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**Title:** **Final Response to District Court Remand Order in Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission**

**Action:**  Final response to district court remand order.

**Agency**

COMMODITY FUTURES TRADING COMMISSION (CFTC)

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**Synopsis**

**SUMMARY:** This release is the Commodity Futures Trading Commission's ("Commission" or "CFTC") final response to the order of the United States District Court for the District of Columbia in *Securities Industry and Financial Markets Association, et al.* v. *United States Commodity Futures Trading Commission,* (" *SIFMA* v. *CFTC* "), remanding eight swaps-related rulemakings to the Commission to resolve what the court held to be inadequacies in the Commission's consideration of costs and benefits, or its explanation of its consideration of costs and benefits, in those rulemakings. In this release the Commission addresses cost-benefit issues raised and suggestions for rule changes made in comments submitted in response to the Commission's Initial Response to the remand order.

**Text**

**SUPPLEMENTARY INFORMATION:** This release is the Commission's final response to the order of the United States District Court for the District of Columbia in *SIFMA* v. *CFTC* n1 remanding eight swaps-related rulemakings to the Commission. It addresses issues raised by public comments submitted in response to a previous **Federal Register** release setting forth the Commission's initial response to the remand order. n2

n1 [*No. 13-1916 (PLF), 67 F. Supp. 3d. 373*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=) (D.D.C. Sept. 16, 2014).

n2 Initial Response to District Court Remand Order in Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission, [*80 FR 12555*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5FGD-C140-006W-80J9-00000-00&context=) (Mar. 10, 2015) ("Initial Response").

The present release is organized as follows. Part II describes the *SIFMA* litigation, the district court order, and the Commission's Initial Response. Part III discusses the Commission's general approach to extraterritorial costs and benefits in this release and potential methods for addressing extraterritorial cost-benefit issues. Part IV supplements the consideration of costs and benefits in the preambles to the original rulemakings and in the Initial Response by describing and evaluating the cost-benefit issues raised in the comments. Section IV.A discusses certain issues related to the costs of the extraterritorial application of the remanded rules. Section IV.B discusses certain issues related to the benefits of the extraterritorial application of the remanded rules. Section IV.C discusses the Commission's efforts to mitigate costs of the extraterritorial application of the Commission's rules, including the Commission's substituted compliance program and other actions. Section IV.D discusses consideration of substantive rule changes outside the scope of the remand order that may affect cross-border costs and benefits. Section IV.E discusses commenters' concerns about "market fragmentation," primarily in the context of the Swap Execution Facility ("SEF") Registration Rule. Section IV.F discusses cost-benefit issues related to the use of a test for the application of transaction-level Dodd-Frank rules to non-U.S. swap dealers based on dealing activities physically located in the United States as described in a November 2013 Division of Swap Dealer and Intermediary Oversight staff advisory. It also discusses cost-benefit issues related to a test for the application of the SEF Registration Rule based on the provision of swap execution services to traders located in the United States as described in a Division of Market Oversight guidance document, also issued in November 2013. Section IV.G discusses certain additional cost-benefit issues specific to particular rules. Part V discusses commenters' recommendations for changes in the substance of the remanded rules and evaluates whether these changes are justified in light of the international cost-benefit considerations addressed in Part IV and other relevant considerations. Finally, Part VI concludes that, taking into account the facts and analysis in the original rulemaking preambles as well as the additional consideration of costs and benefits in the Initial Response and this release, the remanded rules are legally sound, and the Commission will not propose changes in the context of the *SIFMA* v. *CFTC* remand order.

The Commission emphasizes that the purpose of the discussion of costs and benefits in Part IV and of potential rule changes in Parts V and VI is to respond to the mandate of the *SIFMA* remand order and to evaluate the present legal sufficiency of the remanded rulemaking proceedings. The discussion and conclusions in this release should not be interpreted to mean that the Commission will not consider other actions with respect to the rules, including substantive amendments, looking forward. To the contrary, the Commission will amend the rules in the future when amendment is in the public interest, whether in response to new information, experience, or the evolution of the markets and the international legal landscape.

**II. Background n3**

n3 For a more detailed description of the background of this release, see Initial Response, 80 FR at 12556-58.

*A. The District Court Litigation and Decision*

On December 4, 2013, three trade associations sued the Commission in the United States District Court for the District of Columbia, challenging the Commission's Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap ***Regulations*** n4 ("Cross-Border Guidance" or "Guidance") as well as the extraterritorial application of fourteen of the rules promulgated by the Commission to implement the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act n5 regarding swaps. n6

n4 [*78 FR 45292*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=) (July 26, 2013).

n5 *Public Law 111-203*, *124 Stat. 1376* (2010).

n6 *See* [*SIFMA, 67 F. Supp. 3d at 384.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=) The plaintiffs were the Securities Industry and Financial Markets Association, the International Swaps and Derivatives Association, and the Institute of International Bankers. *Id. See also* id. at 437-38.

The fourteen challenged rules were promulgated by the Commission in twelve rulemakings. n7 On September 16, **[\*54479]** 2014, the court issued a decision, granting summary judgment to the Commission on most issues but remanding without vacatur ten rules, promulgated in eight rulemakings. n8 The court held that the preambles for these rules did not adequately address the costs and benefits of the extraterritorial application of the rules pursuant to section 2(i) of the Commodity Exchange Act ("section 2(i)"). n9 Specifically, the court held that the Commission needed to address whether and to what extent the costs and benefits as to overseas activity may differ from those related to the domestic application of the rules. n10

n7 *See* id. at 437-38. Three of the fourteen challenged rules, informally identified by the court as the "Daily Trading Records," "Risk Management," and "Chief Compliance Officer" Rules, were promulgated as part of a single rulemaking. *Id.*

n8 [*SIFMA, 67 F. Supp. 3d 373.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=) For a more complete description of the decision, *See* the Commission's Initial Response, [*80 FR 12555.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5FGD-C140-006W-80J9-00000-00&context=)

n9 [*SIFMA, 67 F. Supp. 3d at 430-33.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

n10 [*Id. at 434-35.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

The eight remanded rulemakings are:

Real-Time Public Reporting of Swap Transactions Data n11 ("Real-Time Reporting Rule");

n11 [*77 FR 1182*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:54NX-1800-006W-818M-00000-00&context=) (Jan. 9, 2012).

Swap Data Recordkeeping and Reporting Requirements n12 ("SDR Reporting Rule");

n12 [*77 FR 2136*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:54PR-VKM0-006W-81VC-00000-00&context=) (Jan. 13, 2012).

Registration of Swap Dealers and Major Swap Participants n13 ("Swap Entity Registration Rule");

n13 [*77 FR 2613*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:54S1-RNW0-006W-825G-00000-00&context=) (Jan. 19, 2012).

Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rule; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants n14 ("Daily Trading Records," "Risk Management," and "Chief Compliance Officer" Rules);

n14 [*77 FR 20128*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55B1-96W0-006W-80HK-00000-00&context=) (Apr. 3, 2012).

Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant" n15 ("Swap Entity Definition Rule");

n15 [*77 FR 30596*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55PP-R380-006W-8100-00000-00&context=) (May 23, 2012).

Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps n16 ("Historical SDR Reporting Rule");

n16 [*77 FR 35200*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55VY-X6W0-006W-834V-00000-00&context=) (June 12, 2012).

Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants n17 ("Portfolio Reconciliation Rule"); and

n17 [*77 FR 55904*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:56JB-XV20-006W-82VT-00000-00&context=) (Sept. 11, 2012).

Core Principles and Other Requirements for Swap Execution Facilities n18 ("SEF Registration Rule").

n18 [*78 FR 33476*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:58K3-49G0-006W-853F-00000-00&context=) (June 4, 2013).

*B. The District Court's Rulings on Consideration of Costs and Benefits*

The district court remanded the eight rulemakings "for further proceedings consistent with the Opinion issued this same day." n19 As the Commission explained in its Initial Response to the remand order, the court's opinion included a number of holdings and observations that provide guidance as to the actions the Commission must take on remand.

n19 [*SIFMA, 67 F. Supp. 3d at 437.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

1. The court held that, because Congress made the determination that the swaps rules apply overseas to the extent specified in section 2(i), the CEA provision on consideration of costs and benefits, section 15(a), does not require the Commission to consider whether it is necessary or desirable for particular rules to apply to overseas activities as specified in section 2(i). n20 Indeed, the court explained, the Commission cannot, based on a consideration of costs and benefits, second-guess Congress's decision that swaps rules apply to certain overseas activities. n21 As a result, the court stated that "the only issues necessarily before the CFTC on remand would be the *substance* of the Title VII rules, *not* the scope of those Rules' extraterritorial applications under [*7 U.S.C. 2(i)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GJ91-NRF4-44CM-00000-00&context=)." n22

n20 [*Id. at 431.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

n21 [*Id. at 432;*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=) *see also* id. at 434-35 & n.35.

n22 [*Id. at 434-35.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

2. At the same time, the court held that, in considering costs and benefits of the substantive regulatory choices it makes when promulgating a swaps rule, the Commission is required to take into consideration the fact that the rule, by statute, will apply to certain overseas activity. n23 Thus, the Commission's consideration of costs and benefits of the application of the rule must encompass both foreign and domestic business activities. n24 The court held that the Commission failed to meet this requirement because, the court stated, in the cost-benefit discussions for the rules at issue, the Commission did not state explicitly whether the identified costs and benefits regarding overseas activities are the same as, or differ from, those pertinent to domestic activities. n25

n23 [*Id. at 431-32.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

n24 *Id.*

n25 *Id.*

3. The court held that the Commission has discretion either to consider costs and benefits of the international application of swaps rules separately from domestic application or to evaluate them together, "so long as the cost-benefit analysis makes clear that the CFTC reasonably considered both." n26 The district court found that, at the time the rules at issue in the litigation were promulgated, foreign swaps ***regulations*** were still under development so that costs of possible duplicative ***regulation*** were hypothetical and did not have to be considered. n27 The court noted that this fact raised the possibility that the costs and benefits of the rules' extraterritorial applications "were essentially identical to those of the Rules' domestic applications" so that the Commission "functionally considered the extraterritorial costs and benefits" of the rules "by considering the Rules' domestic costs and benefits." n28 However, the court concluded that it did not need to address that possibility because the cost-benefit discussions in the rule preambles gave "no indication" that this was so. n29 The court further noted that foreign swaps ***regulations*** passed since the promulgation of the rules at issue in the litigation "may now raise issues of duplicative regulatory burdens," but that "the CFTC may well conclude that its policy of substituted compliance largely negates these costs." n30

n26 [*Id. at 433.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

n27 *Id.*

n28 *Id.*

n29 *Id.*

n30 [*Id. at 435.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

4. Finally, the court noted that "[p]laintiffs raise no complaints regarding the CFTC's evaluation of the general, often unquantifiable, benefits and costs of the domestic application of the Title VII Rules." n31 As a result, the court held, "[o]n remand, the CFTC would only need to make explicit which of those benefits and costs similarly apply to the Rules' extraterritorial applications." n32

n31 *Id.*

n32 *Id.*

*C. The Commission's Initial Response to the Remand Order*

On March 10, 2015, the Commission published its Initial Response to the district court remand order. In that release, the Commission described the district court litigation and order and took two substantive actions.

First, the Commission supplemented the discussion of costs and benefits in the preambles of the remanded rulemakings by stating that it:

hereby clarifies that it considered costs and benefits based on the understanding that the swaps market functions internationally, with many transactions involving U.S. firms **[\*54480]** taking place across international boundaries; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located. The Commission considered all evidence in the record, and in the absence of evidence indicating differences in costs and benefits between foreign and domestic swaps activities, the Commission did not find occasion to characterize explicitly the identified costs and benefits as foreign or domestic. Thus, where the Commission did not specifically refer to matters of location, its discussion of costs and benefits referred to the effects of its rules on all business activity subject to its ***regulations***, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under section 2(i). In the language of the district court, the Commission "functionally considered the extraterritorial costs and benefits," and this was because the evidence in the record did not suggest that differences existed, with certain limited exceptions that the Commission addressed. n33

n33 80 FR at 12558 (internal citation omitted).

Second, to further inform its consideration of costs and benefits on remand, the Commission solicited comments on four questions:

1. Are there any benefits or costs that the Commission identified in any of the rule preambles that do not apply, or apply to a different extent, to the relevant rule's extraterritorial applications?

2. Are there any costs or benefits that are unique to one or more of the rules' extraterritorial applications? If so, please specify how.

3. Put another way, are the types of costs and benefits that arise from the extraterritorial application of any of the rules different from those that arise from the domestic application? If so, how and to what extent?

4. If significant differences exist in the costs and benefits of the extraterritorial and domestic application of one or more of the rules, what are the implications of those differences for the substantive requirements of the rule or rules? n34

n34 *Id.*

The Commission requested that commenters focus on information and analysis specifically relevant to the inquiry required by the remand order, and supply relevant data to support their comments. n35

n35 *Id.*

The Initial Response stated that, following review of the comments, the Commission would publish a further response to the district court remand order, which would include any necessary supplementation of the Commission's consideration of costs and benefits for the remanded rules. The Commission also stated that it would consider whether to amend any of the remanded rules based on information developed in this process. n36

n36 [*Id. at 12555.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5FGD-C140-006W-80J9-00000-00&context=)

*D. Comments in Response to the Commission's Initial Response*

The Commission received four comments in response to its Initial Response to the remand order: A five-page comment jointly filed by the International Swaps and Derivatives Association and the Securities Industry and Financial Markets Association ("ISDA-SIFMA"); a three-page comment filed by the Japanese Bankers Association ("JBA"); a two-page comment filed by UBS Securities LLC ("UBS"); and a twenty-one page comment filed by the Institute of International Bankers ("IIB"). n37 The substance of the comments is discussed in detail in the remainder of this release.

n37 The IIB comment also had a thirteen-page appendix consisting of a comment letter previously filed in response to another Commission request for comments, but covering largely similar subject matter to the primary IIB comment. Comment letters are available on the Commission's Web site at [*http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1564*](http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1564)*.*

Briefly, ISDA-SIFMA cautioned against an overly narrow conception of the burdens of overseas application of Commission rules, stating that, in addition to costs such as registration fees and expenses to construct and administer compliance systems, foreign entities would incur additional costs of "engag[ing] with an unfamiliar, non-domestic regulator and face uncertainty regarding the ramifications of being subject to a new regime." n38 The comment stated that "internal conflicts and customer resistance frequently may follow." n39 ISDA-SIFMA further stated that these costs and uncertainties function as barriers to engagement in U.S. markets, potentially resulting in market fragmentation and decreased liquidity available to U.S. persons. n40 ISDA-SIFMA stated that these costs must be weighed against what ISDA-SIFMA described as "attenuated or minimal benefits" from Commission rules where "foreign ***regulations*** . . . meet the objectives outlined by the G-20 jurisdictions." n41

n38 ISDA-SIFMA at 2. ISDA-SIFMA stated that "[s]imple redeployment of the Commission's apparently domestic previous cost-benefit analysis" would not yield new information or distill lessons from experience to date with the Commission's rules and would "miss a valuable opportunity to contribute to the global discussion regarding resolution of cross-border issues." *Id.* However, in making this observation, ISDA-SIFMA stated that "it is not our purpose in this letter to express a view on what further actions are necessary in order to satisfy the reasonable consideration' and related requirements of the remand order." *Id.* at 2 n.4.

n39 *Id.* at 2.

n40 *Id.*

n41 *Id.* The reference to G-20 objectives is to the 2009 commitment by the G-20 group of major industrial nations to implement ***regulations*** for the over-the-counter derivatives market, including requirements for clearing, trading on exchanges or electronic trading platforms, and reporting of information on derivatives contracts to trade repositories. *See* Leaders' Statement, The Pittsburgh Summit (Sept. 24-25, 2009) at 20, [*https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh\_summit\_leaders\_statement\_250909.pdf*](https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf)*.* Of the ten rules remanded in *SIFMA,* three fall within the specific scope of the 2009 G-20 commitment--the SEF Registration Rule and the SDR and Historical SDR Reporting Rules. Other rules contribute to the broader G-20 objective of reducing risk to the financial system from the use of derivatives.

