 8 (requesting that the Commission and the CFTC coordinate in making substituted compliance determinations and that the Commissions consider whether to accept joint submissions from foreign regulators or foreign market participants); CEDU Letter at 2 (stating that the Commission should work closely with the CFTC ''when determining whether substituted compliance is applicable with respect to a particular jurisdiction'').

[734] *See, e.g.,* SIFMA/FIA/FSR Letter at A–36 (''Foreign regulators are often best placed to describe their rules and provide information for the purposes of a comparability analysis. Such an approach would also allow for a more efficient use of resources.'').

[735] *See* EC Letter at 3 (suggesting that ''the review of a foreign regime should be conducted in cooperation solely with the relevant foreign regulators or legislators, as opposed to firms'' to avoid duplication or confusion); ESMA Letter at 3.

[736] *See* AFR Letter I at 12 (supporting ability to reject or withdraw substituted compliance determinations based on the failure of a foreign regime to exercise supervisory or enforcement authority); BM Letter at 30–31 (criticizing Cross-Border Proposing Release for including ''only passing reference to foreign supervision and enforcement as discretionary factors the SEC may consider in making a substituted compliance determination,'' and stating that any substituted compliance determinations be predicated on evaluation of ''a host of factors regarding the foreign regulatory system, including staff expertise, agency funding, agency independence, technological capacity, supervision *in fact,* and enforcement *in fact''*).

[737] The decision to permit foreign regulators to submit substituted compliance requests may impact our future consideration of proposed rule 3a71–5(c), which specified that applications for substituted compliance determinations in connection with security-based swap dealer requirements may be made by foreign dealers or by groups of foreign dealers.

[738] To the extent we receive multiple requests in connection with a particular jurisdiction, we may consider such requests together.

[739] *See* Exchange Act rule 0–13(e). The final rule addresses the need for applications to provide information regarding how foreign regulatory authorities ''monitor and enforce'' compliance with the applicable rules. The relevant language of the proposal simply referred to ''monitor.''

In addition, the final rule revises the proposed language regarding the Commission's ability to request applications to be withdrawn, by omitting the proposed reference to the Commission acting ''through its staff.'' *See* Exchange Act rule 0–13(a).

The final rule further revises the proposed language regarding the process for considering applications, by providing that an appropriate response will be issued following ''a vote by'' the Commission. *See* Exchange Act rule 0–13(g).

[740] We note that assessments of analogous factors occur in other contexts. For example, assessments conducted by the Federal Reserve in connection with applications by foreign banks to establish a branch, agency or commercial lending company in the United States consider—and the Federal Reserve requires applications to provide information regarding—the following factors regarding the role played by the foreign bank's

Finally, the final rule revises the proposal by removing a provision that would have stated that requestors may seek confidential treatment of their application to the extent provided by Exchange Act rule 200.81. This change reflects the fact that under the final rules substituted compliance applications may be submitted by foreign financial regulatory authorities, and recognizes the importance of having the assessment consider potentially sensitive information regarding a foreign regime's compliance and enforcement capabilities and practices. Accordingly, requests for confidential treatment may be submitted pursuant to any applicable provisions governing confidentiality under the Exchange Act.[741] We expect confidential treatment requests will seek protection for privileged information obtained from foreign regulators.[742]

Recognizing the significance of commenter concerns regarding the need for public comment, debate and analysis of substituted compliance requests, moreover, rule 0–13 provides that the Commission shall provide public notice of requests and solicit public comment when a complete application has been submitted.[743] We recognize that public comment regarding substituted compliance requests may be helpful to our consideration of particular requests.[744]

In adopting rule 0–13, we recognize that the requirement that an application ''include any supporting documents necessary to make the application complete'' implicates commenter concerns regarding the need for further guidance regarding what information must be submitted as part of substituted compliance requests. We expect to address such issues regarding supporting documentation in the future, as we consider the potential availability of substituted compliance in connection with particular Title VII requirements.

C. Economic Analysis

The availability of substituted compliance has the potential to impact the interplay between programmatic costs and benefits associated with the Title VII regulation of security-based swap dealers and major security-based swap participants, as well as those associated with other Title VII requirements. For example, substituted compliance potentially may permit the risk management and other programmatic benefits of dealer regulation to be achieved while avoiding costs that market participants otherwise may incur. At the same time, the process of making substituted compliance requests may cause certain market participants to incur extra costs, although that possibility may be obviated in part by the provision that permits foreign financial authorities to make such requests.

As discussed throughout this release, the security-based swap market is a global market that is subject to regulatory requirements that may vary by jurisdiction. As a result, market participants that operate globally potentially could be subject to overlapping or conflicting regulations. If Title VII requirements for non-U.S. market participants conflict with regulations in local jurisdictions, Title VII could act as a barrier to entry to the U.S. security-based swap market. In such cases, allowing market participants to comply with Title VII via substituted compliance could act as a mechanism to preserve access for non-U.S. persons to the U.S. security-based swap market, reducing the likelihood that non-U.S. persons exit the U.S. market entirely. Therefore, we expect that substituted compliance—so long as it is conditioned on a foreign regime's comparability to the relevant requirements under the Dodd-Frank Act, and on the foreign regime having adequate compliance and enforcement capabilities—would help preserve access and competition in the U.S. market, and thus benefit non-dealer participants in the security-based swap market.[745]

Although the costs associated with the process of making substituted compliance request may be uncertain at this time, the decision to request substituted compliance is purely voluntary. To the extent such requests are made by market participants, moreover, such participants would request substituted compliance only if, in their own assessment, compliance with applicable requirements under a foreign regulatory system was 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 the U.S. market exceeds the private costs they expect to bear, including any conditions the Commission may attach to the substituted compliance determination. Where substituted compliance increases the number of dealers or other participants in the U.S. security-based swap market, or prevents existing participants from leaving the U.S. market, this may help mitigate the programmatic costs associated with the applicable Title VII requirements, while

home country supervisor: (a) the scope and frequency of on-site examinations by the home-country supervisor; (b) off-site monitoring by the home-country supervisor; (c) the role of external auditors; (d) regulation and monitoring of affiliate transactions; (e) other applicable prudential requirements (including capital adequacy, asset classification and provisioning, single or aggregate credit and foreign currency exposure limits, and liquidity) and associated supervisor monitoring; (f) remedial authority of the home-country supervisor to enforce compliance with prudential controls and other supervisory or regulatory requirements; and (g) prior approval requirements (related to investments in other companies or the establishment of overseas offices). *See* Federal Reserve Board, ''International Applications and Prior Notifications under Subpart B of Regulation K,'' (*http://www.federalreserve.gov/reportforms/forms/FR_K–220110331_f.pdf*). In noting this analogous requirement, we are not predicting the extent to which such factors may or may not be considered as part of the Commission's substituted compliance assessments.

[741] For example, Exchange Act rule 24b–2 addresses the potential availability of confidential treatment in connection with any registration statement, report, application, correspondence or other document filed pursuant to the Exchange Act. The rule provides that the person filing the information must make written objection to its public disclosure at the time of the filing. *See* 17 CFR 240.24b–2.

Separately, Commission Rule 200.83 is a procedural rule that addresses how persons submitting information to the Commission may request that the information not be disclosed pursuant to a request under the Freedom of Information Act for reasons permitted by Federal law. The rule does not apply when any other statute or Commission rule provides procedures for confidential treatment regarding particular categories of information, or where the Commission has specified that an alternative procedure be utilized in connection with a particular study, report, investigation or other matter. Under this rule, a person submitting information to the Commission must request confidential treatment at the time of the submission. *See* 17 CFR 200.83.

