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CFTC Proposes Rules to Count Cross-Border Swaps for Swap-Dealer Thresholds and Other Requirements

On October 18, 2016, the Commodity Futures Trading Commission (CFTC or Commission) proposed rules (Proposed Rules)¹ that would (1) define the terms “U.S. person” and “foreign consolidated subsidiary” (FCS) for purposes of applying the CFTC’s transaction-level swap dealer and major swap participant requirements, (2) clarify which cross-border swap activities trigger transaction-level swap requirements, (3) establish cross-border calculation methods for determining whether U.S. and non-U.S. persons meet the swap dealer or major swap participant registration thresholds, and (4) establish when CFTC external business conduct standards apply to cross-border transactions.² The Proposed Rules are the latest in a series of CFTC rulemakings, orders and guidance on cross-border issues arising from the Dodd-Frank Act.³ The Proposed Rules, if finalized, can be expected to cause entities engaged in cross-border swaps activity to expend additional resources to track cross-border swap positions and determine whether they or their counterparties are subject to the new regulations.

Public comments and responses to specific questions in the Proposed Rules are due on or before December 19, 2016.

US Person Definition

The Proposed Rules define “U.S. person” in a manner substantially similar to definitions in previous cross-border rulemakings:⁴

¹ Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 Fed. Reg. 71,946 (Oct. 18, 2016). The Proposed Rules can also be found on the CFTC website [here](#).

² See Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 Fed. Reg. 9734 (Feb. 17, 2012) (codified at 17 C.F.R. 23.400 *et seq.*) (2016). The CFTC intends for the new definitions to be relevant for purposes of future rulemakings concerning the cross-border application of other substantive Dodd-Frank requirements. See 81 Fed. Reg. at 71,948.

³ See our client alerts on prior CFTC cross-border guidance and orders: “[CFTC Proposes Guidance on the Cross-Border Impact of Dodd-Frank’s Swap Regulations](#)” (July 16, 2012); “[CFTC Issues Final Exemptive Order on Cross-Border Application of Certain Swap Regulations](#)” (January 11, 2013); “[CFTC Issues Final Guidance and Accompanying Exemptive Order on Cross-Border Application of Certain Swap Regulations](#)” (July 31, 2013); and “[CFTC Grants Substituted Swaps Compliance for Six Foreign Jurisdictions](#)” (January 13, 2014).

⁴ The proposed definition is based on the definition of “U.S. person” used in the Commission’s rulemaking on the cross-border application of the initial and variation margin requirements for uncleared swaps. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34,818, 34,848 (May 31, 2016) (Cross-Border Margin Rule). For more information on the Cross-Border Margin Rule, see our June 3, 2016, client alert “[CFTC Finalizes Cross-Border Margin Rules for Uncleared Swaps](#).” This definition is also similar to the definition proposed in the Commission’s December 2012 exemptive order for certain cross-border market participants. See Final Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 858, 863 (Jan. 7, 2013). For more information on the December 2012 exemptive order, see our January 11, 2013, client alert.

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- A natural person who is a U.S. resident;
- The estate of a decedent who was a U.S. resident at the time of death;
- A corporation, partnership, limited liability company (LLC), business or other trust, association, joint-stock company, fund or other similar entity that is organized or incorporated in the U.S. or has its principal place of business in the U.S. (“legal entity”), including any branch of the legal entity;
- A pension plan for the employees, officers or principals of a legal entity, unless the pension plan is primarily for foreign employees of such entity;
- A trust “governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust;”
- A legal entity (other than an LLC, limited liability partnership or similar entity where all the owners have limited liability) that is owned by one or more of the above persons and for which those persons bear unlimited responsibility for the entity’s obligations and liabilities, including any branch of the legal entity; and
- An individual account or joint account for which the beneficial owner is one of the above persons.⁵

Citing the difficulty in identifying and tracking beneficial ownership, the CFTC did not include collective investment vehicles that are majority-owned by U.S. persons in the definition. Accordingly, a collective investment vehicle would not be a U.S. person unless it otherwise meets the U.S. organized/principal place of business or unlimited U.S. responsibility prongs of the definition. Likewise, in the interest of providing legal certainty, the CFTC did not insert a “catch-all” provision in the U.S. person definition.⁶

Interpretation of Scope of Cross-Border Activities Subject to Transaction-Level Swap Requirements

In November 2013, the CFTC issued a staff advisory stating that non-U.S. swap dealers that regularly use personnel or agents in the U.S. to “arrange, negotiate, or execute” swaps with non-U.S. persons (ANE transactions) would be required to comply with certain “Transaction-Level Requirements.”⁷ Transaction-Level

⁵ See 81 Fed. Reg. at 71,948-71,949, 71,973.