As evidence of market fragmentation, ISDA-SIFMA referred to ISDA research indicating a reduced percentage of transactions by European swap dealers with U.S. swap dealers in the market for euro denominated interest rate swaps following the implementation of the SEF Registration Rule. n42 ISDA-SIFMA made suggestions for specific substantive changes in two remanded rules. In the Swap Entity Definition Rule, it recommended greater use of safe harbors to reduce uncertainty for businesses hedging financial risk in applying the de minimis exception for determining swap dealer status. n43 In the SDR Reporting Rule, it recommended that the Commission "re-examine" the requirement of Commission rule 45.2(h) that swap counterparties who are not Commission registrants make their books and records available to the Commission and other U.S. authorities. n44

n42 ISDA-SIFMA at 3.

n43 *Id.*

n44 *Id.*

ISDA-SIFMA also urged the Commission to undertake greater harmonization with foreign jurisdictions. In connection with the SEF Registration Rule, ISDA-SIFMA stated that there was a "stark contrast" between what it described as "very rigid execution methods" under the Commission's rule and "greater flexibility" under the rules that the European Union plans to implement, and urged the Commission to "re-examine its approach." n45 ISDA-SIFMA also supported greater international harmonization in the area of swap data reporting. n46 ISDA-SIFMA further stated that significant costs would be incurred if the Commission implemented the test for the application of certain Commission rules based on swap dealing activities within the United States by non-U.S. swap dealers set forth in the Division of Swap Dealer and **[\*54481]** Intermediary Oversight Advisory, Applicability of Transaction-Level Requirements to Activity in the United States (CFTC Staff Advisory No. 13-69, Nov. 14, 2013) ("DSIO Advisory"). n47 Finally, with respect to the use of substituted compliance as a means for addressing issues of duplicative ***regulation***, ISDA-SIFMA stated that "broad, holistic" substituted compliance "can be of substantial help." n48

n45 *Id.*

n46 *Id.*

n47 *Id.* at 4. ISDA-SIFMA called this a "personnel-based test." *Id.*

n48 *Id.*

JBA stated that banks are faced with legal and consulting fees to comply with Dodd-Frank rules and that remaining areas of ambiguity cause them to manage their business in a conservative manner. n49 Banks have also incurred costs to comply with regulatory requirements that differ across jurisdictions, including where comparability is not established. n50 With respect to foreign banks registered as swap dealers, JBA stated that the Commission's initial cost-benefit analysis did not take into consideration the fact that entity-level requirements apply to all of a bank's swaps business even though, for a non-U.S. bank, transactions with U.S. persons account for only 10% of that business. n51 JBA further stated that foreign banks not registered as swap dealers have avoided transacting with U.S. financial institutions to avoid U.S. ***regulation***, inconveniencing their customers and increasing risks and costs for maintaining market liquidity. n52 JBA also stated that customers have avoided transacting with subsidiaries of foreign banks incorporated in the U.S. in order to avoid U.S. ***regulation***, resulting in costs to book transactions with these customers with non-U.S. entities to maintain business relationships. n53 JBA identified the reporting of swap data to trade repositories as one area where banks have been subject to differing requirements in multiple jurisdictions, resulting in increased compliance costs. n54 JBA therefore recommended that the swap data reporting process should be established "through an industry-wide initiative." n55 JBA identified the swaps push-out rule as a second area of particular concern. n56 However, this statutory provision n57 was not part of the *SIFMA* litigation or remand order.

n49 JBA at 1.

n50 *Id.*

n51 *Id.* at 1-2.

n52 *Id.* at 2.

n53 *Id.*

n54 *Id.* at 2-3.

n55 *Id.* at 3.

n56 *Id.*

n57 The phrase "swaps push-out rule" is commonly used to refer to [*15 U.S.C. 8305*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50S9-6B41-NRF4-4005-00000-00&context=), which, broadly speaking and with certain exclusions, prohibits advances from a Federal Reserve credit facility or discount window to assist swap dealers and certain similar entities.

UBS focused on the benefits of the SEF Registration Rule in promoting a level playing field for market participants, facilitating access to liquidity providers, and making the workflow from execution to clearing as robust and efficient as possible. n58 UBS stated that application of the rule to all activities under the Commission's jurisdiction pursuant to section 2(i) helps to ensure that the core principles and benefits of the rule "remain relevant as the global swaps market continues to evolve." n59 UBS also urged the Commission to work with foreign regulators to maximize harmonization, avoid regulatory arbitrage, and establish substituted compliance regimes that address duplicative regulatory burdens, while also maintaining consistency with the principles of the Dodd-Frank Act and Commission ***regulations*** in the SEF area. n60

n58 UBS at 1.

n59 *Id.*

n60 *Id.*

IIB dealt primarily with cost-benefit issues that would arise from implementation of the test based on swap dealing activities physically located in the United States articulated in the DSIO Advisory. n61 IIB focused on swaps between a non-U.S. swap dealer and its non-U.S. counterparties that--under the test set forth in the Advisory--would be subject to transaction-level Dodd-Frank rules if the relevant swaps are arranged, negotiated, or executed by personnel or agents of the non-U.S. swap dealer located in the United States, but not otherwise. According to IIB, in such transactions, the costs of U.S. rules would be greater and benefits lower than in other transactions to which Dodd-Frank rules apply. IIB stated that, in order to avoid U.S. ***regulation***, foreign swap dealers would forgo using staff located in the United States in transactions with foreign counterparties even in circumstances where employing U.S. personnel would be advantageous, for example because a trader located in the United States is more familiar with a particular market. n62 IIB also stated that such a test could result in covered transactions being subject to duplicative and possibly contradictory ***regulation*** by multiple jurisdictions and in costs to establish systems to keep track of which swaps are handled by personnel or agents located in the United States. n63 IIB further stated that benefits would be doubtful in transactions made subject to Commission rules by such a test because the resulting swaps would be between two foreign entities and thus, according to IIB, pose little threat to the U.S. financial system. n64 IIB also discussed cost-benefit implications of a test based on physical presence in the United States in the context of several particular Dodd-Frank rules, including, but not limited to, some of the rules subject to the *SIFMA* remand order. n65 IIB urged the Commission either to not implement such a test or to implement a version considerably narrower than the one described in the DSIO Advisory. n66 IIB also was critical of a different standard based on services provided within the United States by non-U.S. persons, set forth in a Division of Market Oversight guidance document. Under this standard, the SEF Registration Rule applies to foreign-based entities that provide swap execution services to traders located in the United States, even if the traders execute swaps for non-U.S. persons. n67

n61 IIB called this a "U.S. personnel test." IIB at 4.

n62 IIB at 5.

n63 *Id.* at 6-8.

n64 *Id.* at 6.

n65 *Id.* at 9-16. IIB's points regarding particular remanded rules are described in section IV.F, below.

n66 *Id.* at 17-19.

n67 *Id.* at 13-14.

In addition to discussing the application of Commission rules to non-U.S. firms based on activities within the United States, IIB stated that, in the area of swap data reporting, duplicative requirements create costs that could be avoided if the Commission could obtain information from foreign regulators and trade repositories. n68 IIB stated that it supported Commission efforts to address legal and other obstacles to cross-border information sharing. n69 Pending completion of these international efforts, IIB recommended that the Commission formalize existing no-action relief relating to the extraterritorial application of the SDR and Historical SDR Reporting Rules. n70 IIB made no recommendations for specific changes in the substantive requirements of the remanded rules.

n68 *Id.* at 20.

n69 *Id.*

n70 *Id.* **[\*54482]**

**III. General Approach to Costs and Benefits of Extraterritorial Application of Remanded Rules and Methods for Addressing Cost-Benefit Issues Raised by Commenters**

Under the *SIFMA* decision, the ultimate mandate to the Commission on remand, following consideration of the extraterritorial costs and benefits of the remanded rules, is to determine whether such consideration requires any changes to be made in the "substantive transaction- and entity-level requirements" of the remanded rules and, if not, to give a reasoned explanation why not. n71 The Commission observes, consistent with the court's analysis, that Congress's decision to apply the swaps rules extraterritorially may have implications for the costs and benefits of the substance of those rules. This possibility is inherent in cross-border ***regulation*** because different sovereigns will make different substantive choices in implementing swaps-market reforms, and will do so at different paces, which raises the prospect of regulatory arbitrage and/or overlapping or inconsistent rulemaking.

n71 [*67 F. Supp. 3d at 435.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

Although it is likely impossible to fully eliminate those difficulties, there are three general means by which the Commission and other regulators can reduce them. First, the regulator may promulgate rules and pursue policies specifically addressing the geographic reach of its ***regulations***. For the Commission, any such cross-border rules and policies must be within the framework for the extraterritorial application of swaps rules set forth in section 2(i) and must take into account the policies of the relevant Dodd-Frank provisions as well as international harmonization and comity. Second, the regulator may alter the substance of its rules to conform them to those of foreign jurisdictions or to otherwise address the special issues inherent in cross-border ***regulation***. Finally, the regulator may offer substituted compliance or similar relief in situations where a foreign ***regulation*** achieves results that are comparable to its own rules. At the Commission, similar relief may also come at the staff level in the form of no-action letters to address problems that may be more transient in nature, require faster action, or otherwise be better suited to staff action. These three categories of regulatory action may be used individually or in concert.

As to the first of these methods--rules or policies specifically addressing the geographical scope of ***regulations***--the Commission in 2013 issued the Cross-Border Guidance to announce what it judged to be a desirable balance between Dodd-Frank's financial reform policies and international cooperation, consistent with the language of section 2(i). The Commission acknowledged, however, that swaps markets are dynamic and would continue to evolve, necessitating an adaptable approach. n72 In that vein, the Commission stated that it would consider addressing some of the subjects discussed in the Guidance by rulemaking in the future. n73 That remains the Commission's position. As markets evolve and the Commission receives more information, it will consider the possibility of adopting rules concerning the cross-border application of its swaps ***regulations***. n74 Consideration of such rules is, however, outside the scope of the remand order. n75

n72 Cross-Border Guidance, 78 FR at 45297.

n73 [*Id. at 45297 n.39.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

n74 For example, in conjunction with its rule on Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, [*81 FR 636*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5HST-K5J0-006W-82YJ-00000-00&context=) (Jan. 6, 2016), the Commission has adopted an accompanying rule specifically addressing cross-border application. Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants--Cross-Border Application of the Margin Requirements, [*81 FR 34818*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5JWY-VPB0-006W-83HN-00000-00&context=) (May 31, 2016).

n75 [*SIFMA v. CFTC, 67 F. Supp. 3d at 435;*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=) *see also* id. at 434-35 (distinguishing between "substance" of rules and "scope" of their extraterritorial application under section 2(i)).

The second tool for addressing cross-border issues, tailoring substantive rule requirements, is the subject of this release, pursuant to the district court mandate. Although tailoring substantive rule requirements is a possible tool by which to avoid certain issues of regulatory arbitrage and inconsistent ***regulation***, this approach has significant limitations. Chief among these is that the Commission does not have unlimited flexibility to alter rules or lower its standards, consistent with its statutory mandate. Even where the statute permits flexibility, relaxing a particular substantive requirement to address a cross-border issue may be undesirable from a public-policy standpoint when other relevant factors are also considered. This is particularly true since changes in the substance of rules affect domestic as well as extraterritorial transactions and entities.

A further concern with relaxation of substantive rule requirements as a tool to address issues of regulatory arbitrage and costs of ***regulation*** by multiple jurisdictions is that it could contribute to a "race to the bottom" dynamic if engaged in unilaterally rather than as an outcome of internationally coordinated rule harmonization efforts. This point is complicated by the fact, discussed in more detail below, that foreign jurisdictions do not yet have ***regulations*** in place, or fully in place, in important areas covered by the remanded rules. A final consideration in connection with the present remand is that, at the time of its original rulemakings, the Commission consulted with foreign regulators, reviewed comments concerning overseas application of rules, and took these sources of information into account in framing the substance of rules even where the accompanying cost-benefit discussion did not explicitly distinguish between domestic and extraterritorial rule applications. n76

n76 For example, in the Portfolio Reconciliation Rule, the Commission, at the request of commenters, modified the proposed confirmation deadlines to take into account swaps executed in different time zones. 77 FR at 55923. *See also, e.g.,* Real-Time Reporting Rule, 77 FR at 1189-90; SDR Reporting Rule, 77 FR at 2137-38, 2151, 2160-62, 2165, 2167.

Notwithstanding these concerns, the Commission recognizes that incremental changes to harmonize its substantive rules with those of foreign jurisdictions, or otherwise to address issues specific to extraterritorial application, might be desirable under certain circumstances. However, perhaps because of the difficulties described in the previous paragraph, commenters made only a small number of recommendations for specific changes in the substantive requirements of the remanded rules. As explained in Part V, below, the available record does not justify adoption of these proposed changes in the context of the present remand, taking into account both considerations unique to the extraterritorial application of the relevant rules, and considerations common to their domestic and extraterritorial application. Commenters also urged the Commission to continue or expand its engagement in international harmonization efforts for certain rules. The Commission agrees, as discussed in more detail below. However, as also explained below, these efforts have not reached the point today where they can serve as the basis for specific rule changes.

At this time, the Commission is focused, in large part, on the third tool--cooperative international efforts including, but not limited to, substituted compliance and similar relief at the staff level. As outlined in the Cross-Border Guidance, the Commission's substituted compliance program is designed to avoid potential conflicts and duplication between U.S. ***regulations*** and foreign law, consistent with principles of international comity, **[\*54483]** but only in instances where the laws and ***regulations*** of the foreign jurisdiction are comparable and as comprehensive as a corresponding category of U.S. laws and ***regulations***, thus avoiding the risk of a race to the bottom and ensuring that the Commission's public policy goals, established by Congress, are met. n77 As foreign regulators continue to make progress in implementing swaps-market reforms, incentives for regulatory arbitrage will diminish, and substituted compliance can be expanded to reduce duplicative or otherwise unnecessary regulatory burdens. n78

n77 78 FR at 45340.

n78 *See* below at section IV.C.

**IV. Evaluation of International Cost-Benefit Considerations Raised in Comments**

*A. Commenters' General Observations on Costs of Extraterritorial Application of Rules*

ISDA-SIFMA identifies a number of general respects in which compliance with Commission rules may be more difficult for foreign market participants than domestic ones:

When foreign market participants are subject to Commission rules, they must engage with an unfamiliar, non-domestic regulator and face uncertainty regarding the ramifications of being subject to a new regime. A full-bore legal investigation (which may leave unresolved issues) and substantial management attention are prerequisites in any responsible entity becoming subject to a foreign regulator. The addition of specially trained staff is a common adjunct. Internal conflicts and customer resistance frequently may follow. It is unsurprising that non-U.S. market participants simply may be unwilling to take on this burden. n79

n79 ISDA-SIFMA at 2.

ISDA-SIFMA thus suggests that foreign swaps entities may find it more costly to comply with Commission ***regulations*** than domestic entities because foreign entities will be less familiar with U.S. laws and institutions and will need to invest resources in learning about them. Along the same lines, the JBA comments that "banks are faced with increasing costs for legal fees and external consulting fees in their efforts to accurately interpret and comply with [Dodd-Frank rules]." n80 JBA also points out that banks have incurred costs to comply with multiple jurisdictions' ***regulations*** where the timing of implementation or requirements may differ, and that foreign swap dealers need to incur costs to comply with entity-level rules that apply to a firm's overall operations even though only a relatively small portion of the dealer's swaps may be with U.S. counterparties. n81

n80 JBA at 1.

n81 *Id.* at 1-2.