[742] Exchange Act Section 24(d) provides that the Commission generally shall not be compelled to disclose records obtained from a foreign securities authority if: (1) the foreign authority in good faith determines and represents that public disclosure of the records would violate the laws applicable to that foreign securities authority; and (2) the Commission obtains the records pursuant to procedures authorized for use in connection with the administration or enforcement of the securities laws, or a memorandum of understanding.

Exchange Act Section 24(f)(2) further provides that the Commission shall not be compelled to disclose privileged information obtained from any foreign securities authority or law enforcement authority if the foreign authority in good faith has determined and represented that the information is privileged.

[743] The text of the final rule has been revised from the proposal to eliminate a reference to the Commission having ''sole discretion'' to choose to publish a notice, and to provide that publication would occur following submission of a ''complete'' application. *See* Exchange Act rule 0–13(h).

[744] The final rule also makes technical change to the proposal by replacing references to the Commission's Division of Trading and Markets with general references to the ''staff,'' consistent with the broad range of issues that will likely arise in connection with evaluating substituted compliance requests. *See* Exchange Act rule 0–13(a), (g).

[745] *Cf.* Institute of International Finance (''IIF'') Letter (making a similar point).

helping to ensure that the associated programmatic benefits are achieved.

The costs particularly associated with making substituted compliance requests, as well as the general costs and benefits associated with allowing substituted compliance, may be expected to vary between the various categories of Title VII requirements. Relevant considerations may include: whether (and to what extent) substituted compliance is permitted in connection with a requirement; the relevant information required to demonstrate consistency between the foreign regulatory requirements and the Commission's analogous dealer requirements; the relevant information required to demonstrate the adequacy of the foreign regime's compliance and enforcement mechanisms; and whether substituted compliance requests are made by market participants or by foreign regulatory authorities. These factors limit our ability to further predict the economic consequences of this procedural rule.

We recognize that commenters have asked that the Commission coordinate with the CFTC and foreign regulators in making substituted compliance determinations. As discussed above, the Commission is subject to obligations to consult and coordinate with the CFTC and foreign regulators in connection with Title VII.[746] Our revision of the final rule to permit foreign regulators to submit substituted compliance requests also helps address goals of increased coordination. Moreover, our substituted compliance assessments regarding particular requirements applicable to security-based swap dealers also as appropriate may take into account the way that other regulators address similar issues, subject to the need for any allowance of substituted compliance to be predicated on the extent to which compliance with another regulatory regime will help achieve the goals of Title VII.

VII. Antifraud Authority

A. Final Rule

The provisions of the rules and guidance, discussed above, do not limit the cross-border reach of the antifraud provisions or other provisions of the federal securities laws that are not specifically addressed by this release.

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.[747] Congress enacted section 929P(b) in the wake of the Supreme Court's decision in *Morrison* v. *National Australia Bank,*[748] which created uncertainty about the Commission's cross-border enforcement authority under the antifraud provisions of the federal securities laws. Before *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.[749] With respect to the Commission's enforcement authority, section 929P(b) codified the courts of appeals' prior interpretation of the scope of the antifraud provisions' cross-border reach. Section 929P(b) also made clear that the scope of subject-matter jurisdiction was coextensive with the cross-border reach of the antifraud provisions.[750]

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.'' [751] 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.'' [752]

Although no commenters challenged the Commission's interpretation of its cross-border antifraud authority, we are aware that a federal district court recently expressed the view that the statutory language may be unclear.[753] We therefore have determined to adopt a rule that clearly sets forth our interpretation of the Commission's cross-border antifraud authority.[754] We believe that our interpretation is not only the better reading of the antifraud authorities and the statutory text added by section 929P(b), but that our reading is consistent with section 929P(b)'s legislative history and purpose.[755]

[746] *See* section II.B, *supra.*

[747] The antifraud provisions of the securities laws include section 17(a) of the Securities Act, 15 U.S.C. 77q(a); sections 9, 10(b), 14(e), and 15(c)(1)–(2) & (7) of the Exchange Act, 15 U.S.C. 78i, 78j, 78n, 78o(c)(1)–(2); section 206 of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6; and any rule or regulation of the Commission promulgated under these statutory authorities.

[748] *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'').

[749] *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*).

[750] *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 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).

[751] Section 22 of the Securities Act, 15 U.S.C. 77v(a); section 27 of the Exchange Act, 15 U.S.C. 78aa.

[752] Section 214 of the Investment Advisers Act, 15 U.S.C. 80b–14.

[753] *See SEC* v. *A Chicago Convention Center, LLC,* 961 F. Supp. 2d 905 (N.D. Ill. 2013); *see also* Richard W. Painter *et al.,* ''When Courts and Congress Don't Say What They Mean: Initial Reactions to *Morrison* v. *National Australia Bank* and to the Extraterritorial Jurisdiction Provisions of the Dodd-Frank Act,'' 20 Minn. J. of Inter. L. 1 (Winter 2011). *But see Liu* v. *Siemens A.G.,* 2013 WL 5692504, *3 (S.D.N.Y. Oct. 21, 2013) (''Section 929P(b) permits the SEC to bring enforcement actions for certain conduct or transactions outside the United States.''); *SEC* v. *Tourre,* 2013 WL 2407172, *1 n.4 (S.D.N.Y. June 4, 2013) (929P(b) ''effectively reversed *Morrison* in the context of SEC enforcement actions''); *In re Optimal U.S. Litig.,* 865 F. Supp. 2d 451, 456 n.28 (S.D.N.Y. 2012) (''Congress has . . . restor[ed] the conducts and effects test for SEC enforcement actions.''); *SEC* v. *Gruss,* 2012 WL 3306166, *3 (S.D.N.Y. Aug. 13, 2012) (''Section 929P(b) . . . allows the SEC to commence civil actions extraterritorially in certain cases.''); *SEC* v. *Compania Internacional Financiera S.A.,* 2011 WL 3251813, *6 n.2 (S.D.N.Y. July 29, 2011) (''It may be that [929P(b)] was specifically designed to reinstate the Second Circuit's 'conduct and effects' test.''); *Cornwell* v. *Credit Suisse Grp.,* 729 F. Supp. 2d 620, 627 n.3 (S.D.N.Y. 2010) (''[I]n legislation recently enacted, Congress explicitly granted federal courts extraterritorial jurisdiction under the conduct or effect test for proceedings brought by the SEC.'').

[754] *See* rule 250.1.

[755] The *Morrison* decision does not preclude the Commission's interpretation. When the Supreme Court construed section 10(b) in *Morrison* to

Further, we believe that our interpretation of the cross-border antifraud enforcement authority best advances 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, other U.S. market participants, or other U.S. interests.[756] We believe that our interpretation of the cross-border antifraud authority 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. Our interpretation of the cross-border antifraud authority will also allow us to better protect U.S. investors from securities frauds executed outside of the United States where those frauds may involve non-domestic securities transactions but nonetheless threaten to produce, foreseeably do produce, or were otherwise intended to produce effects upon U.S. markets, U.S. investors, other U.S. market participants, or other U.S. interests.

B. Economic Analysis

This rule is designed to ensure the antifraud provisions of the securities laws are provided broad cross-border reach. Effective cross-border enforcement of the antifraud provisions should help detect and deter or stop transnational securities frauds the final rule may mitigate inefficiencies in allocation of capital. For example, by directly diverting financial resources from more productive projects to less productive projects, serious transnational securities frauds can generate welfare losses.

Further, in the absence of the cross-border application of the antifraud provisions, the perceived risk of fraud may indirectly result in less efficient capital allocation if it reduces investors' trust in the securities market.[757] Additionally, given the global nature of the securities market, ensuring that antifraud provisions of the securities laws have cross-border reach will reduce the likelihood of a fragmented market. As a result of reduced ambiguity over the degree to which they are protected from fraud, U.S. market participants will have fewer incentives to avoid cross-border activity because, as explained above, they will have increased confidence in the integrity of the market. Through this channel, the final rules support a market that provides greater opportunities for U.S. market participants to share risks with market participants in other jurisdictions.