⁶ See *id.* at 71,949.

⁷ CFTC Staff Advisory No. 13-69, [Applicability of Transaction-Level Requirements to Activity in the United States](#) (Nov. 14, 2013); see also Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (Jul. 26, 2013). For more information, see our July 31, 2013, [client alert](#).

Requirements are CFTC requirements for transactions with U.S. counterparties related to external business conduct standards, recordkeeping, clearing, reporting and other transaction-based issues.⁸

After considering comments received in response to the staff advisory, the CFTC now is proposing to interpret the terms “arrange” and “negotiate” to refer to “market-facing activity normally associated with sales and trading” instead of “internal, back-office activities.” Accordingly, “ministerial or clerical tasks” performed by individuals who are not involved in trading would not be “arranging” or “negotiating” swaps. Nor would the CFTC consider arranging or negotiating swaps to include swap processing, preparing underlying swap documentation, negotiating master agreements and related documentation, or providing research information to sales and trading personnel abroad.⁹ The term “executed” would refer to the “market-facing act of becoming legally and irrevocably bound to the terms of the transaction.”¹⁰

Cross-Border Application of Registration Thresholds for Swap Dealers and Major Swap Participants¹¹

Any entity that engages in a de minimis quantity of swap dealing with or on behalf of its customers is excepted from the definition of a swap dealer.¹² Similarly, entities with swap positions falling under certain thresholds are excepted from the definition of a “major swap participant.”¹³ The Proposed Rules identify which cross-border swap transactions would be counted to determine whether a person’s swap dealing or swap positions exceed the de minimis thresholds.

Under the proposal, a “Foreign Consolidated Subsidiary” would need to keep count of both U.S. and non-U.S. swap positions

⁸ See 78 Fed. Reg. at 45,333. They are distinct from “Entity-Level Requirements,” which are CFTC requirements designed to manage risks to swap dealers as a whole. For more information on the distinctions between Entity-Level Requirements and Transaction-Level Requirements, see our July 16, 2012, [client alert](#) regarding the CFTC’s proposed guidance and our July 31, 2013, [client alert](#) on the final guidance *supra* note 7.

⁹ See 81 Fed. Reg. at 71,953-71,954.

¹⁰ *Id.* at 71,953.

¹¹ Persons defined to be “swap dealers” or “major swap participants” are required to register with the CFTC. 7 U.S.C. 6s(a) (2012) (CFTC registration requirement); 17 C.F.R. § 23.21(a)-(b) (2016).

¹² 7 U.S.C. 1a(49)(D) (2012); 17 C.F.R. 1.3(ggg)(4) (2016) (stating that person shall not be deemed to be a swap dealer as a result of its swap-dealing activity involving counterparties unless, during the preceding 12 months, the aggregate gross notional amount of the swap positions connected with those dealing activities exceeds the de minimis threshold set out in the CFTC Rule). On October 13, 2016, the CFTC issued an order extending the current de minimis threshold of \$8 billion for swap dealers until December 31, 2018, after which the threshold will be \$3 billion. See Order Establishing De Minimis Threshold Phase-In Termination Date, 81 Fed. Reg. 71,605 (Oct. 18, 2016).

¹³ 7 U.S.C. 1a(33)(B) (2012); 17 C.F.R. 1.3(hhh)-(mmm) (2016).

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for purposes of determining whether the entity is a swap dealer or major swap participant.¹⁴ Expressing concern that a foreign subsidiary's risks can affect a domestic parent and, therefore, present a greater supervisory interest than other non-U.S. market participants, the CFTC proposed to define a Foreign Consolidated Subsidiary to be:

[A] non-U.S. person in which an ultimate parent entity that is a U.S. person ... has a controlling financial interest, in accordance with U.S. [GAAP], such that the U.S. ultimate parent entity includes the non-U.S. person's operating results, financial position and statement of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. [GAAP].¹⁵

The CFTC also proposed that an entity be required to count swap transactions for which it is a "U.S. Guaranteed Entity" for purposes of determining whether the entity is a swap dealer or major swap participant. The Proposed Rules refer to a U.S. Guaranteed Entity as a non-U.S. person whose obligations under a particular swap are guaranteed by a U.S. person. Whether a non-U.S. person would be considered a U.S. Guaranteed Entity would "vary on a swap-by-swap basis," and a non-U.S. person "may be considered a U.S. Guaranteed Entity for one swap and not another, depending on whether the non-U.S. person's obligations under the swap are guaranteed by a U.S. person."¹⁶

The following chart details which swap dealing transactions would be factored into swap dealer de minimis threshold calculations.