With respect to these general points about costs of extraterritorial application of Commission rules, the Commission notes:

1. The commenters do not appear to dispute the basic point made in the Commission's Initial Response that "the swaps market functions internationally, with many transactions involving U.S. firms taking place across international boundaries; with leading industry members typically conducting operations both within and outside the United States; and with industry members commonly following substantially similar business practices wherever located." n82 By the same token, ISDA-SIFMA's and JBA's general observations on costs are not inconsistent with the conclusion that the types of costs and benefits identified in the original preambles to the remanded rule characterize the extraterritorial, as well as the domestic, application of the rules. The Commission agrees, however, that entities doing business internationally likely would face additional costs resulting from the need to comply with swaps ***regulations*** in more than one jurisdiction. The more jurisdictions in which the market participant does business, the greater the costs that predictably will result. This is inherent in cross-border ***regulation***, both as required of the Commission by Congress and by foreign regulators.

n82 80 FR at 12558. Similarly, while the comments set forth various ways in which, according to the commenters, foreign and domestic costs may differ, they do not take issue with the Commission's statement in the Initial Response that, in the original **Federal Register** releases for the rules at issue, "where the Commission did not specifically refer to matters of location, its discussion of costs and benefits referred to the effects of its rules on all business activity subject to its ***regulations***, whether by virtue of the activity's physical location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under section 2(i)." *Id.*

2. ISDA-SIFMA and JBA state that, in at least some instances, foreign firms will find it more costly to comply with CFTC Dodd-Frank rules than domestic firms will. However, for purposes of considering costs and benefits on remand, a number of factors significantly limit the weight that can be given to their general observations on costs.

a. With certain limited exceptions, discussed below, n83 ISDA-SIFMA and JBA provide no quantitative information on, or estimates of, the differential foreign and domestic cost effects they assert. Moreover, even in qualitative terms they provide little in the way of specific analysis or examples of how the cost mechanisms they mention work in practice. n84 This makes it difficult to evaluate how significant any differences in foreign and domestic costs are relative to the similarities resulting from the overall international nature of the swaps markets; and to assess the attendant implications with respect to the substance of the remanded rules.

n83 *See* section IV.E below.

n84 IIB provides somewhat more detail in its discussion of issues raised by the DSIO Advisory. *See* section IV.F. below.

b. The costs identified by ISDA-SIFMA and JBA are, to a considerable extent, not unique to the foreign applications of the remanded rules. Both comments emphasize the cost of learning about, and establishing compliance programs for, a novel regulatory scheme. However, the Dodd-Frank swaps regime, and the Commission's implementing rules, were novel for domestic as well as foreign firms since swaps in the United States were largely unregulated before Dodd-Frank. Moreover, firms located in the United States also must learn about foreign swaps ***regulations*** if they wish to do business overseas. The discussion by ISDA-SIFMA and JBA does not clearly distinguish the special costs of foreign firms complying with novel U.S. ***regulations*** from the costs to all firms of complying with any novel ***regulations***. ISDA-SIFMA also does not adequately take into consideration that some costs of complying with U.S. rules may have been higher simply because the United States moved more quickly than foreign jurisdictions to implement derivatives ***regulations*** in response to the financial crisis; and foreign jurisdictions still do not have ***regulations*** fully in place.

c. The discussion of general costs in ISDA-SIFMA and JBA, to a large extent, does not distinguish between costs attributable to the remanded rules and costs attributable to the underlying statute. As noted, one of the major cost drivers described in these comments is the cost of learning about, and establishing compliance programs for, U.S. law. However, in virtually all areas covered by the remanded rules, the Dodd-Frank statute either specifically required the CFTC to promulgate some form of rule or directly imposed regulatory requirements. n85 And, as held **[\*54484]** by the court in *SIFMA,* the rules were made applicable to foreign activity by CEA section 2(i), not the Commission's rulemaking. As a result, at least part of the cost of figuring out and applying U.S. law discussed in these comments is attributable to the statutory scheme and not to the specific terms of the rules promulgated by the Commission.

n85 For example, reporting of swaps to swap data repositories is required by CEA section 2(a)(13)(G), [*7 U.S.C. 2(a)(13)(G)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GJ91-NRF4-44CM-00000-00&context=); the Swap Entity Registration Rule is required by CEA sections 4s(a) and 4s(b), [*7 U.S.C. 6s(a)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50P5-8F91-NRF4-4001-00000-00&context=) and [*6s(b)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50P5-8F91-NRF4-4001-00000-00&context=); the Daily Trading Records Rule is required by CEA section 4s(g), [*7 U.S.C. 6s(g)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50P5-8F91-NRF4-4001-00000-00&context=); the Real-Time Reporting Rule is required by CEA section 2(a)(13)(C), [*7 U.S.C. 2(a)(13)(C)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GJ91-NRF4-44CM-00000-00&context=); and requirements for risk management and chief compliance officers are imposed by CEA sections 4s(j)(2) and 4s(k), [*7 U.S.C. 6s(j)(2)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50P5-8F91-NRF4-4001-00000-00&context=) and [*6s(k)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50P5-8F91-NRF4-4001-00000-00&context=).

d. The regulatory requirements imposed by the remanded rules fall largely on sophisticated financial firms active in international markets. It is unlikely that such firms would have significantly more difficulty than similar U.S. firms in applying U.S. law.

Foreign firms made subject to the rules by section 2(i) are likely to have significant experience in international markets, including in particular the U.S. market, since that provision only applies to firms whose transactions have a significant connection with or effect on U.S. commerce. Among such firms, the Swap Entity Registration, n86 Daily Trading Records, Risk Management, Chief Compliance Officer, n87 Swap Entity Definition, n88 and Portfolio Reconciliation n89 Rules primarily impose requirements on swap dealers. A foreign business that meets the legal criteria to be classified as a swap dealer is likely to be a major international financial firm, for a number of reasons. Broadly speaking, the statutory swap dealer definition encompasses firms that are in the business of making available swaps to other persons, to meet the business needs of those persons, as opposed to firms that merely use swaps to hedge their own business risks or for their own investment purposes. n90 Firms engaged in this line of business are likely to be sophisticated financial entities. Indeed, the Commission's rule further defining a swap dealer includes a "de minimis" exception under which an entity dealing in swaps is not considered to be a swap dealer unless its volume of dealing activity exceeds a specified notional dollar amount, currently $ 8 billion, with certain limited exceptions. n91

n86 [*77 FR 2613.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:54S1-RNW0-006W-825G-00000-00&context=)

n87 [*77 FR 20128.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55B1-96W0-006W-80HK-00000-00&context=)

n88 [*77 FR 30596.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55PP-R380-006W-8100-00000-00&context=)

n89 [*77 FR 55904.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:56JB-XV20-006W-82VT-00000-00&context=)

n90 *See, e.g.,* the interpretive guidance on the definition of swap dealer in the preamble to the Swap Entity Definition Rule, 77 FR at 30607-16.

n91 [*17 CFR 1.3(ggg)(4)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5RS7-P930-008G-Y3YP-00000-00&context=). Under the terms of the ***regulation***, the amount will change to $ 3 billion at the end of 2017 unless the Commission takes action to the contrary. The Commission is currently evaluating what the de minimis amount should be after this date. *See, e.g.,* Swap Dealer *De Minimis* Exception Preliminary Report, A Report by Staff of the U.S. Commodity Futures Trading Commission Pursuant to ***Regulation*** 1.3(ggg) (Nov. 18, 2015).

Pursuant to section 2(i), a foreign firm that otherwise meets the definition of a swap dealer would not be considered a swap dealer for purposes of Dodd-Frank swaps ***regulations*** unless its dealing activity has a direct and significant connection with activities in or effect on U.S. commerce. The Cross-Border Guidance describes current Commission policy for applying this limitation. Generally speaking, a non-U.S. firm engaged in swap dealing is only treated as a swap dealer if it is a guaranteed or conduit affiliate of a U.S. firm, or if its dealing activity with a connection to or effect on U.S. markets--including trades with U.S. persons and trades with non-U.S. firms that are guaranteed or conduit affiliates of U.S. persons--exceeds the de minimis amount, which, as noted, is currently $ 8 billion. n92 Non-U.S. firms that meet these criteria are likely not only to be sophisticated financial firms, but also to have a significant presence in international markets and at least some familiarity with U.S. law, including Dodd-Frank and the CEA, and capacity for implementing compliance programs based on it. While the Guidance is non-binding, the scope of section 2(i) itself means that foreign entities subject to the swap dealer definition will generally be sophisticated international companies.

n92 Cross-Border Guidance, 78 FR at 45318-20. An exception is non-U.S. firms that are themselves guaranteed or conduit affiliates of U.S. firms. For these firms, all of their swap dealing activity counts toward the de minimis threshold. [*Id. at 45318-19.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

Consistent with this conclusion, of the firms currently registered as swap dealers with the Commission, almost all that are not U.S. companies are either foreign affiliates of U.S. companies, international banking companies, or affiliates of other major international companies. n93 Similarly, in the preamble to the Swap Entity Registration Rule, the Commission noted that many of the foreign-based commenters on the rule had experience navigating U.S. law in connection with lines of business such as banking or insurance, although it acknowledged that there might potentially be higher costs for any swap dealers that may lack familiarity with U.S. law. n94

n93 *See* Dodd-Frank Act, Provisionally Registered Swap Dealers, CFTC.gov, [*http://www.cftc.gov/*](http://www.cftc.gov/) *LawRegulation/DoddFrankAct/registerswapdealer.*

n94 77 FR at 2625.

The remanded reporting rules--the Real-Time Reporting, SDR Reporting, and Historical SDR Reporting Rules--also impose duties largely on sophisticated parties. For transactions executed on or subject to the rules of designated contract markets n95 ("DCMs") or SEFs, reporting duties generally fall on the relevant DCM or SEF. In other swap transactions, the reporting duty generally falls on a swap dealer, assuming at least one of the parties is a dealer. n96 For cleared swaps, certain reporting duties are handled by derivatives clearing organizations, another category of sophisticated entity. n97 The Commission's understanding is that transactions that are not traded on or pursuant to the rules of a DCM or SEF and that do not involve a dealer, account for only a relatively small portion of the market.

n95 Broadly speaking, "designated contract market" is the term used in the CEA for a traditional futures exchange or a similar exchange used for swap trading.

n96 [*17 CFR 43.3(a)(3)(i)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y333-00000-00&context=)-(iii).

n97 *See, e.g.,* [*17 CFR 45.4(b)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y33G-00000-00&context=); Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps, [*80 FR 52544*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5GTG-0FH0-006W-800C-00000-00&context=) (Aug. 31, 2015).

3. The Commission and its staff have taken a variety of actions that mitigate, though they do not eliminate, differential costs of compliance for foreign and domestic swaps business, most importantly, though not only, through the program of substituted compliance. These mitigation actions are described in section IV.C, below.

*B. General Observations by Commenters on Benefits of Extraterritorial Application of Remanded Rules*

ISDA-SIFMA stated that net benefits of the extraterritorial application of Commission rules are likely to be reduced where foreign ***regulations*** accomplish similar results; they refer to "attenuated or minimal benefits" from "overlayering Commission ***regulations*** onto foreign ***regulations*** that meet the objectives outlined by the G-20 jurisdictions." n98 Other commenters also refer to the existence of overlapping ***regulations*** in some areas such as reporting. n99 The Commission agrees that the existence of similar foreign ***regulations*** can potentially reduce the incremental benefits of Commission rules for entities or transactions covered by those ***regulations***. However, there are a number of factors that limit the weight that can be given to commenters' observations on this point in the context of the present remand.

n98 ISDA-SIFMA at 2.

n99 JBA at 2-3, IIB at 19-20.

1. ISDA-SIFMA and other commenters give little or no information as to what foreign ***regulations*** are currently in effect that they believe address the subject areas of the remanded Commission rules, in particular foreign ***regulations*** that are not at this time subject to substituted **[\*54485]** compliance. Several of the remanded rules cover subjects where non-U.S. ***regulation*** is not yet final. One example is the SEF Registration Rule. In the European Union ("EU"), the leading swaps market outside the United States, new ***regulations*** for "multilateral trading facilities" and "organized trading facilities"--EU terms for certain types of facilities that execute swaps--are being put in place pursuant to EU Directive 2014/65, markets in financial instruments directive, commonly known as "MiFID II," and ***Regulation*** No. 600/2014, markets in financial instruments ***regulation***, commonly known as "MiFIR," both of which were adopted in 2014. n100 However, the EU still needs to approve draft Regulatory Technical Standards put forth by the European Securities and Markets Authority implementing MiFID II and MiFIR. n101 For some requirements, individual European states and ***competent*** authorities will need to take action to put requirements in force. n102 As a result, these EU requirements are not currently expected to go into effect until January 3, 2018. n103 Other foreign jurisdictions also generally do not have current ***regulations*** in operation for swaps trading facilities analogous to SEFs. n104

n100 *See, e.g.,* Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, 2014 O.J. (L 173) 349; ***Regulation*** (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending ***regulation*** (EU) No. 648/2012, 2014 O.J. (L 173) 84.

n101 Council of the EU Press Release 255/16, Markets in financial instruments: Council confirms agreement on one-year delay (May 18, 2016).

n102 *Id.*

n103 *Id.*

n104 *See* Financial Stability Board, OTC Derivatives Market Reforms, Tenth Progress Report on Implementation, at 12-13, 17 Table F (Nov. 4, 2015), [*http://www.fsb.org/wp-content/uploads/OTC-Derivatives-10th-Progress-Report.pdf*](http://www.fsb.org/wp-content/uploads/OTC-Derivatives-10th-Progress-Report.pdf)*.*

Another example is the Real-Time Reporting Rule. European ***regulations*** that will require the post-trade publication of swap transaction information are being implemented within the MiFID II/MiFIR framework and therefore are not yet operational. n105 At present, with very limited exceptions, other non-U.S. jurisdictions also do not yet provide for public reporting of swap transaction information similar to that provided by the Real-Time Reporting Rule. n106

n105 *See* International Organization of Securities Commissions ("IOSCO"), Post-Trade Transparency in the Credit Default Swaps Market, Final Report, at 6 (Aug. 2015), [*http://www.iosco.org/library/pubdocs/pdf/IOSCOPD499.pdf*](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD499.pdf)*.*

n106 *See id.* Financial Stability Board, Thematic Review on OTC Derivatives Trade Reporting, Peer Review Report, at 51 Table 12 (Nov. 4, 2015) ("FSB Trade Reporting Review"), [*http://www.fsb.org/wp-content/uploads/Peer-review-on-trade-reporting.pdf*](http://www.fsb.org/wp-content/uploads/Peer-review-on-trade-reporting.pdf)*.*

The Commission will also need to monitor the effect of the recent vote by the United Kingdom to leave the European Union on the timing and other aspects of the implementation of foreign ***regulation*** in the areas of the remanded rules, particularly given the importance of London as a financial center.

2. Even where foreign jurisdictions have in place ***regulations*** broadly similar to U.S. ***regulations***, there can be important benefits to having U.S. rules apply to foreign swaps activity that has a significant connection with or effect on U.S. markets. Among the remanded rules, one example is the Swap Entity Registration Rule, which sets forth the paperwork and related requirements for a swap dealer to register with the Commission. n107 As explained in the cost-benefit discussion in the rule preamble, the major benefit of this rule is that it "will enable the Commission to increase market integrity and protect market participants and the public by identifying the universe of [swap dealers] and [major swap participants] subject to heightened regulatory requirements and oversight in connection with their swaps activities." n108 In other words, the rule provides the Commission with basic identifying and other information to enable it to monitor the activities of swap dealers and major swap participants--whether foreign or domestic--with a significant connection with or effect on the U.S. market, thereby facilitating regulatory actions that may be required. Foreign licensure requirements do not provide the same benefit of directly and systematically providing the Commission information to enable it to identify and monitor foreign participants in U.S. markets.

n107 77 FR at 2614. The underlying requirement to register derives from the statute. *See* CEA section 4s(a), [*7 U.S.C. 6s(a)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50P5-8F91-NRF4-4001-00000-00&context=).

n108 Swap Entity Registration Rule, 77 FR at 2623.

