SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 201 and 240

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RIN 3235-AM13

Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules; proposed interpretations.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is proposing a number of actions to address the cross-border application of certain security-based swap requirements under the Securities Exchange Act of 1934 ("Exchange Act") that were added by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

DATES: Submit comments on or before July 23, 2019.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-07-19 on the subject line.

Paper comments:

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-07-19. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments

more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change. Persons submitting comments are cautioned that the Commission does not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Carol M. McGee, Assistant Director, at 202-551-5870, regarding the proposed interpretive guidance related to security-based swap transactions that have been "arranged" or "negotiated" by personnel located in the United States and the proposed amendment to Exchange Act Rule 3a71-3; Devin Ryan, Senior Special Counsel and Edward Schellhorn, Special Counsel regarding the proposed amendment to Commission Rule of Practice 194; Joanne Rutkowski, Assistant Chief Counsel and Bonnie Gauch, Senior Special Counsel, regarding the proposed amendments to Exchange Act Rule 15Fb2-1 and proposed interpretive guidance related to Exchange Act Rule 15Fb2-4; and Joseph Levinson, Senior Special Counsel, regarding the proposed modifications to proposed Exchange Act Rule

18a-5; at 202-551-5777, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–7010.

SUPPLEMENTARY INFORMATION: The Commission is proposing for public comment guidance regarding the application of certain uses of the terms "arranged" and "negotiated" in connection with the cross-border application of security-based swap regulation under the Exchange Act, guidance regarding the certification and opinion of counsel requirements in Exchange Act Rule 15Fb2-4 and Rule 3a71-6, amendments to Exchange Act Rules 0-13, 3a71-3, 15Fb2-1, and Commission Rule of Practice 194, and modifications to proposed Rule 18a-5. First, the Commission is proposing supplemental guidance to address how certain requirements under Title VII – related to security-based swap transactions that have been "arranged" or "negotiated" by personnel located in the United States – apply to transactions involving limited activities by those U.S. personnel. Separately, the Commission is requesting comment on two alternative proposals to amend Rule 3a71-3 under the Exchange Act to modify a provision addressing the cross-border application of the "security-based swap dealer" de minimis exception. Both of the alternative proposals for the amendment would add an exception to the rule's existing requirement that, for purposes of determining whether an entity must register as a security-based swap dealer, non-U.S. persons must count, as part of their de minimis calculations, security-based swap dealing transactions that have been "arranged, negotiated, or executed" by personnel located in a U.S. branch or office. The Commission also is proposing corresponding technical revisions to Exchange Act Rule 0-13 in conjunction with the proposed amendment. The Commission further is requesting comment on whether to provide other conditional exceptions for certain other requirements that apply to such "arranged, negotiated, or executed" transactions, including regulatory reporting and public dissemination requirements and

security-based swap dealer business conduct requirements. Separately, the Commission is proposing to provide guidance regarding the certification and opinion of counsel requirements in Exchange Act Rule 15Fb2-4. The Commission is proposing to amend Exchange Act Rule 15Fb2-1 to provide additional time for a security-based swap dealer or major security-based swap participant (collectively defined as "SBS Entity") to submit the certification and opinion of counsel required under Rule 15Fb2-4(c)(1). In addition, the Commission is proposing to amend Rule of Practice 194 to exclude an SBS Entity, subject to certain limitations, from the prohibition in Exchange Act Section 15F(b)(6) with respect to an associated person who is a natural person who (i) is not a U.S. person and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person. Finally, the Commission is proposing certain modifications to proposed Exchange Act Rule 18a-5 to address the questionnaire or application for employment that an SBS Entity is required to make and keep current with respect to certain foreign associated persons.

I. Background

The Commission has proposed and finalized a number of rules to implement requirements under Title VII of the Dodd-Frank Act[1] providing for the regulation of security-based swap activity. Several of those rules include provisions to address unique concerns raised by cross-border activity in security-based swaps, including:

- Exchange Act Rule 3a71-3, which, among other things, requires (1) non-U.S. persons to include security-based swap dealing transactions that have been "arranged, negotiated, or

[1] Public Law 111–203, 124 Stat. 1376 (2010). Unless otherwise indicated, references to Title VII in this release are to Subtitle B of Title VII.

executed" using U.S. personnel[2] in their calculations under the de minimis exception to the "security-based swap dealer" definition,[3] and (2) registered security-based swap dealers to comply with business conduct requirements in connection with certain transactions that have been arranged, negotiated or executed by U.S. personnel.

- Regulation SBSR Rules 908(a)(1)(v) and 908(b)(5), which require regulatory reporting and public dissemination of security-based swap transactions "arranged, negotiated, or executed" using personnel located within the United States.
- Exchange Act Rule 15Fb2-4, which requires, among other things, that each nonresident security-based swap dealer and nonresident major security-based swap participant (each as defined in Exchange Act Rule 15Fb2-4, collectively "nonresident SBS Entity") registering with the Commission provide a certification and opinion of counsel regarding its willingness and ability to provide the Commission with prompt access to its books and records and submit to onsite inspection and examination by the Commission, on Schedule F to Forms SBSE, SBSE-A and SBSE-BD, as appropriate, which applicants use to provide the certification.
- Exchange Act Rule 15Fb6-2, and proposed Rule 18a-5, which together would require each registered SBS Entity, whether a U.S. or non-U.S. person, (1) to certify that it neither knows, nor in the exercise of reasonable care should have known, that any person associated with it who effects or is involved in effecting security-based swaps on its behalf is subject to a statutory disqualification and (2) to make and retain a background questionnaire to support this certification.

As discussed in more detail below, market participants and other commenters have raised concerns regarding possible disruptive effects of the above requirements, suggesting that the requirements would create significant operational burdens and impose unwarranted costs. Such costs and operational burdens may be exacerbated by differences between the Commission's rules in these areas and corresponding rules of the Commodity Futures Trading Commission ("CFTC") in connection with the regulation of the swaps market. For these reasons, the Commission has determined that it is appropriate to reconsider its approach to these issues and

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2 For purposes of this release, the term "U.S. personnel" means personnel located in a branch or office in the United States of an entity that is engaged in security-based swap activity, or by personnel of an agent of that entity.

3 The term "security-based swap dealer" is defined in Exchange Act Section 3(a)(71), and further defined by Exchange Act Rules 3a71-1 through 3a71-5. Section 3(a)(71)(D) provides that the Commission shall promulgate regulations to establish factors with respect to the making of any determination to exempt a security-based swap dealer that engages in a de minimis quantity of security-based swap dealing.

consider whether those rules could be tailored in a manner that would continue to advance the objectives of Title VII while reducing associated costs and burdens and, where appropriate, minimizing differences from the approach taken by the CFTC.

In developing these proposals, the Commission has consulted and coordinated with staff of the CFTC and the prudential regulators,[4] in accordance with the consultation mandate of the Dodd-Frank Act.[5] The Commission also has consulted and coordinated with foreign regulatory authorities through Commission staff participation in numerous bilateral and multilateral discussions with foreign regulatory authorities addressing the regulation of OTC (over-the-counter) derivatives.[6] Through these multilateral and bilateral discussions and the Commission

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4 The term "prudential regulator" is defined in Section 1a(39) of the Commodity Exchange Act ("CEA"), 7 U.S.C. 1a(39), and that definition is incorporated by reference in Section 3(a)(74) of the Exchange Act, 15 U.S.C. 78c(a)(74). Pursuant to the definition, the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration, or the Federal Housing Finance Agency (collectively, the "prudential regulators") is the "prudential regulator" of a security-based swap dealer or major security-based swap participant if the entity is directly supervised by that regulator.

5 Section 712(a)(2) of the Dodd-Frank Act provides in part that the Commission shall "consult and coordinate to the extent possible with the Commodity Futures Trading Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible."

In addition, Section 752(a) of the Dodd-Frank Act provides in part that "[i]n order to promote effective and consistent global regulation of swaps and security-based swaps, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the prudential regulators . . . as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps."

6 Staff participates in a number of international standard-setting bodies and workstreams working on OTC derivatives reforms. For example, Commission staff participates in the Financial Stability Board's Working Group on OTC Derivatives Regulation. Commission staff also participates in the International Organization of Securities Commissions ("IOSCO")'s Committee on Derivatives, the joint Basel Committee on Banking Supervision ("BCBS") and IOSCO Working Group on Margin Requirements' Monitoring Group and participates in international working groups that impact OTC derivatives financial market infrastructures, such as CPMI–IOSCO joint working groups assessing legal and regulatory frameworks for central counterparties and trade repositories and examining central counterparty resilience and recovery.

staff's participation in various international task forces and working groups, the Commission has gathered information about foreign regulatory reform efforts and their effect on and relationship with the U.S. regulatory regime. The Commission has taken and will continue to take these discussions into consideration in developing rules, forms, and interpretations for implementing Title VII of the Dodd-Frank Act.

A. Application of Title VII to Transactions "Arranged, Negotiated, or Executed" Using Personnel Located within the United States

1. Proposed Guidance, Exception, and Solicitation of Comment

The Commission is taking a number of steps to address continuing concerns that have been raised regarding the various uses of an "arranged, negotiated, or executed" test in the cross-border application of Title VII.

First, the Commission is proposing supplemental guidance regarding the types of activities by U.S. personnel that would – and would not – constitute "arranging" or "negotiating" security-based swap transactions for purposes of tests that are used to implement a number of Title VII requirements in the cross-border context.[7] Separately, the Commission is proposing two alternatives for a conditional exception from the "arranged, negotiated, or execute" test that forms part of the de minimis counting provisions of Exchange Act Rule 3a71-3. Both alternatives would provide an exception from the requirement that non-U.S. persons count, against the thresholds associated with the de minimis exception, their security-based swap dealing transactions with non-U.S. counterparties that were arranged, negotiated, or executed by

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[7] The proposed guidance would address the application of "arranged" and "negotiated" criteria as used in connection with: two provisions addressing the cross-border application of the de minimis exception to the "security-based swap dealer" definition, security-based swap dealer business conduct requirements, the regulatory reporting and public dissemination requirements of Regulation SBSR, and certain major security-based swap participant requirements. See part II, infra.

U.S. personnel.[8] Finally, the Commission is soliciting comment as to whether to provide additional conditional exceptions from certain other requirements under Title VII that otherwise would apply to transactions "arranged, negotiated, or executed" by U.S. personnel.[9]

These actions – the proposed guidance, the proposed alternatives for a conditional exception from the "arranged, negotiated, or executed" de minimis counting provision, and the solicitation of comment regarding other possible exceptions from "arranged, negotiated, or executed" test used to implement Title VII – are intended to help appropriately tailor the application of Title VII to the U.S. market concerns raised by the transactions that do not involve U.S. counterparties but that nonetheless result from activity within the United States.

In proposing this guidance and exception, the Commission is mindful that the various uses of "arranged, negotiated, or executed" criteria are intended to serve important interests related to avoiding competitive disparities and market fragmentation, and to public transparency.[10] The use of the "arranged, negotiated, or executed" test in the context of the security-based swap dealer de minimis counting provision particularly plays an important role in helping to prevent entities from using booking practices to avoid registering as security-based swap dealers, despite being engaged in security-based swap dealing activity in the United States.[11] The Commission's proposals to mitigate the negative consequences potentially

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8 See Exchange Act Rule 3a71-3(b)(1)(iii)(C).