VIII. Impacts on Efficiency, Competition, and Capital Formation

In developing our approach to the cross-border application of the Title VII security-based swap dealer and major participant definitions, we have focused on meeting the goals of Title VII, including the promotion of the financial stability of the United States, by the improvement of accountability and transparency in the U.S. financial system and the protection of counterparties to security-based swaps. We also have considered the effects of our policy choices on competition, efficiency, and capital formation as mandated under section 3(f) of the Exchange Act. That section requires us, 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.[758] In addition, section 23(a)(2) of the Exchange Act requires us, 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.[759]

In this section, we focus particularly on these effects. In adopting these final rules, we recognize that the most significant impact of the cross-border implementation of the dealer and major participant definitions will derive from the role of the definitions in determining which market entities are subject to security-based swap dealer and major security-based swap participant regulation under Title VII and which entities are not. That is, the scope of the final definitions will affect the ultimate regulatory costs and benefits that will accompany the full implementation of Title VII rules aimed at increasing transparency, accountability, and financial stability. Furthermore, the final cross-border rules may create incentives for market participants, including dealers as well as non-dealers and other non-registered entities who transact with dealers, to structure their businesses to operate wholly outside of the Title VII framework. This incentive may be particularly strong for entities at the boundaries of the definitions—for example, entities with relatively limited contact with U.S. persons—for whom the benefits of operating outside of Title VII may exceed the costs of restructuring or forgoing trading opportunities with U.S. counterparties.

A. Competition

As noted above, a key goal of Title VII of the Dodd-Frank Act is to promote the financial stability of the United States by improving accountability and transparency in the financial system. To that end, Title VII imposes new regulatory requirements on market participants who register as security-based swap dealers or major participants. The final cross-border implementation of the dealer and major participant definitions discussed in this release, including the cross-border implementation of the *de minimis* exception, 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. Though these substantive Title VII requirements have not been finalized, application of Title VII to registered dealers and major participants may directly affect the competitive landscape of the security-based swap market.

As detailed above, the security-based swap market is a global, interconnected market. Within this global market, foreign and domestic dealers compete for business from counterparties, while non-dealers (including major participants) that participate in the

determine its territorial scope, it acknowledged that the language of section 10(b) neither required nor precluded extraterritorial application. *Morrison,* 130 S.Ct. at 2881–82. It was merely silent. The Court also looked to other provisions of the Exchange Act for evidence of extraterritorial intent, but found none. The Court thus applied a default ''presumption'' against extraterritoriality to find that section 10(b) lacked extraterritorial effect, while making clear that this presumption was not ''a limit upon Congress's power to legislate'' and only applied ''unless a contrary intent appears.'' *Id.* at 2877. Section 929P(b) now provides that contrary intent——in the words of *Morrison,* it supplies the ''indication of an extraterritorial application'' that had been missing. Our interpretation is thus, at a minimum, a reasonable reading of the antifraud provisions in light of section 929P(b)'s enactment.

[756] *See generally* Restatement (Third) of Foreign Relations Law of the United States § 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'').

[757] *See e.g.,* Luigi Guiso, Paola Sapienza, and Luigi Zingales. ''Trusting the stock market,'' 63 J. Fin. Vol. 63, No. 6: 2557 2600 (2008); *see also* David Easley and Maureen O'Hara, Microstructure and Ambiguity, 65 J. Fin. 1817 (2010).

[758] 15 U.S.C. 78c(f).

[759] 15 U.S.C. 78w(a)(2).

market use security-based swaps for purposes that can include speculation and hedging. Because the market for security-based swaps is a global market and some participants may not engage in relevant security-based swap activity within the United States, the rules we adopt pursuant to Title VII will not reach all participants or all transactions in the global market. We are aware that application of rules to a subset of participants in the worldwide security-based swap market would change the costs and benefits of market participation for one group (those that engage in relevant security-based swap activity within the United States) relative to another (those that do not) and therefore create competitive effects.

More specifically, in addition to requiring U.S. dealers to register, our final rules implementing the cross-border approach to the security-based swap dealer definition would generally apply dealer registration and other Title VII requirements to non-U.S. entities that conduct dealing activity (as defined in the Intermediary Definitions Adopting Release) in excess of the *de minimis* threshold, but where calculation of the threshold depends on various features of the person's transactions (*e.g.,* whether the person's counterparty is a U.S. or non-U.S. person, whether the transaction is guaranteed by a U.S. person, whether the counterparty is a registered or non-registered foreign branch of a U.S. person, and whether the person is a conduit affiliate of a U.S. person). Similarly, our final rules implementing cross-border application of the major security-based swap participant definition would apply major participant registration and other Title VII requirements to entities that have exposures to U.S. persons that exceed the major participant thresholds (as defined in the Intermediary Definitions Adopting Release). Given the approach we are adopting with respect to application of the dealer *de minimis* and major participant threshold calculation requirements, U.S. persons should have no incentive to favor a non-U.S. person counterparty over a U.S.-person counterparty.

However, we recognize that the final rule treats U.S. persons and different types of non-U.S. persons differently. Unless their dealing activity is guaranteed by a U.S. person, non-U.S. persons may exclude from their *de minimis* calculations dealing activity with other non-U.S. persons. Similarly, unless their security-based swap activity is guaranteed by a U.S. person, non-U.S. persons may exclude from their major participant threshold calculations their positions with non-U.S. persons. U.S. persons, non-U.S. persons whose security-based swap transactions are guaranteed by a U.S. person, and conduit affiliates cannot exclude such transactions or positions from their own calculations. This differential treatment makes it more likely that non-U.S. persons will not be subject to the regulatory requirements associated with dealer and major participant registration. Furthermore, because transactions with U.S. persons in excess of the *de minimis* and major participant thresholds trigger registration requirements, non-U.S. dealers and other market participants may be reluctant to trade with U.S. counterparties or clear security-based swap transactions through U.S. person clearing agencies because of the potential application of Title VII regulation. For example, our final rules may produce competitive frictions insofar as market participants prefer to clear transactions using non-U.S. person clearing agencies who may have U.S. person members instead of U.S. person clearing agencies, because only positions held against the latter would count against their major participant thresholds.[760] Indeed, 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 entirely. Non-U.S. persons may find this option more 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. However, U.S. entities may also have an incentive to establish separately-capitalized foreign subsidiaries to conduct their security-based swap operations, since such subsidiaries would qualify as non-U.S. persons.[761] In this case, the cross-border application of Title VII rules may affect participants depending on their size, as larger participants could be better-equipped to set up offshore vehicles enabling them to transact as non-U.S. persons.

To the extent that entities engaged in dealing activity exit the U.S. security-based swap market, the end result could be a U.S. market where fewer intermediaries compete less intensively for business. These exits could result in higher spreads and reduced liquidity, and could affect the ability and willingness of non-dealers within the United States to engage in security-based swaps. The concentrated nature of dealing activity suggests that there are high barriers to entry in connection with security-based swap dealing activity, which could preclude the ability of new dealers to enter the security-based swap market and compete away spreads.

Notwithstanding the potential that our final rule may reduce competition, the Commission believes it appropriate to require U.S. persons to count all dealing transactions towards the *de minimis* threshold and all positions toward the major security-based swap participant thresholds, given the potential for these transactions to create risk to U.S. persons and in the U.S. financial system. We also note that it is uncertain that such requirements will reduce competition. In fact, the final rule may enhance competition among dealers, as the Title VII regulatory requirements and the ability to meet the standards set by Title VII may allow registered dealers to credibly signal high quality, better risk management, and better counterparty protection relative to foreign unregistered dealers that compete for the same order flow. In this scenario, non-dealers in the U.S. market may be willing to pay higher prices for higher-quality services in regulated markets, and registration requirements may separate high-quality intermediaries that are willing and able to register from low-quality firms that are not.[762] Furthermore, while dealers and speculative traders may prefer to transact in opaque markets, transparency requirements that apply to

[760] *See* section V.D.1(b).