Other important examples are the SDR and Historical SDR Reporting Rules. Among the primary benefits of these rules is to provide the Commission and other U.S. regulators with information on swaps trades to enable them to monitor and analyze the market. n109 This benefit is relevant to swaps outside the United States made subject to reporting by section 2(i), since such swaps are likely to have significant effects on or connections to the U.S. financial system. While the EU and some other major swaps jurisdictions have rules in place requiring reporting of swaps transactions to "trade repositories," U.S. regulators currently do not have ready access to this data for a variety of legal and practical reasons. n110 While efforts are underway to address these issues, at present reporting to foreign trade repositories does not provide the same benefits for U.S. markets as the Commission's SDR and Historical SDR Reporting Rules. n111

n109 *See, e.g.,* discussion of benefits of SDR Reporting Rule in rule preamble, 77 FR at 2176, 2179, 2181.

n110 *See* FSB Trade Reporting Review at 27-28.

n111 *See id.* at 29-30 (recommendation that all jurisdictions should have a legal framework in place to permit access to data in trade repositories by foreign regulatory authorities by June 2018).

3. In circumstances where foreign and U.S. ***regulations*** address similar concerns, there may be economies in compliance activity that partially compensate for the effects of regulatory overlap. For example, investments by a firm in information and compliance systems to comply with foreign legal requirements in areas such as reporting and risk management are likely to be useful for--and thus reduce the incremental cost of--complying with similar U.S. requirements even if the rules differ in detail.

4. Through substituted compliance and other actions, the Commission has allowed businesses to rely on foreign law in circumstances where it can be shown that that law achieves benefits similar to the Commission's requirements. The Commission expects to make additional use of substituted compliance or other forms of recognition of similar foreign ***regulation*** as appropriate in the future, including when other foreign rules take effect. Substituted compliance and related actions are discussed in detail in section IV.C, below.

*C. Substituted Compliance and Other Commission Actions To Mitigate Costs of Application of Remanded Rules Outside the United States*

The Commission has taken a variety of actions to modify the overseas application of the remanded rules in circumstances where other jurisdictions have similar ***regulations*** in place. These actions may not eliminate the costs associated with duplicative ***regulation***, but they substantially mitigate them, and therefore reduce any justification for substantive rule changes to address extraterritorial concerns.

The most important of the Commission's actions to address problems of duplicative ***regulation*** is substituted compliance. A framework for substituted compliance was set forth in the Commission's Cross-Border **[\*54486]** Guidance. n112 Notably, since the Guidance is a non-binding policy statement, the Commission is not precluded from employing substituted compliance in circumstances, or on terms, not specified in the Guidance if there are good reasons for doing so. n113

n112 78 FR at 45342ff.

n113 For example, in the recently promulgated rule on the cross-border application of the Commission's rule on margin requirements for uncleared swaps, the Commission established standards as to when substituted compliance would be available with respect to that rule that are somewhat different from the standards set forth in the Cross-Border Guidance. *See* 81 FR at 34829-30.

Substituted compliance is relevant to entities that are subject to the Commission's rules pursuant to section 2(i), but also are subject to the swaps laws of a foreign jurisdiction. Examples given in the Guidance include non-U.S. firms required under section 2(i) to register with the Commission as swap dealers and foreign branches and foreign-located guaranteed and conduit affiliates of U.S. swap dealers. n114 Substituted compliance means that the Commission will permit the entity to comply with the law of the relevant foreign jurisdiction in lieu of compliance with one or more of the Commission's regulatory requirements. n115 As a condition for substituted compliance, the Commission must find that the foreign jurisdiction's requirements, in a particular subject area, are comparable to and as comprehensive as, the Commission's requirements. n116 The foreign jurisdiction's requirements need not be identical, however, so long as they achieve similar outcomes. n117 Under the program described in the Guidance, the availability of substituted compliance may vary depending on the type of ***regulations*** or transactions at issue. For example, for certain ***regulations***, called "transaction-level requirements" in the Guidance, substituted compliance is available to foreign swap dealers that are affiliates of U.S. firms in transactions with foreign counterparties, but not in transactions with counterparties who are U.S. persons, in light of the greater U.S. interest in the latter. n118

n114 78 FR at 45342.

n115 *Id.*

n116 *Id.*

n117 [*Id. at 45342-43.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

n118 [*Id. at 45350-61.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

Procedurally, persons interested in substituted compliance must apply to the Commission for a comparability determination. Applicants must identify the Commission requirements for which they seek substituted compliance and provide information about the foreign law that they believe is comparable. n119 Applicants can include regulated firms, foreign regulators, and trade associations or similar groups. n120 However, a resulting comparability determination will apply to all entities or transactions in the relevant jurisdiction, not just to particular applicants. n121 In addition to the formal application, comparability determinations typically also involve consultation by the Commission with foreign regulators and may involve follow-up memoranda of understanding providing for information sharing and other forms of cooperation between regulators. n122 These elements of the process allow the Commission to reduce burdens without sacrificing its regulatory interests as defined by the CEA and Dodd-Frank.

n119 [*Id. at 45344.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

n120 *Id.*

n121 *Id.*

n122 *Id.*

In December 2013, the Commission announced comparability determinations--making substitute compliance possible--with respect to six foreign jurisdictions: Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland in certain rulemaking areas. All of these jurisdictions were found to have laws comparable to two of the remanded rules, the Chief Compliance Officer and Risk Management Rules. n123 The EU and Japan were found to have laws comparable to the Daily Trading Records Rule. n124 The EU was also found to have laws comparable to most, and Japan to have laws comparable to some, provisions of the Portfolio Reconciliation Rule. n125 The comparability determinations incorporated a number of exceptions, typically to ensure that the Commission or other U.S. authorities obtain information on foreign registrants. n126

n123 [*17 CFR 3.3*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5S36-B4Y0-008G-Y0R1-00000-00&context=), [*23.600*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y35W-00000-00&context=)-[*23.606*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y35V-00000-00&context=); *See* Comparability Determination for Australia: Certain Entity-Level Requirements, [*78 FR 78864, 78868-75*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81BT-00000-00&context=) (Dec. 27, 2013); Comparability Determination for Canada: Certain Entity-Level Requirements, [*78 FR 78839, 78842-49*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81BR-00000-00&context=) (Dec. 27, 2013); Comparability Determination for the European Union: Certain Entity-Level Requirements, [*78 FR 78923, 78927-35*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81C0-00000-00&context=) (Dec. 27, 2013); Comparability Determination for Hong Kong: Certain Entity-Level Requirements, [*78 FR 78852, 78855-62*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81BS-00000-00&context=) (Dec. 27, 2013); Comparability Determination for Japan: Certain Entity-Level Requirements, [*78 FR 78910, 78914-21*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81BY-00000-00&context=) (Dec. 27, 2013); Comparability Determination for Switzerland: Certain Entity-Level Requirements, [*78 FR 78899, 78902-08*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81BX-00000-00&context=) (Dec. 27, 2013).

n124 [*17 CFR 23.202*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y35G-00000-00&context=); *See* Comparability Determination for the European Union: Certain Entity-Level Requirements, [*78 FR 78878, 78887-88*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81BV-00000-00&context=) (Dec. 27, 2013); Comparability Determination for Japan: Certain Transaction-Level Requirements, [*78 FR 78890, 78896-97*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B51-G1V0-006W-81BW-00000-00&context=) (Dec. 27, 2013).

n125 [*17 CFR 23.501*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y3BC-00000-00&context=)-[*23.506*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y364-00000-00&context=); *See* 78 FR at 78883-87; 78 FR at 78894-95.

n126 For example the comparability determinations for the Risk Management and Chief Compliance Officer Rules required covered entities to make reports to the Commission, although these reports could be the same as the equivalent reports provided to the relevant foreign regulators.

Nothing in the Commission's policies for substituted compliance precludes additional comparability determinations, beyond those made in 2013, as the international legal landscape for swaps evolves. The Commission recently made a comparability determination for certain European rules for central counterparties, the EU equivalent of what U.S. law calls derivatives clearing organizations. n127 While this is a subject area outside the *SIFMA* litigation, the Commission remains open to further substituted compliance for the remanded rules, upon an adequate showing of comparability.

n127 Comparability Determination for the European Union: Dually Registered Derivatives Clearing Organizations and Central Counterparties, [*81 FR 15260*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5JC1-6N80-006W-80TC-00000-00&context=) (Mar. 22, 2016).

Comparability determinations have been supplemented by other actions to mitigate costs of the extraterritorial application of the remanded rules and accommodate foreign ***regulation***. For example, in the Cross-Border Guidance, the Commission set forth a policy that, with certain exceptions, foreign swap dealers generally would not be required to comply with transaction-level requirements in connection with their swaps with foreign counterparties independently of the substituted compliance program. n128 Another major example is the use of staff no-action letters. These have been used particularly in areas where the law is unsettled, either because of the continuing evolution of foreign law, efforts to harmonize ***regulation*** across jurisdictions, or, in some instances, possible changes in the Commission's own rules. Staff no-action relief has typically been for limited periods of time, with extensions granted as appropriate.

n128 78 FR at 45369. In connection with the cross-border application of the margin rule for uncleared swaps, which postdates the present litigation, the Commission has established certain exclusions by rule. *See* 81 FR at 34850-51 (Table A).

One example is no-action relief in the area of the SDR and Historical SDR Reporting Rules. With certain exceptions, the Commission's Division of Market Oversight has granted no-action relief with respect to these rules for swap dealers and major swap participants established under the laws of Australia, Canada, the European **[\*54487]** Union, Japan, or Switzerland. n129 This relief was issued after the Commission received requests for comparability determinations for trade repository reporting rules in these jurisdictions. n130 The primary exceptions to the relief are for entities that are part of an affiliated group with a U.S. parent and for transactions with counterparties who are U.S. persons or guaranteed or conduit affiliates of U.S. persons. n131 These exceptions reflect the stronger U.S. supervisory and oversight interest in such entities and transactions. n132

n129 CFTC Letter No. 15-61 (extending no-action relief provided in CFTC Letter No. 13-75 and extended under CFTC Letter No. 14-141).

n130 *See id.* at 2; CFTC Letter No. 13-75 at 1-2. In response to a request from ISDA, this relief was extended in late 2015 until the earlier of (a) 30 days after the issuance of a relevant comparability determination or (b) December 1, 2016. CFTC Letter No. 15-61 at 2.

n131 CFTC Letter No. 15-61 at 2. There are also exceptions for certain recordkeeping requirements. *Id.*

n132 *See* CFTC Letter No. 13-75 at 2.

For certain other jurisdictions, the Division of Market Oversight, in response to an ISDA request, has granted no-action relief in connection with requirements in the SDR and Historical SDR Reporting Rules to report identifying information regarding swap counterparties in certain circumstances where doing so would conflict with foreign privacy laws or other legal requirements. n133 The most recent no-action letter on this subject extends relief through March 1, 2017. n134

n133 *See, e.g.,* CFTC Letter Nos. 16-03, 13-41; *see also* IIB at 20 (supporting Commission's efforts to dispel conflicts with foreign privacy laws through no-action relief, data standardization, and memoranda of understanding).

n134 CFTC Letter No. 16-03 at 4-5.

In connection with the SEF Registration Rule, in 2014 the Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight issued a letter stating that no-action relief from that rule would be available to multilateral trading facilities in EU member states upon certification that they were subject to regulatory requirements of their home governments similar to those of the SEF Registration Rule in specified ways. n135 The letter also stated that certain no-action relief would be available to persons trading on these facilities to reflect the fact that the facilities would be carrying out functions like those of U.S. SEFs. n136 This includes partial relief from two of the remanded rules, SDR Reporting and Real-Time Reporting, since the EU trading facility, like a SEF, would be reporting the swap data in question. n137 To date, no European trading facilities have submitted the required certification to obtain this no-action relief.

n135 *See* CFTC Letter No. 14-46. This letter superseded an earlier no-action letter on the same subject, CFTC Letter No. 14-16.

n136 CFTC Letter No. 14-46.

n137 *Id.*

The Division of Market Oversight and the Division of Swap Dealer and Intermediary Oversight have also issued a letter announcing the availability of similar no-action relief for certain Australian licensed financial markets. n138 An Australian trading facility has advised the Division of Market Oversight that it intends to make the certification required by the enabling letter. n139 In the interim, the Division has issued a series of no-action letters granting the facility time-limited no-action relief from the SEF Registration Rule, subject to certain conditions. n140 This relief currently extends until September 15, 2016. n141

n138 CFTC Letter No. 14-117, updated by CFTC Letter No. 15-29.

n139 *See* CFTC Letter No. 16-52.

n140 *Id.*

n141 *Id.*

Further, in response to industry requests, the Commission staff has issued no-action relief to address a variety of issues related to the implementation of some of the remanded rules that do not specifically involve cross-border issues, but that may provide relief to foreign as well as domestic businesses subject to the rules. n142 In addition, the Commission is codifying some existing no-action relief via rulemaking. n143

n142 *See, e.g.,* CFTC Letter Nos. 15-60, 15-38.

n143 The Commission has recently done this for registration requirements involving foreign nationals. Alternative to Fingerprinting Requirement for Foreign Natural Persons, [*81 FR 18743*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5JF4-RPB0-006W-821B-00000-00&context=) (Apr. 1, 2016). *See also,* Definitions of "Portfolio Reconciliation" and "Material Terms" for Purposes of Swap Portfolio Reconciliation, [*81 FR 27309*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5JPM-F7J0-006W-80WD-00000-00&context=) (May 6, 2016).

*D. Commission Consideration of Substantive Rule Changes Outside the Context of the Remand Order*

Another factor weighing against adopting substantive rule changes in the immediate context of the *SIFMA* remand is that the Commission currently is involved in a number of ongoing international efforts that may in the future result in the Commission considering substantive rule changes and may thereby lead to further mitigation of costs of extraterritorial application of the remanded rules. These include discussions with foreign regulators at a variety of levels of formality. For example, in the SEF area, the Commission has worked with European counterparts to understand similarities and differences in our rules.

In the area of swap data reporting, the Commission staff is actively involved in international efforts to develop guidance regarding data elements used for reporting in different jurisdictions. n144 While the primary purpose of this effort is to make reported information more valuable to regulators, better standardization of data elements may also reduce compliance costs for entities operating under the laws of multiple jurisdictions and help facilitate the use of substituted compliance for reporting requirements in the future. In another example of ongoing developments involving swaps data reporting, in December 2015 Congress amended the Dodd-Frank provision regarding swaps data repositories to remove an indemnification requirement that has proven to be an obstacle to the sharing of data internationally. n145 The Commission staff is considering recommendations to the Commission for amendments to Commission rules to address this statutory change. As with data standards, improved sharing of information among regulators potentially could support the future use of substituted compliance in the swap data reporting area.

n144 *See, e.g.,* Committee on Payments and Market Infrastructures and Board of the International Organization of Securities Commissions, Consultative report, Harmonisation of key OTC derivatives data elements (other than UTI and UPI)--first batch (Sept. 2015). The Commission co-chairs an international working group in this area. *Id.* at Annex 2.

n145 *See, e.g.,* FAST Act Includes Dodd-Frank Swap Fix on Global Transparency, Practical Law (Dec. 15, 2015), [*http://us.practicallaw.com/w-001-0649?q=&qp=&qo=&qe=*](http://us.practicallaw.com/w-001-0649?q=&qp=&qo=&qe=)*.*

The Commission believes that harmonization through substantive rule changes is best considered first in consultation with foreign counterparts, rather than unilaterally and reactively. Indeed, section 752 of Dodd-Frank directs the Commission to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the ***regulation*** (including fees) of swaps." n146 This ensures that rule changes are more likely to result in harmonized ***regulation*** rather than a race to the bottom or rules that do not function efficiently in combination. Where such progress has not yet produced agreement or relief, it does not affect the present costs and benefits of the extraterritorial application of the remanded rules. But the existence of these efforts is a factor weighing against making immediate changes in the rules in the context of the *SIFMA* v. *CFTC* remand.

n146 *Public Law 111-203*, *124 Stat. 1376* (2010). **[\*54488]**

*E. Market Fragmentation and Related Issues*

ISDA-SIFMA and JBA state that, in addition to imposing direct costs on foreign businesses, the extraterritorial application of the remanded rules may induce such businesses to reduce their participation in the U.S. market to avoid U.S. ***regulation***. For example, ISDA-SIFMA observes:

These costs and uncertainties [of foreign entities' compliance with U.S. rules] function as barriers to entry and to continued engagement in U.S. markets, potentially resulting in market fragmentation and *decreased liquidity available to U.S. persons* as foreign market participants change their business practices so as not to subject themselves to Commission ***regulation***. n147

n147 ISDA-SIFMA at 2. *See also* JBA at 2. IIB also discusses market withdrawal issues, but primarily in the context of application of the DSIO Advisory and Division of Market Oversight guidance document relating to legal standards for the application of Commission rules based on the provision of swap-related services by non-U.S. persons within the United States. IIB's concerns in this area are discussed below in section IV.F.