9 Those requests particularly address the use of "arranged, negotiated, or executed" or equivalent criteria in connection with: the application of the de minimis counting standard of Exchange Act Rule 3a71-3(b)(1)(iii)(A) to certain dealing transactions involving counterparties that are foreign branches of registered security-based swap dealers, regulatory reporting and public dissemination requirements in Rules 908(a)(1)(v) and 908(b)(5) of Regulation SBSR, security-based swap dealer business conduct standards that are not exempted by Exchange Act Rule 3a71-3(c), and major security-based swap requirements in Exchange Act Rule 3a67-10.

10 See notes 19 and 20, infra.

11 See note 18, infra.

associated with the various uses of this type of test accordingly are designed to promote the important Title VII interests that the Commission advanced when it incorporated the test into the various cross-border rules.

2. Current Uses of "Arranged, Negotiated, or Executed" Criteria

Exchange Act Rule 3a71-3 provides in part that, when determining whether non-U.S. persons will be deemed to be security-based swap dealers – and hence subject to the Title VII requirements applicable to security-based swap dealers – non-U.S. persons must count, against the applicable de minimis threshold, their security-based swap dealing transactions with non-U.S. counterparties that were "arranged, negotiated, or executed" by personnel within the United States.[12] The rule separately requires that non-U.S. persons count dealing transactions with U.S. counterparties, and dealing transactions in which their performance under the security-based swap is guaranteed by a U.S. affiliate.[13]

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[12] See Exchange Act Rule 3a71-3(b)(1)(iii)(C). Rule 3a71-3(b) specifically addresses which cross-border security-based swap transactions must be counted against thresholds associated with the de minimis exception to the security-based swap dealer definition. Persons whose dealing activities exceed the de minimis thresholds will be required to register as security-based swap dealers once a compliance date is set. See Exchange Act Section 3(a)(71)(D); Exchange Act Rule 3a71-2.

The requirement that non-U.S. persons count transactions that have been arranged, negotiated or executed in the United States does not apply to non-U.S. persons that are international organizations such as the International Monetary Fund, the International Bank for Reconstruction and Development and the United Nations. See Exchange Act Rule 3a71-3(a)(4)(iii) and Rule 3a71-3(b)(1)(iii)(C).

[13] Overall, Rule 3a71-3 provides that non-U.S. persons (other than conduit affiliates as defined in paragraph (a)(1) of the rule) must count against the de minimis thresholds the following types of security-based swap dealing transactions: (i) transactions entered into with U.S. persons (other than certain transactions involving foreign branches of the U.S. person); (ii) guaranteed transactions in which the counterparty has rights of recourse against a U.S. person affiliated with the non-U.S. person; and (iii) transactions that are arranged, negotiated or executed by personnel of the non-U.S. person located in a U.S. branch or office, or by personnel of an agent of the non-U.S. person located in a U.S. branch or office. See Exchange Act Rule 3a71-3(b)(1)(iii).

A non-U.S. person's transactions with foreign branches of registered security-based swap dealers need not be counted so long as the transaction was not arranged, negotiated or executed by U.S. personnel on behalf of the foreign branch. See Exchange Act Rules 3a71-3(b)(1)(iii)(A)

Subsequent to incorporating the "arranged, negotiated, or executed" test into the de minimis counting standard, the Commission also incorporated the test into other rules addressing the cross-border application of Title VII. Regulation SBSR in part subjects transactions "arranged, negotiated, or executed" in the United States to regulatory reporting and public dissemination requirements.[14] Registered security-based swap dealers also are subject to certain business conduct standards with respect to transactions arranged, negotiated or executed by personnel within the United States.[15]

(counting standard) and 3a71-3(a)(3) (definition of "transaction conducted through a foreign branch"); see also note 81, infra.

The de minimis counting rule further provides that a person engaged in transactions that are required to be counted also must count certain transactions of its affiliates, other than affiliates that are registered as security-based swap dealers (and certain others). See Exchange Act Rules 3a71-3(b)(2), 3a71-4.

In addition, Rule 3a71-5, which provides an exception from the de minimis counting requirement for certain cleared anonymous transactions, is not available to transactions arranged, negotiated or executed by U.S. personnel. As discussed below, the proposed Rule 3a71-5 exception would not be relevant to the transactions subject to that proposed exception. See note 100, infra. The proposed guidance regarding what activity would trigger the "arranged, negotiated, or executed" test would be relevant to the application of the Rule 3a71-5 exception, however. See note 90, infra.

[14] In particular, Regulation SBSR Rule 908(a)(1)(v) requires regulatory reporting and public dissemination of transactions, connected with a non-U.S. person's security-based swap dealing activity, that are arranged, negotiated or executed by the U.S. personnel of the non-U.S. person, or by U.S. personnel of the non-U.S. person's agent. Rule 908(b)(5) further specifies that non-U.S. persons may be subject to regulatory reporting and public dissemination requirements in conjunction with security-based swap transactions arranged, negotiated or executed by U.S. personnel. See also note 80, infra.

[15] Exchange Act Rule 3a71-3(c) provides that security-based swap dealers are not subject to certain business conduct standards with regard to their "foreign business," a term that incorporates additional definitions of "U.S. business" and "transaction conducted through a foreign branch" (see Exchange Act Rules 3a71-3(a)(3), (8) and (9)). The rule in effect applies business conduct requirements to certain security-based swap transactions of foreign security-based swap dealers, and certain transactions conducted through foreign branches of U.S. security-based swap dealers, only when the transactions were arranged, negotiated or executed by U.S. personnel. See also note 79, infra.

Equivalent criteria also have been incorporated into rules regarding the cross-border application of Title VII requirements applicable to major security-based swap participants. See note 82, infra.

The use of "arranged, negotiated, or executed" criteria as part of the de minimis counting test reflects the Commission's view that a non-U.S. person that, as part of its dealing, "engages in market-facing activity using personnel located in the United States" would perform activities that fall within the security-based swap dealer definition "at least in part in the United States."[16] When adopting that test and addressing alternative views suggested by commenters, the Commission stated that it was appropriate to impose Title VII requirements on such activity given, among other things, the focus of the "security-based swap dealer" definition on a person's dealing activity,[17] the risk that non-U.S. persons engaged in security-based swap dealing activity in the United States could avoid regulation under Title VII,[18] concerns about competitive

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16 "Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed By Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent; Security-Based Swap Dealer De Minimis Exception," Exchange Act Release No. 77104 (Feb. 10, 2016), 81 FR 8598, 8621 (Feb. 19, 2016) ("ANE Adopting Release"); see also id. at 8622 ("a non-U.S. person's market-facing activity in the United States suggests the type of involvement in the U.S. security-based swap market that may raise financial contagion, customer protection, market integrity, and market transparency concerns").

17 The statutory definition of "security-based swap dealer" encompasses the following activities: (1) holding oneself out as a dealer in security-based swaps, (2) making a market in security-based swaps; (3) regularly entering into security-based swaps with counterparties as an ordinary course of business for one's own account; or (4) engaging in any activity causing oneself to be commonly known in the trade as a dealer in security-based swaps. See Exchange Act Section 3(a)(71)(A); see also ANE Adopting Release, 81 FR at 8614-15 & n.158 (further concluding that the appropriate analysis also considers whether a non-U.S. person is engaged in the United States in an amount above the de minimis thresholds in any of the activities set forth in the statutory security-based swap dealer definition or in the Commission's further definition of that term, and that the final rule's treatment of activity performed by an agent on behalf of a non-U.S. person in connection with its dealing activity was consistent with Exchange Act Section 30(c), which prohibits the application of Title VII requirements to a person that transacts a security-based swap business "without the jurisdiction of the United States").

18 See id. at 8615. "As long as a non-U.S. person limited its dealing activity with U.S. persons to levels below the dealer de minimis thresholds, it could enter into an unlimited number of transactions connected with its dealing activity in the United States without being required to register as a security-based swap dealer." Id.

disparities and possible market fragmentation absent such a test,[19] and the role of public transparency.[20]

3. Commission Consideration of Alternatives Relying on Registered Broker-Dealers and Banks

Before the Commission incorporated an "arranged, negotiated, or executed" test into the Rule 3a71-3(b)(1)(iii)(C) de minimis counting standard applicable to transactions involving two non-U.S. persons, certain commenters had expressed the view that other Exchange Act protections would obviate the need to use Title VII security-based swap dealer regulation to address regulatory concerns arising from non-U.S. persons' dealing activity using U.S. personnel. Some commenters particularly depicted the concerns raised by such U.S. market-facing activity as relating primarily to counterparty protection, and argued that it would be duplicative to apply Title VII security-based swap dealer requirements to that activity – on the grounds that agents acting on behalf of non-U.S. persons engaged in security-based swap dealing activity generally would be required to register as brokers and could be required to comply with

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[19] See id. at 8616. The Commission stated that if financial groups using non-U.S. persons to carry out dealing business in the United States can "exit the Title VII regulatory regime without exiting the U.S. market with respect to their security-based swap dealing business with non-U.S.-person counterparties (including non-U.S.-person dealers)," those non-U.S.-person dealers likely would incur fewer costs related to their U.S. dealing activity than U.S.-person dealers transacting with the same counterparties, and that non-U.S. person counterparties likely would incur lower costs and obtain better pricing by entering into security-based swaps with non-U.S. dealers that are not required to register as security-based swap dealers. The Commission added that U.S.-person dealers would be at a disadvantage as financial groups use their non-registered dealers to cross-subsidize the dealing activity of affiliated registered security-based swap dealers that engage in dealing activity with U.S.-person counterparties. See id.

[20] See id. at 8615 (stating that aside from mitigating counterparty and operational risks, Title VII security-based swap dealer requirements also "advance other important policy objectives of security-based swap dealer regulation under Title VII, including enhancing counterparty protections and market integrity, increasing transparency, and mitigating risk to participants in the financial markets and the U.S. financial system more broadly").

relevant Exchange Act and Financial Industry Regulatory Authority ("FINRA") requirements with respect to the security-based swap transactions that they intermediate.[21]

Commenters further sought to draw parallels between those circumstances and Exchange Act Rule 15a-6(a)(3), which provides an exemption from the broker-dealer registration requirement for a foreign broker-dealer that uses a registered broker-dealer to intermediate certain transactions.[22] Certain commenters particularly suggested that non-U.S. persons should not be required to count the transactions at issue against the security-based swap dealer de minimis thresholds subject to conditions such as: that the U.S. activity be conducted by a registered broker-dealer; or by a bank that complies with certain business conduct and books and records requirements; or that the non-U.S. person be registered in a jurisdiction that the Commission recognizes as comparable; or that the non-U.S. person be subject to Basel capital standards or be located in a G-20 jurisdiction.[23]

In rejecting those alternatives, the Commission stated its belief that "the approach suggested by commenters is inconsistent with the comprehensive, uniform statutory framework

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21 See id. at 8617-18.

