

## Press Release

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# SEC Adopts Actions to Stand Up Security-Based Swap Regulatory Regime

### FOR IMMEDIATE RELEASE

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*Washington D.C., Dec. 18, 2019* — The Securities and Exchange Commission today adopted a package of rule amendments, guidance, and a related order to expand and improve the framework for regulating cross-border security-based swaps, including single-name credit default swaps. The adoption of this package also stands up the Commission's broad security-based swap regulatory regime as it triggers the compliance date for security-based swap entities to register with the Commission and the implementation period for previously adopted rules under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules establish a coherent approach to the regulation of margin, capital, segregation, recordkeeping and reporting and business conduct for security-based swaps.

The final rule amendments and guidance adopted today build upon the Commission's experience with the multi-faceted, multi-jurisdictional security-based swap market, and prior Commission actions, in four key areas:

- the use of transactions that have been “arranged, negotiated, or executed” by personnel located in the United States as a trigger for enhanced U.S. regulation of security-based swaps and market participants;
- the requirement that nonresident security-based swap dealers and major security-based swap participants (collectively known as “SBS Entities”) provide a certification and opinion of counsel regarding the ability of the Commission to access information and conduct onsite examinations;
- the cross-border application of statutory disqualification provisions; and
- questionnaires or employment applications that registered SBS Entities must maintain with regard to their foreign associated persons.

The rule amendments are intended to improve the regulatory framework by pragmatically addressing implementation issues and efficiency concerns, including jurisdiction-specific data privacy requirements and broader issues of international comity. In addition, the rule amendments and guidance reflect consultation with the Commodity Futures Trading Commission (CFTC). Many market participants are active in markets regulated by both the Commission and the CFTC, as such participants may use instruments regulated by the Commission to hedge risks in products regulated by the CFTC, and vice versa.

“The rules adopted today are the culmination of many years of effort on the part of the staff and the Commission to put in place OTC derivatives reforms for the global security-based swap market,” said SEC Chairman Jay Clayton. “Our Division of Trading and Markets and our Office of International Affairs have worked tirelessly to construct a rule set that effectively implements our Title VII regime in a manner that is consistent with a vast array of international requirements. Our counterparts in many jurisdictions also worked diligently and constructively with us with a focus on improving regulation globally.”

“More broadly, today's action represents a significant milestone in standing up the security-based swap regime under Title VII, as it starts the clock on compliance and implementation,” added the Chairman. “I

once again would like to thank my colleague Commissioner Peirce for her extraordinary efforts in leading these initiatives.”

“These rules represent the Commission’s efforts to stand up an effective regulatory regime for security-based swaps that recognizes the importance of these markets,” said Commissioner Hester Peirce. “Today’s measures will allow foreign dealers a realistic path to register with the Commission, maintain an active presence in U.S. markets, and use U.S. personnel to serve their clients here and abroad.”

“I have particularly enjoyed working closely with our staff, who have put enormous effort into grappling with these complex issues,” added Commissioner Peirce. “I am also thankful for Chairman Clayton’s determination to complete this long-delayed rulemaking and for the opportunity to play a significant role in this effort. I look forward to further engagement with other regulators and market participants, including through substituted compliance applications, as we move toward the registration compliance date.”

The accompanying fact sheet describes the amendments and guidance in more detail.

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## **FACT SHEET**

### **Final Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements**

**Dec. 18, 2019**

#### **Background**

The Commission has adopted rule amendments and provided guidance to address the cross-border application of certain security-based swap requirements under the Securities Exchange Act of 1934 (“Exchange Act”) that were added by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”).

