

# Derivatives Alert

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## CFTC Finalizes Cross-Border Swaps Rule

On July 23, 2020, the Commodity Futures Trading Commission (CFTC or Commission) voted 3-2 to approve a final rule (Final Rule) on the cross-border application of certain swap provisions under the Commodity Exchange Act (CEA).<sup>1</sup> The Final Rule represents a significant rulemaking implementing Title VII of the Dodd-Frank Act.

Chairman Heath P. Tarbert said the Final Rule “provides critically needed regulatory certainty to the global swaps markets” and “properly balances protection of our national interests with appropriate deference to international counterparts.”<sup>2</sup>

## Background

In 2010, the Dodd-Frank Act amended the CEA to create a new regulatory framework for swaps. Congress added CEA Section 2(i) to address the cross-border application of the CEA’s swap provisions. Section 2(i) provides that the CEA’s swap provisions enacted under Title VII “shall 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” or unless they contravene Commission rules or regulations “as are necessary or appropriate to prevent the evasion of” the CEA’s swap provisions under Title VII.<sup>3</sup> The CFTC’s implementation of its cross-border swap rules has encompassed a number of rulemakings and guidance spanning nearly a decade:

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<sup>1</sup> See Press Release, “CFTC Approves Final Cross-Border Swaps Rule and an Exempt SEF Amendment Order at July 23 Open Meeting,” CFTC (July 23, 2020) [hereinafter “Press Release”]. Chairman Heath P. Tarbert and commissioners Brian D. Quintenz and Dawn DeBerry Stump voted in favor of approving the Final Rule, while commissioners Rostin Behnam and Dan M. Berkovitz dissented.

<sup>2</sup> “Statement of Chairman Heath P. Tarbert in Support of Final Cross-Border Swap Rule,” CFTC (July 23, 2020) [hereinafter “Statement of Chairman Heath P. Tarbert”]. However, dissenting Commissioner Berkovitz criticized the Final Rule for weakening standards for U.S. persons conducting swap activities abroad, domestic swap activity and substituted compliance. See “Dissenting Statement of Commissioner Dan M. Berkovitz on the Final Rule for Cross-Border Swap Activity of Swap Dealers and Major Swap Participants,” CFTC (July 23, 2020) [hereinafter “Berkovitz Dissent”]. Commissioner Behnam expressed similar concerns, stating that in adopting the Final Rule, the Commission “relies on broad deference that opens a gaping hole in the federal regulatory structure.” See “Dissenting Statement of Commissioner Rostin Behnam Regarding the Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to SDs and MSPs – Final Rule,” CFTC (July 23, 2020) (footnote omitted) [hereinafter “Behnam Dissent”].

<sup>3</sup> See CFTC, “Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants” at 1 (July 23, 2020) (citing 7 U.S.C. § 2(i)) [hereinafter “Final Rule”].

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**May 2012:** The CFTC and Securities and Exchange Commission issued a joint rulemaking that further defined registration thresholds for swap dealers (SD) and major swap participants (MSP).<sup>4</sup>

**July 2013:** The CFTC published interpretive guidance and a policy statement regarding the cross-border application of certain CEA swap provisions, and established a nonbinding framework for the cross-border application of some provisions, including registration and business conduct requirements for SDs and MSPs, and a process for making substituted compliance determinations.<sup>5</sup>

**November 2013:** The CFTC Division of Swap Dealer and Intermediary Oversight (DSIO) issued an advisory stating that a non-U.S. SD that regularly uses personnel or agents in the U.S. to “arrange, negotiate, or execute” a swap with a non-U.S. person (ANE Transaction) would generally be required to comply with certain Transaction-Level Requirements (TLRs).<sup>6</sup> The CFTC subsequently issued no-action relief to non-U.S. SDs registered with the CFTC from these requirements and in January 2014 sought public comment on the advisory.<sup>7</sup> The advisory proved controversial, with some foreign regulators arguing that it would apply duplicative rules to transactions between non-U.S. persons.<sup>8</sup>

**May 2016:** The CFTC issued a final rule on the cross-border application of the agency’s margin requirements for uncleared swaps. It addressed circumstances under which certain SDs and MSPs would be eligible for substituted compliance, and established a framework for determining the comparability of foreign jurisdictions’ margin requirements.<sup>9</sup>

<sup>4</sup> See Final Rule at 6-7 (citing 17 C.F.R. § 1.3 (definitions of “swap dealer” and “major swap participant”)); Further definition of “swap dealer,” “security-based swap dealer,” “major swap participant,” “major security-based swap participant” and “eligible contract participant,” 77 Fed. Reg. 30,596 (May 23, 2012).