This is an important issue worthy of the Commission's sustained attention. The possibility that compliance costs may induce some businesses--whether domestic or foreign--to reduce their swaps activities was recognized at the time of the original rulemakings and was discussed in the cost-benefit section of the preamble to the Swap Entity Definition Rule, albeit without specifically distinguishing between domestic and cross-border activity. n148 It is plausible that foreign firms are more likely to reduce their swaps activities in U.S. markets in response to U.S. ***regulation*** since U.S. markets may be less important to foreign firms, at least for some firms and some categories of swaps. However, it is difficult to evaluate the magnitude of any such effects since, with the important but limited exception of ISDA data on the SEF Registration Rule discussed immediately below, commenters generally did not provide quantitative information on the subject.

n148 *See* 77 FR at 30703 & n.1272, 30705.

Nevertheless, it is reasonable to believe that if an individual firm judges that costs of complying with U.S. rules exceed the costs of reducing its participation in or withdrawing from U.S. markets, it may choose to avoid U.S. markets, at least temporarily. Accordingly, it is important to consider, as ISDA-SIFMA has raised, whether and to what extent rule-induced avoidance of U.S. markets will have a significant effect on the liquidity and the overall operation of those markets. ISDA-SIFMA discusses two ISDA research notes which provide relevant quantitative information on this issue for one of the remanded rules, the SEF Registration Rule. n149

n149 ISDA-SIFMA at 3 & n.6 (citing ISDA Research Note, Cross-Border Fragmentation of Global OTC Derivatives: An Empirical Analysis (Jan. 2014), [*https://www2.isda.org/attachment/NjIzNw==/Cross%20Border%20Fragmentation%20-%20An%20Empirical%20Analysis.pdf*](https://www2.isda.org/attachment/NjIzNw==/Cross%20Border%20Fragmentation%20-%20An%20Empirical%20Analysis.pdf)*;* and ISDA Research Note, Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-Year 2014 Update (July 2014), [*https://www2.isda.org/attachment/NjY0NQ==/Fragmentation%20study%20FINAL.pdf*](https://www2.isda.org/attachment/NjY0NQ==/Fragmentation%20study%20FINAL.pdf)).

The research notes studied transactions between U.S. and European swap dealers before and after the compliance date of the rule in October 2013. They studied transactions involving two categories of cleared swaps, euro-denominated interest rate swaps ("euro IRS") and U.S. dollar-denominated interest rate swaps ("dollar IRS"). n150 For euro IRS, the notes found that, before the compliance date of the SEF Registration Rule, the average volume of transactions between European and U.S. dealers was approximately 29% of the total volume of euro IRS. This figure fell to 9% in October 2013 and 6% in May 2014. n151

n150 ISDA Research Note, Cross-Border Fragmentation of Global OTC Derivatives: An Empirical Analysis (Jan. 2014), and ISDA Research Note, Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-Year 2014 Update (July 2014).

n151 ISDA-SIFMA at 3.

The ISDA figures on euro IRS volume provide evidence of a reduction in European involvement in the U.S. interdealer market following the compliance date of the SEF Registration Rule, but do not measure liquidity or market quality. The ISDA evidence raises concerns about market fragmentation and justifies further inquiry, including inquiry into possible effects of market fragmentation on liquidity. However, the ISDA data does not require immediate changes in the SEF Registration Rule in the context of the *SIFMA* v. *CFTC* remand, for a number of reasons.

1. There is a significant possibility that the ISDA data reflect a temporary transition period rather than the permanent effects of the SEF Registration Rule. As discussed above, the European Union, in MiFID II and MiFIR, has determined to put in place a regulatory framework for swap trading facilities that aims at many of the same objectives as the Dodd-Frank regime for SEFs. n152 As also discussed above, these ***regulations*** are planned to take effect in 2018. As a result, to the extent that the reduced participation in the U.S. market reported by ISDA is driven by differences in U.S. and European ***regulation*** of trading facilities, those differences can be expected to narrow in the next few years. For the same reason, the results reported by ISDA may not reflect European dealers' response to the specific substantive requirements of the SEF Registration Rule but, rather, a preference to trade in a market where more robust ***regulation*** of trading platforms has yet been put into effect. It is also possible that, as the European Union regime is implemented, the Commission may consider substituted compliance or similar actions that might affect choice of counterparties by European dealers. n153

n152 *See, e.g.,* MiFIR, *supra* note 100, at 2-3 (recital 8).

n153 *See, e.g.,* CEA section 5h(g), [*7 U.S.C. 7b-3(g)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:50P5-8GF1-NRF4-4001-00000-00&context=) (authorizing conditional or unconditional exemptions from SEF registration for SEFs subject to comparable, comprehensive supervision and ***regulation*** by governmental authorities in the home country of the facility). For comparison, in the area of clearing, the Commission has granted conditional exemptions from U.S. registration to a number of foreign-regulated derivatives clearing organizations under the authority of CEA section 5b(h), [*7 U.S.C. 7a-1(h)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GWM1-NRF4-42G0-00000-00&context=). *See, e.g.,* Order of Exemption from Registration, *In the Matter of the Petition of Japan Securities Clearing Corporation for Exemption from Registration as a Derivatives Clearing Organization* (CFTC Oct. 26, 2015), available on the Commission's Web site at [*http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/jsccdcoexemptorder10-26-15.pdf*](http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/jsccdcoexemptorder10-26-15.pdf)*.*

2. It is not clear how far the results reported by ISDA for euro IRS generalize. According to the more recent of the research notes cited by ISDA-SIFMA, in the interdealer market for dollar IRS, the portion of the market involving transactions between European and U.S. swap dealers declined to some extent for several months after the SEF Registration Rule took effect, but then returned to more-or-less pre-rule levels. n154 The note suggests that the difference between the results for euro IRS and dollar IRS "may be because the market for US IRS is US-centric, whereas the market for euro IRS has a more global character and is thus more prone to fragmentation." n155 The market for euro IRS is large enough that even results confined to this market are still important for Commission policymaking, but the differences in the results reported by ISDA for different IRS markets affected by the same SEF Registration Rule are a reason for caution in drawing conclusions with respect to the specifics of the rule. n156

n154 ISDA Research Note, Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-Year 2014 Update at 8.

n155 *Id.*

n156 It may also be noted that, in the euro IRS market, U.S. swap dealers continued to do most of their trading with European swap dealers after the implementation of the SEF Registration Rule, notwithstanding the apparent shift away from the U.S. market by the European firms. According to the more recent of the research notes, U.S. swap dealers did 66% of the volume of their euro IRS trades with European swap dealers in 2013, and still did 61% of the volume of these trades with European swap dealers in the first part of 2014. *Id.* at 5. **[\*54489]**

3. To the extent that the results reported by ISDA are attributable to ***regulation***, they may be partly attributable to regulatory requirements that are not subject to the *SIFMA* remand, including statutory requirements. As the more recent of the ISDA research notes points out, initial "made available to trade" determinations occurred in early 2014, triggering a requirement under U.S. law that the types of swaps studied by ISDA be traded on SEFs or DCMs. According to the research note, this could have contributed to the European swap dealer behavior reported by ISDA. n157 However, the requirement that certain swaps be traded on either SEFs or DCMs is not imposed by the remanded SEF Registration Rule. It arises primarily from the combined effect of the mandatory clearing requirement under CEA section 2(h)(1); n158 the Commission's Clearing Determination Rule, n159 which was part of the *SIFMA* lawsuit, but was not remanded; and the statutory requirement that swap transactions subject to mandatory clearing be traded on a SEF or DCM if a SEF or DCM makes the swap available to trade. n160 This adds a further complication in drawing conclusions from the ISDA data for purposes of the remand order.

n157 *Id.* at 1, 4-5.

n158 [*7 U.S.C. 2(h)(1)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GJ91-NRF4-44CM-00000-00&context=).

n159 17 CFR part 50.

n160 *See* CEA section 2(h)(8), [*7 U.S.C. 2(h)(8)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GJ91-NRF4-44CM-00000-00&context=).

4. The criteria for identifying dealers as European and U.S. in the ISDA research notes is not completely clear, but appear to be based, at least in part, on country of incorporation. n161 However, some swap dealers incorporated in Europe are subsidiaries or affiliates of U.S. companies while some swap dealers incorporated in the United States are subsidiaries or affiliates of European companies. n162 As a result, it is likely that some of the swaps business that shifted away from U.S. dealers as reported in the ISDA notes moved to swap dealers incorporated in Europe that have corporate relationships with U.S. swap dealers. The economic effect of such a shift may depend on the nature of the business relationship between the affiliated dealers--for example whether their swaps activities are managed in a unified manner or how risks and obligations are transferred among the affiliates. These issues are not explored in the research notes.

n161 *See* ISDA Research Note, Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-Year 2014 Update at 4 n.5.

n162 *See* Dodd-Frank Act, Provisionally Registered Swap Dealers, CFTC.gov, [*http://www.cftc.gov/*](http://www.cftc.gov/) *LawRegulation/DoddFrankAct/registerswapdealer* (list of registered swap dealers).

5. Even apart from scheduled changes in European law, enhanced ***regulation*** of multilateral swap trading platforms, such as SEFs, is still relatively new and the industry is likely to continue to evolve. n163 There is also ongoing research into the effects of SEF ***regulation***, including the market fragmentation issue raised by ISDA-SIFMA. n164 As a result, a better understanding of the issue and its implications is likely to be available in the reasonably near future compared with the present record.

n163 *See, e.g.,* Chris Barnes, *Is an All-to-All SEF Market About to Arrive?* Clarus Financial Technology (Sept. 8, 2015), [*https://www.clarusft.com/is-an-all-to-all-sef-market-about-to-arrive/*](https://www.clarusft.com/is-an-all-to-all-sef-market-about-to-arrive/)*.*

n164 *See, e.g.,* Evangelos Benos, Richard Payne & Michalis Vasios, Centralized trading, transparency and interest rate swap market liquidity: evidence from the implementation of the Dodd-Frank Act, Staff Working Paper No. 580 (Jan. 2016), [*http://www.bankofengland.co.uk/research/Documents/workingpapers/2016/swp580.pdf*](http://www.bankofengland.co.uk/research/Documents/workingpapers/2016/swp580.pdf)*;* ISDA Research Note, Cross-Border Fragmentation of Global Interest Rate Derivatives: The New Normal? First Half 2015 Update (Oct. 2015), [*http://www2.isda.org/attachment/Nzk2NA==/Market%20fragmentation%20Oct15%20FINAL.pdf*](http://www2.isda.org/attachment/Nzk2NA==/Market%20fragmentation%20Oct15%20FINAL.pdf)*.* Because these sources postdate the comment period on the Commission's Initial Response, the Commission is not relying on their findings. They are cited as evidence that relevant research is ongoing.

6. The evidence of market fragmentation cited by ISDA-SIFMA needs to be considered against the background of the expected benefits to the functioning of the swap market provided by the requirements of the SEF Registration Rule. These benefits were discussed in detail in the preamble to the rule. n165 They include, among others, increased pre-trade transparency (availability of information about prices and quantities at which traders are prepared to transact), potentially making the market more efficient by facilitating the ability of participants to identify potential counterparties. n166 The requirements of the rule are also calculated to put market participants on a more even footing, reducing the effects of informational asymmetries or other forms of market power, and potentially making the swaps market less concentrated and more ***competitive***. n167 All of this can potentially increase market liquidity. n168 The research notes cited by ISDA-SIFMA raise significant issues but provide little, if any, information on how the functioning of U.S. swaps markets has been affected, so far, by any reduced participation on the part of European swap dealers. For example, they do not provide comparative information on bid-ask spreads or other indicators of market efficiency.

n165 *See* 78 FR at 33553-56, 33564-81.

n166 [*Id. at 33564-65.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:58K3-49G0-006W-853F-00000-00&context=)

n167 [*Id. at 33564.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:58K3-49G0-006W-853F-00000-00&context=)

n168 *See* id. at 33554-55.

Notwithstanding these considerations, the research cited by ISDA-SIFMA raises important issues that justify further inquiry. But, for the reasons stated, it does not require immediate changes to the SEF Registration Rule in the context of the *SIFMA* remand.

*F. Issues Relating to Application of Commission Rules to Foreign Firms Based on Swaps Activities Within the United States*

1. Background

The IIB comment focused on the cost-benefit implications for the remanded rules if the Commission employs a test based on swaps-related activities physically located within the United States for determining, in certain circumstances, whether U.S. swaps rules apply to transactions between two non-U.S. firms. ISDA-SIFMA addressed the implications of such a test more briefly, making points similar to those of IIB. As noted previously, the idea of a test based on physical presence of activities in the United States in connection with rules for swap dealers was articulated in the November 2013 DSIO Advisory; while a test based on trading by persons inside the United States on multilateral platforms located outside the country was articulated in the Division of Market Oversight Guidance on Application of Certain Commission ***Regulations*** to Swap Execution Facilities (November 15, 2013) ("DMO Guidance"). Before addressing the issues raised by IIB and ISDA-SIFMA, some background will be given as context.

The DSIO Advisory dealt with certain issues involving the application of transaction-level requirements to non-U.S. swap dealers, *i.e.,* foreign firms that do sufficient U.S.-related swap dealing that they are required to register with the Commission as swap dealers. In the Cross-Border Guidance, the Commission stated that its policy for applying Commission rules to such dealers in accordance with section 2(i) of the CEA would make use of a distinction between what it described as entity-level requirements and transaction-level requirements. n169 As the names imply, an entity-level requirement is a rule **[\*54490]** requirement that is recognized by the Commission as applying to a firm as a whole, while a transaction-level requirement is a requirement that is recognized by the Commission as applying at the level of the individual transaction. n170 Among the remanded rules, the Real-Time Reporting, Daily Trading Records, and Portfolio Reconciliation Rules are characterized as transaction-level rules in the Guidance. n171 According to the policy announced in the Cross-Border Guidance, transaction-level requirements would generally be expected to apply to swaps between a non-U.S. swap dealer and U.S. counterparty, but they would not generally be expected to apply, with certain exceptions, to swaps between a non-U.S. swap dealer and a non-U.S. counterparty. n172 The general exceptions are for transactions with certain non-U.S. counterparties with a particularly close connection to the U.S. market, specifically guaranteed and conduit affiliates of U.S. firms. n173

n169 78 FR at 45331.

n170 *Id.*

n171 [*Id. at 45333.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

n172 [*Id. at 45350-53.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

n173 [*Id. at 45353-59.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=)

The DSIO Advisory addresses situations where a non-U.S. swap dealer has personnel located within the United States that regularly engage in certain forms of swap dealing activity. The advisory expressed the view that a non-U.S. dealer who is "regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute a swap with a non-U.S. person generally would be required to comply with the Transaction-Level Requirements" with respect to such swaps, even though a non-U.S. swap dealer generally is not required to comply with transaction-level requirements for swaps with another non-U.S. counterparty. n174 In support of this position, the advisory stated that, in the view of DSIO, "the Commission has a strong supervisory interest in swap dealing activities that occur within the United States, regardless of the status of the counterparties." n175 The advisory stated that it reflected the views of DSIO only, and did not necessarily represent the position of the Commission or any other office or division of the Commission. n176

n174 DSIO Advisory at 2.

n175 *Id.*

n176 *Id.*

Shortly after the DSIO Advisory was issued, the Division of Swap Dealer and Intermediary Oversight, the Division of Market Oversight, and the Division of Clearing and Risk issued temporary no-action relief with respect to activity within the scope of that described in the DSIO Advisory regarding transaction-level requirements. n177 This relief has since been extended, most recently until the earlier of September 30, 2016, or the effective date of any Commission action with respect to the issues raised by the DSIO Advisory. n178 In January of 2014, the Commission published a notice in the **Federal Register** seeking public comment on the DSIO Advisory. n179 Comments on the DSIO Advisory remain under review and the Commission, to date, has not sought to enforce its rules against a foreign entity based solely on the type of swap dealing activity discussed in the advisory.

n177 CFTC Letter No. 13-71.

n178 CFTC Letter No. 15-48.

n179 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 FR 1347*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5B7K-5W20-006W-829P-00000-00&context=) (Jan. 8, 2014).

