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COMMODITY FUTURES TRADING COMMISSION

17 CFR Parts 1, 3, 23, 37, 43, 45, 46, 170

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

AGENCY: Commodity Futures Trading Commission.

ACTION: Final response to district court remand order.

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,[1] ("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.[2]

[1] No. 13-1916 (PLF), 67 F. Supp. 3d. 373 (D.D.C. Sept. 16, 2014).

[2] 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 (Mar. 10, 2015) ("Initial Response").

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SUPPLEMENTARY INFORMATION:

I. Overview and Scope

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 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.

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[3]

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[4] ("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[5]

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

[4] 78 FR 45292 (July 26, 2013).

[5] Pub. L. 111-203, 124 Stat. 1376 (2010).

regarding swaps.[6] The fourteen challenged rules were promulgated by the Commission in twelve rulemakings.[7] On September 16, 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.[8] 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)").[9] 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.[10]

The eight remanded rulemakings are:

Real-Time Public Reporting of Swap Transactions Data[11] ("Real-Time Reporting Rule");

Swap Data Recordkeeping and Reporting Requirements[12] ("SDR Reporting Rule");

Registration of Swap Dealers and Major Swap Participants[13] ("Swap Entity Registration Rule");

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[6] See SIFMA, 67 F. Supp. 3d at 384. 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.

[7] 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.

[8] SIFMA, 67 F. Supp. 3d 373. For a more complete description of the decision, see the Commission's Initial Response, 80 FR 12555.

[9] SIFMA, 67 F. Supp. 3d at 430-33.

[10] Id. at 434-35.

[11] 77 FR 1182 (Jan. 9, 2012).

[12] 77 FR 2136 (Jan. 13, 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[14] ("Daily Trading Records," "Risk Management," and "Chief Compliance Officer" Rules);

Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant"[15] ("Swap Entity Definition Rule");

Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps[16] ("Historical SDR Reporting Rule");

Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants[17] ("Portfolio Reconciliation Rule"); and

Core Principles and Other Requirements for Swap Execution Facilities[18] ("SEF Registration Rule").

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."[19] As the Commission explained in its

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[13] 77 FR 2613 (Jan. 19, 2012).

[14] 77 FR 20128 (Apr. 3, 2012).

[15] 77 FR 30596 (May 23, 2012).

[16] 77 FR 35200 (June 12, 2012).

[17] 77 FR 55904 (Sept. 11, 2012).

[18] 78 FR 33476 (June 4, 2013).

[19] SIFMA, 67 F. Supp. 3d at 437.

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.

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).[20] 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.[21] 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. section 2(i)."[22]

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.[23] Thus, the Commission's consideration of costs and benefits of the application of the rule must encompass both foreign and domestic business activities.[24] The court held that the Commission failed to meet this requirement because,

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[20] Id. at 431.

[21] Id. at 432; see also id. at 434-35 & n.35.

[22] Id. at 434-35.

[23] Id. at 431-32.

[24] Id.

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.[25]

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."[26] 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.[27] 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."[28] 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.[29] The court further noted that foreign swaps regulations passed since the promulgation of the rules at issue in the litigation "may now raise issues

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[25] Id.

[26] Id. at 433.

[27] Id.

[28] Id.

[29] Id.

of duplicative regulatory burdens," but that "the CFTC may well conclude that its policy of substituted compliance largely negates these costs."[30]

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."[31] 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."[32]

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 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

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[30] Id. at 435.

[31] Id.

[32] Id.

> 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.[33]

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?
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> 2. Are there any costs or benefits that are unique to one or more of the rules' extraterritorial applications? If so, please specify how.
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> 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?[34]

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.[35]

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

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[33] 80 FR at 12558 (internal citation omitted).

[34] Id.

[35] Id.

whether to amend any of the remanded rules based on information developed in this process.[36]

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").[37] The substance of the comments is discussed in detail in the remainder of this release.

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."[38] The comment stated that "internal conflicts and customer resistance

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[36] Id. at 12555.

[37] 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 website at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1564.