Exchange Act Section 15(a) requires persons who engage in brokerage activities involving securities to register with the Commission unless they can avail themselves of an exception from the registration requirement. The definition of "broker" in Exchange Act Section 3(a)(10), generally encompasses persons engaged in the business of effecting transactions in securities for the account of others, but does not encompass banks that are engaged in certain activities, which may include a significant proportion of banks' security-based swap dealing activity. See ANE Adopting Release, 81 FR at 8619.

The definition of "security" in the Exchange Act (see Exchange Act Section 3(a)(10)) encompasses security-based swaps. The Commission has provided time-limited exemptive relief, expiring February 5, 2020, from the application of certain Exchange Act requirements related to securities activities involving security-based swaps. See Exchange Act Release No. 84991 (Jan. 25, 2019), 84 FR 863 (Jan. 31, 2019).

22 See ANE Adopting Release, 81 FR at 8618.

23 See id. at 8619.

established by Congress for the regulation of security-based swap dealers in Title VII."[24] Significantly, in the Commission's view, broker-dealer regulation does not apply to banks engaged in certain activities.[25] The Commission also emphasized that there are distinctions between the regulatory requirements applicable to broker-dealers and those applicable to security-based swap dealers.[26] The Commission further explained that the absence of a U.S. activity trigger for de minimis threshold calculations would create a strong incentive to move booking for transactions with non-U.S. persons to booking entities that are non-U.S. persons.[27]

4. Reconsideration of the Use of "Arranged, Negotiated, or Executed" Criteria

Although the "arranged, negotiated, or executed" test for de minimis counting has yet to be implemented, as the prerequisites for the registration of security-based swap dealers have not yet been finalized, the Commission believes that it is appropriate to reconsider the approach it adopted in 2016 in light of ongoing concern among market participants and other commenters,

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24 Id.

25 Id.

26 Id.

27 Id. at 8620.

The Commission also addressed one comment that suggested that allowing U.S. personnel to rely on broker-dealer requirements would increase efficiency by permitting such personnel to "be subject to a single set of regulatory compliance obligations with respect to both their underlying securities transactions and derivatives transactions." In response, the Commission noted that such efficiencies would be unavailable to banks that are excepted from the "broker" definition for certain activities, that any such intra-firm efficiencies would be accompanied by competitive disparities, and that Exchange Act and FINRA rules applicable to broker-dealers may incorporate "similar requirements" once relevant exemptions terminate. See id. at 8620.

The Commission further noted that concerns expressed by commenters could be mitigated in part by the availability of substituted compliance, which would permit non-U.S. person-dealers to comply with comparable foreign requirements as an alternative to complying with certain Title VII requirements. The Commission recognized, however, that substituted compliance may not be available for some requirements, and that the availability of substituted compliance would be contingent on the relevant foreign requirements being comparable to Title VII requirements. See id. at 8620.

potential reconsideration by the CFTC of the cross-border application provisions under Title VII governing swap market participants and swaps activities, and regulatory developments in other jurisdictions.

First, market participants have continued to raise several concerns about the use of "arranged, negotiated, or executed" criteria. They argue that requiring a non-U.S. dealer to identify transactions that it arranges, negotiates or executes using personnel located in the United States for purposes of compliance with the rule poses significant operational challenges.[28] In addition, they express concern that foreign non-dealer counterparties will avoid interacting with personnel located in the United States if doing so would subject them to U.S. regulatory requirements, given the potential for duplication or conflict with foreign regulatory requirements and the concomitant burden.[29] To address these concerns, they state that they will be required to "implement compliance systems that eliminate U.S.-located personnel from arranging, negotiating and executing the clients' non-U.S. transactions," which in turn will lead to market

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[28] See Institute of International Bankers ("IIB"), "U.S. Supervision and Regulation of International Banks: Recommendations for the Report of the Treasury Secretary" (Apr. 28, 2017) at 64-65 ("IIB Treasury Letter") ("These systems will create barriers within entities and corporate groups based solely on the geographic location of personnel, to the detriment of globalized risk management and at increased cost to clients. Personnel-based tests are also cumbersome to administer, requiring entities to make seemingly arbitrary distinctions about permitted activities of personnel based on their geographic location at any time."); see also, e.g., Memorandum from Richard Gabbert, Counsel to Commissioner Hester M. Peirce, dated Nov. 30, 2018 (regarding a November 16, 2018 meeting with representatives of SIFMA), available at https://www.sec.gov/comments/s7-05-14/s70514-4714190-176653.pdf; Memorandum from Richard Gabbert, Counsel to Commissioner Hester M. Peirce, dated Nov. 30, 2018 (regarding a November 16, 2018 meeting with representatives of the International Swaps and Derivatives Association (ISDA)), available at https://www.sec.gov/comments/s7-05-14/s70514-4714187-176649.pdf.

[29] In particular, IIB noted concerns raised by the need under this test for foreign clients interacting with personnel located in the United States to "amend[] their trading documentation," change their trading practices to account for public reporting requirements, and change their interactions with trading platforms and clearing houses in order to comply with the Commission's rules. See id. at 64.

fragmentation, lower levels of security-based swap activity by foreign dealers in the U.S. market, and potentially lower levels of liquidity, globally and in the U.S. market.[30] These market participants argue that the risk that such transactions present to the U.S. financial market (and thus the benefit of subjecting such activity to the Commission's regulatory framework) is negligible and cannot justify the imposition of these requirements with their concomitant direct and indirect costs.[31]

The Treasury Department issued a report in October 2017 expressing the view that the Commission and the CFTC should "reconsider the implications" of applying Title VII rules – including the Commission's de minimis counting rules as well as other Commission and CFTC requirements – to certain transactions "merely on the basis that U.S.-located personnel arrange, negotiate, or execute the swap, especially for entities in comparably regulated jurisdictions."[32] Since the publication of this report, market participants have reiterated their concerns. For example, two commenters jointly restated their concern that the test "would discourage non-U.S. clients from interacting with U.S. personnel and impede risk management by expert trading

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30 See id. at 65 ("The increased costs of compliance and changes to market behavior will impede the ability of non-U.S. dealers to invest and participate in U.S. markets and could lead to the elimination of a significant number of jobs for U.S.-located personnel."); see also Securities Industry and Financial Markets Association ("SIFMA"), "Capital Markets Report – Modernizing and Rationalizing Regulation of U.S. Capital Markets" (Aug. 10, 2017) at 115 ("SIFMA Treasury Letter") (arguing that the test should be modified "[t]o encourage firms to hire U.S. front office personnel and promote global market liquidity").

31 See IIB Treasury Letter at 65 ("The costs of these rules far exceed any risk-mitigating benefit. For non-U.S. transactions, the presence of U.S.-located personnel in arranging, negotiating or executing does not result in risk flowing to the United States."); SIFMA Treasury Letter at 120 ("The participation of U.S. personnel does not create risks justifying the imposition of Title VII requirements to these otherwise non-U.S. swaps.").

32 See Treasury Department, "A Financial System That Creates Economic Opportunities: Capital Markets" (Oct. 2017) at 133-36, available at https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

personnel located in the U.S." and impose significant operational burdens, even though "the benefits of applying additional requirements to [transactions captured by the test] are limited."[33]

The Commission further is aware of concerns that application of the counting rule could require a financial group to register multiple non-U.S. entities as security-based swap dealers solely because each of those entities makes use of affiliated persons based in the United States to arrange, negotiate or execute security-based swap transactions with non-U.S. counterparties at levels exceeding the de minimis threshold. This may incentivize such groups to relocate U.S. personnel (or the activities performed by U.S. personnel) abroad to avoid triggering security-based swap dealer registration – a result that may raise issues similar to those raised by the commenters described above, including increased fragmentation to the detriment of U.S. market participants, which could harm U.S. markets and the U.S. economy. These concerns may be particularly acute for non-U.S. financial groups with dealers located in jurisdictions for which the Commission has not made a substituted compliance determination.[34]

Additionally, commenters have continued to urge the Commission to harmonize its rules under Title VII with those of the CFTC, as the CFTC has largely implemented its regulatory framework for swaps and many, if not most, market participants that transact security-based swaps also transact swaps pursuant to the CFTC's rules.[35] Market participants have noted

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33 IIB and SIFMA, "SEC-CFTC Harmonization: Key Issues under Title VII of the Dodd-Frank Act" (June 21, 2018) at 5-6 ("IIB/SIFMA 6/21/18 Letter"), available at https://www.sec.gov/comments/s7-05-14/s70514-3938974-167037.pdf.

34 Exchange Act Rule 3a71-6 permits registered non-U.S. security-based swap dealers to satisfy certain security-based swap dealer requirements – related to business conduct, supervision, chief compliance officers and trade acknowledgment and verification – by complying with foreign requirements that the Commission by order has determined are comparable to the analogous Title VII requirements.

35 See IIB/SIFMA 6/21/18 Letter at 1; see also Futures Industry Association, "Harmonization of SEC and CFTC Regulatory Frameworks," (Nov. 29, 2018) at 9, available at https://www.sec.gov/comments/s7-08-12/s70812-4722398-176717.pdf (encouraging the

potential inefficiencies that may arise from differences between the Commission's and the CFTC's rules and guidance, including the operational challenges that face a dealer's trading desk that transacts in both swaps and security-based swaps, as different or overlapping requirements may apply depending on the specific product or products being traded in connection with a particular transaction.[36] Commenters specifically have urged the Commission to amend its rules to be consistent with the CFTC's approach, which would not require transactions arranged, negotiated, or executed in the United States to be counted toward the de minimis thresholds.[37] In the alternative, these commenters have suggested that the Commission consider an exception for such activity to the extent that it is carried out by U.S. personnel employed by an affiliate that is either a registered security-based swap dealer or a registered broker-dealer and the affiliated foreign dealer is "subject to BCBS-IOSCO compliant capital and margin requirements."[38]

In October 2018, CFTC Chairman Giancarlo issued a document setting forth his views regarding possible modifications to the CFTC's cross-border application of its swap regulations.[39] Among other things, the Giancarlo White Paper suggests an approach to the regulation of transactions arranged, negotiated, or executed by personnel located in the United States on behalf of a foreign dealer.[40] The Giancarlo White Paper suggests that these

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Commission and the CFTC to "jointly propose and adopt rules reflecting a harmonized and unified approach to the cross-border application of the swaps and security-based swaps provisions of Title VII").

36 See IIB/SIFMA 6/21/18 Letter at 1.

37 See id. at 5.

38 Id.

39 See Chris Giancarlo, CFTC Chairman, "Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation" (Oct. 1, 2018) ("Giancarlo White Paper"), available at https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf.

40 See Giancarlo White Paper at 76.

transactions generally should be subject to U.S. requirements but also suggests that it may be appropriate to defer to the foreign jurisdiction's requirements if the foreign dealer is subject to regulation in a "Comparable Jurisdiction."[41]

Finally, in recent years, foreign jurisdictions have continued to implement their own regulatory reforms of the OTC derivatives markets, making it important to explore possible ways to try to reduce conflicts, gaps, inconsistencies and overlaps between Title VII requirements and corresponding foreign requirements. For example, according to the Financial Stability Board ("FSB") OTC Derivatives Working Group's 12th and 13th Progress Reports, only three FSB member jurisdictions had margin requirements for non-centrally cleared derivatives in force at the end of August 2016, while 16 FSB member jurisdictions had such margin requirements in force at the end of September 2018.[42]

In light of the foregoing, the Commission believes that it is appropriate to reconsider its approach to these transactions before foreign dealers and other foreign market participants are required to comply with requirements based on "arranged, negotiated, or executed" criteria, as used in Exchange Act Rule 3a71-3 and elsewhere to implement Title VII in the cross-border context, to enable the Commission to avoid or mitigate any negative effects that the test may create if firms were required to comply with it as adopted. First, the Commission preliminarily believes that it is appropriate to provide guidance to market participants regarding the types of market-facing activity that the "arranged" or "negotiated" criteria would not encompass.