<sup>5</sup> See Final Rule at 7-8 (citing Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013)). Substituted compliance is the process by which a SD or MSP subject to the rules of a foreign jurisdiction — but whose swap activities bring them within the scope of certain CFTC regulations — may rely on compliance with the rules of the foreign jurisdiction as a substitute for compliance with certain CFTC regulations. See, e.g., Press Release, “CFTC Approves Comparability Determination for Australia Uncleared Swap Margin Rules for Substituted Compliance Purposes,” CFTC (Mar. 27, 2019).

<sup>6</sup> See Final Rule at 8-9 (citing CFTC Staff Advisory No. 13-69, “Applicability of Transaction-Level Requirements to Activity in the United States” (Nov. 14, 2013)).

<sup>7</sup> See Final Rule at 9 (citing CFTC Staff Letter No. 13-71, “No-Action Relief: Certain Transaction-Level Requirements for Non-U.S. Swap Dealers” (Nov. 26, 2013); Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States, 79 Fed. Reg. 1347, 1348-49 (Jan. 8, 2014)).

<sup>8</sup> See Statement of Chairman Heath P. Tarbert (citing Letter from Steven Maijoor, Chair, European Securities and Markets Authority to Acting CFTC Chairman Regarding the CFTC Staff’s “ANE Advisory,” No. 13-69 (Mar. 13, 2014)).

<sup>9</sup> See Final Rule at 9 (citing Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34,818 (May 31, 2016)). For more on this rulemaking, see Skadden’s June 3, 2016, client alert.

**October 2016:** The CFTC proposed rules regarding the cross-border application of certain CEA swaps provisions under Dodd-Frank, including registration requirements, business conduct standards and ANE Transactions.<sup>10</sup>

**January 2020:** The CFTC withdrew the October 2016 proposal and proposed a new rulemaking to address the cross-border application of registration thresholds and certain requirements for SDs and MSPs, and establish a process for requesting comparability determinations for those requirements from the CFTC.<sup>11</sup>

## Final Rule

The Final Rule adopts the January 2020 proposal while superseding the CFTC’s 2013 cross-border guidance with respect to the CFTC requirements that the Final Rule encompasses.<sup>12</sup> The Final Rule adopts a risk-based approach to the cross-border application of the CEA’s Title VII swap provisions while according substantial deference to foreign regulators.

## Registration

The Final Rule contains requirements regarding the cross-border application of the SD registration threshold and MSP registration tests.<sup>13</sup>

- The Final Rule requires a U.S. person to include all of its SD transactions in its de minimis threshold calculation.<sup>14</sup>

<sup>10</sup> 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) [Proposed Rule].

<sup>11</sup> Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952 (Jan. 8, 2020) [Proposed Rule].

<sup>12</sup> See Press Release.

<sup>13</sup> A person may be required to register as a SD based on the aggregate gross notional amount of swaps that it enters into over the prior 12 months in connection with its swap dealing activities. The current de minimis threshold for SD registration is \$8 billion. See 17 C.F.R. § 1.3 (definition of “swap dealer”). Similarly, CFTC rules provide that a person will not be deemed a MSP unless its swap positions exceed one of several threshold tests. See 17 C.F.R. § 1.3 (definition of “major swap participant”).

<sup>14</sup> See Final Rule at 112, 294-95 (Final Rule 23.23(b)(1)). “U.S. person,” as defined in the Final Rule, includes “(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) [a]n account (whether discretionary or non-discretionary) of a U.S. person; or (D) [a]n estate of a decedent who was a resident of the United States at the time of death.” See Final Rule at 293-94 (Final Rule 23.23(a)(23)(i)). The Final Rule clarifies that while its definition of “U.S. person” is narrower in scope than the definition in the 2013 guidance, “any person designated as a ‘U.S. person’ under the Final Rule is also a ‘U.S. Person’ under the Guidance definition,” and “market participants may ... rely on representations previously obtained using the ‘U.S. person’ definition in the guidance.” See Final Rule at 60. The Final Rule also contains a narrower definition of “guarantee” than the 2013 guidance, which dissenting commissioners suggested could “allow significant risk to be transferred back to the U.S. financial system.” See Behnam Dissent; see also Berkovitz Dissent.