[38] 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.

frequently may follow."[39] 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.[40] 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."[41]

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.[42] 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.[43] 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

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[39] Id. at 2.

[40] Id.

[41] 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. 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.

[42] ISDA-SIFMA at 3.

[43] Id.

Commission registrants make their books and records available to the Commission and other U.S. authorities.[44]

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."[45] ISDA-SIFMA also supported greater international harmonization in the area of swap data reporting.[46] 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 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").[47] 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."[48]

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

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[44] Id.

[45] Id.

[46] Id.

[47] Id. at 4. ISDA-SIFMA called this a "personnel-based test." Id.

[48] Id.

business in a conservative manner.[49] Banks have also incurred costs to comply with regulatory requirements that differ across jurisdictions, including where comparability is not established.[50] 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.[51] 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.[52] 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.[53] 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.[54] JBA therefore recommended that the swap data reporting process should be established "through an industry-wide initiative."[55] JBA

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[49] JBA at 1.

[50] Id.

[51] Id. at 1-2.

[52] Id. at 2.

[53] Id.

[54] Id. at 2-3.

[55] Id. at 3.

identified the swaps push-out rule as a second area of particular concern.[56] However, this statutory provision[57] was not part of the SIFMA litigation or remand order.

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.[58] 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."[59] 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.[60]

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.[61] 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

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[56] Id.

[57] The phrase "swaps push-out rule" is commonly used to refer to 15 U.S.C. 8305, 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.

[58] UBS at 1.

[59] Id.

[60] Id.

[61] IIB called this a "U.S. personnel test." IIB at 4.

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 forego 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.[62] 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.[63] 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.[64] 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.[65] 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.[66] 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

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[62] IIB at 5.

[63] Id. at 6-8.

[64] Id. at 6.

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

[66] Id. at 17-19.

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.[67]

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.[68] IIB stated that it supported Commission efforts to address legal and other obstacles to cross-border information sharing.[69] 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.[70] IIB made no recommendations for specific changes in the substantive requirements of the remanded rules.

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,

[67] Id. at 13-14.

[68] Id. at 20.

[69] Id.

[70] Id.

to give a reasoned explanation why not.[71] 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.

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.

[71] 67 F. Supp. 3d at 435.

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.[72] In that vein, the Commission stated that it would consider addressing some of the subjects discussed in the Guidance by rulemaking in the future.[73] 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.[74] Consideration of such rules is, however, outside the scope of the remand order.[75]

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

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[72] Cross-Border Guidance, 78 FR at 45297.

[73] Id. at 45297 n.39.

[74] For example, in conjunction with its rule on Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (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 (May 31, 2016).

[75] SIFMA v. CFTC, 67 F. Supp. 3d at 435; see also id. at 434-35 (distinguishing between "substance" of rules and "scope" of their extraterritorial application under section 2(i)).

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.[76]

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

[76] 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.

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, 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.[77] As foreign regulators continue to make progress in implementing swaps-market reforms, incentives

[77] 78 FR at 45340.

for regulatory arbitrage will diminish, and substituted compliance can be expanded to reduce duplicative or otherwise unnecessary regulatory burdens.[78]

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.[79]

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]."[80] JBA also points out that banks have incurred costs to comply with multiple jurisdictions' regulations where the timing of

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[78] See below at section IV.C.

[79] ISDA-SIFMA at 2.

[80] JBA at 1.

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.[81]

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."[82] 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

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[81] Id. at 1-2.

[82] 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.

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.

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,[83] 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.[84] 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.

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

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[83] See section IV.E below.

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

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.[85] And, as held 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.

[85] 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); the Swap Entity Registration Rule is required by CEA sections 4s(a) and 4s(b), 7 U.S.C. 6s(a) and 6s(b); the Daily Trading Records Rule is required by CEA section 4s(g), 7 U.S.C. 6s(g); the Real-Time Reporting Rule is required by CEA section 2(a)(13)(C), 7 U.S.C. 2(a)(13)(C); 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) and 6s(k).