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41 See id. at 79, 80-81.

42 See FSB, "OTC Derivatives Market Reforms: Twelfth Progress Report on Implementation" (Jun. 29, 2017) at 2, available at http://www.fsb.org/2017/06/otc-derivatives-market-reforms-twelfth-progress-report-on-implementation; and FSB, "OTC Derivatives Market Reforms: Thirteenth Progress Report on Implementation" (Nov. 19, 2018) at 1, available at http://www.fsb.org/wp-content/uploads/P191118-5.pdf.

Second, the Commission preliminarily believes that it is possible that an alternative approach may better balance any risks posed by such transactions to the U.S. market against the market-fragmentation and operational risks of subjecting foreign dealers engaged in such transactions to the full range of Title VII regulatory requirements. Moreover, reconsideration of the Commission's approach would be consistent both with its statutory obligation to consult and coordinate with the CFTC and with both agencies' recent efforts to harmonize more closely, to the extent possible, their respective requirements under Title VII.[43] Finally, reconsideration would permit the Commission to evaluate whether the implementation of regulatory reforms in foreign jurisdictions may address some of the concerns that led the Commission to adopt the various uses of the "arranged, negotiated, or executed" test in connection with the cross-border application of Title VII.

For all of these reasons, the Commission preliminarily believes that it is appropriate to provide guidance about the scope of the "arranged" or "negotiated" criteria. The proposed guidance is designed to provide market participants with additional information regarding the types of conduct that would trigger the Title VII requirements that use those criteria, and hence provide improved clarity regarding the types of market-facing conduct that would not be subject to the relevant Title VII requirements.

Separately, the Commission is proposing an exception from the application of the "arranged, negotiated, or executed" test in connection with the de minimis counting requirement in Exchange Act Rule 3a71-3(b)(1)(iii)(C), and is soliciting comment regarding possible

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[43] See "Chief Compliance Officer Duties and Annual Report Requirements for Futures Commission Merchants, Swap Dealers, and Major Swap Participants," 83 FR 43510 (Aug. 27, 2018); "Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers," Exchange Act Release No. 84409 (Oct. 11, 2018), 83 FR 53007 (Oct. 19, 2018).

additional exceptions to the use of those criteria in Exchange Act Rules 3a71-3(b)(1)(iii)(A) (with regard to certain dealing transactions involving certain foreign branches of a registered security-based swap dealer), 3a71-3(c) (with regard to the cross-border application of security-based swap dealer business conduct requirements), 3a67-10 (with regard to the cross-border application of security-based swap dealer business conduct requirements), and Regulation SBSR Rules 908(a)(1)(v) and 908(b)(5) (relating to cross-border application of regulatory reporting and public dissemination requirements). The Commission preliminarily believes that the proposed exception to Rule 3a71-3(b)(1)(iii)(C) would reduce the market fragmentation and operational risks associated with the "arranged, negotiated, or executed" test, provide a possible framework for reducing divergence from the CFTC in connection with the treatment of these transactions, and appropriately recognize the role that foreign regulation may play in addressing certain risks that may arise from these transactions, while protecting the important interests that underpin that use of the "arranged, negotiated, or executed" test.

B. Proposed Guidance and Amendments related to the Certification and Opinion of Counsel Requirements

In 2015, the Commission adopted rules regarding the registration of SBS Entities.[44] These rules include certain requirements specific to nonresident SBS Entities. In particular, Exchange Act Rule 15Fb2-4 requires, among other things, that each nonresident SBS Entity registering with the Commission certify that it can, as a matter of law, and will provide the Commission with prompt access to its books and records and submit to on-site inspection and

[44] See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (Aug. 5, 2015), 80 FR 48964 (Aug. 14, 2015) ("Registration Adopting Release").

examination by the Commission.[45] It also requires that the nonresident SBS Entity obtain and provide to the Commission an opinion of counsel to support this certification.[46] As the Commission stated when adopting these requirements, significant elements of an effective regulatory regime are the Commission's abilities to access registered SBS Entities' books and records and to inspect and examine the operations of registered SBS Entities.[47]

The certification and opinion of counsel requirements adopted by the Commission are designed to provide assurances that the Commission is able to access directly the books and records of a nonresident SBS Entity as provided under Sections 15F and 17 of the Exchange Act and the Commission's rules thereunder, and conduct on-site inspections and examinations of those records.[48] In support of these endeavors, the Commission has proposed recordkeeping rules that would require an SBS Entity to furnish promptly to a representative of the Commission legible, true, complete, and current copies of those records of the SBS Entity that are required to be preserved by the rules, or any other records of the SBS Entity subject to examination or required to be made or maintained pursuant to the Exchange Act that are requested by a representative of the Commission.[49]

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45 See 17 CFR 240.15Fb2-4(c)(1)(i).

46 See 17 CFR 240.15Fb2-4(c)(1)(ii). As discussed below, the Commission has incorporated these certification and opinion of counsel requirements into Exchange Act Rule 3a71-6, which governs applications for substituted compliance.

47 See Registration Adopting Release, 80 FR at 48981.

48 See id.

49 See paragraph (j) of Exchange Act Rule 17a-4, and paragraph (g) of proposed Exchange Act Rule 18a-6 (Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194 (May 2, 2014) ("Recordkeeping and Reporting Proposing Release")).

The Commission is proposing guidance to Exchange Act Rule 15Fb2-4 regarding: (i) the foreign laws that must be covered by the certification and opinion of counsel; (ii) the scope of the books and records that are the subject of the certification and opinion of counsel, namely that the certification and opinion of counsel need only address: (1) records that relate to the "U.S. business" (as defined in Exchange Act Rule 3a71-3(a)(8)) of the nonresident SBS Entity; and (2) financial records necessary for the Commission to assess the compliance of the nonresident SBS Entity with capital and margin requirements under the Exchange Act and rules promulgated by the Commission thereunder, if these capital and margin requirements apply to the nonresident SBS Entity; (iii) predication of a firm's certification and opinion of counsel, as necessary, on the nonresident SBS Entity obtaining prior consent of the persons whose information is or will be included in the books and records to allow the firm to promptly provide the Commission with direct access to its books and records and to submit to on-site inspection and examination; (iv) applicability of the certification and opinion of counsel to contracts entered into prior to the date on which the SBS Entity submits an application for registration pursuant to Section 15F(b); and (v) whether the certification and opinion of counsel submitted by a nonresident SBS Entity can take into account approvals, authorizations, waivers or consents provided by local regulators.

The Commission is also proposing to amend Exchange Act Rule 15Fb2-1 to provide additional time for a nonresident SBS Entity to submit the certification and opinion of counsel required under Exchange Act Rule 15Fb2-4(c)(1). The Commission is proposing to add new paragraphs (d)(2) and (e)(2) to Exchange Act Rule 15Fb2-1. Proposed paragraph (d)(2) would provide that a nonresident applicant that is unable to provide the certification and opinion of counsel required under Rule 15Fb2-4(c)(1) shall be conditionally registered, for up to 24 months after the compliance date for Rule 15Fb2-1, if the applicant submits a Form SBSE-C and a Form

SBSE, SBSE-A, or SBSE-BD, as appropriate, that is complete in all respects but for the failure to provide the certification and the opinion of counsel required by Rule 15Fb2-4(c)(1). Proposed paragraph (e)(2) would provide that if a nonresident SBS Entity became conditionally registered in reliance on paragraph (d)(2), the firm would remain conditionally registered until the Commission acts to grant or deny ongoing registration, and that if the nonresident SBS Entity fails to provide the certification and opinion of counsel within 24 months of the compliance date for Rule 15Fb2-1, the Commission may institute proceedings to determine whether ongoing registration should be denied. As indicated in the Registration Adopting Release, once an SBS Entity is conditionally registered, all of the Commission's rules applicable to registered SBS Entities apply to the entity and it must comply with them.

The guidance regarding the certification and opinion of counsel requirements would also be relevant to Exchange Act Rule 3a71-6, which allows SBS Entities to comply with certain requirements under Section 15F of the Exchange Act through substituted compliance.[50] Paragraph (c)(2)(ii) of Rule 3a71-6 provides that substituted compliance applications by parties or groups of parties – other than foreign financial regulatory authorities – must include the certification and opinion of counsel associated with the SBS Entity registration requirements as if the party were subject to that requirement at the time of the request. Recognizing the expected time necessary for the Commission to consider substituted compliance applications it receives, the Commission welcomes submissions of such applications with respect to any of its final rules for which substituted compliance is potentially available. Consistent with this position, the Commission wishes to clarify that, during the pendency of this proposal, the Commission will consider all substituted compliance applications submitted by parties or groups of parties who

[50] Exchange Act Rule 3a71-6.

are not foreign regulatory authorities even when not accompanied by a certification or opinion of counsel.[51] This clarification, however, does not mean that the Commission would grant any application for substituted compliance submitted by such parties or groups of parties before the required certification and opinion of counsel are filed.

C. Proposed Amendment to Commission Rule of Practice 194

Exchange Act Section 15F(b)(6) makes it unlawful for an SBS Entity to permit an associated person[52] who is subject to a statutory disqualification[53] to effect or be involved in effecting security-based swaps on behalf of the SBS Entity if the SBS Entity knew, or in the exercise of reasonable care should have known, of the statutory disqualification, "[e]xcept to the extent otherwise specifically provided by rule, regulation, or order of the Commission."[54] In this regard, Exchange Act Section 15F(b)(6) gives the Commission the discretion to determine, by rule, regulation or order, that a statutorily disqualified associated person may effect or be

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51 The Commission's rules do not require that applications submitted by foreign regulatory authorities be accompanied by a certification or opinion of counsel. Exchange Act Rule 3a71-6(c).

52 Exchange Act Section 3(a)(70) generally defines the term "person associated with" an SBS Entity to include (i) any partner, officer, director, or branch manager of an SBS Entity (or any person occupying a similar status or performing similar functions); (ii) any person directly or indirectly controlling, controlled by, or under common control with an SBS Entity; or (iii) any employee of an SBS Entity. See 15 U.S.C. 78c(a)(70). The definition generally excludes persons whose functions are solely clerical or ministerial. Id. The definition of "person" under Exchange Act Section 3(a)(9) is not limited to natural persons, but extends to both entities and natural persons. 15 U.S.C. 78c(a)(9) ("The term 'person' means a natural person, company, government, or political subdivision, agent, or instrumentality of a government.").