The DMO Guidance addressed a variety of issues regarding application of the SEF Registration Rule. As relevant here, the DMO Guidance addressed circumstances in which a multilateral swaps trading platform located outside the United States provides U.S. persons or persons located in the United States--including personnel or agents of non-U.S. persons--with the ability to trade or execute swaps on or pursuant to the rules of the platform, whether directly or through intermediaries. n180 The DMO Guidance expressed the view that provision of the ability to trade or execute swaps to U.S. located-persons, including personnel or agents of non-U.S. persons, "may create the requisite connection under CEA section 2(i) for purposes of the SEF/DCM registration requirement." n181 As a result, the Division of Market Oversight "expects that a multilateral swaps trading platform located outside the United States" that provides U.S. located persons, including personnel or agents of non-U.S. firms, with the ability to trade or execute swaps pursuant to the rules of the platform "will register as a SEF or DCM." n182 The DMO Guidance indicated that in determining whether a particular foreign trading platform needed to register as a SEF, it would take into consideration whether the platform directly solicits or markets its services to U.S.-located persons and whether a significant portion of its business involved U.S.-located persons. n183 The DMO Guidance stated that it represents the views of the Division of Market Oversight only and does not represent the views of the Commission or any other office or division of the Commission. n184

n180 DMO Guidance at 2.

n181 *Id.*

n182 *Id.* at 2.

n183 *Id.* at 2 n.8.

n184 *Id.* at 5.

2. Comments on Cost-Benefit Implications of DSIO Advisory

a. Points Made by Commenters

IIB identifies a number of general costs--not specific to particular rules--from applying a test based on presence in the United States to transactions between non-U.S. swap dealers and non-U.S. counterparties. The major cost, according to IIB, is that such a test would create incentives to avoid using personnel located in the United States in such transactions in order to avoid being subject to U.S. transaction-level rules. n185 While the transactions could still occur, IIB states that parties would lose certain advantages that may be associated with the use of personnel located in the United States. In particular, IIB states that personnel with the greatest expertise in some markets, such as U.S. dollar denominated interest rate swaps, are typically located in the United States. n186 Relatedly, presence in the United States may provide traders with better access to information on U.S. markets. n187 In addition, U.S.-located personnel can have advantages for time zone reasons. n188 IIB also states that some advantages of centralized risk management may be lost if functions previously handled by personnel located in the United States are split, with U.S. personnel retaining the functions for transactions with U.S. counterparties and personnel outside the U.S. handling those same functions for other transactions to avoid the effects of a U.S. presence test. n189

n185 IIB at 5-6; *see also* ISDA-SIFMA at 4.

n186 IIB at 5 & n.12.

n187 *Id.* at 5.

n188 *Id.*

n189 *Id.* at 5-6.

IIB also states that, since such a test applies to transactions between non-U.S. firms, it exposes them to the cost of dealing with duplicative and possibly contradictory foreign ***regulation***. n190 IIB also notes that there will be costs associated with keeping track of which swaps with non-U.S. counterparties are arranged, negotiated, or executed by personnel located in the United States and incorporating that information into compliance systems. n191 IIB further observes that, even if most of these costs fall on non-U.S. swap dealers who maintain offices in the United States, some will fall on non-U.S. **[\*54491]** counterparties who deal with these swap dealers. n192

n190 *Id.* at 6-7.

n191 *Id.* at 8.

n192 *Id.* at 8-9.

IIB also characterizes the benefits of applying a test based on physical presence in the United States to transaction-level requirements as doubtful. IIB states that transactions made subject to U.S. ***regulation*** by such a test do not give rise to risks to the U.S. financial system because they do not involve a counterparty that is a U.S. person or a guaranteed or conduit affiliate of a U.S. person. n193 IIB further asserts that this test does not offer ***competitive*** parity benefits. IIB states that, even if the Commission believes that, without a physical presence test, there is an unlevel playing field between U.S. and non-U.S. swap dealers employing U.S.-located front-office personnel, such concerns are outweighed by the applicability of foreign ***regulation*** to those non-U.S. swap dealers and by new ***competitive*** disparities such a test would create between U.S. and non-U.S. personnel. n194 Finally, IIB states that any benefits from application of rules pursuant to a physical presence test would be "largely illusory" to the extent that non-U.S. entities structure transactions to fall outside the test. n195

n193 *Id.* at 6. As explained above, under the policies for applying section 2(i) announced in the Cross-Border Guidance, transactions between a non-U.S. swap dealer and a counterparty that is a U.S. person or guaranteed or conduit affiliate are subject to transaction-level requirements independently of the location of the swap dealer's personnel.

n194 IIB at 6.

n195 *Id.*

IIB also discusses certain implications of the application of such a test to particular rules, including the three transaction-level rules that are part of the *SIFMA* remand. n196 IIB notes that the Portfolio Reconciliation Rule and the Daily Trading Records Rule are intended to mitigate risks to the U.S. financial system. n197 IIB states that the risks those rules are intended to address are not borne by the personnel who arrange, negotiate, or execute swaps, but rather by the parties to the swap. n198 In transactions made subject to these rules solely based on the physical presence of dealing activity in the United States, neither counterparty is a U.S. person or a guaranteed or conduit affiliate of a U.S. person so, according to IIB, the risks do not flow back to the U.S. financial system and the purposes of the rules are not served or only served in an attenuated way. n199

n196 Much of IIB's discussion of specific rules concerns external business conduct and entity-level rules that are outside the remand and therefore are not addressed here. *See, e.g.,* IIB at 14-16, 19-20.

n197 IIB at 9.

n198 *Id.*

n199 *Id.* at 9 & n.27.

With respect to the Real-Time Reporting Rule, IIB appears to acknowledge that this rule, as a general matter, may generate useful market information since it states that non-U.S. counterparties "can effectively free ride and obtain the benefits of the CEA's real-time public reporting requirements by accessing publicly available price data and taking that data into account when negotiating its swaps." n200 However, IIB asserts that these same non-U.S. counterparties have a financial incentive to avoid engaging in transactions that are subject to this rule, and will therefore have an incentive to avoid transactions involving U.S. personnel if a physical presence test applies. In particular, according to IIB, swap dealers may provide worse pricing in transactions subject to real-time reporting. This is so, according to IIB, because swap dealers must allow for the possibility that they will be unable to hedge the transaction before the terms of the underlying transaction are disclosed pursuant to the Real-Time Reporting Rule, and may face worse market terms for their hedge transactions as a result of the disclosure. n201 IIB does not, however, provide data indicating how often this phenomenon is likely to occur or comparing bid-ask spreads in transactions subject to the Real-Time Reporting Rule with those in similar transactions not covered by the rule. IIB also states that application of a physical presence test to the Real-Time Reporting Rule may be costly to implement because current systems used by non-U.S. swap dealers to identity which of their swaps must be reported under the rule do not track information on the location of front-office personnel involved in arranging, negotiating, or executing the swap. n202 IIB does not provide quantitative cost estimates, however.

n200 *Id.* at 12.

n201 *Id.*

n202 *Id.*

b. Commission Response

The Commission agrees with IIB and ISDA-SIFMA that the test articulated in the DSIO Advisory raises significant issues that need to be considered by the Commission. However, their comments are overwhelmingly presented as a criticism of the test itself, not as a basis for substantive rule changes. The *SIFMA* v. *CFTC* remand order does not cover this issue, because the test relates to the geographical scope of application of certain Commission rules and not to their substance. n203 Accordingly, the Commission will not pass judgment on it in the context of this release. Rather, as noted above, the Commission has separately solicited, and is considering, comments on the DSIO Advisory; and, in the interim, the Commission's regulatory divisions have granted staff no-action relief.

n203 *See* [*SIFMA, 67 F. Supp. 3d at 434-35.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

For purposes of the remand, the Commission will address a narrower issue: do the possible cost-benefit implications of a physical presence test sufficiently alter the evaluation of the costs and benefits of the three remanded transaction-level rules to require the Commission to make changes in the substance of those rules at the present time. The Commission concludes that they do not, for a number of reasons:

1. The cost-benefit implications of the test articulated in the DSIO Advisory for the three remanded transaction-level rules are currently uncertain because the Commission is still considering public comments and it is uncertain at this time whether the Commission will apply the test. As a result of no-action relief, the test has not, to date, been applied or, therefore, affected the costs and benefits of the remanded rules. As a result, even if the test potentially might affect costs and benefits in a manner that is distinct from the mere fact of extraterritorial ***regulation***, it is not appropriate at this time to fashion substantive rule changes to account for it.

2. The test articulated in the DSIO Advisory affects a somewhat limited segment of the market--only swap transactions that a non-U.S. swap dealer enters into with non-U.S. counterparties that are not guaranteed or conduit affiliates of U.S. persons and that are arranged, negotiated, or executed using personnel or agents of the non-U.S. swap dealer that are located in the United States. This limits the implications of the test for the overall costs and benefits of the remanded rules even if the points made by the commenters are important for purposes of the costs and benefits of the rules as applied to transactions within the scope of such a test. In addition, this fact makes it likely that the best way to address issues raised with respect to the test will involve assessing the test itself rather than making rule changes that would affect numerous transactions outside its scope. Consistent with this conclusion, the IIB comment makes recommendations with regard to application of the test itself, but makes no recommendations for across-the-board changes in the substance of the **[\*54492]** three remanded transaction-level rules. n204 Similarly, ISDA-SIFMA identifies costs that it states would be caused by implementation of the test, but does not make recommendations for changes to the substance of the remanded transaction-level rules as a way of addressing those costs. n205

n204 *See* IIB at 16-19.

n205 ISDA-SIFMA at 4.

3. Even assuming that a test based on dealing activities by non-U.S. firms physically present in the United States were to be implemented for transaction-level rules, there are a number of considerations that limit, though they do not eliminate, the weight that can be given to some of the points made by commenters with respect to the implications of such a test for costs and benefits.

(a) IIB and ISDA-SIFMA do not provide quantitative information or estimates of the effects they project. n206 The fact that staff no-action relief was promptly put in place presumably affected the ability to obtain quantitative information on the effects of the test in the DSIO Advisory, but the absence of quantitative information, or even estimates, makes it difficult to assess how important the effects described by the commenters would be in practice.

n206 The ISDA research notes on market fragmentation do not relate to the test in the DSIO Advisory since they involve transactions between European and U.S. swap dealers, while the DSIO Advisory primarily relates to transactions between two non-U.S. firms.

(b) Convergence between foreign and U.S. ***regulation*** may reduce incentives to avoid U.S. ***regulation*** and therefore to avoid making use of U.S. personnel or agents to avoid such ***regulation***. For example, as described above, the EU currently is planning to implement public reporting of swaps transactions broadly similar to the Real-Time Reporting Rule in 2018.

(c) The discussion of the implications of a physical presence test for the Real-Time Reporting Rule in the IIB comment asserts that swap dealers will tend to offer worse pricing to counterparties in transactions subject to the Real-Time Reporting Rule because reporting may expose dealers to worse prices in their hedging transactions. n207 However, this possibility was recognized in the original rulemaking and provisions were built into the rule to minimize the chance that the otherwise anonymous public reporting of trades would provide the market with information that would enable traders to identify planned, but not-yet-executed, hedge trades by dealers and take advantage of that information. These provisions include time delays for reporting of large transactions n208 and reporting of rounded or "capped" notional amounts rather than the actual notional amount for block trades and certain other large transactions. n209 The cost-benefit discussion in the preamble to the rule concluded that time delays "will counter the possibility for front-running large block trades before they can be adequately hedged." n210 The IIB comment does not address the consideration of this issue in the original rulemaking and in a subsequent rulemaking that amended the anonymity-protecting provisions. n211

n207 IIB at 12.

n208 *See* [*17 CFR 43.5*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y335-00000-00&context=).

n209 *See* [*17 CFR 43.4(h)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y334-00000-00&context=).

n210 Real-Time Reporting Rule, 77 FR at 1239.

n211 *See* Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, [*78 FR 32866, 32928-31*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:58J8-7MX0-006W-84SF-00000-00&context=) (May 31, 2013) (discussing costs and benefits of amendments to anonymity protection provisions of Real-Time Reporting Rule).

3. Comments on Application of SEF Registration Rule to Non-U.S. Trading Platforms Based on Provision of Services Within the United States

a. Points Made in Comments

IIB discusses cost-benefit issues arising from the application of a test based on provision of services within the United States to the SEF Registration Rule pursuant to the interpretation of section 2(i) in the DMO Guidance. n212 As described above, according to this interpretation, a non-U.S. swaps trading platform would be subject to the SEF Registration Rule even if the platform provides swap execution services solely to non-U.S. persons, if it provides personnel or agents of those persons with the ability to make trades from locations within the United States. According to IIB, this has a number of negative effects. IIB states that some non-U.S. multilateral trading platforms have refused access to U.S.-located personnel of foreign firms in order to avoid the costs of having to register as SEFs. n213 According to IIB, this encourages U.S. personnel of non-U.S. entities to trade swaps bilaterally, over-the-counter, contrary to the Commission's overall transparency objectives. n214 IIB does not, however, provide information on how often these phenomena may have occurred or give examples. IIB also does not discuss whether U.S. SEFs or other non-U.S. multilateral trading platforms may sometimes be able to provide substitute services if a particular non-U.S. multilateral trading platform refuses access. IIB also notes that the test in the DMO Guidance extends to trades executed through an intermediary and states that the benefits of SEF registration are highly attenuated in transactions where U.S. personnel of non-U.S. firms trade on a non-U.S. multilateral trading facility through an intermediary because the intermediary will be regulated by the Commission and this will provide significant customer and market integrity protections. n215

n212 IIB at 13-14.

n213 *Id.* at 13.

n214 *Id.*

n215 *Id.* at 14.

b. Commission Response

As with the DSIO Advisory, the issues raised by IIB with respect to the DMO Guidance relate to the geographic scope of the SEF Registration Rule as opposed to substantive rule requirements that may carry unique cross-border costs. Consistent with this, IIB recommends changes in the geographic approach taken in the DMO Guidance and does not recommend changes in the SEF Registration Rule itself. Moreover, to the extent that there are cost implications of the type identified by IIB, they relate to a limited subset of the market--transactions between non-U.S. firms that the firms would prefer to have executed on a non-U.S. trading platform with at least one firm using a U.S.-based trader. For these reasons, the Commission concludes that the issues raised by IIB with respect to the DMO Guidance do not warrant changes in the substantive provisions of the SEF Registration Rule and are beyond the scope of the remand.