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- The Final Rule requires a person that is a “Guaranteed Entity” or “significant risk subsidiary” to count all of its swap dealing toward its de minimis threshold.<sup>15</sup>
- An “Other Non-U.S. Person” is required to count swap dealing with a U.S. person toward its de minimis threshold, except for swaps conducted through a foreign branch of a registered U.S. SD.<sup>16</sup>
- The Final Rule requires — subject to certain exceptions — an Other Non-U.S. Person to count swap dealing toward its de minimis threshold if its counterparty is a Guaranteed Entity.<sup>17</sup>
- The Final Rule provides that an Other Non-U.S. Person may exclude from its de minimis threshold any swap that it anonymously enters into on a designated contract market, a swap execution facility registered with the Commission or exempted by the Commission from registration, or a foreign board of trade registered with the Commission, if the swap is also cleared through a registered or exempt derivatives clearing organization.<sup>18</sup>

The Final Rule adopts a similar approach for the cross-border application of MSP registration thresholds.<sup>19</sup>

## Exceptions

The Final Rule creates several groups of swaps requirements for purposes of determining the availability of certain exceptions from, or substituted compliance for, those requirements.

- Group A includes certain regulations related to chief compliance officers, risk management, swap data record-keeping and antitrust considerations.<sup>20</sup>

<sup>15</sup> See Final Rule at 113-16, 119-21, 295 (Final Rule 23.23(b)(1) & (2)(iii)). A “Guaranteed Entity” is a non-U.S. person whose swaps are guaranteed by a U.S. person, with respect to those swaps that are so guaranteed. See Final Rule at 73 (discussing use of the term “Guaranteed Entity”), 290 (Final Rule 23.23(a)(9)) (defining “Guarantee”). A “significant risk subsidiary” is “any non-U.S. significant subsidiary of an ultimate U.S. parent entity where the ultimate U.S. parent entity has more than \$50 billion in global consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year,” with certain exceptions. See Final Rule at 291 (Final Rule 23.23(a)(13)). See Final Rule at 291-92 (Final Rule 23.23(a)(14)) for further definition of the thresholds that make an entity a “significant subsidiary.”

<sup>16</sup> See Final Rule at 113, 116-19, 295 (Final Rule 23.23(b)(2)(i)). “Other Non-U.S. Person” refers to a non-U.S. person that is neither a Guaranteed Entity nor a significant risk subsidiary. See Final Rule at 74.

<sup>17</sup> See Final Rule at 113, 121-25, 295 (Final Rule 23.23(b)(2)(iii)(A) & (B)). Such swaps must be counted except when the Guaranteed Entity is registered as a SD or its swaps are subject to a guarantee by a U.S. person that is a nonfinancial entity. See *id.*

<sup>18</sup> See Final Rule at 128-32, 296 (Final Rule 23.23(d)).

<sup>19</sup> See Final Rule at 134-49, 295-96 (Final Rule 23.23(c)).

<sup>20</sup> See Final Rule at 165-71, 289 (Final Rule 23.23(a)(6)).

- Group B includes certain regulations related to swap trading relationship documentation, portfolio reconciliation and compression, trade confirmations and daily trading records.<sup>21</sup>
- Group C includes the CFTC’s external business conduct rules as well as certain rules regarding the segregation of assets held as collateral in uncleared swap transactions.<sup>22</sup>

The Final Rule also creates four principal exceptions with regard to these groups.

- An exception from some Group B and C requirements for certain anonymous exchange-traded and cleared foreign-based swaps.<sup>23</sup>
- An exception from Group C requirements for certain foreign-based swaps with foreign counterparties.<sup>24</sup>
- A limited exception from Group B requirements for foreign-based swaps of foreign branches of U.S. swap entities with certain foreign counterparties.<sup>25</sup>
- An exception from Group B requirements for foreign-based swaps of certain non-U.S. swap entities with certain foreign counterparties.<sup>26</sup>

## Substituted Compliance and Comparability Determinations

The Final Rule creates a framework for substituted compliance with certain of the rule groups, subject to the terms of the CFTC’s comparability determination for a given foreign jurisdiction. The Final Rule allows a non-U.S. swap entity to satisfy any applicable Group A requirement on an entitywide basis by complying with the applicable standards of a foreign jurisdiction.<sup>27</sup> The Final Rule also allows a non-U.S. swap entity or foreign branch

<sup>21</sup> See Final Rule at 171-75, 289 (Final Rule 23.23(a)(7)).

<sup>22</sup> See Final Rule at 176-79, 289 (Final Rule 23.23(a)(8)).

<sup>23</sup> See Final Rule at 182-88, 297 (Final Rule 23.23(e)(1)(i)). The Final Rule defines a “foreign-based swap” as “(i) A swap by a non-U.S. swap entity, except for a swap booked in a U.S. branch; or (ii) A swap conducted through a foreign branch.” Final Rule at 289 (Final Rule 23.23(a)(4)).