53 The term statutory disqualification as used in Exchange Act Section 15F(b)(6) parallels the definition of statutory disqualification in Exchange Act Section 3(a)(39)(A)–(F), 15 U.S.C. 78c(a)(39)(A)–(F). See "Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved in Effecting Security-Based Swaps," Exchange Act Release No. 84858 (Dec. 19, 2018), 84 FR 4906 (Feb. 19, 2019) ("Rule of Practice 194 Adopting Release").

54 15 U.S.C. 78o-10(b)(6). The statutory prohibition in Exchange Act Section 15F(b)(6) is substantially the same as the statutory provision for a swap dealer or major swap participant (collectively "Swap Entities") in Section 4s(b)(6) of the CEA, 7 U.S.C. 6s(b)(6).

involved in effecting security-based swaps on behalf of an SBS Entity, and/or to establish rules concerning the statutory prohibition in Exchange Act Section 15F(b)(6).[55] As outlined below, the Commission has taken several actions with respect to the prohibition in Section 15F(b)(6) of the Exchange Act in its implementation of Title VII of the Dodd-Frank Act.[56]

1. Registration Requirements for SBS Entities

On August 5, 2015, the Commission adopted registration requirements for SBS Entities.[57] Several aspects of the adopted rules relate to the statutory prohibition in Exchange Act Section 15F(b)(6). In particular, the Commission adopted Rule 15Fb6-2(a), which requires that an SBS Entity certify electronically on its Form SBSE-C that it neither knows, nor in the exercise of reasonable care should have known, that any person associated with that SBS Entity who effects or is involved in effecting security-based swaps on its behalf is subject to a statutory disqualification, unless otherwise specifically provided by rule, regulation or order of the Commission.[58] In addition, Rule 15Fb6-2(b) requires that, to support the certification required by Rule 15Fb6-2(a), the Chief Compliance Officer of an SBS Entity, or his or her designee, must

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55 See id.

56 On June 15, 2011, the Commission issued an order that, among other things, granted temporary relief from compliance with Exchange Act Section 15F(b)(6) for persons subject to a statutory disqualification who were, as of July 16, 2011, associated with an SBS Entity and who effected or were involved in effecting security-based swaps on behalf of such SBS Entity and allowed such persons to continue to be associated with an SBS Entity until the date upon which rules adopted by the Commission to register SBS Entities became effective. See "Temporary Exemptions and Other Temporary Relief, Together With Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps," Exchange Act Release No. 64678 (June 15, 2011), 76 FR 36287, 36301, 36305-07 (Jun. 22, 2011) ("June 2011 Temporary Exemptions Order"); see also "Order Extending Certain Temporary Exemptions and a Temporary and Limited Exception Related to Security-Based Swaps," Exchange Act Release No. 75919 (Sept. 15, 2015), 80 FR 56519 (Sep. 18, 2015) (extending the June 2011 Temporary Exemptions Order).

57 See Registration Adopting Release.

58 See 17 CFR 240.15Fb6-2(a) and Form SBSE-C (17 CFR 249.1600c).

review and sign a questionnaire or application for employment—that the SBS Entity is required to obtain pursuant to the relevant recordkeeping rule—which has been executed by each associated person who is a natural person and who effects or is involved in effecting security-based swaps on behalf of the SBS Entity. The questionnaire or application for employment, in turn, would serve to verify that the associated natural person is not subject to statutory disqualification.[59]

The Commission also included within the Registration Adopting Release guidance on the scope of the phrase "involved in effecting security-based swaps," as that phrase is used in Exchange Act Section 15F(b)(6).[60] Specifically, the Commission stated that the term "involved in effecting security-based swaps" generally means engaged in functions necessary to facilitate the SBS Entity's security-based swap business, including, but not limited to the following activities: (1) drafting and negotiating master agreements and confirmations; (2) recommending security-based swap transactions to counterparties; (3) being involved in executing security-based swap transactions on a trading desk; (4) pricing security-based swap positions; (5) managing collateral for the SBS Entity; and (6) directly supervising persons engaged in the above-described activities.[61]

2. Commission Rule of Practice 194

On December 19, 2018, the Commission adopted Rule of Practice 194, which provides, among other things, a process by which an SBS Entity could apply to the Commission to permit an associated person who is a natural person and who is subject to a statutory disqualification to

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59 See 17 CFR 240.15Fb6-2(b).

60 See Registration Adopting Release, 80 FR at 48974, 48976.

61 See id. at 48976.

effect or be involved in effecting security-based swaps on behalf of the SBS Entity.[62] Rule of Practice 194 establishes a process by which the Commission can assess on a case-by-case basis whether to grant relief from the statutory prohibition in Exchange Act Section 15F(b)(6).

Rule of Practice 194 excludes associated persons that are not natural persons (defined herein as "associated person entities") from the statutory disqualification prohibition in Exchange Act Section 15F(b)(6).[63] As the Commission explained when adopting Rule of Practice 194, granting an automatic exclusion for associated person entities could reduce potential disruptions to the business of SBS Entities that could lead to possible market disruption.[64] The exclusion for associated person entities also results in consistency with the CFTC's approach with respect to the statutory prohibition for Swap Entities as set forth in CEA Section 4s(b)(6).[65]

3. Proposed Rule of Practice 194(c)(2)

As the Commission noted in adopting Rule of Practice 194, there may be instances where it is consistent with the public interest to permit an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of an SBS Entity.[66] As discussed in greater detail below, the Commission is now proposing to amend Rule of Practice 194, by including proposed paragraph (c)(2), to exclude an SBS Entity, subject to

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62 See Rule of Practice 194 Adopting Release, 84 FR at 4906-47; see also 17 C.F.R. §§ 240.194(a)-(i).

63 See 17 CFR 240.194(c); see also Rule of Practice 194 Adopting Release, 84 FR at 4906.

64 See Rule of Practice 194 Adopting Release, 84 FR at 4911.

65 See 7 U.S.C. 6s(b)(6). The CFTC, with respect to statutorily disqualified associated persons of swap entities, limits the definition of associated persons of swap entities to natural persons. See 17 CFR 1.3. As a result, the prohibition in CEA Section 4s(b)(6) applies to natural persons (not entities) associated with a swap entity.

66 See Rule of Practice 194 Adopting Release, 84 FR at 4908.

certain limitations, from the prohibition in Exchange Act Section 15F(b)(6) with respect to an associated person who is a natural person who (i) is not a U.S. person and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person.

D. Proposed Exchange Act Rule 18a-5

In April 2014, the Commission proposed recordkeeping, reporting, and notification requirements applicable to SBS Entities, securities count requirements applicable to certain security-based swap dealers, and additional recordkeeping requirements applicable to broker-dealers to account for their security-based swap and swap activities.[67] The proposed requirements were modeled on existing broker-dealer requirements.[68] The Commission received a number of comments in response to these proposals.[69] Separately, the Commission proposed rules governing the cross-border treatment of recordkeeping and reporting requirements with respect to SBS Entities.[70] The Commission received comments in response to these cross-border proposals as well.[71]

In the Recordkeeping and Reporting Proposing Release, the Commission, among other things, proposed new Exchange Act Rule 18a-5 (patterned after Exchange Act Rule 17a-3 - the

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67 See Recordkeeping and Reporting Proposing Release.

68 See id., 79 FR at 25196-97 (providing the rationale for modeling the proposed requirements on the relevant broker-dealer requirements).

69 The comment letters are available at https://www.sec.gov/comments/s7-05-14/s70514.shtml.

70 See "Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants," Exchange Act Release No. 69490 (May 1, 2013), 78 FR 30968 (May 23, 2013) ("Cross-Border Proposing Release").

71 The comment letters are available at https://www.sec.gov/comments/s7-02-13/s70213.shtml.

recordkeeping rule for registered broker-dealers) to establish recordkeeping standards for firms without a prudential regulator that are registered with the Commission only as an SBS Entity (and not as a broker-dealer as well) and SBS Entities for which there is a prudential regulator (collectively, "stand-alone and bank SBS Entities").[72]

As part of that rulemaking, the Commission proposed to require that an SBS Entity make and keep current a questionnaire or application for employment for each associated person who is a natural person, that includes the associated person's identifying information, business affiliations for the past ten years, relevant disciplinary history, relevant criminal record, and place of business, among other things (hereinafter the "questionnaire requirement").[73] The Commission also proposed a definition of the term "associated person" that would include persons associated with an SBS Entity as defined under Section 3(a)(70) of the Exchange Act.[74] One commenter requested that the Commission modify the rule for foreign SBS Entities so that the questionnaire requirement would not apply to associated persons who effect or are involved in effecting security-based swap transactions with non-U.S. persons or foreign branches.[75] In a subsequent letter, this commenter also requested that the rule be modified to exclude from the questionnaire requirement an associated person employed or located in a non-U.S. branch, office, or affiliate of the firm in circumstances where: (1) applicable non-U.S. law prohibits the firm from conducting background checks on the associated person and consent does not cure the prohibition or may not be a condition of employment; (2) the associated person is not subject to a

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72 See Recordkeeping and Reporting Proposing Release, 79 FR at 25205.

73 Paragraphs (a)(10)(i) and (b)(8)(i) of proposed Rule 18a-5.

74 Id.

75 See SIFMA letter to Kevin M. O'Neill, dated Sep. 5, 2014 ("SIFMA 9/5/14 Letter") at 9, available at https://www.sec.gov/comments/s7-05-14/s70514-10.pdf.

statutory disqualification that the firm actually knows about; (3) the associated person does not effect and is not involved in effecting security-based swaps with U.S. counterparties on behalf of the firm; and (4) the associated person complies with applicable registration and licensing requirements in the jurisdiction(s) where he or she effects or is involved in effecting security-based swaps on behalf of the firm.[76]

As indicated in Exchange Act Rule 15Fb6-2, the questionnaire requirement is intended to serve as a basis for a background check of the associated person who is a natural person and who effects or is involved in effecting security-based swap transactions on the SBS Entity's behalf to verify that the person is not subject to statutory disqualification.[77] The Commission preliminarily believes that it is appropriate to provide flexibility with respect to the questionnaire requirement as applied to associated persons of stand-alone and bank SBS Entities. As discussed above in Section I.C.3., the Commission is proposing to add paragraph (c)(2) to Rule of Practice 194 in order to provide an exclusion from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to an associated person who is not a U.S. person and does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person, subject to certain conditions. Consistent with this proposal, the Commission is also proposing modifications to proposed Rule 18a-5 to provide that a stand-alone or bank SBS Entity is not required to make and keep current a questionnaire or application for employment executed by an associated person if the SBS Entity is excluded from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to such associated person.

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76 See Letter from IIB and SIFMA, dated Aug. 26, 2016 ("IIB/SIFMA 8/26/16 Letter"), available at https://www.sec.gov/comments/s7-05-14/s70514-18.pdf.

77 See 17 CFR 240.15Fb6-2(b).

The Commission also is proposing modifications to proposed Rule 18a-5 to address situations where the laws of a non-U.S. jurisdiction in which an associated person is employed or located may prohibit a stand-alone or bank SBS Entity from receiving, creating or maintaining a record of any of the information mandated by the questionnaire requirement.[78] The modifications would apply with respect to an associated person who is not a U.S. person and would provide that the stand-alone or bank SBS Entity need not record certain information mandated by the questionnaire requirement with respect to that person if the receipt of that information, or the creation or maintenance of records reflecting such information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located. The Commission emphasizes, however, that every SBS Entity must still comply with Section 15F(b)(6) of the Exchange Act and Rule 15Fb6-2 with respect to every associated person who effects or is involved in effecting security-based swaps on behalf of the SBS Entity absent an exclusion from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act.