| Potential Swap Dealer | | What Must a Potential Swap Dealer Include? ¹⁷ |
|-----------------------|---|--|
| U.S. Person | | All swap-dealing transactions. |
| Non-U.S. Person | U.S. Guaranteed Entity | All swap-dealing transactions with respect to which it is a U.S. Guaranteed Entity. |
| | Foreign Consolidated Subsidiary | All swap-dealing transactions. |
| | Non-U.S. Person That Is Not a Foreign Consolidated Subsidiary or U.S. Guaranteed Entity (Other Non-U.S. Person) | All swap-dealing transactions with counterparties that are U.S. Persons, U.S. Guaranteed Entities or Foreign Consolidated Subsidiaries unless swap is a) executed anonymously, b) executed on a registered designated contract market, swap execution facility or foreign board of trade, and c) cleared. Would not include swap dealing transactions with Other Non-U.S. Persons, even if they are ANE transactions. |

¹⁴ See 81 Fed. Reg. at 71,947-71,948, 71,950.

¹⁵ See *id.* at 71,950, 71,973. The proposed definition is based on the definition used in the Cross-Border Margin Rule. See *id.* at 71,947; 81 Fed. Reg. at 34,826.

¹⁶ See 81 Fed. Reg. at 71,954 n.76.

¹⁷ Under the Proposed Rules, a potential swap dealer, regardless of whether it is a U.S. person or non-U.S. person, must aggregate its swap-dealing transactions with those of persons controlling, controlled by or under common control with it, to the extent that those persons are themselves required to include those swaps in their own de minimis thresholds. See *id.* at 71,957.

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The following chart details which swap dealing transactions should be factored into major swap participant de minimis threshold calculations.

| Potential Major Swap Participant | | What Must a Potential Major Swap Participant Include? ¹⁸ |
|----------------------------------|---|--|
| U.S. Person | | All swap positions. |
| Non-U.S. Person | U.S. Guaranteed Entity | All swap positions with respect to which it is a U.S. Guaranteed Entity. |
| | Foreign Consolidated Subsidiary | All swap positions. |
| | Non-U.S. Person That Is Not a Foreign Consolidated Subsidiary or U.S. Guaranteed Entity (Other Non-U.S. Person) | All swap positions with counterparties that are U.S. Persons, U.S. Guaranteed Entities or Foreign Consolidated Subsidiaries unless swap is a) executed anonymously, b) executed on a registered designated contract market, swap execution facility or foreign board of trade, and c) cleared. Would not include swap positions with Other Non-U.S. Persons, even if they are ANE transactions. |

Cross-Border Application of External Business Conduct Standards for Swap Dealers and Major Swap Participants

The Proposed Rules also address which entities would be required to comply with the CFTC's external business conduct standards.¹⁹ As shown in the following chart, compliance would depend on whether the entity is a U.S. swap dealer, U.S. major swap participant, or branch of a U.S. swap dealer or major swap participant.

| Entity Type | | Would the Entity Be Required to Comply with External Business Conduct Standards? |
|-----------------|--|---|
| U.S. Person | U.S. Swap Dealers and U.S. Major Swap Participants | Yes, without substituted compliance, except with regard to transactions conducted through a foreign branch of the U.S. swap dealer or U.S. major swap participant. |
| | Foreign Branches of U.S. Swap Dealers and U.S. Major Swap Participants | |
| Non-U.S. Person | Swap Dealers and Major Swap Participants | Yes, without substituted compliance, if the counterparty is a U.S. person other than a foreign branch of a U.S. swap dealer or U.S. major swap participant. These entities are not subject to external business conduct standards for swaps with non-U.S. persons and foreign branches of a U.S. swap dealer or major swap participant, except: Foreign branches of U.S. swap dealers and non-U.S. swap dealers that use personnel in the U.S. to arrange, negotiate or execute those transactions would need to comply with Commission Regulations 23.410 (Prohibition on Fraud, Manipulation and Other Abusive Practices) and 23.433 (Fair Dealing) without substituted compliance. |

¹⁸All swap positions subject to recourse to the parent, other affiliate or guarantor of the potential major swap participant would be attributed to a guarantor regardless of whether the guarantor is a U.S. person or non-U.S. person, unless the guarantor, the guaranteed entity and its counterparty are Other Non-U.S. Persons.

¹⁹The external business conduct standards prohibit certain activities and impose certain duties on swap dealers and major swap participants in their dealings with counterparties. See 17 C.F.R. Part 23 Subpart H. The Proposed Rules would supersede prior CFTC guidance that provided a cross-border framework for applying external business conduct standards, similar to the framework in the Proposed Rules. See 78 Fed. Reg. at 45,369; 81 Fed. Reg. at 71,962. See Skadden's July 31, 2013 Client Alert, *supra* note 7 for a summary of the prior CFTC guidance.