Specifically, the Commission has:

- Provided guidance to address how certain requirements under Title VII of the Dodd-Frank Act — related to security-based swap transactions that have been “arranged” or “negotiated” by personnel located in the United States — apply to transactions involving limited activities by those U.S. personnel;
- Adopted a conditional exception to provisions of Exchange Act Rule 3a71-3 that otherwise would require non-U.S. persons to count — against the thresholds associated with the de minimis exception to the “security-based swap dealer” definition — security-based swap dealing transactions with non-U.S. counterparties when U.S. personnel arrange, negotiate, or execute those transactions, along with certain ancillary limited exemptions from related provisions of the Exchange Act and certain rules thereunder;
- Adopted corresponding technical revisions to Exchange Act Rule 0-13 in conjunction with revisions to Rule 3a71-3;
- Adopted an amendment to Exchange Act Rule 15Fb2-1 to allow a nonresident security-based swap dealer or major security-based swap participant (each, an “SBS Entity”) that is unable to provide the certification and opinion of counsel required by Rule 15Fb2-4, to be conditionally registered if the nonresident SBS Entity instead submits a certification and an opinion of counsel that identify, and are conditioned upon, the occurrence of a future action that would provide the Commission with adequate assurances of prompt access to the books and records of the nonresident SBS Entity, and the ability of the nonresident SBS Entity to submit to onsite inspection and examination by the Commission. A nonresident SBS Entity that submits a conditional certification and opinion of counsel in connection with an application that otherwise is

complete in all respects will be conditionally registered and will remain conditionally registered until the Commission acts to grant or deny ongoing registration. If none of the future actions that are included in an applicant's conditional certification and opinion of counsel occurs within 24 months of the compliance date for Rule 15Fb2-1, and there is not otherwise a basis that would provide the Commission with the required assurances, the Commission may institute proceedings thereafter to determine whether ongoing registration should be denied;

- Provided guidance regarding the requirements, in Exchange Act Rules 15Fb2-4(c) and 3a71-6, to provide the Commission with a certification and opinion of counsel, including with respect to the foreign laws to be covered in the certification and opinion of counsel of a nonresident SBS Entity; the scope of the books and records covered by the certification and opinion of counsel; whether the certification and opinion of counsel can be predicated on consents (if consents are allowed in the relevant jurisdiction); and whether the certification and opinion of counsel can rely on a memorandum of understanding, agreement, protocol, or other regulatory arrangement with the Commission facilitating access to the books and records of SBS Entities located in the relevant foreign jurisdiction, an applicant's understanding of the general experience with the application of the relevant local law or rule, or a Commission order granting substituted compliance based on a finding of "adequate assurances" in accordance with Exchange Act Rule 3a71-6(c);
- Adopted revisions to Commission Rule of Practice 194 to exclude an SBS Entity, subject to certain limitations, from the prohibition in Exchange Act Section 15F(b)(6) with respect to an associated person who is a natural person who (i) is not a U.S. person and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person;
- Adopted amendments to Rule 18a-5 to provide that: (i) a bank or stand-alone SBS Entity is not required to make and keep current a questionnaire or application for employment executed by an associated person if the SBS Entity is excluded from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to such associated person; and (ii) a questionnaire or application for employment executed by an associated person who is not a U.S. person need not include the information described in paragraphs (a)(10)(i)(A) through (H) and (b)(8)(i)(A) through (H) of Rule 18a-5 unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located; provided, however, that the SBS Entity must comply with Section 15F(b)(6) of the Exchange Act; and
- Issued a statement regarding compliance with rules for security-based data repositories and Regulation SBSR.

## Highlights

### *Application of Title VII of the Dodd-Frank Act to certain transactions "arranged, negotiated, or executed" by U.S. personnel*

- The Commission has provided guidance regarding the definition of "arranged" or "negotiated" in connection with determining which transactions non-U.S. persons must count against de minimis thresholds to determine whether they must register as security-based swap dealers; certain security-based swap dealer business conduct requirements; regulatory reporting and public dissemination requirements under Regulation SBSR; and major security-based swap participant rules. Under the guidance, Title VII requirements will not be triggered merely because U.S. personnel provide "market color" in the form of certain background information regarding pricing or market conditions associated with particular instruments or with markets more generally — so

long as those U.S. personnel do not receive transaction-linked compensation or exercise client responsibility in connection with those transactions.