<sup>24</sup> See Final Rule at 189-97, 297 (Final Rule 23.23(e)(1)(ii)). The Final Rule also provides that a non-U.S. swap entity is excepted from the Group C requirements with respect to any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch nor a Guaranteed Entity. See Final Rule at 194, 297 (Final Rule 23.23(e)(2)).

<sup>25</sup> See Final Rule at 197-205, 297-98 (Final Rule 23.23(e)(4)).

<sup>26</sup> See Final Rule at 206-11, 297-98 (Final Rule 23.23(e)(3)).

<sup>27</sup> See Final Rule at 215, 299 (Final Rule 23.23(f)(1)). The Commission stated that Group A requirements, which relate to compliance programs, risk management and swap data record-keeping, “cannot be effectively applied on a fragmented jurisdictional basis.” *Id.* at 215.

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of a U.S. swap entity to use substituted compliance for Group B requirements in certain circumstances, depending on the nature of its counterparty. It also permits a non-U.S. swap entity to satisfy any applicable Group B requirement, for any swap booked in a U.S. branch with a foreign counterparty that is neither a foreign branch nor a Guaranteed Entity, by complying with the applicable standards of the foreign jurisdiction.<sup>28</sup> However, the Commission determined that no substituted compliance will be available with respect to Group C requirements.<sup>29</sup>

In addition, the Final Rule establishes a process for conducting comparability determinations regarding a foreign jurisdiction's regulation of swap entities, including a flexible standard of review that:

- allows the Commission to consider any factor it deems appropriate in assessing comparability;
- allows the Commission to find a foreign jurisdiction's standards comparable if, viewed holistically, those standards achieve a regulatory outcome that adequately serves the same regulatory purposes as the Group A or B requirements as a whole; and
- allows the Commission to base comparability on a foreign jurisdiction's regulatory standards instead of regulatory requirements.<sup>30</sup>

<sup>28</sup> See Final Rule at 215-17, 299 (Final Rule 23.23(f)(2)-(3)). The Commission noted that unlike the Group A requirements, the Group B requirements — related to counterparty relationship documentation, portfolio reconciliation and compression, trade confirmation and daily trading records — “are more closely tied to local market conventions and can be effectively implemented on a transaction-by-transaction or relationship basis.” *Id.* at 215.

<sup>29</sup> See Final Rule at 217.

<sup>30</sup> See Final Rule at 219-23, 301-02 (Final Rule 23.23(g)(4)). See also Final Rule at 222 (noting that certain jurisdictions implement prudential supervisory guidelines to regulate swaps).

## ANE Transactions

The Commission stated that ANE Transactions will not be considered as relevant for purposes of thresholds for swap dealer registration.<sup>31</sup> The Commission noted that the Final Rule addresses whether Transaction-Level Requirements should apply to swaps between certain non-U.S. SDs and non-U.S. counterparties that are “arranged, negotiated, or executed” by the SDs’ personnel or agents in the United States by establishing the exceptions to Group B and C requirements, and that the issue will be addressed with respect to the remaining TLRs in connection with future rulemakings.<sup>32</sup> The Commission stated that, until those future rulemakings are adopted, it would not consider a non-U.S. swap entity’s use of personnel or agents in the United States to “arrange, negotiate, or execute” swaps with non-U.S. counterparties for purposes of determining whether these unaddressed TLRs apply to such circumstances.<sup>33</sup> In connection with the Final Rule, DSIO also withdrew its 2013 guidance on ANE Transactions, and several CFTC divisions withdrew prior no-action relief and issued new no-action relief regarding cross-border application of certain swap provisions.<sup>34</sup>

The Final Rule will be effective 60 days after it is published in the Federal Register.<sup>35</sup>

<sup>31</sup> See Final Rule at 158-61. The CFTC stated that ANE Transactions “by definition are swaps between non-U.S. persons” wherein “the risk ... lies primarily outside of the U.S.,” and that it sees “little value in requiring countering of ANE Transactions when, if such counting resulted in SD registration, such ANE Transactions would not be subject to most of the SD requirements.” Final Rule at 161.

<sup>32</sup> See Final Rule at 159.

<sup>33</sup> See *id.*

<sup>34</sup> See “[CFTC Withdraws ‘ANE’ Staff Advisory and Issues New Cross-Border No-Action Relief](#),” CFTC (July 23, 2020). The new no-action letter provides relief to non-U.S. SDs from TLRs for ANE Transactions — to the extent those requirements are not addressed in the Final Rule — until the CFTC addresses whether a particular unaddressed requirement is applicable to the transactions. See CFTC Letter No. 20-21, “[Withdrawal of Staff Advisory and No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers](#)” (July 23, 2020).

<sup>35</sup> Final Rule at 2.