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,[86] Daily Trading Records, Risk Management, Chief Compliance Officer,[87] Swap Entity Definition,[88] and Portfolio Reconciliation[89] 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.[90] 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

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[86] 77 FR 2613.

[87] 77 FR 20128.

[88] 77 FR 30596.

[89] 77 FR 55904.

[90] 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.

activity exceeds a specified notional dollar amount, currently $8 billion, with certain limited exceptions.[91]

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.[92] 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.

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[91] 17 CFR 1.3(ggg)(4). 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).

[92] 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.

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.[93] 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.[94]

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[95] ("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.[96] For cleared swaps, certain reporting duties are handled by derivatives clearing organizations, another category of sophisticated entity.[97] 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.

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

[94] 77 FR at 2625.

[95] 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.

[96] 17 CFR 43.3(a)(3)(i)-(iii).

[97] See, e.g., 17 CFR 45.4(b); Amendments to Swap Data Recordkeeping and Reporting Requirements for Cleared Swaps, 80 FR 52544 (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."[98] Other commenters also refer to the existence of overlapping regulations in some areas such as reporting.[99] 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.

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 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

[98] ISDA-SIFMA at 2.

[99] JBA at 2-3, IIB at 19-20.

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.[100] 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.[101] For some requirements, individual European states and competent authorities will need to take action to put requirements in force.[102] As a result, these EU requirements are not currently expected to go into effect until January 3, 2018.[103] Other foreign jurisdictions also generally do not have current regulations in operation for swaps trading facilities analogous to SEFs.[104]

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

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[100] 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.

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

[102] Id.

[103] Id.

[104] 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.

operational.[105] 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.[106]

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.[107] 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."[108] In other words, the rule provides the Commission with basic identifying and other information to enable

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[105] 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.

[106] 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.

[107] 77 FR at 2614. The underlying requirement to register derives from the statute. See CEA section 4s(a), 7 U.S.C. 6s(a).

[108] Swap Entity Registration Rule, 77 FR at 2623.

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.

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.[109] 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.[110] 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.[111]

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

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

[110] See FSB Trade Reporting Review at 27-28.

[111] 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).

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 Guidance.[112] Notably, since the Guidance is a non-binding policy statement, the Commission is not precluded from

[112] 78 FR at 45342ff.

employing substituted compliance in circumstances, or on terms, not specified in the Guidance if there are good reasons for doing so.[113]

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.[114] 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.[115] 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.[116] The foreign jurisdiction's requirements need not be identical, however, so long as they achieve similar outcomes.[117] 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

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[113] 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.

[114] 78 FR at 45342.

[115] Id.

[116] Id.

[117] Id. at 45342-43.

in transactions with counterparties who are U.S. persons, in light of the greater U.S. interest in the latter.[118]

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.[119] Applicants can include regulated firms, foreign regulators, and trade associations or similar groups.[120] However, a resulting comparability determination will apply to all entities or transactions in the relevant jurisdiction, not just to particular applicants.[121] 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.[122] These elements of the process allow the Commission to reduce burdens without sacrificing its regulatory interests as defined by the CEA and Dodd-Frank.

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

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[118] Id. at 45350-61.

[119] Id. at 45344.

[120] Id.

[121] Id.

[122] Id.

of the remanded rules, the Chief Compliance Officer and Risk Management Rules.[123] The EU and Japan were found to have laws comparable to the Daily Trading Records Rule.[124] 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.[125] The comparability determinations incorporated a number of exceptions, typically to ensure that the Commission or other U.S. authorities obtain information on foreign registrants.[126]

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.[127] 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.

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[123] 17 CFR 3.3, 23.600-23.606; see Comparability Determination for Australia: Certain Entity-Level Requirements, 78 FR 78864, 78868-75 (Dec. 27, 2013); Comparability Determination for Canada: Certain Entity-Level Requirements, 78 FR 78839, 78842-49 (Dec. 27, 2013); Comparability Determination for the European Union: Certain Entity-Level Requirements, 78 FR 78923, 78927- 35 (Dec. 27, 2013); Comparability Determination for Hong Kong: Certain Entity-Level Requirements, 78 FR 78852, 78855-62 (Dec. 27, 2013); Comparability Determination for Japan: Certain Entity-Level Requirements, 78 FR 78910, 78914-21 (Dec. 27, 2013); Comparability Determination for Switzerland: Certain Entity-Level Requirements, 78 FR 78899, 78902-08 (Dec. 27, 2013).