- The Commission also has adopted a conditional exception from the requirement in Exchange Act Rule 3a71-3(b)(1)(iii)(C) that non-U.S. persons count against the de minimis thresholds associated with security-based swap dealer registration those security-based swap dealing transactions that are with non-U.S. counterparties, but that were arranged, negotiated, or executed by U.S. personnel. The exception is subject to conditions designed to safeguard the interests associated with security-based swap dealer regulation under Title VII while reducing potentially negative consequences that otherwise could be associated with the existing counting rule. Those conditions include:
  - use of personnel of a registered security-based swap dealer or registered broker (the “registered entity”) that is a majority-owned affiliate of the non-U.S. person relying on the exception (the “relying entity”) in connection with the arranging, negotiating and executing activity in the United States (paragraph (d)(1)(i) of Rule 3a71-3); if the registered entity is a broker not approved to use models to compute deductions for market or credit risk, a requirement that the broker maintain minimum net capital and establish and maintain risk management control systems as if the broker were also registered as a security-based swap dealer (paragraph (d)(1)(i)(A)(1)-(2) of Rule 3a71-3);
  - a requirement that the registered entity comply with certain security-based swap dealer requirements as if it were a counterparty to the transaction and, if the registered entity is a registered broker but not a registered security-based swap dealer, also as if it were a registered security-based swap dealer (paragraph (d)(1)(ii) of Rule 3a71-3);
  - a limitation on the availability of the exception to no more than \$50 billion of inter-dealer transactions over the immediately preceding 12-month period (paragraphs (d)(1)(vii) and (d)(6) of Rule 3a71-3);
  - a requirement that the relying entity provide relevant books, records, and testimony to representatives of the Commission and consent to service of process, and that the registered entity create and maintain books and records of the transactions subject to the exception, as well as obtain from the relying entity, and maintain, documentation of the terms of the trading relationship with the counterparty and documentation regarding the relying entity’s compliance with the \$50 billion limitation (paragraph (d)(1)(iii) of Rule 3a71-3);
  - notification by the registered entity to counterparties that the relying entity is not a registered security-based swap dealer and that certain U.S. securities laws do not apply to the transaction (paragraph (d)(1)(iv) of Rule 3a71-3);
  - a requirement that the relying entity be subject to the margin and capital requirements of a jurisdiction that the Commission has designated as a “listed jurisdiction” (paragraph (d)(1)(v) of Rule 3a71-3); and
  - the registered entity filing with the Commission a notice that its associated persons may conduct “arranging, negotiating, or executing” activity in the United States (paragraph (d)(1)(vi) of Rule 3a71-3).
- As ancillaries to the conditional exception, the Commission has adopted limited exemptions from the broker registration requirement in Section 15(a) of the Exchange Act and from the transaction confirmation requirement in Exchange Act Rule 10b-10 as applied to registered entities whose personnel “arrange, negotiate, or execute” transactions on behalf of a non-U.S. affiliate relying on the exception (paragraphs (d)(4)-(5) of Rule 3a71-3).
- In connection with the “listed jurisdiction” condition, the Commission has adopted rule amendments to create a process by which the Commission may consider designating a jurisdiction as a “listed jurisdiction” (paragraph (d)(2) of Rule 3a71-3) and has issued a separate

order designating Australia, Canada, France, Germany, Japan, Singapore, Switzerland, and the United Kingdom as listed jurisdictions.