II. Proposed Guidance Regarding the Meaning of "Arranged" and "Negotiated" in Connection with the Cross-Border Application of Title VII

A. Provision of "Market Color"

1. Earlier guidance

In adopting the Exchange Act Rule 3a71-3(b)(1)(iii)(C) "arranged, negotiated, or executed" de minimis counting standard applicable to transactions between two non-U.S. counterparties, the Commission addressed the types of activity that would – and would not – trigger that portion of the de minimis test. The Commission subsequently relied on the analysis underpinning that use of the "arranged, negotiated, or executed" test within the de minimis

[78] See paragraphs (a)(10)(iii) and (b)(8)(iii) of Rule 18a-5, as proposed.

counting standard when the Commission adopted final rules incorporating those criteria into the cross-border application of security-based swap dealer business conduct provisions,[79] and into the cross-border application of Regulation SBSR's regulatory reporting and public dissemination provisions.[80] The Commission previously incorporated those criteria into the portion of the security-based swap dealer de minimis exception related to transactions involving counterparties

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79 Exchange Act Rule 3a71-3(c) excuses a registered security-based swap dealer from compliance with certain security-based swap dealer business conduct standards with respect to its foreign business. That rule incorporates a standard, via underlying definitions of "foreign business," "U.S. business" and "transaction conducted through a foreign branch" (see Exchange Act Rules 3a71-3(a)(3), (8) and (9)), that uses "arranged, negotiated, and executed" terminology that functionally is equivalent to the "arranged, negotiated, or executed" standard incorporated by Rule 3a71-3(b)(1)(iii)(C).

In adopting Rule 3a71-3(c), the Commission particularly stated that the business conduct rules should apply to transactions that a foreign security-based swap dealer "arranges, negotiates, or executes using personnel located in a U.S. branch or office," both to "preserve customer protections for U.S. counterparties that would expect to benefit from the protection afforded to them by Title VII" and to "help maintain market integrity by subjecting the large number of transactions that involve relevant dealing activity in the United States to these requirements, even if both counterparties are non-U.S. persons." See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 30065 (May 13, 2016) ("Business Conduct Adopting Release"). The Commission further stated that the business conduct rules need not be applied to a U.S. dealer's transactions that have been arranged, negotiated or executed through a foreign branch with a non-U.S. counterparty (or with another foreign branch counterparty), reasoning that "Title VII is concerned with the protection of U.S. markets and participants in those markets, and it remains our view that imposing these requirements on a U.S.-person dealer when it arranges, negotiates, or executes through its foreign branch with another foreign branch or a non-U.S. person would produce little or no benefit to U.S. market participants." Id., 81 FR at 30066.

80 In incorporating an "arranged, negotiated, or executed" standard into Regulation SBSR Rules 908(a)(1)(v) and 908(b)(5), regarding the cross-border application of regulatory reporting and public dissemination requirements, the Commission stated that "[c]onsistent with its territorial application of Title VII requirements, the Commission believes that, when a foreign dealing entity uses U.S. personnel to arrange, negotiate, or execute a transaction in a dealing capacity, that transaction occurs at least in part within the United States and is relevant to the U.S. security-based swap market," and that "[a]s the Commission has stated previously, declining to apply Title VII requirements to security-based swaps of foreign dealing entities that use U.S. personnel to engage in ANE activity would have the effect of allowing such entities 'to exit the Title VII regulatory regime without exiting the U.S. market.'" See Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 78321 (Jul. 14, 2016), 81 FR 53546, 53590-91 (footnote omitted).

that are foreign branches of registered security-based swap dealers,[81] and also has incorporated those criteria into Title VII rules regarding major security-based swap participants.[82]

In discussing the "arranged, negotiated, or executed" test in the context of the de minimis counting standard applicable to transactions involving two non-U.S. counterparties, the

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81 Exchange Act Rule 3a71-3(b)(1)(iii)(A) generally requires non-U.S. persons to count transactions with U.S. counterparties for purposes of the de minimis thresholds, but carves out transactions that constitute "transactions conducted through a foreign branch of the counterparty." The definition of "transaction conducted through a foreign branch" in part requires that the transaction be "arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States." See Exchange Act Rule 3a71-3(a)(3)(i)(B).

When the Commission adopted that foreign branch-related de minimis counting requirement, the Commission concluded that the definition of "transaction conducted through a foreign branch" identifies the functions associated with foreign branch activity "in a manner that appropriately focuses the exclusion for non-U.S. person's transactions toward situations in which the branch performs the core dealing functions outside the United States." See "Application of 'Security-Based Swap Dealer' and 'Major Security-Based Swap Participant' Definitions to Cross-Border Security-Based Swap Activities; Republication" Exchange Act Release No. 72472 (Jun. 25, 2014), 81 FR 47278, 47322 (Aug. 12, 2014) ("Cross-Border Adopting Release"). That is consistent with the analysis underlying the use of "arranged, negotiated, or executed" test in connection with the de minimis counting provisions of Rule 3a71-3(b)(1)(iii)(C), related to transactions between two non-U.S. persons, which was intended to prevent the conduct of an unregistered security-based swap dealing business in the United States. See notes 18 and 19, supra.

Unless specified otherwise, references to the application of the "arranged, negotiated, or executed" test in the context of de minimis counting refer both to the Rule 3a71-3(b)(1)(iii)(C) test regarding dealing transactions involving two non-U.S. persons, and the Rule 3a71-3(b)(1)(iii)(A) test regarding dealing transactions involving a counterparty that is the foreign branch of a registered security-based swap dealer.

82 The rule implementing the "major security-based swap participant" definition generally requires consideration of a non-U.S. person's security-based swap positions with U.S. counterparties, but excludes positions that arise from transactions conducted through a foreign branch of a counterparty that is a registered security-based swap dealer. See Exchange Act Rule 3a67-10(b)(3)(i). This rule incorporates the Rule 3a71-3 definition of "transaction conducted through a foreign branch," which makes use of "arranged, negotiated, and executed" criteria. In adopting that provision, the Commission noted its consistency with the security-based swap dealer de minimis counting provision related to transactions with counterparties that are foreign branches of registered security-based swap dealers. See Cross-Border Adopting Release, 79 FR at 47343.

U.S. and non-U.S. major security-based swap participants similarly are excluded from having to comply with certain business conduct requirements in connection with transactions conducted through a foreign branch, based on that same definition. See Exchange Act Rule 3a67-10(d). In adopting that provision, the Commission noted its consistency with the cross-border application of security-based swap dealer business conduct rules. See Business Conduct Adopting Release, 81 FR at 30069.

Commission explained that the terms "arrange" and "negotiate" were intended to "indicate market-facing activity of sales or trading personnel in connection with a particular transaction, including interactions with counterparties or their agents."[83] The Commission added that the term "execute" in the rule "refers to the market-facing act that, in connection with a particular transaction, causes the person to become irrevocably bound under the security-based swap under applicable law."[84]

The Commission further distinguished market-facing activity by sales and trading personnel from activity by personnel who perform back-office functions that generally do not involve direct contact with counterparties. In doing so, the Commission identified types of activities that would not require counting of transactions against the de minimis thresholds, including: processing trades and other back-office activities; designing security-based swaps without engaging in market-facing activity in connection with specific transactions; preparing underlying documentation including negotiating master agreements ("as opposed to negotiating with the counterparty the specific economic terms of a particular security-based swap transaction"); and clerical and ministerial tasks such as entering executed transactions on a non-U.S. person's books.[85]

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83 See ANE Adopting Release, 81 FR at 8622.

84 See id. The Commission added that the test also applies when U.S. persons direct other persons to arrange, negotiate or execute particular security-based swaps. "In other words, sales and trading personnel of a non-U.S. person who are located in the United States cannot avoid application of this rule by simply directing other personnel to carry out dealing activity[.]" The Commission further noted that the test includes transactions in which personnel located in a U.S. branch or office "specify the trading strategy or techniques carried out through algorithmic trading or automated electronic execution of security-based swaps, even if the related server is located outside the United States." Id. at 8623.

85 See id. at 8622.

In addition, the Commission stated that it generally viewed the test as requiring the counting of transactions arranged, negotiated or executed by, for example, "personnel assigned to, on an ongoing or temporary basis, or regularly working in a U.S. branch or office."[86] On the other hand, the counting standard does not extend to transactions arranged, negotiated or executed "by personnel assigned to a foreign office if such personnel are only incidentally in the United States," such as while attending an educational or industry conference.[87]

2. Proposed supplemental guidance

The Commission is proposing to provide supplemental guidance regarding the types of market-facing activity that would – and would not – constitute "arranging" or "negotiating" a security-based swap for purposes of the relevant Title VII requirements.[88] For the reasons discussed below, this proposed guidance would take the position that a person may provide "market color" in specific circumstances without that activity constituting "arranging" or "negotiating" security-based swap transactions for purposes of the "arranged, negotiated, or

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86 Id. at 8623. The Commission separately explained that the rule applies to security-based swap transactions that the non-U.S. person, in connection with its dealing activity, arranges, negotiates or executes, using personnel located in a U.S. branch or office, even when such transactions are in response to inquiries from a non-U.S. person counterparty outside business hours in the counterparty's jurisdiction and occur pursuant to product, credit and market risk parameters set by management personnel outside the United States. See id. at 8623-24.

87 See id. at 8623. The Commission stated that this should mitigate the burdens of determining whether a particular transaction needs to be counted. See id.

More generally, the Commission emphasized that the rule would avoid the need for the non-U.S. person to monitor the location of its counterparty's personnel or receive associated representations. See id. at 8621-22; see also id. at 8612-13 (discussing prior Commission proposal to address the cross-border application of the security-based swap dealer definition via a test that would have required counting of transactions that were solicited, negotiated, executed or booked in the United States by or on behalf of either counterparty).

88 The Commission does not believe there is a reason to revisit its prior guidance regarding the scope of the term "execute"; the Commission therefore is not providing any additional guidance regarding the interpretation of that term.

executed" test[89] that is used in connection with de minimis counting,[90] the cross-border application of business conduct rules,[91] regulatory reporting and public dissemination requirements,[92] and major security-based swap participant rules.[93] For purposes of this guidance, the term "market color" means background information regarding pricing or market conditions associated with particular instruments or with markets more generally, including information regarding current or historic pricing, volatility or market depth, and trends or predictions regarding pricing, volatility or market depth, as well as other types of information reflecting market conditions and trends.

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89 Certain provisions applying Title VII security-based swap requirements in the cross-border context, such as the de minimis counting test in Rule 3a71-3(b)(2)(iii), incorporate "arranged, negotiated, or executed" terminology. Other cross-border provisions make use of the definition of "transaction conducted through a foreign branch" in Rule 3a71-3(a)(3), which incorporates the functionally equivalent "arranged, negotiated, and executed" terminology. This proposed guidance would apply to both uses of that terminology, as found in the rules discussed in notes 90 through 93, infra, and accompanying text.

