

FACT SHEET

Cross-Border Security-Based Swap Rules Regarding Activity in the United States

SEC Open Meeting

April 29, 2015

Action

The Commission will consider whether to propose rules that would require a non-U.S. company that uses U.S. personnel to arrange, negotiate or execute a security-based swap transaction to include that transaction in determining whether it is required to register as a security-based swap dealer. The proposed rules would help ensure that both U.S. and foreign dealers are subject to Title VII of the Dodd Frank Act when they engage in security-based swap activity in the United States, resulting in increased transparency and enhanced oversight.

The SEC's proposed rules would, among other things specify:

- When certain non-U.S. persons would be required to count a security-based swap transaction with another non-U.S. person toward the requirement to register as a security-based swap dealer based on the dealer's activity in the United States.
- Which transactions of a registered security-based swap dealer are subject to Title VII's external business conduct standards.
- When and by whom certain security-based swap transactions must be reported to a registered security-based swap data repository and publicly disseminated under Regulation SBSR.

Highlights of the Proposed Rules

Requirement that a Non-U.S. Person Register with the SEC as a Security-Based Swap Dealer

In 2012, the SEC adopted rules jointly with the CFTC, providing that a market participant would be considered a security-based swap dealer required to register with the SEC if its dealing transactions conducted in the past 12 months exceeded certain thresholds. The SEC's 2014 cross-border adopting release finalized rules providing that non-U.S. persons are required to include the following types of transactions in their *de minimis* threshold calculations:

- Dealing transactions with counterparties that are U.S. persons, including foreign branches of U.S. banks (unless the foreign branch is a branch of a registered security-based swap dealer).
- Dealing transactions of a non-U.S. person with a counterparty that has a right of recourse against a U.S. affiliate of the non-U.S. person in connection with the non-U.S. person's obligation under the security-based swap.
- All dealing activity if a non-U.S. person acts as a "conduit affiliate" of a U.S. person.

The rules proposed today, if adopted, would further require that a non-U.S. person include in its calculation any transaction connected with its dealing activity that it arranges, negotiates, or executes using its personnel or personnel of its agent located in the United States.

Application of the External Business Conduct Requirements

The proposed rules, if adopted, would subject the “U.S. business” of a registered security-based swap dealer to the external business conduct standards in section 15F(h) of the Exchange Act and the rules and regulations thereunder. The “foreign business” of a registered security-based swap dealer would be excepted from the external business conduct standards.

The proposal would define U.S. business as the following:

- For non-U.S. persons, any transaction entered into or offered to be entered into by or on behalf of the foreign security-based swap dealer with a U.S. person (other than a transaction conducted through a foreign branch of that U.S. person), or any transaction arranged, negotiated, or executed by personnel of the foreign security-based swap dealer or of its agent located in a U.S. branch or office.
- For U.S. persons, any transaction by or on behalf of the U.S.-person security-based swap dealer, wherever it occurs, except for transactions conducted through a foreign branch of the U.S. person with a non-U.S. person or with another U.S. person that is itself engaged in a transaction conducted through a foreign branch.

The proposal would define foreign business as any transactions that are not defined as U.S. business for that dealer.

Application of Regulation SBSR

The proposed rules, if adopted, would subject a security-based swap to Regulation SBSR’s regulatory reporting and public dissemination requirements if it meets any of the following conditions:

- It is executed on a platform having its principal place of business in the United States;
- It is effected by or through a registered broker-dealer (including a registered security-based swap execution facility); or
- It is connected with a non-U.S. person’s security-based swap dealing activity and is arranged, negotiated, or executed by personnel of a non-U.S. person located in a U.S. branch or office, or by personnel of an agent of a non-U.S. person located in a U.S. branch or office.

In addition, the proposed amendments to Regulation SBSR would amend the reporting rules to specify which side of a transaction has the reporting duty for transactions between two non-registered counterparties where one or both sides include a non-U.S. person. The proposal also includes conforming amendments to certain other provisions of Regulation SBSR to address the

proposed amendment that a registered broker-dealer report certain security-based swap transactions that it effects between two non-U.S. persons.