[124] 17 CFR 23.202; see Comparability Determination for the European Union: Certain Entity-Level Requirements, 78 FR 78878, 78887-88 (Dec. 27, 2013); Comparability Determination for Japan: Certain Transaction-Level Requirements, 78 FR 78890, 78896-97 (Dec. 27, 2013).

[125] 17 CFR 23.501-23.506; see 78 FR at 78883-87; 78 FR at 78894-95.

[126] 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.

[127] Comparability Determination for the European Union: Dually Registered Derivatives Clearing Organizations and Central Counterparties, 81 FR 15260 (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.[128] 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.

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 Union, Japan, or Switzerland.[129] This relief was issued after the Commission received requests for comparability determinations for trade repository reporting rules in these jurisdictions.[130] The primary exceptions to the relief are for entities that are part of an

[128] 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).

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

[130] 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.

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.[131] These exceptions reflect the stronger U.S. supervisory and oversight interest in such entities and transactions.[132]

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.[133] The most recent no-action letter on this subject extends relief through March 1, 2017.[134]

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.[135] 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.[136] This includes partial relief from two of the

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[131] CFTC Letter No. 15-61 at 2. There are also exceptions for certain recordkeeping requirements. Id.

[132] See CFTC Letter No. 13-75 at 2.

[133] 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).

[134] CFTC Letter No. 16-03 at 4-5.

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

[136] CFTC Letter No. 14-46.

remanded rules, SDR Reporting and Real-Time Reporting, since the EU trading facility, like a SEF, would be reporting the swap data in question.[137] To date, no European trading facilities have submitted the required certification to obtain this no-action relief.

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.[138] An Australian trading facility has advised the Division of Market Oversight that it intends to make the certification required by the enabling letter.[139] 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.[140] This relief currently extends until September 15, 2016.[141]

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.[142] In addition, the Commission is codifying some existing no-action relief via rulemaking.[143]

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[137] Id.

[138] CFTC Letter No. 14-117, updated by CFTC Letter No. 15-29.

[139] See CFTC Letter No. 16-52.

[140] Id.

[141] Id.

[142] See, e.g., CFTC Letter Nos. 15-60, 15-38.

[143] The Commission has recently done this for registration requirements involving foreign nationals. Alternative to Fingerprinting Requirement for Foreign Natural Persons, 81 FR 18743 (Apr. 1, 2016). See also, Definitions of "Portfolio Reconciliation" and "Material Terms" for Purposes of Swap Portfolio Reconciliation, 81 FR 27309 (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.[144] 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

[144] 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.

to the sharing of data internationally.[145] 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.

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."[146] 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.

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:

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[145] 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=.

[146] Pub. L. 111-203, 124 Stat. 1376 (2010).

> 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.[147]

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.[148] 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.

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,

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[147] 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.

[148] See 77 FR at 30703 & n.1272, 30705.

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.[149]

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").[150] 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.[151]

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,

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[149] 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; 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).

[150] 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).

[151] ISDA-SIFMA at 3.

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.[152] 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.[153]

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[152] See, e.g., MiFIR, supra note 100, at 2-3 (recital 8).

[153] See, e.g., CEA section 5h(g), 7 U.S.C. 7b-3(g) (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). 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 website at 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.[154] 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."[155] 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.[156]

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

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

[155] Id.

[156] 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.

contributed to the European swap dealer behavior reported by ISDA.[157] 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);[158] the Commission's Clearing Determination Rule,[159] 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.[160] This adds a further complication in drawing conclusions from the ISDA data for purposes of the remand order.

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.[161] 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.[162] 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

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[157] Id. at 1, 4-5.

[158] 7 U.S.C. 2(h)(1).

[159] 17 CFR part 50.