90 In connection with de minimis counting, this proposed guidance would apply to: (1) Exchange Act Rule 3a71-3(b)(1)(iii)(C), which requires the counting of security-based swap dealing transactions between non-U.S. counterparties that have been "arranged, negotiated, or executed" in the United States; (2) Exchange Act Rule 3a71-3(b)(2), which addresses the counting of affiliate transactions described by paragraph (b)(1) (which includes the (b)(1)(iii)(C) requirement); (3) Exchange Act Rule 3a71-5, which excepts certain cleared anonymous transactions from the individual counting requirement of paragraph (b)(1) of Rule 3a71-3 and from the affiliate counting requirement of paragraph (b)(2), but is unavailable to transactions "arranged, negotiated, or executed" by U.S. personnel; and (4) the de minimis counting requirement of Exchange Act Rule 3a71-3(b)(1)(iii)(A), requiring the counting of dealing transactions between dealing transactions involving a foreign branch of a registered security-based swap dealer and a non-U.S. counterparty (or another foreign branch). The regulatory interests underlying the Rule 3a71-3(b)(1)(iii)(C) and Rule 3a71-3(b)(1)(iii)(A) uses of arranged, negotiated and/or executed criteria to implement the de minimis counting requirement are similar (as are, derivatively, the Rule 3a71-3(b)(2) and Rule 3a71-5 uses). See note 81, supra.

91 See note 79, supra (addressing Exchange Act Rule 3a71-3(c) business conduct exclusion).

92 See note 80, supra (addressing Regulation SBSR Rules 908(a)(1)(v) and 908(b)(5), regarding the cross-border application of regulatory reporting and public dissemination requirements).

93 See note 82, supra (addressing cross-border major security-based swap participant provisions of Exchange Act Rules 3a67-10(b)(3)(i) and 3a67-10(d)).

The Commission believes that the earlier guidance, which focused on the presence of market-facing activities by U.S. personnel, provides a useful starting point for identifying the types of U.S. activity that should trigger the various uses of the "arranged, negotiated, or executed" test. The Commission nonetheless has come to recognize that there are significant variations among the types of market-facing activity that may occur in connection with security-based swap transactions, and that U.S. personnel in some circumstances may engage in activity that, although market-facing, reasonably may not be characterized as "arranging" or "negotiating" a security-based swap transaction – as those terms are understood generally and in the context of the relevant regulatory interests.

On one hand, U.S. personnel may actively market security-based swaps to counterparties on behalf of a firm. Those types of market-facing activity by U.S. personnel appropriately would trigger the various uses of the "arranged, negotiated, or executed" test, because otherwise those activities could cause a firm to engage in a dealing business in the United States without being subject to applicable Title VII requirements.

At the other end of the spectrum, U.S. personnel may engage in limited market-facing activity such as providing market-related information to counterparties in response to inquiries, or providing market data or other information that helps to set the price associated with a security-based swap transaction that otherwise is negotiated by non-U.S. personnel. When the remaining market-facing activity connected with a transaction occurs outside the United States, such limited market-facing activity by U.S. personnel standing alone does not trigger the

concerns and regulatory interests that underpin the various uses of the "arranged, negotiated, or executed" test in connection with the transaction.[94]

Accordingly, the earlier reliance on the presence of market-facing activity may not sufficiently recognize circumstances in which the market-facing activity of U.S. personnel is so limited that it would not implicate the regulatory interests underlying the relevant Title VII requirements.[95]

For those reasons, the Commission is proposing guidance that U.S. personnel who provide market color in connection with security-based swap transactions – in the form of information or data as described above, including market-related information regarding the pricing of particular instruments or background information regarding general market conditions

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94 Such limited U.S. market-facing activity of that type seems unlikely to implicate the regulatory interests underlying the various uses of the "arranged, negotiated, or executed" test for purposes of the security-based swap dealer de minimis counting requirement, or for purposes of the regulatory reporting and public dissemination requirements of Regulation SBSR, because the activity of the U.S. personnel standing alone would not appear comprehensive enough to pose a significant risk of allowing an entity to exit the Title VII regulatory regime without exiting the U.S. market.

That type of limited U.S. market-facing activity further seems unlikely to implicate the regulatory interests underlying the use of the "arranged, negotiated, or executed" test for purposes of the security-based swap dealer business conduct requirements for the same reason, and also because non-U.S. counterparties reasonably may not expect Title VII business conduct requirements to apply merely as the result of receiving technical information from U.S. personnel.

95 When the Commission adopted the "arranged, negotiated, or executed" counting rule applicable to transactions between two non-U.S. counterparties, the Commission stated that "to the extent that personnel located in a U.S. branch or office engage in market-facing activity normally associated with sales and trading, the location of those personnel would be relevant, even if the personnel are not formally designated as sales persons or traders." See ANE Adopting Release, 81 FR at 8622 n.224. Just as the "arranged, negotiated, or executed" test reasonably may be triggered by U.S. personnel that are not formally designated as sales persons or traders when they engage in arranging or negotiating activity, the Commission does not believe that the test invariably must be triggered by the presence of U.S. personnel who are designated as sales persons or traders when their activity is too limited to implicate the principles underlying the uses of the test.

– do not trigger the Title VII requirements that use an "arranged, negotiated, or executed" test, when the following circumstances exist:

- No client responsibility – The U.S. personnel have not been assigned, and do not otherwise exercise client responsibility in connection with the transaction.
- No transaction-linked compensation – The U.S. personnel do not receive compensation based on or otherwise linked to the completion of transactions on which the "U.S. personnel" provide market color.[96]

In those circumstances, U.S. personnel may provide information to counterparties, pursuant to the proposed guidance, regarding pricing or market conditions associated with particular instruments or with markets more generally, including information regarding current or historic market pricing, volatility or market depth, as well as general trends or predictions regarding those matters and information related to risk management. This should help promote the efficient use of such U.S. personnel without raising concerns that such activity constitutes "arranging" or "negotiating" a security-based swap transaction for purposes of the requirements under Title VII that incorporate the "arranged, negotiated, or executed" test – i.e., requirements related to de minimis counting, the cross-border application of business conduct and regulatory reporting and public dissemination requirements, and the cross-border major security-based swap participant rules.[97]

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[96] The Commission understands that it is commonplace for firms to account for the overall profit or loss of the firm, or of a particular division or office, in calculating bonuses. The language regarding "compensation based on or otherwise linked to the completion of transactions" is not intended to extend to such profit-sharing arrangements or other compensation practices that account for aggregated profits, as such arrangements would not be expected to incentivize U.S. personnel in a similar manner or to a similar degree as compensation that is directly linked to the success of individual transactions.

[97] Nothing in this guidance would restrict the ability of firms to risk manage their security-based swap positions on a global basis.

Separately, in circumstances where the proposed guidance allows for market-facing activity by U.S. personnel without triggering the "arranged, negotiated, or executed" standard, the federal securities laws, including applicable antifraud provisions, still may apply to that activity depending on the particular facts and circumstances.

Under the guidance, U.S. persons could provide market-based information in connection with security-based swap transactions – including but not limited to information regarding pricing, depth of market, and anticipated demand – in support of non-U.S. persons who actually arrange, negotiate and execute those transactions on behalf of their clients.

B. Solicitation of Comments

The Commission is soliciting comment regarding all aspects of this proposed guidance, including whether other approaches would be appropriate – as a supplement to or in lieu of the proposed guidance – to address particular types of market-facing activity that may not raise the concerns that underpinned the "arranged, negotiated, or executed" test. Commenters particularly are invited to address the following:

1. To what extent do non-U.S. persons that engage in security-based swap dealing activity with non-U.S. counterparties make use of U.S. personnel in a market-facing capacity in connection with that dealing activity? What specific types of market-facing activities do such U.S. personnel conduct?
2. Would the proposed guidance provide a workable approach for distinguishing between market-facing activity that falls within the scope of "arranging" and "negotiating" security-based swap transactions and that which does not? Would a different type of Commission action (e.g., exemptive relief or some other approach) be more appropriate?
3. Would the proposed guidance appropriately apply to the use of the "arranged, negotiated, or executed" test in the context of de minimis counting, the cross-border application of regulatory reporting and public dissemination, and the cross-border application of business conduct requirements? If not, in which circumstances would the proposed guidance be more or less appropriate when applied to particular requirements?

4. Would the use of U.S. personnel solely to provide "market color" to the counterparties of non-U.S. dealers – such as by providing information regarding pricing or market conditions, including information regarding current or historic pricing, volatility or market depth, and trends or predictions regarding those matters – raise concerns regarding the uniform application of the Title VII security-based swap dealer regime and/or the ability of firms to conduct an unregistered security-based swap dealing business in the United States? Commenters particularly are invited to address any gaps in regulation that may result from guidance that excludes from the test transactions involving such market-facing activity in the United States from the ambit of the various requirements that make use of the "arranged, negotiated, or executed" test, including, inter alia, issues associated with the failure to apply security-based swap dealer requirements to those U.S. market-facing activities as a result of excluding certain transactions from the de minimis counting requirement.
5. Would the proposed guidance effectively distinguish the types of market-facing activity that appropriately should fall within the "arranged, negotiated, or executed" test from other types of market-facing activity? Alternatively, are different or additional standards appropriate to distinguish between those two types of activity? For example, should the "arranged, negotiated, or executed" test encompass activity by U.S. personnel that involves arranging or finalizing non-pricing aspects of the transaction, such as underlier, notional amounts or tenor, or otherwise play more than a peripheral role with regard to the completion of the transaction? In regard to these issues, commenters are invited to discuss current practices regarding the use of U.S. personnel to provide limited information such as "market color," including the nature of the information provided, the

time of day such information is provided, and the underliers typically associated with that type of activity.

6. Is the proposed distinction between market-facing activity that involves transaction-based compensation of U.S. personnel and market-facing activity that does not involve transaction-based compensation workable in light of existing compensation practices associated with such activity by U.S. personnel? Are there typical compensation practices that would raise interpretive issues regarding the application of the "arranged, negotiated, or executed" test under the guidance? Commenters particularly are requested to discuss firm-specific or other typical arrangements for compensating U.S. personnel of foreign dealing entities in circumstances where the U.S. personnel have some involvement with the firm's transactions with non-U.S. counterparties. Commenters further are requested to address whether firms may restructure their compensation arrangements to rely on this type of guidance, and whether the resulting alternative compensation practices would incentivize U.S. personnel in a similar manner or to a similar degree as compensation that is linked directly to the success of individual transactions.
7. What other market practices, if any, should the Commission address in any guidance it provides regarding the scope of "arranging" and "negotiating" for purposes of the test?
8. If the Commission separately were to adopt rules providing for an exception from the application of the "arranged, negotiated, or executed" test to the security-based swap dealer de minimis counting requirement, pursuant to one of the alternatives being proposed (see part III, infra), in what circumstances would non-U.S. persons have an incentive to rely on the proposed guidance? For example – and depending on the

contours of this guidance – is it possible that such guidance primarily would be used by a non-U.S. person that is not located in a "listed jurisdiction"?[98] Is it possible that such guidance primarily would be used by a non-U.S. person that does not have a U.S. broker-dealer affiliate, or that would prefer to use non-affiliated personnel to engage in such market-facing activities?