This proposal also solicits comment regarding potential exemptive relief from the public dissemination requirement in the Regulation SBSR adopting release for transactions that are guaranteed by a U.S. person in which the other side of the transaction includes no counterparty that is a U.S. person, registered security-based swap dealer, or registered major security-based swap participant

Mandatory Clearing and Mandatory Trade Execution

If adopted, the proposed rules would not impose mandatory clearing or mandatory trade execution on a security-based swap transaction between two non-U.S. persons solely because one or both counterparties arrange, negotiate, or execute the security-based swap using personnel located in the United States. The counterparty credit risk associated with these transactions resides primarily outside the United States, and the Commission's preliminary view is that imposing the mandatory clearing requirement would not significantly advance the key objectives of the clearing requirement, namely the mitigation of systemic and operational risk in the United States. Because mandatory trade execution applies only to transactions that are subject to the mandatory clearing, these transactions also would not be subject to mandatory trade execution. Consistent with Commission practice, Commission staff will monitor developments in the security-based swap market that may warrant reconsideration of this proposed approach.

Background

Dodd-Frank Act – The 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act established a comprehensive framework for regulating the over-the-counter derivatives market. Title VII of the Dodd-Frank Act gave the SEC regulatory authority over security-based swaps and certain key players in that market, including security-based swap dealers and major security-based swap participants. Among other things, Title VII amends the Securities Exchange Act of 1934 to address the registration and regulation of security-based swap dealers, including the establishment of business conduct standards for such dealers; the reporting and public dissemination of security-based swap data; and the mandatory clearing and trade execution of certain security-based swaps.

Cross-Border Security-Based Swap Market – The security-based swap market often involves counterparties located in different countries. According to data analyzed by SEC staff, a majority of transactions involving single-name credit default swaps on U.S. reference entities involve one or more counterparties located abroad. Based on staff estimates, only 12 percent of global notional volume between 2008 and 2014 was between two U.S.-domiciled counterparties. This compares to 48 percent entered into between one U.S.-domiciled counterparty and one foreign-domiciled counterparty, and 40 percent entered into between two foreign-domiciled counterparties. In addition, some security-based swaps may be negotiated and executed in two different countries and then booked in other countries. Finally, the security-based swap market is largely an inter-dealer market. Commission staff estimates that approximately 65 percent of

notional volume has International Swaps and Derivatives Association (ISDA)-recognized dealers as counterparties on both sides of the transaction.

Cross-Border Proposing Release – In May 2013, the SEC proposed a series of rules to address the application of each of the regulatory requirements under Title VII of the Dodd-Frank Act to cross-border security-based swap activities. The proposed rules reflected a territorial approach to application of these requirements and generally would have required counterparties to comply with Title VII transactions involving counterparties that are U.S. persons or that are guaranteed by U.S. persons or transactions conducted within the United States, subject to certain exceptions.

Cross-Border Adopting Release – In June 2014, the SEC finalized certain rules proposed in the cross-border proposing release. These rules determine when market participants are deemed to be security-based swap dealers or major security-based swap participants as a result of their cross-border activities, and thus subject to dealer or major participant regulation. The SEC indicated at that time that it expected to address other aspects of its cross-border proposing release in subsequent releases (including trade reporting and dissemination of trade details to the public, mandatory clearing and trade execution, and rules applicable to registered security-based swap dealers and major security-based swap participants, and security-based swap market infrastructure).

In addition, the final rules did not adopt a final rule to address whether transactions between two non-U.S. persons would be required to be counted for purposes of the dealer definition if the security-based swap transaction was conducted within the United States. Given the complex and important issues raised by that proposed requirement, the SEC stated that it expected to solicit additional comment regarding when a transaction between two non-U.S. persons should be included in the relevant dealer thresholds because one or both counterparties are engaged in security-based swap activity within the United States.

Action by the CFTC – In November 2013, the CFTC staff issued a staff advisory addressing the applicability of certain CFTC requirements to swap activity by non-U.S. registered swap dealers arranged, negotiated, or executed by personnel or agents of the non-U.S. swap dealer located in the United States. The CFTC subsequently requested comment on the staff advisory and both the staff advisory and comments received on it are under review at the CFTC.

What's Next?

If approved for publication by the Commission, the proposed rules will be published on the Commission's website and in the Federal Register. The comment period for the proposed rules will be 60 days after publication in the Federal Register.