[160] See CEA section 2(h)(8), 7 U.S.C. 2(h)(8).

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

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

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.

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.[163] There is also ongoing research into the effects of SEF regulation, including the market fragmentation issue raised by ISDA-SIFMA.[164] 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.

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.[165] 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.[166] The requirements of the rule are also calculated to put market participants on a more even

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[163] 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/.

[164] 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; 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. 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.

[165] See 78 FR at 33553-56, 33564-81.

[166] Id. at 33564-65.

footing, reducing the effects of informational asymmetries or other forms of market power, and potentially making the swaps market less concentrated and more competitive.[167] All of this can potentially increase market liquidity.[168] 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.

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

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[167] Id. at 33564.

[168] See id. at 33554-55.

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.[169] As the names imply, an entity-level requirement is a rule 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.[170] Among the remanded rules, the Real-Time Reporting, Daily Trading Records, and Portfolio Reconciliation Rules are characterized as transaction-level rules in the Guidance.[171] 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.

[169] 78 FR at 45331.

[170] Id.

[171] Id. at 45333.

counterparty.[172] 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.[173]

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.[174] 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."[175] 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.[176]

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

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[172] Id. at 45350-53.

[173] Id. at 45353-59.

[174] DSIO Advisory at 2.

[175] Id.

[176] Id.

that described in the DSIO Advisory regarding transaction-level requirements.[177] 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.[178] In January of 2014, the Commission published a notice in the Federal Register seeking public comment on the DSIO Advisory.[179] 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.

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.[180] 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."[181] As a result, the Division of Market Oversight "expects that a

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[177] CFTC Letter No. 13-71.

[178] CFTC Letter No. 15-48.

[179] 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 (Jan. 8, 2014).

[180] DMO Guidance at 2.

[181] Id.

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."[182] 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.[183] 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.[184]

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.[185] 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

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[182] Id. at 2.

[183] Id. at 2 n.8.

[184] Id. at 5.

[185] IIB at 5-6; see also ISDA-SIFMA at 4.

denominated interest rate swaps, are typically located in the United States.[186] Relatedly, presence in the United States may provide traders with better access to information on U.S. markets.[187] In addition, U.S.-located personnel can have advantages for time zone reasons.[188] 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.[189]

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.[190] 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.[191] 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. counterparties who deal with these swap dealers.[192]

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

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[186] IIB at 5 & n.12.

[187] Id. at 5.

[188] Id.

[189] Id. at 5-6.

[190] Id. at 6-7.

[191] Id. at 8.

[192] Id. at 8-9.

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.[193] 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.[194] 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.[195]

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.[196] IIB notes that the Portfolio Reconciliation Rule and the Daily Trading Records Rule are intended to mitigate risks to the U.S. financial system.[197] 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.[198] In transactions made

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[193] 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.

[194] IIB at 6.

[195] Id.

[196] 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.

[197] IIB at 9.

[198] Id.

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.[199]

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."[200] 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.[201] 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

[199] Id. at 9 & n.27.

[200] Id. at 12.

[201] Id.

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.[202] IIB does not provide quantitative cost estimates, however.

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.[203] 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.

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:

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[202] Id.

[203] See SIFMA, 67 F. Supp. 3d at 434-35.

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 three remanded transaction-level rules.[204] Similarly, ISDA-SIFMA identifies costs that it states would be caused by implementation

[204] See IIB at 16-19.

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.[205]

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.[206] 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.

(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

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[205] ISDA-SIFMA at 4.

[206] 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.

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.[207] 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 [208] and reporting of rounded or "capped" notional amounts rather than the actual notional amount for block trades and certain other large transactions.[209] 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."[210] 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.[211]

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[207] IIB at 12.

[208] See 17 CFR 43.5.

[209] See 17 CFR 43.4(h).

[210] Real-Time Reporting Rule, 77 FR at 1239.

[211] See Procedures to Establish Appropriate Minimum Block Sizes for Large Notional Off-Facility Swaps and Block Trades, 78 FR 32866, 32928-31 (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.[212] 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.[213] 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.[214] 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-

[212] IIB at 13-14.