*G. Additional Observations Made by Commenters on Costs and Benefits of Extraterritorial Application of Particular Rules*

1. SEF Registration Rule

The UBS comment emphasized the benefits of the SEF Registration Rule, particularly provisions requiring SEFs to provide impartial access so that market participants can ***compete*** on a level playing field and to provide straight-through-processing, which is designed to make the workflow from trade execution to clearing as robust and efficient as possible. n216 The comment endorsed the extraterritorial application of the rule consistent with section 2(i), stating that, "[i]n light of the global and flexible nature of swaps execution, failing to apply the provisions of [the rule] to all activities subject to the Commission's jurisdiction would risk undermining the importance of the core principles contained therein as the **[\*54493]** global swaps market continues to evolve." n217 The comment further stated that, as other jurisdictions proceed with finalizing swap execution rules, the Commission should attempt to maximize harmonization while preserving core principles that are critical to a well-functioning market. n218

n216 UBS at 1.

n217 *Id.*

n218 *Id.*

The Commission agrees that broad application of the SEF Registration Rule within its jurisdiction will benefit the market in terms of transparency, efficiency, and ***competitiveness***. The Commission also agrees that realization of those benefits may be enhanced by harmonization with foreign regimes, consistent with the Commission's own regulatory objectives.

ISDA-SIFMA also recommended harmonization in the SEF area; and specifically urged the Commission to "re-examine" what ISDA-SIFMA considered to be a "very rigid" approach to execution methods in the SEF Registration Rule in light of what ISDA-SIFMA characterized as greater flexibility for swap trading platforms in the European Union under MiFID II. n219 As described previously, the MiFID II regime is still in the process of being implemented and is not expected to be in operation until 2018. The Commission also notes that the SEF Registration Rule provides for flexibility in execution methods, albeit not in the precise ways that ISDA and SIFMA have recommended in other documents. n220 In particular, the rule requires SEFs to make available trading via an order book, but also allows trades to be executed on SEFs using a request for quotes system. n221 It also allows block trading for large transactions. n222 Additional flexibility for SEFs with respect to block trades has been provided through staff no-action relief. n223 The MiFID II standards for pre-trade transparency in transactions on derivatives trading platforms, in some important respects, may be more stringent and prescriptive than the Commission's SEF rules. n224

n219 ISDA-SIFMA at 3.

n220 *See generally* ISDA, Path Forward for Centralized Execution of Swaps (Apr. 2015), cited in ISDA-SIFMA at 3 n.7.

n221 [*17 CFR 37.9*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R80-008G-Y3CX-00000-00&context=).

n222 [*17 CFR 37.9(a)(2)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R80-008G-Y3CX-00000-00&context=).

n223 *See* CFTC Letter No. 15-60.

n224 *See, e.g.,* MiFIR, *supra* note 100, at 2-3 (recital 8); Amir Khwaja, *MiFID II and Transparency for Swaps: What You Need to Know,* Clarus Financial Technology (Sept. 29, 2015), [*https://www.clarusft.com/mifid-ii-and-transparency-for-swaps-what-you-need-to-know/*](https://www.clarusft.com/mifid-ii-and-transparency-for-swaps-what-you-need-to-know/)*.*

2. SDR and Historical SDR Reporting Rules

Commenters observed that the current international regime in which, pursuant to international commitments made following the 2008 financial crisis, multiple jurisdictions have put in place requirements to report data on swap transactions to swap data repositories or their foreign equivalents has increased costs and reduced benefits of reporting. For example, ISDA-SIFMA stated:

[I]mplementation of trade reporting mandates in different jurisdictions is producing a disjointed and costly framework of overlapping reporting obligations, in some cases in conflict with local laws, with market participants reporting to a multiplicity of trade repositories on different bases. Despite having access to tremendous amounts of information, regulators are unable to consolidate, aggregate and effectively use that information. n225

n225 ISDA-SIFMA at 3.

JBA and IIB made substantially similar observations. n226 None of the commenters provided quantitative data on, or estimates of, the cost of duplicative reporting. Commenters also did not provide detailed or specific qualitative information on how the Commission's reporting rules interact with foreign requirements. With the exception of a recommended change in Commission rule 45.2(h), discussed below, none of the commenters recommended specific substantive changes in the SDR or Historical SDR Reporting Rules. Commenters generally recommended that the Commission address the current problems with the international reporting regime through international cooperative means such as memoranda of understanding with foreign regulators, initiatives to promote data standardization and remove legal obstacles to cross-border access to reported information, and international rules to determine parties responsible for reporting. n227 IIB also recommended that, while efforts to resolve international data reporting issues are ongoing, the Commission keep in place and formalize existing no-action relief. n228

n226 JBA at 2-3; IIB at 19-20.

n227 JBA at 3; IIB at 20.

n228 IIB at 20.

The Commission agrees that improvements in standardization and sharing of reported swap data across jurisdictions would be beneficial, and Commission staff is working toward these objectives, as noted in section IV.D, above. Among other benefits, they might facilitate the use of substituted compliance or similar arrangements to reduce duplicative ***regulation*** in the swap reporting area. By their nature, however, improvements in these areas require international cooperative efforts, as commenters generally recognized. As a result, the issues with swap data reporting raised by the commenters do not support unilateral changes in the substance of the SDR or Historical SDR Reporting Rules in the context of the present remand.

**V. Commenters' Recommendations for Changes in Substantive Requirements of Rules**

*A. Introduction*

As noted above in Part III, under the *SIFMA* decision, the ultimate mandate to the Commission on remand, following consideration of any differences between the extraterritorial and domestic costs and benefits of the remanded rules, is to determine whether such consideration requires any changes to be made in the substantive requirements of the remanded rules and, if not, to give a reasoned explanation why not. n229 For this purpose the Commission, as mentioned above, asked commenters about "the implications of" any differences between extraterritorial and domestic costs and benefits "for the substantive requirements" of the remanded rules. n230 In addition to general discussions of cross-border costs and benefits of some of the remanded rules, addressed in Part IV, above, commenters put forth two requests for specific changes in particular substantive rule requirements, which are discussed here. The Commission believes that it is useful in this context to evaluate the commenters' proposed changes in light of the fact that the Commission is required to apply to its own regulatory proposals pursuant to section 15(a) of the Commodity Exchange Act ("section 15(a)"). n231 The Commission also incorporates by reference the discussions in the preceding sections.

n229 *See* [*67 F. Supp. 3d at 435.*](https://advance.lexis.com/api/document?collection=cases&id=urn:contentItem:5D54-71R1-F04C-Y11D-00000-00&context=)

n230 Initial Response, 80 FR at 12558.

n231 Section 15(a)(1), [*7 U.S.C. 19(a)(1)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GRD1-NRF4-42KS-00000-00&context=), requires the Commission, with certain exceptions, to consider the costs and benefits of its action before promulgating a ***regulation*** or issuing an order. Section 15(a)(2), [*7 U.S.C. 19(a)(2)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GRD1-NRF4-42KS-00000-00&context=) states that the costs and benefits of the proposed Commission action shall be evaluated in light of--(A) considerations of protection of market participants and the public; (B) consideration of the efficiency, ***competitiveness***, and financial integrity of futures markets; (C) considerations of price discovery; (D) considerations of sound risk management practices; and (E) other public interest considerations.

In addition to making recommendations regarding the substance of some of the remanded rules, the commenters made a number of recommendations as to how the **[\*54494]** Commission should apply section 2(i) in particular circumstances to establish the extraterritorial scope of one or more of the rules. n232 For purposes of its response to the remand order, the Commission will not attempt to make determinations regarding the merits of commenters' recommendations for rule changes or other actions defining the extraterritorial scope, as opposed to the substance, of the rules.

n232 An example is IIB's recommendation that the Commission not make use of a test based on the physical presence of swap dealing activity in the United States test in determining what transactions are subject to transaction-level rules. IIB at 16-19.

*B. Expanded Use of Safe Harbors in the Swap Entity Definition Rule*

1. Commenter Proposal

Based on its observation that foreign entities are likely to have more difficulty figuring out U.S. law than U.S. firms, ISDA-SIFMA states that the costs of extraterritorial application of rules could be mitigated by "greater clarity around the scope of Commission rules and greater use of safe harbors." n233 The Commission agrees that use of safe harbors or other forms of "bright line" rules can make it easier for businesses to determine whether they are in compliance with ***regulations***. On the other hand, use of bright line rules commonly involves a trade-off between simplicity of implementation and risks of either underinclusiveness or overinclusiveness with regard to the policy objectives of the ***regulation***. As a result, suggestions for greater use of bright line rules need to be evaluated in specific contexts.

n233 ISDA-SIFMA at 3.

ISDA-SIFMA makes only one specific suggestion for greater use of safe harbor provisions, in the definition of a swap dealer. The comment states:

[P]ersons utilizing the de minimis exemption from swap dealer status may be avoiding transactions with U.S. swap dealers due to uncertainty regarding whether their swaps hedging their own financial risks would be considered to be entered into "in connection with dealing activity." Expansion of the safe harbor now restricted to physical commodity hedging, so as to encompass a broader array of hedging transactions, could mitigate this effect. n234

n234 *Id.*

The ISDA-SIFMA recommendation relates to an issue that was considered by the Commission at the time of the original Swap Entity Definition rulemaking. As noted above, under the Commission's ***regulation*** defining a swap dealer, a person who enters into swap transactions is only considered to be a swap dealer if its swap positions in connection with its dealing activity exceed a specified de minimis amount, currently $ 8 billion. n235 Thus, in order to determine if it needs to register as a swap dealer, a business that enters into a large volume of swaps may need to evaluate whether its positions involve dealing or are for some other purpose. In close cases, this may involve a judgment taking into account a number of factors. n236 However, the Commission has specified that some categories of swap transactions are not considered in determining whether an entity is a swap dealer. One of these safe harbor categories is swaps used to hedge market positions in physical commodities. n237

n235 [*17 CFR 1.3(ggg)(4)(i)(A)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5RS7-P930-008G-Y3YP-00000-00&context=).

n236 *See, e.g.,* 77 FR at 30614-16 (discussing interpretive issues in application of statutory definition of swap dealer).

n237 [*17 CFR 1.3(ggg)(6)(iii)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5RS7-P930-008G-Y3YP-00000-00&context=).

At the time of the original rulemaking, the Commission considered whether to also create a safe harbor for swaps used to hedge commercial risks--including financial risks--not associated with physical commodities. n238 The Commission stated that hedging generally was not a form of dealing activity, but determined that a *per se* safe harbor for commercial hedging should not be adopted because, in practice, it is often difficult to distinguish commercial hedging transactions from dealing transactions without taking into consideration the surrounding facts and circumstances. n239 "[N]o method has yet been developed to reliably distinguish, through a *per se* rule between: (i) [s]waps that are entered into for the purpose of hedging or mitigating commercial risk; and (ii) swaps that are entered into for the purpose of accommodating the counterparty's needs or demands or otherwise constitute swap dealing activity, but which also have a hedging consequence." n240 By contrast, the Commission had extensive experience in the futures market with exclusions for hedging risks associated with physical commodities and therefore concluded that it could safely make use of a *per se* rule for swaps used for this purpose. n241 The hedging safe harbor was adopted as an interim final rule and the Commission invited comments, including on whether the safe harbor should be expanded to include hedging of financial risks. n242 However, the Commission has not, to date, found reason to modify the safe harbor as originally promulgated.

n238 77 FR at 30611-13.

n239 *Id.*

n240 [*Id. at 30613.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55PP-R380-006W-8100-00000-00&context=)

n241 [*Id. at 30612-13.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55PP-R380-006W-8100-00000-00&context=)

n242 [*Id. at 30613.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:55PP-R380-006W-8100-00000-00&context=)

The ISDA-SIFMA safe-harbor proposal thus raises issues that go well beyond ISDA-SIFMA's concern with making U.S. law easier for foreign firms to figure out. Maintaining the integrity of the line between hedging and dealing activities is fundamental to a definition of a swap dealer that is meaningful in practice and thus fundamental to the effectiveness of the Dodd-Frank regulatory regime for swap dealers, both foreign and domestic. Unfortunately, the ISDA-SIFMA comment does not put forward a solution to the problem identified in the original rulemaking--devising a reliable *per se* rule for distinguishing between swaps entered into to hedge commercial risks and swaps that constitute dealing activity without taking into consideration additional facts and circumstances.

2. Evaluation in Light of Section 15(a) Factors

a. Protection of Market Participants and the Public

Expanding the hedging safe harbor in the definition of swap dealer to cover hedging of financial risks poses significant risks of reducing protection of market participants and the public. As noted above, the Commission found in the preamble to the Swap Entity Definition Rule that no reliable *per se* method has been found for distinguishing between hedging financial risks using swaps and swap dealing. As a result, a safe harbor for hedging financial risks could increase the possibility that some entities engaged in a large volume of swap dealing would be misclassified and not treated as dealers. This is particularly true since, in close cases, businesses would have incentives to label transactions as hedging rather than dealing to take advantage of the safe harbor. Thus, a safe harbor for hedging financial risks could result in some entities engaged in large volumes of swap dealing not being subject to the provisions of Dodd-Frank and Commission implementing ***regulations*** designed to protect market participants and the public against wrongdoing by swap dealers and against the risks to the financial system that were associated with unregulated swap dealing before Dodd-Frank. This includes both some of the remanded rules and statutory provisions and Commission rules that are not subject to the remand order but that would not apply to firms that were no longer classified as swap dealers as **[\*54495]** a result of an expanded safe harbor. n243 This concern applies to overseas as well as domestic entities since, given the de minimis volume element of the swap dealer definition and limits of section 2(i), a safe harbor would only be relevant to foreign entities engaged in a reasonably large volume of swaps that affect or are connected to U.S. markets. The ISDA-SIFMA comment does not specify methods for crafting a safe harbor for hedging financial risks that avoids misidentification or otherwise give reasons to overturn the Commission's judgment regarding the workability of a safe harbor in the preamble to the Swap Entity Definition Rule.

n243 Relevant remanded rules include the Swap Entity Registration, Daily Trading Records, Risk Management, Chief Compliance Officer, and Portfolio Reconciliation Rules. Examples of other requirements imposed on swap dealers to protect market participants and the public include the business conduct standards set forth at 17 CFR part 23, subpart H.

b. Efficiency, ***Competitiveness***, and Financial Integrity

A safe harbor for hedging of financial risks poses a significant risk of reducing efficiency, ***competitiveness***, and financial integrity because, as already explained, it could result in firms that engage in large volumes of swap dealing not being subject to Dodd-Frank provisions and Commission ***regulations*** that apply to swap dealers and that are themselves designed to promote efficiency, ***competitiveness***, and financial integrity in the business of swap dealing. Examples include the Daily Trading Records, Risk Management, Chief Compliance Officer, Portfolio Reconciliation, and Real-Time Reporting Rules, among others.

c. Price Discovery

The recommended safe harbor appears unlikely to have a significant effect on price discovery. A safe harbor for swaps used to hedge financial risks could increase the volume of swaps transactions by some amount, but in light of the limited circumstances in which it is likely to make a difference, any change in volume of transactions is unlikely to affect price discovery. This is particularly true with respect to the even narrower category of foreign swaps market participants who might be affected by an expanded safe harbor.

d. Sound Risk Management Practices

The recommended safe harbor could increase the use of swaps to manage financial risks in some limited circumstances--for example where a firm's volume of swap transactions is close to the de minimis amount for classification as a swap dealer, the firm wishes to expand its use of swaps to hedge financial risks, the costs of ***regulation*** as a swap dealer would outweigh the benefits from expanded use of swaps, and the nature of the firm's business model creates ambiguity as to whether it is engaged in hedging or dealing in the absence of a safe harbor. It is unclear from available information how often this is likely to be the case. For foreign firms, a safe harbor is unlikely to significantly increase use of swaps to manage risks because such firms can already avoid ***regulation*** as U.S. swap dealers by entering into swaps beyond the de minimis amount with non-U.S. counterparties.