#### *Certification and opinion of counsel requirements*

The rule amendments will become effective on the later of March 1, 2020 or 60 days after publication of the adopting release in the Federal Register. As noted in previous Commission releases, the compliance date for registration of SBS Entities will be 18 months after the effective date (the “Registration Compliance Date”). The compliance date for the amendments to Rule 3a71-3 will be two months prior to the Registration Compliance Date. The compliance date for the amendments to Rules 18a-5 and 15Fb2-1 will be the same as the Registration Compliance Date. The compliance date associated with the other rule amendments adopted today will be the same as the effective date. The Commission also issued a statement with regard to compliance with rules for security-based swap data repositories and Regulation SBSR governing regulatory reporting and public dissemination of security-based swap transactions. In this regard, the Commission set forth which actions with respect to security-based swap reporting rules will not provide a basis for enforcement action for four years following Regulation SBSR’s first compliance date.

- Exchange Act Rule 15Fb2-4(c)(1), which addresses the registration of non-U.S. resident SBS Entities (known as nonresident SBS Entities), requires that nonresident SBS Entities certify and provide an opinion of counsel that the Commission can access their books and records and conduct onsite inspections and examinations.
- Firms have raised questions concerning the interplay between this certification and opinion of counsel requirement and various foreign blocking laws, privacy laws, secrecy laws and other legal requirements.
- The Commission recognizes that because of these concerns, a nonresident SBS Entity may be unable to provide the certification and opinion of counsel required by Rule 15Fb2-4 at the time it is required to register. To address this issue, the Commission has adopted amendments to Rule 15Fb2-1 to permit a nonresident SBS Entity to submit a certification and an opinion of counsel that identify, and are conditioned upon, the occurrence of a future action that would provide the Commission with adequate assurances of prompt access to the books and records of the nonresident SBS Entity, and the ability of the nonresident SBS Entity to submit to onsite inspection and examination by the Commission.
- As set forth in Rule 15Fb2-1(d)(3), such future action could include: (1) entry by the Commission and the foreign financial regulatory authority of the jurisdiction(s) in which the nonresident SBS Entity maintains the books and records that are addressed by the certification and opinion of counsel required by Rule 15Fb2-4 into a memorandum of understanding, agreement, protocol, or other regulatory arrangement providing the Commission with adequate assurances of (i) prompt access to the books and records of the nonresident SBS Entity, and (ii) the ability of the nonresident SBS Entity to submit to onsite inspection and examination by the Commission; (2) issuance by the Commission of an order granting substituted compliance in accordance with Rule 3a71-6 based on adequate assurances by the foreign financial authority in the jurisdiction(s) in which the nonresident SBS Entity maintains the books and records that are addressed by the certification and opinion of counsel required by Rule 15Fb2-4(c)(1); or (3) any other action that would provide the Commission with assurances regarding prompt access to books and records and the ability to conduct onsite inspection and examination of the nonresident SBS Entity.
- As set forth in Rule 15Fb2-1(d) and (e), a nonresident SBS Entity that submits a conditional certification and opinion of counsel in connection with an application that otherwise is complete in all respects will be conditionally registered and will remain conditionally registered until the Commission acts to grant or deny ongoing registration. If none of the future actions that are included in an applicant’s conditional certification and opinion of counsel occurs within 24 months of the compliance date for Rule 15Fb2-1, and there is not otherwise a basis that would provide the

Commission with the required assurances, the Commission may institute proceedings thereafter to determine whether ongoing registration should be denied;