[213] Id. at 13.

[214] Id.

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.[215]

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

[215] Id. at 14.

robust and efficient as possible.[216] 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 global swaps market continues to evolve."[217] 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.[218]

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.[219] 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

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[216] UBS at 1.

[217] Id.

[218] Id.

[219] ISDA-SIFMA at 3.

execution methods, albeit not in the precise ways that ISDA and SIFMA have recommended in other documents.[220] 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.[221] It also allows block trading for large transactions.[222] Additional flexibility for SEFs with respect to block trades has been provided through staff no-action relief.[223] 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.[224]

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,

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

[221] 17 CFR 37.9.

[222] 17 CFR 37.9(a)(2).

[223] See CFTC Letter No. 15-60.

[224] 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/.

regulators are unable to consolidate, aggregate and effectively use that information.[225]

JBA and IIB made substantially similar observations.[226] 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.[227] 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.[228]

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,

[225] ISDA-SIFMA at 3.

[226] JBA at 2-3; IIB at 19-20.

[227] JBA at 3; IIB at 20.

[228] IIB at 20.

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.[229] 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.[230] 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

[229] See 67 F. Supp. 3d at 435.

[230] Initial Response, 80 FR at 12558.

section 15(a) of the Commodity Exchange Act ("section 15(a)").[231] The Commission also incorporates by reference the discussions in the preceding sections.

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 Commission should apply section 2(i) in particular circumstances to establish the extraterritorial scope of one or more of the rules.[232] 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.

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."[233] 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

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[231] Section 15(a)(1), 7 U.S.C. 19(a)(1), 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) 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.

[232] 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.

[233] ISDA-SIFMA at 3.

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.

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.[234]

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.[235] 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.[236] However, the Commission has specified that some categories of swap transactions are not considered in determining

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[234] Id.

[235] 17 CFR 1.3(ggg)(4)(i)(A).

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

whether an entity is a swap dealer. One of these safe harbor categories is swaps used to hedge market positions in physical commodities.[237]

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.[238] 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.[239] "[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."[240] 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.[241] 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

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[237] 17 CFR 1.3(ggg)(6)(iii).

[238] 77 FR at 30611-13.

[239] Id.

[240] Id. at 30613.

[241] Id. at 30612-13.

to include hedging of financial risks.[242] However, the Commission has not, to date, found reason to modify the safe harbor as originally promulgated.

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

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[242] Id. at 30613.

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 a result of an expanded safe harbor.[243] 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.

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

[243] 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.

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 other U.S. authorities."[244] 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.[245] 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.

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[244] ISDA-SIFMA at 3.

[245] 17 CFR 45.2(h).

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.[246] 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.

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.[247] The Commission lacks information that would permit it to quantify any such effects, however.

[246] CEA sections 4b(a)(2), 6(c), 7 U.S.C. 6b(a)(2), 9.

[247] CEA section 6(c), 7 U.S.C. 9.

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.[248] 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.

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 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.

[248] E.g., ISDA-SIFMA at 3; IIB at 20.

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

Appendix 1 – Commission Voting Summary

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

Appendix 2 – Statement of Chairman 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.

Appendix 3 – Dissenting Statement 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.[1] 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.

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).[2] 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.[3] This uncoordinated approach has

[1] 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.

[2] 78 FR 45292 (Jul. 26, 2013).

[3] Id.

continued through the CFTC's Cross-Border Application of Margin Requirements,[4] in which the Commission unilaterally imposed a set of preconditions to substituted compliance that is overly complex, unduly narrow and operationally impractical.[5]

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.[6] As a good start, the CFTC should replace its Interpretative Guidance with a formal rulemaking that recognizes outcomes-based substituted compliance for competent non-U.S. regulatory regimes.[7] Such an approach is practical, provides certainty and is in keeping with the cooperative spirit of the 2009 G-20 Pittsburgh Accords.[8]

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[4] 81 FR 34818 (May 31, 2016).

[5] Id. at 34853-54.

[6] G-20 Statement, par. 12.

[7] 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.

[8] See generally G-20 Statement.