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CFTC Chairman Giancarlo's White Paper Outlines Specific Recommendations to Cross-Border Swaps Regulation

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After a several-year pause, the CFTC is again re-assessing its approach to cross-border regulation of swap activities. The CFTC's current approach is embodied in various rulemakings, guidance, orders, and agreements with non-U.S. regulators that have been adopted, issued, and entered into since 2013. The CFTC has, over the past several years, periodically sought to adjust or re-evaluate its approach to cross-border swaps regulation, including in a **2016 Proposed Cross-Border Rule**. CFTC Chairman Giancarlo has revived these efforts by issuing a **White Paper** that sets out guiding principles for the CFTC in interpreting its statutory authority[1] to regulate cross-border swaps activities and recommends five specific areas for reform, which are described below.

While Chairman Giancarlo describes the CFTC's current approach to cross-border swaps regulation as "over-expansive, unduly complex, and operationally impractical," and as giving insufficient deference to jurisdictions with regulations deemed by the CFTC to be comparable to the CFTC's (**comparable jurisdictions**), the practical results of the White Paper's recommendations may be a mixed bag in terms of moving towards less expansive, less complex rules. Some recommendations, particularly those for non-U.S. CCPs, non-U.S. trading venues, and non-U.S. swap dealers in comparable jurisdictions, demonstrate a more measured approach to regulation of cross-border and non-U.S. activities. Others, such as the treatment of activities in non-comparable jurisdictions and transactions of non-U.S. persons "arranged, negotiated, or executed" in the United States (**ANE**), may represent a lengthening of the CFTC's cross-border reach. In several contexts, the White Paper describes how cross-border swap activities in non-comparable jurisdictions is significantly lower than in comparable jurisdictions, indicating that the Chairman has

already, at least preliminarily, determined which jurisdictions are likely to be comparable or not.

The White Paper is not a rule proposal, nor does it have any immediate effect. It instead is intended for consideration by the full Commission. Given that the CFTC is now at full strength, and has two new Commissioners who each bring significant experience in these matters, it will be interesting to see whether and when the full Commission will take up formal rulemaking proposals. Chairman Giancarlo has hinted that a rulemaking focusing on amendments to the swap execution facility (**SEF**) rules, consistent with his first white paper on that topic, will be forthcoming shortly.

We describe the White Paper's key cross-border reform proposals below, highlighting how these proposals would modify currently applicable requirements.

Registration of Non-U.S. CCPs

Under the CEA and CFTC guidance, a non-U.S. CCP may not provide clearing services to U.S. customers without being registered as a derivatives clearing organization (**DCO**). The CFTC has, to date, individually exempted four non-U.S. CCPs from its DCO registration requirements, permitting them to clear the proprietary swap positions of U.S. clearing members and their affiliates, without being so registered. Even an exempted non-U.S. CCP may not clear for U.S. customers of a non-U.S. or U.S. clearing member. This limitation has posed challenges for both non-U.S. CCPs and U.S. market participants, as swap clearing requirements have come into effect in more jurisdictions and uncleared swap margin requirements are fully implemented, which may encourage the largest market participants to prefer cleared transactions.

The White Paper recommends expanding the use of the CFTC's exemptive authority for non-U.S. CCPs that (1) are subject to comparable, comprehensive supervision and regulation in their home countries and (2) do not pose substantial risk to the U.S. financial system. These CCPs would be permitted to provide clearing services to U.S. customers indirectly through non-U.S. clearing members, without the non-U.S. CCP having to register as a DCO or its non-U.S. clearing members having to register as FCMs. This approach addresses the limitation of the exemptive orders granted to date and is consistent with the CFTC's cross-border approach to futures clearing.

Non-U.S. CCPs that are deemed by the CFTC to pose substantial risk to the U.S. financial system or that are in non-comparable jurisdictions would continue to be required to register with the CFTC as DCOs if they provide clearing services to U.S. customers.

Registration of Non-U.S. Trading Venues

Currently, other than for certain specified EU trading venues, the CFTC's SEF registration requirement applies to any multilateral swap trading platform located outside the United States, if the venue directly or indirectly permits access to U.S. persons or persons located in the United States, including personnel and agents of non-U.S. persons located in the United States. Consistent with Chairman Giancarlo's long-standing views on the harms of the bifurcation of trading pools, the White Paper recommends additional deference to local law for non-U.S. swap trading venues in comparable jurisdictions. Specifically, the White Paper recommends that a non-U.S. swap trading venue located in a comparable jurisdiction be exempt from the CFTC's SEF registration requirements even where it provides direct or indirect access to U.S. persons that are ECPs. This approach is consistent with the treatment of derivatives trading venues in the **2017 CFTC – EC agreement**, under which MTFs and OTFs are exempt from CFTC SEF registration requirements and CFTC regulation of DCMs and SEFs is deemed equivalent to the relevant requirements in the EU.

Trading venues in non-comparable jurisdictions would be required to register as SEFs (or DCMs) if they provide direct or indirect access to U.S. persons. This registration requirement would, however, be subject to a materiality threshold to be set by the CFTC based on criteria designed to reflect a level of trading involving U.S. persons that would not rise to the "direct and significant" standard of Section 2(i) of the CEA.

Non-U.S. Swap Dealer Registration and Regulation

While recognizing that the activities of a non-U.S. swap dealer may pose "direct and significant" risks to the U.S. financial system,[2] the White Paper challenges the existing calibration of the 2013 Cross-Border Guidance's requirements for non-U.S. swap dealers under this standard. For example, the White Paper suggests that the CFTC should take into account the effects of non-U.S. regulatory regimes, including

mandatory clearing, in determining whether swap activities give rise to direct and significant risks it the U.S. financial system.