[761] The rules we are adopting regarding conduit affiliates should mitigate this risk to some degree, as the foreign affiliate's non-U.S. person counterparties would not generally be able to engage in security-based swap dealing activity on behalf of its U.S.-person affiliate without itself being required to include those transactions in its own *de minimis* calculations.

[762] *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 customers 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 listing in the U.S. and that this effect is greater for firms from countries with poorer investor rights''). While economic theory supports the assertion that registration can separate high-quality dealers from low-quality dealers, with corresponding differences in pricing, we received no comments either agreeing or disagreeing with the assertion that some market participants may be willing to pay higher prices to trade with a high-quality intermediary.

U.S. dealers and transactions that occur within the scope of Title VII may be attractive to hedgers and other market participants who do not benefit from opacity. Therefore, Title VII requirements may promote liquidity in the U.S.; liquid markets should attract additional participants, thereby enhancing risk sharing and making markets more competitive. These regulatory benefits could mitigate the competitive burdens imposed by the proposed and anticipated final 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.

Similarly, the cross-border application of the *de minimis* exception could reduce the number of entities likely to exit the U.S. market entirely 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 and become a registered security-based swap dealer.[763] 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 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 dealer registration requirements.

Finally, incentives to restructure ultimately depend on future regulatory developments, both with respect to final Title VII rules and foreign regulatory frameworks; the differences in regulatory requirements across jurisdictions; and strategic interactions with non-dealer participants. For example, although pre-and post-trade transparency requirements provide a number of benefits both to financial markets and the real economy, dealers benefit from operating in opaque markets. To the extent that foreign jurisdictions require only regulatory reporting, without public dissemination requirements, dealers may wish to operate in jurisdictions where they can continue to benefit from opaque markets.

Other market participants, however, may prefer transparency, and the availability of transparent trading venues that result from Title VII pre- and post-trade transparency requirements could shift market power away from dealers. If non-dealer market participants are able to demand transparent trade execution, the incentives to restructure may be tempered, particularly if transparent venues attract liquidity away from opaque markets. Ultimately, the effects of transparency requirements on dealers' incentives to restructure depend on differences across jurisdictions, as well as whether non-dealer participants prefer transparency. These preferences may, in turn, depend on motives for trading among non-dealers. Hedgers and participants that need liquidity may prefer transparent venues while participants who believe they have private information about asset values may prefer opaque markets that allow them to trade more profitably on their information.

The potential restructurings and exits described above may impact competition in the U.S. market in different ways. 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 a person'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. non-dealers 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 as well as registration and 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 approach, we cannot preclude the possibility that large non-dealer financial entities and other non-dealer market participants in the United States, such as investment funds, 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, either because liquidity has moved offshore or because these participants want to avoid Title VII requirements (such as transparency requirements) that may reveal information about trading strategies. 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 offshore, 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 market participants of security-based swaps to access the security-based swap market more than large ones, as smaller participants are less likely to have the resources that would enable or justify a restructuring of their business.

In addition to the global nature of the security-based swap market and the implications for the reach of Title VII dealer and major participant registration requirements, we also noted above the current opacity of the over-the-counter derivatives market and the informational advantage that dealers currently have over non-dealers. By having greater private order flow information, dealers are in a position to make more-informed assessments of market values and can use that information to extract rents from less-informed counterparties. While this issue will be the focus of future Commission rulemaking covering pre- and post-trade transparency, we note that the final rule to exclude cleared, anonymous transactions from the *de minimis* threshold for non-U.S. persons has implications for competition in the security-based swap market. Because cleared, anonymous transactions will not trigger registration requirements, the exclusion strengthens incentives for trading in transparent venues, reducing market power and the competitive advantage currently enjoyed by dealers over non-dealer market participants. Furthermore, while Title VII rules governing clearing, trade execution, and trade reporting have not been finalized, providing stronger incentives to trade on transparent venues and through CCPs increases the likelihood that the benefits of Title VII, including increased transparency and reduced potential for risk spillovers, will be realized.[764]

The overall effects of the final 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 ultimately respond to different elements of Title VII. Application of the dealer and major participant registration requirements may create incentives for dealers and market participants to favor non-U.S.

[763] *See* IIF Letter (noting that, ''. . . the rule proposal if adopted would make it much easier for foreign market participants to offer services in the US, providing greater choice and competition, and making it easier for instance for corporates to hedge their risks).''

[764] The exclusion for cleared, anonymous transactions does not require participants to use a registered clearing agency. Therefore, this benefit may be limited if final Title VII rules for registered clearing agencies create incentives for market participants to trade through CCPs that are not registered and regulated under Title VII.

counterparties; incentives to restructure due to inconsistent regulatory requirements may increase concentration among security-based swap dealers providing services to U.S. non-dealers. However, registration and compliance with Title VII may signal high quality and mitigate the incentive to restructure and exit U.S. markets for intermediaries with the ability to meet the standards set by Title VII. Furthermore, if hedgers and other market participants who do not benefit from opacity demand transparency and counterparty protections that come from trading with a registered dealer, dealers may prefer to register if serving this market is profitable. Finally, while fewer dealing entities could lead to decreased competition and wider spreads in the security-based swap market, exclusion of cleared, anonymous trades from the *de minimis* threshold strengthen incentives to trade in transparent venues, reducing the ability of dealing entities to post wider spreads and reducing the competitive advantage over access to information enjoyed by dealers.

B. Efficiency

As noted above, in adopting the rules and guidance discussed in this release, we are required to consider whether these actions would promote efficiency. In significant part, the effect of these rules on efficiency is linked to the effect of these rules on competition. Definitional rules that promote, or do not unduly restrict, competition can be accompanied by regulatory benefits that minimize the risk of liquidity crises, aggregate capital shortfalls, and other manifestations of contagion. Furthermore, by reducing the costs that individual market participants impose on others through their trades—that is, by imposing registration requirements and substantive regulations on dealers and major participants who, by virtue of the volume of their transactions, their number of counterparties, and their aggregate positions and exposures, are most likely to contribute to risk spillovers—the rules promote efficiency within the market. Generally, rules and interpretations that promote competitive capital markets 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.[765]

As discussed several times throughout this release, the global nature of the security-based swap market suggests that the regulatory framework adopted under Title VII may not reach all participants or all transactions. Additionally, differing regulatory timelines and differences in regulatory scope may moderate the benefits flowing from Title VII. In particular, if other regulatory regimes offer more opacity in transactions, those who are most harmed by transparency (including dealers who currently benefit from privately observing order flow) have incentives to restructure their business to operate abroad or otherwise take advantage of regulatory gaps. Restructuring itself, while potentially optimal for an individual participant, represents a form of inefficiency for the overall market in that firms expend resources simply to circumvent regulation and not for any productive purpose.