The recommended safe harbor also has a significant likelihood of reducing use of sound risk management practices by some firms that engage in swap dealing. As discussed previously, a safe harbor for swaps used to hedge financial risks may lead to some firms that engage in a large volume of swap dealing affecting U.S. markets being misclassified and not regulated as swap dealers. Many of the Dodd-Frank provisions and Commission rules applicable to swap dealers are designed to ensure that swap dealers adopt sound risk management practices, including, but not limited to, the Daily Trading Records, Risk Management, Chief Compliance Officer, and Portfolio Reconciliation Rules.

e. Other Public Interest Considerations

For some firms, an expanded safe harbor could contribute to efficiency by making it easier to determine whether the firm needs to comply with ***regulations*** applicable to swap dealers. This would be true primarily, if not only, for firms that engaged in a total volume of swap transactions that approached or exceeded the de minimis amount and whose overall business model did not otherwise make clear whether or not they were engaged in swap dealing. ISDA-SIFMA does not provide information on the number of firms, either foreign or domestic, likely to be in this category and the Commission is not aware of other sources of information on this question. ISDA-SIFMA suggests that ease of determining whether a firm is within the definition of a swap dealer would be particularly valuable to foreign firms, on the theory that such firms have difficulty coping with U.S. law. However, it is unclear how important this factor would be for firms to which the recommended safe harbor is most relevant since such firms, for the reasons just stated, would likely have some level of financial and legal sophistication, whether domestic firms engaged in substantial swaps activity or foreign firms engaged in a significant volume of cross-border swaps affecting or connected to U.S. markets.

Relatedly, the recommended safe harbor might encourage some foreign counterparties who currently enter into swaps to hedge financial risks with non-U.S. firms to move some of their business to U.S. swap dealers. In particular, this might be true for foreign counterparties whose other business does not make them swap dealers; who engage, or would potentially engage, in more than the de minimis amount of swaps with U.S. persons; whose business model currently creates ambiguity as to whether the swaps in question are a form of dealing in the absence of a safe harbor; and who do not have other reasons for confining their swaps business to local, non-U.S., dealers. The available record does not provide information on the number of firms that would meet all these criteria or the volume of swaps business that would be involved. However, given the limited circumstances in which a safe harbor would have an effect, it appears unlikely, in the absence of information to the contrary, that the volume of swaps involved would have a major impact on the overall liquidity of U.S. markets.

Based on its evaluation of these factors, the Commission concludes that expanding the hedging safe harbor is not warranted on the present record. This is particularly true in light of (1) the fact that the suggested expansion of the safe harbor would apply across the board and not just in circumstances where foreign firms have greater difficulty than U.S. firms in applying the swap dealer definition; (2) the importance of maintaining the integrity of the swap dealer definition to the entire Dodd-Frank regulatory regime; and (3) the conclusion in the original Swaps Entity Definition rulemaking that there is no reliable *per se* test for distinguishing between hedging financial risk and dealing, and the absence of any showing by the commenters that this conclusion is incorrect.

*C. "Re-examination" of Application of Rule 45.2(h) to Non-Registrants*

1. Commenter Proposal

ISDA-SIFMA recommends that the Commission "re-examine the provisions of ***Regulation*** 45.2 that require non-registrants subject to the jurisdiction of the Commission' to make books and records available to the Commission and **[\*54496]** other U.S. authorities." n244 Commission rule 45.2 generally deals with recordkeeping requirements for registered entities and parties involved in swaps transactions. Section 45.2(h) requires covered persons subject to the Commission's jurisdiction, including registrants such as swap dealers but also swap counterparties not required to register with the Commission, to make records available on request to the Commission, the Justice Department, and the Securities and Exchange Commission; and to U.S. prudential regulators (*i.e.,* bank regulators) as authorized by the Commission. n245 The ISDA-SIFMA comment does not explain specifically how and to what extent costs of compliance for § 45.2(h) differ for foreign and domestic entities, beyond ISDA-SIFMA's general assertion, discussed in section IV.A above, that some foreign firms may have more difficulty coping with U.S. law than U.S. firms.

n244 ISDA-SIFMA at 3.

n245 [*17 CFR 45.2(h)*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5PTC-4R70-008G-Y33D-00000-00&context=).

2. Evaluation in Light of Section 15(a) Factors

a. Protection of Market Participants and the Public

Eliminating or significantly restricting application of § 45.2(h) to non-registrants, including both domestic swaps counterparties and foreign counterparties sufficiently involved in U.S. swaps markets to be subject to U.S. ***regulation*** pursuant to section 2(i), can be expected to reduce protection of market participants and the public since prompt and efficient access to records is necessary for effective ***regulation*** of financial activity, both for purposes of law enforcement and for purposes of market surveillance. This benefit is limited somewhat by the alternative possibilities of obtaining information about swap market participants by means such as legal process or obtaining the assistance of foreign regulators. However, such alternatives are likely to be slower and less efficient than use of § 45.2(h). Prompt and efficient access to records is particularly important in developing situations, for example when there is reason to believe that fraud or other law violations are ongoing and that records may be destroyed or assets dissipated or hidden. It is similarly important when there is reason to believe that insolvency or other business problems at a firm with a large swaps portfolio may pose risks to other market participants or the market in general. While it is not practicable to quantify the benefits of § 45.2(h) in protecting market participants and the public, there is strong reason to believe that the benefits are high relative to the costs since the provision commonly is employed in situations where regulators have a specific reason to be concerned about a firm's swaps activities or otherwise have a specific need for information.

b. Efficiency, ***Competitiveness***, and Financial Integrity

Eliminating or significantly restricting application of § 45.2(h) to non-registrants is likely to reduce efficiency, ***competitiveness***, and financial integrity of relevant markets since it would make it more difficult to enforce legal requirements designed to promote these objectives, such as the anti-fraud and anti-market manipulation provisions of the Commodity Exchange Act. n246 As noted in the previous section, it would also make it more difficult for U.S. authorities to make prompt inquiries when the financial integrity of a market participant is in question. The Commission does not have data that would permit it to quantify these effects, however. The Commission also does not have quantitative information on the costs of § 45.2(h). However, there is reason to believe that overall costs are relatively modest since this provision does not itself require either recordkeeping or routine making of reports, but only provision of access to existing records on request.

n246 CEA sections 4b(a)(2), 6(c), [*7 U.S.C. 6b(a)(2)*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GPD1-NRF4-43D1-00000-00&context=), [*9*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GSH1-NRF4-4391-00000-00&context=).

c. Price Discovery

Changes in § 45.2(h) appear unlikely to have any direct impact on price discovery. Scaling back this requirement could have negative indirect effects on price discovery since the provision can be used to investigate violations of provisions designed to promote the price discovery function of Commission-regulated markets, such as the prohibition against price manipulation. n247 The Commission lacks information that would permit it to quantify any such effects, however.

n247 CEA section 6(c), [*7 U.S.C. 9*](https://advance.lexis.com/api/document?collection=statutes-legislation&id=urn:contentItem:4YF7-GSH1-NRF4-4391-00000-00&context=).

d. Sound Risk Management Practices

Scaling back § 45.2(h) appears unlikely to have a significant effect on use of swaps to manage risks since, as noted, this provision does not require recordkeeping or routine making of reports, but only requires that records be made available to the CFTC and other authorities on request.

e. Other Public Interest Considerations

Conceivably, some foreign non-registrant swap counterparties who would prefer to avoid even a chance of involvement with U.S. authorities might switch business from foreign swap providers to U.S. swap dealers if § 45.2(h) did not apply to them. ISDA-SIFMA does not provide information on how often this would be the case. However, in the absence of information to the contrary, it appears unlikely that any such effect would be large enough to have a significant impact on the overall liquidity of U.S. markets since the foreign firms in question would still be subject to inspection by their home authorities; and their records might still become available to U.S. authorities, albeit less expeditiously, through mechanisms such as cooperative enforcement arrangements with foreign jurisdictions.

In light of these considerations and the importance of access to books and records for law enforcement, market surveillance, and other regulatory purposes, the Commission concludes that ISDA-SIFMA has not justified an amendment to § 45.2(h) to exclude non-registrants.

*D. Process Recommendations*

Commenters made a number of recommendations for Commission engagement in processes that could be expected to lead to substantive changes in some of the remanded rules. In particular, commenters generally supported Commission engagement in efforts for international harmonization of rules in the area of swap data reporting and ***regulation*** of SEFs and their foreign equivalents. n248 The Commission agrees that such efforts are important and is participating in them, as described in section IV.C and IV.D, above. However, they are not at the point where they can provide the basis for specific rule changes in the context of the *SIFMA* remand. Consistent with this, commenters did not identify specific rule changes based on harmonization efforts to date.

n248 *E.g.,* ISDA-SIFMA at 3; IIB at 20.

**VI. Conclusion**

The comments on the Initial Response identify some respects in which the costs and benefits of the extraterritorial application of the remanded rules may differ from the domestic application. However, taking into account the facts and analysis in the original rulemaking preambles as well as the additional consideration of costs and benefits in the Initial Response and this release, the record does not establish a need to make **[\*54497]** changes in the substantive requirements of the remanded rules as originally promulgated at the present time and in the context of the *SIFMA* remand order.

Issued in Washington, DC, on August 4, 2016, by the Commission.

**Christopher J. Kirkpatrick,**

*Secretary of the Commission.*

**Note:** The following appendices will not appear in the Code of Federal ***Regulations***.

**Appendices to Final Response to District Court Remand Order in Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission --Commission Voting Summary, Chairman's Statement, and Commissioner's Statement**

***Regulations***

1. **Summary**

On this matter, Chairman Massad and Commissioner Bowen voted in the affirmative. Commissioner Giancarlo voted in the negative.

1. **rman Timothy G. Massad**

I support the two actions the Commission and staff have taken today, which address issues related to the cross-border application of our rules on swaps. I thank the staff for their hard work on these matters, my fellow Commissioners for their consideration, and the public for their feedback.

Today, the CFTC has issued a final response to the remand order of the U.S. District Court for the District of Columbia in litigation brought by the Securities Industry and Financial Markets Association and other industry associations against the Commission. The litigation challenged the extra-territorial application of several swaps rules and unsuccessfully sought to invalidate the Commission's 2013 cross-border guidance. Today we have supplemented our earlier answer to the Court's inquiry regarding the costs and benefits of the overseas application of those rules.

In addition, Commission staff today has extended for another year the previously issued no-action relief from certain transaction-level requirements for transactions between non-U.S. parties that regularly use personnel or agents located in the U.S. to "arrange, negotiate, or execute" them.

These actions are part of our overall effort to address the cross-border implications of swap activity, while at the same time harmonizing derivatives ***regulation*** with other jurisdictions as much as possible. The past several years have been marked by progress in this regard. In the last year alone, we have accomplished a great deal in each of the four basic areas of derivatives ***regulation***--central clearing, oversight of swap dealers, trading and reporting. Consider the following:

With regard to central clearing, we and the European Commission agreed upon a common approach regarding requirements for central clearing counterparties (CCPs), which will permit U.S. and European CCPs to continue providing clearing services to entities in each other's jurisdiction. We also granted exempt status to several foreign clearinghouses. The CFTC is also co-chairing a task force with international regulators to address resiliency requirements and engage in recovery planning, while also participating in international resolution planning for CCPs.

When it comes to the oversight of swap dealers, we harmonized the substance of rules setting margin requirements for uncleared swaps, one of the most important parts of our overall regulatory framework. We also agreed on an international timetable for implementation. Although the European Commission recently delayed their implementation for technical reasons, they have made clear that this delay will be modest. We adopted a cross-border application of our margin rule, which provides a broad scope of substituted compliance. And we are currently working with other jurisdictions on substituted compliance determinations that will supplement those we have previously made in other areas.

On trading, the CFTC is looking at ways to harmonize our swap execution facility rules with those of other jurisdictions. For example, now that the European Securities and Markets Authority has published its MiFiD II technical standards, we are working with our European counterparts to look at differences in our respective rules and make progress toward harmonization. We also recently issued no-action relief to an Australia-based trading platform.

We are focused on harmonizing data reporting standards as well. The CFTC co-chairs an international task force that is leading this effort. CFTC staff is also working with international regulators and the Office of Financial Research to develop effective means to identify swaps and swap activity by participant, transaction and product type throughout the swap lifecycle.

We will continue making progress in all these areas. For example, this fall I intend to ask the Commission to consider a rule to begin to address the "arrange, negotiate, or execute" issues raised by the no-action relief that we have extended today.

Our first responsibility is to implement our nation's laws faithfully, which requires us to address the cross-border implications of swap activity. A strong global regulatory framework is the best way to do so, and that is why harmonization is so important. To focus on the fact that full harmonization has not been reached, or that progress sometimes occurs in fits and starts, I believe misses the forest for the trees. ***Regulations*** are implemented by individual nations, or unions of nations, each of which has its own legal traditions, regulatory philosophies, political processes, and often, statutory timetables. There will always be differences, just as there are in every other area of financial ***regulation***. The more important story is we are making good, steady progress.

1. **ent of Commissioner J. Christopher Giancarlo**

I respectfully dissent from the Commodity Futures Trading Commission's (CFTC or Commission) final response in the SIFMA litigation.

The CFTC appears to have addressed the District Court's inquiry whether the costs and benefits identified in the remanded rulemakings apply to swaps activities outside of the United States (U.S.) and what differences are present in the costs and benefits between domestic and overseas activities. Nevertheless, it must be noted that the Commission has repeatedly failed to coordinate effectively with foreign regulators to "implement global standards" in financial markets as agreed to by the G-20 leaders in Pittsburgh in 2009. n1 The lack of harmonization in the implementation date for margin for uncleared swaps is the latest example. The result for financial markets has been a complex, conflicting and costly array of CFTC cross-border ***regulations***.

n1 G-20 Leaders' Statement, The Pittsburgh Summit at 7 (Sept. 24-25, 2009) (G-20 Statement), *available at* [*http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh\_summit\_leaders\_statement\_250909.pdf*](http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf)*.*

The Commission's uncoordinated approach to ***regulation*** of swaps trading started with its July 2013 Interpretative Guidance and Policy Statement Regarding Compliance With Certain Swap ***Regulations*** (Interpretative Guidance). n2 The Interpretative Guidance, which the District Court found is a non-binding general statement of policy, basically stated that every single swap a U.S. Person enters into, no matter where it is transacted, has a direct and significant connection with activities in, and effect on, commerce of the U.S. that requires imposing CFTC transaction rules. n3 This uncoordinated approach has continued through the CFTC's Cross-Border Application of Margin Requirements, n4 in which the Commission unilaterally imposed a set of preconditions to substituted compliance that is overly complex, unduly narrow and operationally impractical. n5

n2 [*78 FR 45292*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5905-WPK0-006W-80PB-00000-00&context=) (Jul. 26, 2013).

n3 *Id.*

n4 [*81 FR 34818*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5JWY-VPB0-006W-83HN-00000-00&context=) (May 31, 2016).

n5 [*Id. at 34853-54.*](https://advance.lexis.com/api/document?collection=administrative-codes&id=urn:contentItem:5JWY-VPB0-006W-83HN-00000-00&context=)

Unfortunately, the Commission's uncoordinated approach to cross-border harmonization has allowed foreign regulators to respond in kind. The CFTC's and European Union's (EU) tortured and repeatedly delayed central counterparty clearinghouse equivalence process is a stark example, as is the EU's recent decision to postpone until 2017 new rules setting collateral requirements for uncleared derivatives.

The CFTC must do better to work with foreign regulators to implement global standards consistently in a way that ensures a level playing field and avoids market fragmentation, protectionism and regulatory arbitrage. n6 As a good start, the CFTC should replace its Interpretative Guidance with a formal rulemaking that recognizes outcomes- **[\*54498]** based substituted compliance for ***competent*** non-U.S. regulatory regimes. n7 Such an approach is practical, provides certainty and is in keeping with the cooperative spirit of the 2009 G-20 Pittsburgh Accords. n8

n6 G-20 Statement, par. 12.

n7 Keynote Address of CFTC Commissioner J. Christopher Giancarlo at The Global Forum for Derivatives Markets, 35th Annual Burgenstock Conference, Geneva, Switzerland, Sept. 24, 2014, [*http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlos-1*](http://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlos-1)*.*

n8 *See generally* G-20 Statement.

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**Dates**

**DATES:** August 16, 2016.

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