- The Commission also has provided guidance to address the application of the certification and opinion of counsel requirement when such potential legal impediments and barriers are present. Consistent with the amendment to Rule 15Fb2-1 discussed above, the guidance provides that the certification and opinion of counsel:
  - need only address the law of the jurisdiction or jurisdictions in which the nonresident SBS Entity maintains the relevant books and records.
  - need only address books and records related to the “U.S. business” of the nonresident SBS Entity, and for a nonresident SBS Entity subject to the Exchange Act capital and margin requirements, the financial records necessary for the Commission to assess the nonresident SBS Entity’s compliance with Exchange Act capital and margin requirements.
  - may be predicated on the nonresident SBS Entity obtaining the prior consent of the persons whose information is or will be included in the books and records.
  - need not address contracts entered into prior to the date on which the SBS Entity submits an application for registration pursuant to Section 15F(b);
  - may take into account: whether the relevant regulatory authority in a foreign jurisdiction has entered into a memorandum of understanding, agreement, protocol, or other regulatory arrangement providing the Commission with adequate assurances of (1) prompt access to the books and records of the nonresident SBS Entity, and (2) the ability of the nonresident SBS Entity to submit to onsite inspection or examination by the Commission, and further take into account an applicant’s experience with the foreign jurisdiction’s application of the relevant local law or rule; and whether the Commission has granted substituted compliance, in accordance with Rule 3a71-6(c)(3), to the jurisdiction(s) in which the SBS Entity maintains its covered books and records.
  - The guidance, and the certification and opinion of counsel requirement generally, would not affect the independent requirement that nonresident SBS Entities must provide the Commission with prompt access to their books and records.

#### *Cross-border application of statutory disqualification provisions*

- Exchange Act Section 15F(b)(6) makes it unlawful for an SBS Entity to permit an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the SBS Entity if the SBS Entity knew, or in the exercise of reasonable care should have known, of the statutory disqualification, “[e]xcept to the extent otherwise specifically provided by rule, regulation, or order of the Commission.”
- Commission Rule of Practice 194 provides, among other things, a process by which an SBS Entity could apply to the Commission so that the Commission can assess on a case-by-case basis whether to grant relief from the statutory disqualification prohibition in Exchange Act Section 15F(b)(6).
- The Commission has adopted revisions to Rule of Practice 194 to more closely harmonize the Commission’s rules with the CFTC’s approach to the statutory disqualification of non-domestic associated persons of CFTC registered swap entities.
  - As adopted, new paragraph (c)(2) of Rule of Practice 194 provides an exclusion from the statutory prohibition in Exchange Act Section 15F(b)(6) for SBS Entities with respect to an associated person who is a natural person who: (i) is not a U.S. person, and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-

based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person.

- An SBS Entity would not be able to avail itself of the exclusion provided in Rule of Practice 194(c)(2) if the associated person of that SBS Entity is currently subject to an order—i.e., an affirmative determination by the Commission, the CFTC, a self-regulatory organization (such as the Financial Industry Regulatory Authority), a registered futures association (the National Futures Association), or a foreign financial regulatory authority—that prohibits such associated person from participating in the U.S. financial market, including the U.S. securities or swap market, or the foreign financial markets of the jurisdiction in which the associated person is employed. *Questionnaires and employment applications*
- Exchange Act Rule 18a-5 establishes recordkeeping standards for stand-alone and bank SBS Entities that require each SBS Entity to make and keep current a questionnaire or application for employment for each associated person who is a natural person.
- In response to commenter concerns, the Commission is adopting an amendment to Rule 18a-5 that an SBS Entity need not make or keep current such questionnaires or employment applications if the entity is excluded from the statutory disqualification prohibition in Exchange Act 15F(b)(6) with respect to the associated person (such as due to the amendment to Rule of Practice 194, discussed above).
- The Commission also is adopting amendments to Rule 18a-5 to provide that a questionnaire or application for employment executed by an associated person who is not a U.S. person need not include certain information unless the SBS Entity (1) is required to obtain such information under applicable law in the jurisdiction in which the associated person is employed or located or (2) obtains such information in conducting a background check that is customary for such firms in that jurisdiction, and the creation or maintenance of records reflecting that information would not result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.
- Notwithstanding this recordkeeping relief, the SBS Entity must comply with Section 15F(b)(6) of the Exchange Act.

#### *Other Highlights*

- The Commission also issued a statement with regard to compliance with rules for security-based swap data repositories and Regulation SBSR governing regulatory reporting and public dissemination of security-based swap transactions. In this regard, the Commission set forth which actions with respect to security-based swap reporting rules will not provide a basis for enforcement action for four years following Regulation SBSR's first compliance date.

#### **What's Next?**

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