More importantly, altering business models to take advantage of looser regulatory regimes undermines other efficiency benefits to Title VII. For example, U.S. dealers may have an incentive to restructure their businesses by setting up separately capitalized entities in non-U.S. jurisdictions, through which they would continue their dealing operations in order to take advantage of the rules applicable to non-U.S. persons. As discussed above, if some market participants choose to operate wholly outside of the Title VII regulatory framework, risk and liquidity may concentrate in less regulated, opaque corners of the market, undermining the benefits of Title VII. Moreover, insofar as the types of restructuring contemplated above purely constitute attempts at arbitraging regulations, including regulations applied to registered dealers, such as capital and reporting regulations, they represent a use of resources that could potentially be put to more productive uses. Ultimately, the incentive to restructure, and the corresponding loss of benefits, depends on the extent to which other jurisdictions implement comprehensive OTC derivatives regulations. If foreign jurisdictions subject security-based swap transactions to regulatory oversight consistent with Title VII, the ability to arbitrage regulations will be limited.[766]

Nevertheless, two features of our rules adopted today may mitigate the incentive for market participants to undermine the benefits of Title VII through inefficient restructuring or evasion. First, the requirement that conduit affiliates count all dealing activity towards the *de minimis* threshold closes one potential path for evasion. We have tailored the application of these requirements in connection with affiliates of registered security-based swap dealers and major security-based swap participants, as we do not believe that transactions involving these types of registered entities and their foreign affiliates raise the types of evasion concerns that the conduit affiliate concept is designed to address.[767] Second, the exclusion of cleared, anonymous transactions from the *de minimis* threshold for non-U.S. persons strengthens incentives for trading in transparent venues, reducing the incentive to trade in opaque corners of the market in order to avoid the reach of Title VII. Strengthening incentives for non-U.S. persons to trade in transparent venues reduces the likelihood that liquidity will fragment to opaque corners of the market and increases the likelihood that risks that non-U.S. persons present to the U.S. financial system will be covered by the Title VII regulatory framework. Furthermore, shifting trades to transparent venues produces benefits associated with pre- and post-trade price transparency, including more efficient valuations of financial assets.[768]

Finally, we received several comments from outside commenters urging us to harmonize our final rules with interpretations set forth in the CFTC's guidance.[769] While our final rules track the CFTC's guidance in many respects—for example, in the treatment of conduit affiliates, the treatment of transactions with foreign branches, and the exclusion for cleared, anonymous transactions from non-U.S. persons' *de minimis* calculations—we are not adopting rules identical to the policies and interpretations in the guidance. For example, our treatment of investment funds with respect to the U.S. person definition differs from the CFTC's, which, in addition to looking to the location of incorporation and principal place of business, considers majority-ownership. While we acknowledge the benefits of harmonization, we believe our rules meet the goals of Title VII while appropriately minimizing the costs to security-based swap market participants. More specifically, our rules are designed to capture transactions and

[765] Definitional rules do not promote efficiency by themselves; rather, the effect is through the number of entities required to register as dealers and major participants, and the corresponding effect on the programmatic costs and benefits associated with registration requirements.

[766] *See* Section III.B, *supra* (discussing global regulatory efforts).

[767] *See* note 320, *supra.*

[768] As discussed above, this benefit may be limited if final Title VII rules for registered clearing agencies create incentives for market participants to trade through CCPs that are not registered and regulated under Title VII.

[769] *See* note 193, *supra.*

entities that pose risk to U.S. persons and potentially to the U.S. financial system, while excluding those transactions and entities that do not warrant regulation under Title VII. In the case of investment funds, we have decided not to look to majority-ownership for determining U.S.-person status, notwithstanding that the CFTC Cross-Border Guidance articulates such an approach. Our belief is that, by adopting an approach that generally focuses on the location of economic decisions made on behalf of a fund, we are more accurately measuring whether a fund poses risks to U.S. persons and to the U.S. financial system of the type that Title VII was intended to address.[770] Nevertheless, we acknowledge that different regulations for swaps and security-based swaps may create inefficiencies for market participants due to conflicting or overlapping requirements, particularly for those participants who deal in both swaps and security-based swaps.

C. Capital Formation

We believe that many aspects of the final cross-border approach to the dealer and major participant definitions are likely to promote capital formation, by focusing dealer and major participant regulation on activity and entities that are most likely to serve as conduits of risk to U.S. persons and potentially to the U.S. financial system. We also believe that applying the full range of Title VII requirements to this group of entities will increase the likelihood that the benefits of Title VII, including increased transparency, accountability, and financial stability, will be realized. To the extent that these requirements reduce asymmetric information about market valuations, we expect that a security-based swap market with enhanced 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.

Additionally, strengthening incentives for non-U.S. persons to trade in transparent venues encourages market participants to express their true valuations for security-based swaps; information revealed through transparent trades 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 trading provides signals not only about security-based swap valuation, but also about the value of the reference assets underlying the swap.[771] Similarly, we expect 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 new financing for new business opportunities.[772]

However, the Commission recognizes that, to the extent that the cross-border implementation of the dealer and major participant definitions encourages inefficient restructuring or results in market fragmentation, the final rules may impair capital formation and result in a redistribution of capital across jurisdictional boundaries. We note that, unlike in the proposed rules, we are requiring non-U.S. persons with U.S. guarantees to include all transactions that benefit from a U.S. guarantee in their *de minimis* calculations. Similarly, we are requiring conduit affiliates to include all transactions in their *de minimis* calculations, whether with a U.S. person or not. Inclusion of these transactions will limit the risk these participants pose to U.S. persons and to the U.S. financial system. More generally, the definition of ''U.S. person'' mitigates the risk of contagion affecting U.S. markets as a result of cross-border swap activity. To the extent that future substantive regulation under Title VII is conditioned on entities' registration status, this definition may also improve transparency and provide increased customer protection for U.S. persons who participate in the security-based swap market. Nevertheless, expanding the scope of transactions that must be included in these calculations may also increase the scope of potential market fragmentation, to the extent that it raises the costs that market participants will incur if they engage in security-based swap activity through guaranteed non-U.S. persons or conduit affiliates.

IX. Paperwork Reduction Act

A. Introduction

The Paperwork Reduction Act of 1995 (''PRA'')[773] imposes certain requirements on Federal agencies in connection with their conducting or sponsoring any ''collection of information.''[774] 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 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.[775]

In the Cross-Border Proposing Release, we identified a number of proposed rules that contained ''collection of information requirements'' within the meaning of the PRA.[776] The majority of those proposed rules and forms are outside of the scope of the dealer and major participant definitions at issue in this release.[777] In two areas, however,

[770] For instance, as discussed above, LTCM demonstrated that an investment vehicle could have a negative impact on U.S. financial institutions and on the stability of the U.S. financial system more generally when the vehicle is directed, controlled, or coordinated from within the United States. *See* note 271, *supra.*

[771] *See* 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).

[772] *See* Philip Bond, Alex Edmans, and Itay Goldstein, ''The Real Effects of Financial Markets,'' Annual Review of Financial Markets, Vol. 4 (Oct. 2012) (reviewing the theoretical literature on the feedback between financial market prices and the real economy).

[773] 44 U.S.C. 3501 *et seq.*

[774] 44 U.S.C. 3502(3).

[775] 44 U.S.C. 3507(a)(1)(D) (internal formatting omitted); *see also* 5 CFR 1320.5(a)(1)(iv).

[776] *See* Cross-Border Proposing Release, 77 FR 31103.

[777] In particular, the present release does not address the following proposed rules and forms that implicated collections of information under the Paperwork Reduction Act: proposed Rule 3Ch–2; reproposed Forms SBSE, SBSE–A and SBSE–BD; proposed Rule 18a–4, and reproposed Rules 242.900 through 242.911 of Regulation SBSR. We expect to address those Paperwork Reduction Act issues in connection with our consideration of those proposed rules and forms.

In addition, the representation provision of the proposed definition of ''transaction conducted within the United States'' contained a collection of information. These final rules do not encompass that collection of information requirement, however, because we are not adopting the ''transaction conducted within the United States'' element of the proposed rule in this release. *See* section I.A, *supra.*

Exchange Act rule 3a71–3 which we are adopting today contains collections of information requirements. First, the rule's definition of ''transaction conducted through a foreign branch,'' which we are adopting largely as proposed, contains a representation provision that constitutes a collection of information. Moreover, the rule's final definition of ''U.S. person'' incorporates, as an addition to the proposal, a representation provision that constitutes a collection of information.[778] Commenters did not address Paperwork Reduction Act issues in connection with the proposal.