The White Paper recommends modifications to the CFTC current guidelines for non-U.S. persons in measuring their swap dealing activities towards the swap dealer *de mimimis* registration threshold and in the availability of substituted compliance for non-U.S. swap dealers.

- **Guaranteed Entity**. A non-U.S. person whose swaps are guaranteed by a U.S. person would need to count all dealing swaps toward its *de minimis* A Guaranteed Entity in a comparable jurisdiction would be eligible for substituted compliance with the applicable requirements. This *de minimis* counting requirement is generally consistent with the approach in the 2013 Cross-Border Guidance and the 2016 Proposed Cross-Border Rule, but the White Paper recommends making substituted compliance more broadly available to a Guaranteed Entity that is a registered swap dealer.
- **Foreign Consolidated Subsidiaries (FCS)[3] and other non-U.S. Persons**. The White Paper recommends that FCS in comparable jurisdictions and all other non-U.S. persons should count dealing swaps only with U.S. persons and Guaranteed Entities. They further would be able to exclude swaps (1) with a Guaranteed Entity that is a CFTC-registered swap dealer or is affiliated with a registered swap dealer; (2) with a Guaranteed Entity guaranteed by a non-financial guarantor; or (3) with the foreign branch of a U.S. bank that is a CFTC-registered swap dealer. This recommendation represents a scaling back of *de minimis*threshold requirements proposed in 2016, particularly as they relate to FCS. Under the 2016 Proposed Cross-Border Rule, an FCS would have had to count dealing swaps with all persons towards its *de minimis* In addition, a non-U.S. person would have had to count dealing swaps with FCS toward its *de minimis* threshold. The White Paper does not make a specific recommendation on the treatment of FCS in non-comparable jurisdictions, on the basis that the treatment of such FCS "raises more complex issues."

In addition, the White Paper recommends that FCS and non-U.S. persons in comparable jurisdictions should be permitted to rely on substituted compliance with the applicable requirements, which would make substituted compliance more broadly available.

Clearing and Trade Execution

The White Paper recommends that the CFTC give more deference to clearing and trade execution requirements in jurisdictions with comparable regulation. It also recommends the CFTC apply more scrutiny in determining whether a non-U.S. clearing requirement is comparable to the CFTC's than when making such a determination for a non-U.S. trade execution requirement. This recommendation is based on the clearing requirement being more central to systemic risk considerations. Trade execution, in contrast, relates to market structure and trade practices which Chairman Giancarlo believes is more appropriately in the purview of the local regulators.

In terms of application of the CFTC's clearing and trade execution requirements, the White Paper would broaden the availability of substituted compliance in comparable jurisdictions for some transactions of non-U.S. persons. Specifically, it recommends that a non-U.S. person, including a Guaranteed Entity or an FCS, in a comparable jurisdiction be permitted to rely on substituted compliance for the CFTC's swap clearing and trade execution requirements, regardless of counterparty type. Thus, a non-U.S. person could comply with a local clearing requirement under local standards when executing a swap in a jurisdiction with comparable regulation with a U.S. person counterparty. Under the 2013 Cross-Border Guidance, substituted compliance is not be available for a non-U.S. person when transacting with a U.S. person.

For non-comparable jurisdictions, the White Paper recommends differing application of the clearing requirements based upon whether a U.S. person is a foreign branch of a U.S. bank, a Guaranteed Entity, or another non-U.S. person. The White Paper makes no specific recommendation on the treatment of FCS under this requirement. The White Paper also does not outline an approach to the application of the CFTC's trade execution requirement in non-comparable jurisdictions and notes that it may be better to deal with these non-U.S. jurisdictions on a case-by-case basis.

ANE Transactions

Under CFTC staff-no action letters,[4] a swap between two non-U.S. persons does not become subject to CFTC transaction-level regulations by virtue of being ANE in the United States. The White Paper re-examines the treatment of such ANE swaps, including based upon whether a counterparty is located in a comparable jurisdiction.

The White Paper champions the principle of "one unified marketplace, under one set of comparable trading rules and under one competent regulator" in considering ANE transactions.

The White Paper makes two general points about the application of swaps regulations to ANE transactions: (1) if a swap is executed in the United States, U.S. swap trade execution and clearing rules should apply and (2) a swap ANE in the United States by personnel or agents of a non-U.S. person should not be counted toward the non-U.S. person's *de minimis* threshold if the non-U.S. dealer is in a comparable jurisdiction. The White Paper also suggests that swaps between non-U.S. persons arranged or negotiated on a SEF should be subject to U.S. regulations, by virtue of being arranged or negotiated subject to the rules of the SEF, and that a swap bilaterally arranged and negotiated (but not executed) in the United States is a "U.S. trade" also subject to CFTC rules, though substituted compliance may be appropriate. The White Paper suggests that the CFTC staff will need to further consider these issues and recommends that they attempt to draw regulatory lines that capture ANE transaction activity that has a direct and significant effect on the U.S. financial system and exclude other more incidental activity.

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[1] Section 2(i) of the Commodity Exchange Act (**CEA**) prohibits the CFTC from regulating swap activities outside the United States unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States. 7 U.S.C. § 2(i).

[2] *See id.*

[3] FCS are non-U.S. persons whose operating results, financial position, and statement of cash flows are consolidated, in accordance with U.S. Generally Accepted Accounting Principles, with those of an ultimate parent entity that is a U.S. person.

[4] CFTC Letter No. 17-36; CFTC Letter No. 16-64; CFTC Letter No. 15-48; CFTC Letter No. 14-140; CFTC Letter No. 14-74; CFTC Letter No. 14-01; CFTC Letter No. 13-71.