The Commission previously submitted proposed rule 3a71–3, as well as certain other rules proposed as part of the Cross-Border Proposing Release, to OMB for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title of the collection related to proposed rule 3a71–3 is ''Reliance on Counterparty Representations Regarding Activity Within the United States.'' OMB has not yet assigned Control Numbers in connection with rule 3a71–3 or the other rules submitted in connection with the proposal.

B. Reliance on Counterparty Representations Regarding Transactions Conducted Through a Foreign Branch

1. Summary of Collection of Information

When determining whether a security-based swap transaction constitutes a ''transaction conducted through a foreign branch,'' a person may rely on its counterparty's representation that the transaction ''was arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States, unless such person knows or has reason to know that the representation is not accurate.'' [779]

2. Proposed Use of Information

Under the final rules, a non-U.S. person need not count, against the applicable thresholds of the dealer exception and the major security-based swap participant definition, dealing transactions with foreign branches of U.S. banks that are registered as security-based swap dealers. For these purposes, the foreign branch must be the counterparty to the security-based swap transaction, and the transaction must be arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States.[780]

As discussed in the Cross-Border Proposing Release, the Commission acknowledges that verifying whether a security-based swap transaction falls within the definition of ''transaction conducted through a foreign branch'' could require significant due diligence. The definition's representation provision would mitigate the operational difficulties and costs that otherwise could arise in connection with investigating the activities of a counterparty to ensure compliance with the corresponding rules.[781]

These representations would be provided voluntarily by the counterparties to certain security-based swap transactions to other 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 described in this representation provision 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.[782]

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 estimates that up to 15 entities that are registered as security-based swap dealers 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).[783]

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 discussions by our staff with market participants. The Commission believes that, in most cases, the representations associated with the definition of ''transaction conducted through a foreign branch'' would be made through amendments to the parties' existing trading documentation (*e.g.,* the schedule to a master agreement).[784] 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 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

[778] We also note that Exchange Act rule 0–13, which we are adopting today, determines the procedures for market participants and foreign regulatory authorities to submit substituted compliance requests. The rule, however, does not provide any substituted compliance rights, and its applicability will be determined solely by the substituted compliance provisions of the substantive rulemakings. Accordingly, collection of information arising from substituted compliance requests, including associated control numbers, will be addressed in connection with any applicable substantive rulemakings that provide for substituted compliance.

[779] *See* Exchange Act rule 3a71–3(a)(3)(ii).

[780] *See* Exchange Act rule 3a71–3(a)(3)(i).

[781] *See* Cross-Border Proposing Release, 78 FR 31107.

[782] *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 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)).

[783] We have estimated that up to 50 entities may register with the Commission as security-based swap dealers, based on an analysis of 2012 data indicating that 27 entities had $3 billion or more in notional transactions that would be counted against the thresholds under the final rules, and further accounting for new entrants into the market. *See* note 444, *supra,* and accompanying text. Because six of those 27 entities are domiciled in the United States, we conservatively estimate that it is possible that new entrants may lead up to 15 registered dealers to be U.S. banks. Although not all U.S. banks engaged in security-based swap dealing activity currently operate foreign branches, we also conservatively estimate that all such dealers that are U.S. banks would do so.

In the Cross-Border Proposing Release, we preliminarily estimated that 50 entities may include a representation that a transaction constitutes a ''transaction conducted through a foreign branch.'' *See* Cross-Border Proposing Release, 78 FR 31108. This revised estimate reflects the fact that under the final rules such a representation would be relevant only if provided by a person that is registered with the Commission as a security-based swap dealer. In practice, however, based on our understanding of changes in the way major U.S. dealers engage with non-U.S. counterparties in the single-name CDS market following the issuance of the CFTC Cross-Border Guidance, we believe that few, if any, U.S. persons currently may participate in the single-name CDS market through their foreign branches. Also, as noted above, moreover, we recognize that other regulatory provisions may limit the ability of U.S. banks to conduct security-based swap activity. *See* note 366, *supra.*

[784] The Commission believes that because trading relationship documentation is established between two counterparties, the question of whether one of those counterparties, that is registered with the Commission as a security-based swap dealer, is able to represent that it is entering into a ''transaction conducted through a foreign branch'' 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.

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 U.S. bank registered as a security-based swap dealer that may make such representations, no more than five hours, and up to $2,000 for the services of outside professionals, for an estimate of approximately 75 hours and $30,000 across all security-based swap counterparties that may make such representations. This estimate assumes little or no reliance on standardized disclosure language.

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 counterparties and onboarding new counterparties, for a maximum of approximately 150 hours across all applicable security-based swap counterparties.[785]

C. Reliance on Counterparty Representations Regarding Non-U.S. Person Status

1. Summary of Collection of Information

When determining whether its counterparty is a U.S. person for purposes of the application of the dealer and major participant analyses, a person may rely on its counterparty's representation that the counterparty does not meet the applicable criteria to be a U.S. person, unless the person knows or has reason to know that the representation is not accurate.[786]

2. Proposed Use of Information

Under the final rules, a non-U.S. person's dealer and major participant analysis require it to determine whether its security-based swap counterparties are U.S. persons because certain security-based swaps in which the counterparty is not a U.S. person will not have to be counted against the applicable thresholds.

The Commission recognizes that the ''U.S. person'' definition encompasses a number of distinct components, and that in some circumstances verifying whether a security-based swap counterparty is a ''U.S. person'' could require significant due diligence. As a result, the final rules have added a representation provision to that definition, to help mitigate the operational difficulties and costs that could arise in connection with investigating the status of a counterparty.

As with the representations associated with the ''transaction conducted through a foreign branch'' definition, these representations would be provided voluntarily by the counterparties to certain security-based swap transactions to other counterparties. 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 this representation provision 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.[787]

3. Respondents

Based on our understanding of the OTC derivatives markets, including the domiciles of counterparties that are active in the market, the Commission estimates that up to 2400 entities may provide representations that they do not meet the criteria necessary to be U.S. persons.[788]

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 discussions by our staff with market participants. Consistent with the discussion above related to the representation provision of the ''transaction conducted through a foreign branch'' definition, the Commission believes that in most cases the representations associated with the ''U.S. person'' definition would be made through amendments to the parties' existing trading documentation (*e.g.,* the schedule to a master agreement).[789] Here too, 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 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.

As above, the Commission estimates the maximum total paperwork burden associated with developing new representations would be, for each counterparty that may make such representations, no more than five hours and up to $2,000 for the services of outside professionals, for a maximum of approximately 12,000 hours and $4.8 million across all security-based swap counterparties that may make such representations. This estimate assumes little or no reliance on standardized disclosure language.

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 counterparties and onboarding new counterparties, for a maximum of approximately 24,000 hours across all applicable security-based swap counterparties.[790]

[785] The Commission staff estimates that this burden would consist of 10 hours of in-house counsel time for each security-based swap market participant that may make such representations.

[786] *See* Exchange Act rule 3a71–3(a)(4)(iv).

[787] *See* note 782, *supra.*

[788] Data regarding activity from 2012 indicates that a total of 4452 accounts had positions in single-name CDS, with those activities conducted by a total 1030 transacting agents such as investment advisers. Of those 4452 accounts, 1199 are domiciled outside of the United States. Accounting for potential growth in the number of market participants domiciled outside of the United States—particularly in light of information suggesting there has been some shifting of derivatives activities to non-U.S. entities—leads to our estimate that such representations may be made on behalf of 2400 accounts. To the extent that one transacting agent such as an investment adviser conducts derivatives activities on behalf of multiple accounts, it is possible that a single representation by a transacting agent would address the U.S.-person status of multiple accounts.

[789] *See* section IV.E.2, *supra.*

[790] The Commission staff estimates that this burden would consist of 10 hours of in-house counsel time for each security-based swap market participant that may make such representations.

X. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (''RFA'') [791] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a) of the Administrative Procedure Act,[792] 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.'' [793] Section 605(b) of the RFA [794] 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; [795] 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,[796] 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.[797] 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; [798] (ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with $7 million or less in annual receipts; [799] (iii) for entities engaged in financial investments and related activities, entities with $7 million or less in annual receipts; [800] (iv) for insurance carriers and entities engaged in related activities, entities with $7 million or less in annual receipts; [801] and (v) for funds, trusts, and other financial vehicles, entities with $7 million or less in annual receipts.[802]

The Cross-Border Proposal stated that, based on feedback from industry participants and our own information about the security-based swap markets, we preliminarily believed that non-U.S. entities that would be required to register and be regulated as security-based swap dealers and major security-based swap participants exceed the thresholds defining ''small entities'' set out above. Thus, we noted that we preliminarily believed 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. As a result, we certified that the proposed rules would not have a significant economic impact on a substantial number of small entities for purposes of the RFA and requested written comments regarding this certification.[803]

While we received comment letters that addressed cost issues in connection with the proposed rules, we did not receive any comments that specifically addressed whether the rules applying the definitions of ''security-based swap dealer'' or ''major security-based swap participant'' to the cross-border context would have a significant economic impact on small entities.

We continue to believe that the types of entities that would engage in more than a *de minimis* amount of dealing activity involving security-based swaps—which generally would be major banks—would not be ''small entities'' for purposes of the RFA. Similarly, we believe that only the largest financial companies would be likely to develop security-based swap exposures of the size that would be required to cross the major security-based swap participant definition thresholds. Accordingly, the SEC certifies that the final rules applying the definitions of ''security-based swap dealer'' or ''major security-based swap participant'' to the cross-border context will not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

XI. Effective Date and Implementation

These final rules will be effective 60 days following publication in the **Federal Register.**

If any provision of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Because Exchange Act rules 3a67–10 and 3a71–3 through 3a71–5 address the application of the dealer and major participant definitions to cross-border security-based swap activities, those rules will not immediately impose requirements upon market participants even after the rules become effective. In the Intermediary Definitions Adopting Release, we noted that because the Commission has not yet promulgated final rules implementing the substantive requirements imposed on dealers and major participants by Title VII, persons determined to be dealers or major participants under the regulations adopted in that release need not register as such until the dates provided in the Commission's final rules regarding security-based swap dealer and major security-based swap participant registration requirements, and will not be subject to the requirements applicable to those dealers and major participants until the dates provided in the applicable final rules.[804] Those principles apply here too.

Although Exchange Act rule 0–13—regarding the procedures for the submission of substituted compliance requests—also will become effective at that time, we would not expect to receive any such requests until relevant substantive rulemakings have been completed. Those rulemakings are necessary to determine when substituted compliance may be available, and to promulgate the requirements against which we may assess comparability for purposes of making substituted compliance determinations.

[791] 5 U.S.C. 601 *et seq.*

[792] 5 U.S.C. 603(a).

[793] 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, 28, 1982), 47 FR 5215 (Feb, 4, 1982) (File No. AS–305).

[794] 5 U.S.C. 605(b).

[795] *See* 17 CFR 240.0–10(a).

[796] 17 CFR 240.17a–5(d).

[797] *See* 17 CFR 240.0–10(c).

[798] *See* 13 CFR 121.201 (Subsector 522).

[799] *See id.* at Subsector 522.

[800] *See id.* at Subsector 523.

[801] *See id.* at Subsector 524.

[802] *See id.* at Subsector 525.

[803] *See* Cross-Border Proposing Release, 78 FR 31205.

[804] *See* Intermediary Definitions Adopting Release, 77 FR 30700. We also noted that an extended compliance period was available with regard to the applicable thresholds used in the *de minimis* exception to the dealer definition. *See id.; see also* section III.A, *supra.*

Statutory Authority and Text of Final Rules

Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.,* and particularly, sections 3(b), 23(a)(1), and 30(c) thereof, sections 761(b), and 929P(b) of the Dodd-Frank Act, the SEC is adopting rules 0–13, 3a67–10, 3a71–3, 3a71–4, and 3a71–5 under the Exchange Act, and the SEC is adding Part 250 to chapter II of Title 17 of the Code of Federal Regulations.

List of Subjects

17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 241 and 250

Securities.

Text of Final Rules

For the reasons stated in the preamble, the SEC is amending Title 17, Chapter II, of the Code of Federal Regulations as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The general authority citation for part 240 continues to read, and a sectional authority is added 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, 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 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 Pub. L. 111–203, section 761(b), 124 Stat. 1754 (2010), and 15 U.S.C. 78dd(c).

* * * * *

■ 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, by a party that potentially would comply with requirements under the Exchange Act pursuant to a substituted compliance order, or by the relevant foreign financial regulatory authority or authorities. 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 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* 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 and enforce 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 staff will review the application. Once all questions and issues have been answered to the satisfaction of the staff, the staff will make an appropriate recommendation to the Commission. After consideration of the recommendation and a vote by the Commission, the Commission's Office of the Secretary will issue an appropriate response and will notify the applicant.

(h) The Commission shall publish in the **Federal Register** a notice that a complete application has been submitted. The notice will 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 will 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.

■ 3. Add § 240–3a67–10 to read as follows:

§ 240.3a67–10 Foreign major security-based swap participants.

(a) *Definitions.* As used in this section, the following terms shall have the meanings indicated:

(1) *Conduit affiliate* has the meaning set forth in § 240.3a71–3(a)(1).

(2) *Foreign branch* has the meaning set forth in § 240.3a71–3(a)(2).

(3) *Transaction conducted through a foreign branch* has the meaning set forth in § 240.3a71–3(a)(3).

(4) *U.S. person* has the meaning set forth in § 240.3a71–3(a)(4).

(b) *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 positions:

(1) If such person is a U.S. person, all security-based swap positions that are

entered into by the person, including positions entered into through a foreign branch;

(2) If such person is a conduit affiliate, all security-based swap positions that are entered into by the person; and

(3) If such person is a non-U.S. person other than a conduit affiliate, all of the following types of security-based swap positions that are entered into by the person:

(i) Security-based swap positions that are entered into with a U.S. person; provided, however, that this paragraph (b)(3)(i) shall not apply to:

(A) Positions with a U.S. person counterparty that arise from transactions conducted through a foreign branch of the counterparty, when the counterparty is a registered security-based swap dealer; and

(B) Positions with a U.S. person counterparty that arise from transactions conducted through a foreign branch of the counterparty, when the transaction is entered into prior to 60 days following the earliest date on which the registration of security-based swap dealers is first required pursuant to the applicable final rules and regulations; and

(ii) Security-based swap positions for which the non-U.S. person's counterparty to the security-based swap has rights of recourse against a U.S. person; for these purposes a counterparty has rights of recourse against the U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap.

(c) *Attributed positions*—(1) *In general.* 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 also shall include the following security-based swap positions:

(i) If such person is a U.S. person, any security-based swap position of a non-U.S. person for which the non-U.S. person's counterparty to the security-based swap has rights of recourse against that U.S. person.

Note to paragraph (c)(1)(i). This paragraph describes attribution requirements for a U.S. person solely with respect to the guarantee of the obligations of a non-U.S. person under a security-based swap. The Commission and the Commodity Futures Trading Commission previously provided an interpretation about attribution to a U.S. parent, other affiliate, or guarantor to the extent that the counterparties to those positions have recourse against that parent, other affiliate, or guarantor in connection with the position. *See* Intermediary Definitions Adopting Release, *http://www.gpo.gov/fdsys/pkg/FR–2012–08–13/pdf/2012–18003.pdf.* The Commission explained that it intended to issue separate releases addressing the application of the major participant definition, and Title VII generally, to non-U.S. persons. *See id.* at note 1041.

(ii) If such person is a non-U.S. person:

(A) Any security-based swap position of a U.S. person for which that person's counterparty has rights of recourse against the non-U.S. person; and

(B) Any security-based swap position of another non-U.S. person entered into with a U.S. person counterparty who has rights of recourse against the first non-U.S. person, provided, however, that this paragraph (c)(1)(ii)(B) shall not apply to positions described in § 240.3a67–10(b)(3)(i)(A) and (B).

(2) *Exceptions.* Notwithstanding paragraph (c)(1) of this section, a person shall not include such security-based swap positions if the person whose performance is guaranteed in connection with the security-based swap is:

(i) Subject to capital regulation by the Commission or the Commodity Futures Trading Commission (including, but not limited to regulation as a swap dealer, major swap participant, security-based swap dealer, major security-based swap participant, futures commission merchant, broker, or dealer);

(ii) Regulated as a bank in the United States;

(iii) Subject to capital standards, adopted by the person's home country supervisor, that are consistent in all respects with the Capital Accord of the Basel Committee on Banking Supervision; or

(iv) Deemed not to be a major security-based swap participant pursuant to § 240.3a67–8(a).

■ 4. 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 section, the following terms shall have the meanings indicated:

(1) *Conduit affiliate*—(i) *Definition. Conduit affiliate* means a person, other than a U.S. person, that:

(A) Is directly or indirectly majority-owned by one or more U.S. persons; and

(B) In the regular course of business enters into security-based swaps with one or more other non-U.S. persons, or with foreign branches of U.S. banks that are registered as security-based swap dealers, for the purpose of hedging or mitigating risks faced by, or otherwise taking positions on behalf of, one or more U.S. persons (other than U.S. persons that are registered as security-based swap dealers or major security-based swap participants) who are controlling, controlled by, or under common control with the person, and enters into offsetting security-based swaps or other arrangements with such U.S. persons to transfer risks and benefits of those security-based swaps.

(ii) *Majority-ownership standard.* The majority-ownership standard in paragraph (a)(1)(i)(A) of this section is satisfied if one or more persons described in § 240.3a71–3(a)(4)(i)(B) directly or indirectly own a majority interest in the non-U.S. person, where ''majority interest'' is 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.

(2) *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.

(3) *Transaction conducted through a foreign branch*—(i) *Definition. Transaction conducted through a foreign branch* means a security-based swap transaction that is arranged, negotiated, and 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 arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States.

(ii) *Representations.* A person shall not be required to consider its counterparty's activity in connection with paragraph (a)(3)(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 the security-based swap transaction is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States, unless such person knows or has reason to know that the representation is not accurate; for the purposes of this final rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

(4) *U.S. person.* (i) Except as provided in paragraph (a)(4)(iii) of this section, *U.S. person* means any person that is:

(A) A natural person resident in the United States;

(B) 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;

(C) An account (whether discretionary or non-discretionary) of a U.S. person; or

(D) An estate of a decedent who was a resident of the United States at the time of death.

(ii) For purposes of this section, *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.

(iii) 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.

(iv) A person shall not be required to consider its counterparty to a security-based swap to be a U.S. person if such person receives a representation from the counterparty that the counterparty does not satisfy the criteria set forth in paragraph (a)(4)(i) of this section, unless such person knows or has reason to know that the representation is not accurate; for the purposes of this final rule a person would have reason to know the representation is not accurate if a reasonable person should know, under all of the facts of which the person is aware, that it is not accurate.

(5) *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), except as provided in § 240.3a71–5, 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;

(ii) If such person is a conduit affiliate, all security-based swap transactions connected with the dealing activity in which such person engages; and

(iii) If such person is a non-U.S. person other than a conduit affiliate, all of the following types of transactions:

(A) Security-based swap transactions connected with the dealing activity in which such person engages that are entered into with a U.S. person; provided, however, that this paragraph (b)(1)(iii)(A) shall not apply to:

(*1*) Transactions with a U.S. person counterparty that constitute transactions conducted through a foreign branch of the counterparty, when the counterparty is a registered security-based swap dealer; and

(*2*) Transactions with a U.S. person counterparty that constitute transactions conducted through a foreign branch of the counterparty, when the transaction is entered into prior to 60 days following the earliest date on which the registration of security-based swap dealers is first required pursuant to the applicable final rules and regulations; and

(B) Security-based swap transactions connected with the dealing activity in which such person engages for which the counterparty to the security-based swap has rights of recourse against a U.S. person that is controlling, controlled by, or under common control with the non-U.S. person; for these purposes a counterparty has rights of recourse against the U.S. person if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap; and

(2) If such person engages in transactions described in paragraph (b)(1) of this section, except as provided in § 240.3a71–4, all of the following types of security-based swap transactions:

(i) 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;

(ii) Security-based swap transactions connected with the dealing activity in which any conduit affiliate controlling, controlled by, or under common control with such person engages; and

(iii) Security-based swap transactions connected with the dealing activity of any non-U.S. person, other than a conduit affiliate, that is controlling, controlled by, or under common control with such person, that are described in paragraph (b)(1)(iii) of this section.

§ 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 (an ''affiliate'') controlling, controlled by, or under common control with such person where such affiliate either is:

(a) Registered with the Commission as a security-based swap dealer; or

(b) Deemed not to be a security-based swap dealer pursuant to § 240.3a71–2(b).

§ 240.3a71–5 Exception for cleared transactions executed on a swap execution facility.

(a) For purposes of § 240.3a71–3(b)(1), a non-U.S. person, other than a conduit affiliate, shall not include its security-based swap transactions that are entered into anonymously on an execution facility or national securities exchange and are cleared through a clearing agency; and

(b) For purposes of § 240.3a71–3(b)(2), a person shall not include security-based swap transactions of an affiliated non-U.S. person, other than a conduit affiliate, when such transactions are entered into anonymously on an execution facility or national securities exchange and are cleared through a clearing agency.

PART 241—INTERPRETIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

■ 5. Part 241 is amended by adding Release No. 34–72472 to the list of interpretive releases as follows:

Subject	Release No.	Date	Fed. Reg. vol. and page
Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities.	34–72472	June 25, 2014	79 FR [Insert FR Page Number]

■ 6. Part 250, consisting of § 250.1, is added to read as follows:

PART 250—CROSS–BORDER ANTIFRAUD LAW–ENFORCEMENT AUTHORITY

Authority: 15 U.S.C. 77s, 77v(c), 78w, 78aa(b), 80b–11, and 80b–14(b).

§ 250.1 Cross-border antifraud law-enforcement authority.

(a) Notwithstanding any other Commission rule or regulation, the antifraud provisions of the securities laws apply to:

(1) Conduct within the United States that constitutes significant steps in furtherance of the violation; or

(2) Conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

(b) The antifraud provisions of the securities laws apply to conduct described in paragraph (a)(1) of this section even if:

(1) The violation relates to a securities transaction or securities transactions occurring outside the United States that involves only foreign investors; or

(2) The violation is committed by a foreign adviser and involves only foreign investors.

(c) Violations of the antifraud provisions of the securities laws described in this section may be pursued in judicial proceedings brought by the Commission or the United States.

By the Commission.

Date: June 25, 2014.

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2014–15337 Filed 7–3–14; 8:45 am]

Editorial Note: Proposed rule document 2014–15337 was originally published on pages 39067 through 39162 in the issue of Wednesday, July 9, 2014. In that publication the footnotes contained erroneous entries. The corrected document is republished in its entirety.

[FR Doc. R1–2014–15337 Filed 8–11–14; 8:45 am]

BILLING CODE 1505–01–D