9. Would the proposed guidance obviate the need for the more general exception to the "arranged, negotiated, or executed" test that the Commission is proposing (related to de minimis counting of transactions involving two non-U.S. counterparties)?

10. Are the limits to the proposed guidance sufficient to prevent non-U.S. counterparties that interact with such U.S. personnel from incorrectly presuming that the entire Title VII regulatory framework would apply to the transaction? If not, what additional limits could be appropriate to control that possibility?

11. Could the availability of the proposed market color guidance potentially affect the security-based swap booking practices of U.S. or non-U.S. dealing entities? For example, if this type of guidance were available, would a non-U.S. person that currently uses U.S. personnel to engage in dealing transactions with U.S. and non-U.S. counterparties have the incentive to prospectively book transactions with U.S. counterparties into a registered affiliate, so the non-U.S. person may avoid registering as a security-based swap dealer while still being able to use U.S. personnel to facilitate its dealing transactions with non-U.S. counterparties? If so, would bifurcating dealing books in this way limit the liquidity available to U.S. market participants?

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[98] See part III.B.5, infra (addressing "listed jurisdiction" condition to availability of proposed conditional exception from use of "arranged, negotiated, or executed" test in connection with security-based swap dealer de minimis counting provisions).

III. Proposed Exception to Rule 3a71-3

A. Purpose

The Commission continues to believe that the use of the "arranged, negotiated, or executed" test appropriately applies the security-based swap dealer de minimis counting requirement in connection with transactions involving two non-U.S. counterparties. At the same time, based on the concerns that have been expressed regarding that use of the test, the Commission recognizes that in some circumstances this use of the test, among other possible outcomes, may cause financial groups to relocate U.S. personnel or relocate the activities performed by U.S. personnel, to avoid security-based swap dealer registration, and that such results have the potential to increase fragmentation and harm U.S. market participants and the U.S. economy.[99]

To address that concern, the Commission is soliciting public comment on two alternative proposals for a conditional exception from the use of the "arranged, negotiated, or executed" test in connection with that part of the de minimis counting requirement, set forth in Exchange Act Rule 3a71-3(b)(1)(iii)(C).[100] These alternative proposals are intended to protect the policy goals

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[99] See part I.A.4, supra. The potential ramifications of this use of the "arranged, negotiated, or executed" test are linked in part to whether market participants in practice would relocate personnel or functions due to this use of the test, as well as to the actual effects of such relocations. Alternative practices by market participants – such as compliance with the counting requirement with no relocation of personnel or functions – may mitigate those ramifications and/or produce other ramifications. Similarly, it is possible that relocation of personnel or functions may not lead to the fragmentation and other consequences that have been described. The Commission is soliciting comment regarding the uses of U.S. personnel in connection with the transactions at issue, and the potential ramifications of not providing this type of exception. See parts III.D.1, III.D.2, infra.

[100] The proposed conditional exception to Rule 3a71-3(b)(1)(iii)(C) would have ramifications to the affiliate counting provisions of paragraph (b)(2) of Rule 3a71-3. Paragraph (b)(2) requires persons engaged in security-based swap transactions described in paragraph (b)(1) of the rule – which includes the transactions at issue – also to count certain dealing transactions of affiliates under common control, including transactions described in paragraph (b)(1)(iii) (unless, pursuant to Rule 3a71-4, the affiliate itself is a registered security-based swap dealer or a person in the

associated with security-based swap dealer regulation by focusing relevant requirements on the arranging, negotiating and executing activity occurring in the United States, while avoiding potentially problematic consequences – such as relocation of personnel outside the United States that may lead to fragmentation that reduces market access available to persons within the United States – that otherwise may be associated with that aspect of the counting requirement.[101]

The first alternative proposal (Alternative 1) conditionally would permit a non-U.S. person not to count the security-based swap dealing transactions at issue against the de minimis thresholds so long as all arranging, negotiating or executing activity within the United States is

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process of registering as a security-based swap dealer). As a result, transactions subject to the proposed Rule 3a71-3(b)(1)(iii)(C) exception further would not be subject to the paragraph (b)(2) affiliate transaction counting requirement.

Also, Exchange Act Rule 3a71-5 excepts certain cleared anonymous transactions from the individual counting requirement of paragraph (b)(1) of Rule 3a71-3 (which includes the (b)(1)(iii)(C) requirement) and from the affiliate counting requirement of paragraph (b)(2), but the Rule 3a71-5 exception is unavailable to transactions arranged, negotiated, or executed by U.S. personnel. Because the proposed exception to (b)(1)(iii)(C) would prevent the transactions at issue from triggering either the (b)(1) or (b)(2) counting requirements, the Rule 3a71-5 exception would not be relevant to those transactions.

[101] In practice, the proposed exception would affect the set of dealing transactions that a non-U.S. person must include within the 12-month lookback for determining whether it can avail itself of the de minimis exception from the "security-based swap dealer" definition. Exchange Act Rule 3a71-2(a)(1) determines the availability of the de minimis exception based on whether a person's security-based swap dealing activity over the prior 12 months is below the applicable notional threshold, and the cross-border counting provisions of Exchange Act Rule 3a71-2(b) (including the "arranged, negotiated, or executed" provision of Rule 3a71-3(b)(1)(iii)(C)) partially determine which positions must be counted pursuant to Rule 3a71-2(a)(1).

The structure of the de minimis counting provisions also would make this proposed exception available to non-U.S. persons that are registered as security-based swap dealers. In particular, Exchange Act Rule 3a71-2(c) (in conjunction with paragraph (a) of that rule) provides that a security-based swap dealer may apply to withdraw its registration if it has been registered for at least 12 months and its dealing activity over the preceding 12 months is below the applicable de minimis thresholds. Because the proposed exception from the "arranged, negotiated, or executed" counting requirement of Rule 3a71-3(b)(1)(iii)(C) would cause the transactions at issues not to be counted against the applicable thresholds, a registered security-based swap dealer could rely on the exception to make use of the withdrawal provision. The Commission is soliciting comment regarding whether the proposed exception should be modified to make it unavailable to registered security-based swap dealers. See part III.D.10, infra.

performed by personnel associated with an affiliated entity that is registered with the Commission as a security-based swap dealer. The second alternative proposal (Alternative 2) would be broader than the first alternative by also allowing for activity in the United States to be performed by personnel associated with an affiliate that is registered with the Commission as a broker (or, as with the first alternative, that is registered as a security-based swap dealer). As discussed in further detail below, under either alternative the non-U.S. person and the affiliated registered entity would have to comply with certain conditions related to business conduct, trade acknowledgments, portfolio reconciliation, disclosure, records, and financial responsibility.

The proposed exception may be particularly relevant, for example, for financial groups that use one or more non-U.S. dealing entities to transact (i.e., book transactions directly) with Canadian or Latin American counterparties, but that manage the trading or sales relationships with those counterparties out of an affiliated entity in the United States – whether for customer convenience, for more direct access to the market in which the underliers are traded, or for operational or other reasons. Under the proposed exception, transactions that are booked by the foreign dealing entity but arranged, negotiated or executed by personnel associated with an affiliated registered entity in the U.S. generally would not be counted toward the foreign entity's de minimis threshold, and the entity accordingly would not be required to register as a security-based swap dealer by virtue of those transactions.[102] Antifraud provisions of the federal securities laws and certain relevant Title VII requirements would continue to apply to the transaction – e.g., transaction reporting and the prohibitions in Section 5(e) of the Securities Act

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[102] Other dealing activity of that foreign entity, such entering into security-based swap transactions with U.S. person counterparties, may cause the entity to exceed the de minimis threshold and thus have to register as a security-based swap dealer. The foreign entity also would be subject to provisions requiring it to count certain dealing transactions of its affiliates. See notes 13 and 100, supra (addressing other prongs of the cross-border de minimis counting test).

of 1933 and Section 6(l) of the Exchange Act with respect to transactions with counterparties that are not eligible contract participants ("ECPs"). The Commission preliminarily believes that this approach would appropriately balance the application of Title VII requirements to any risks presented by the activity while reducing the likelihood of market fragmentation that otherwise might arise if the foreign dealing entity were subject to requirements that are not tailored to the associated risks.

As discussed below, although the proposed exception would subject arranging, negotiating and executing activity in the United States to certain Title VII requirements, the exception would not fully apply certain other requirements, such as financial responsibility requirements, in connection with security-based swaps resulting from that U.S. activity. On balance, the Commission preliminarily believes that the conditions that have been proposed for the exception would mitigate any potential negative consequences that otherwise might arise from tailoring the security-based swap dealer requirements that apply to those activities.

In making this proposal, the Commission is mindful that U.S.-based dealing entities may use this type of exception to structure their booking practices to manage the application of Title VII to their security-based swap dealing business – e.g., by booking dealing transactions with non-U.S. counterparties into their non-U.S. affiliates, to reduce the application of Title VII security-based swap dealer requirements to those transactions. The Commission is soliciting comment regarding the potential effect of the proposed exception on booking practices, and further address those potential consequences as part of the economic analysis.[103]

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[103] See parts III.D.9 (solicitation of comment), VII.A.7 (estimate of persons that may rely on proposed exception) and VII.B.1 (addressing costs and benefits of the proposed amendment), infra.

B. Alternative 1 – First Alternative Proposed Conditional Exception

The Commission is proposing to amend Exchange Act Rule 3a71-3 to incorporate a conditional exception from the "arranged, negotiated, or executed" counting standard under conditions that would apply a focused alternative method of regulation to the transactions at issue. The proposal recognizes that certain arranging, negotiating or executing activity involving U.S. personnel warrants Title VII oversight, but also recognizes that U.S. activity in connection with transactions between two non-U.S. persons may not implicate the same types of risks to U.S. persons and to U.S. markets as other types of dealing activity in the United States. The proposed exception hence is intended to more closely align the application of Title VII oversight to the U.S. market concerns associated with such transactions between non-U.S. persons.

Proposed new paragraph (d) of Exchange Act Rule 3a71-3 would incorporate this conditional exception.[104] Under Alternative 1, this paragraph (d) would except a non-U.S. person from having to count transactions arranged, negotiated or executed in the United States for purposes of the security-based swap dealer definition, subject to the following conditions:

- All such arranging, negotiating and executing activity in the United States would be conducted by personnel located in a U.S. branch or office in their capacity as associated persons of a majority-owned affiliate that is registered with the Commission as a security-based swap dealer;
- That registered security-based swap dealer would comply with specific requirements applicable to security-based swap dealers as if the entity were a counterparty to the non-U.S. person's counterparties;
- The Commission could access relevant books, records and testimony of the non-U.S. person, and the registered security-based swap dealer would be required to maintain records related to the transaction;

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104 Apart from adding a conditional exception as new paragraph (d) of Rule 3a71-3, proposed Alternative 1 (as well as proposed Alternative 2) would amend the introductory language of paragraph (b)(1)(iii)(C) of Rule 3a71-3, to specify that the "arranged, negotiated, or executed" counting requirement is subject to the conditional exception.

- The non-U.S. person would consent to service of process for any civil action brought by or proceeding before the Commission;
- The registered security-based swap dealer would provide certain disclosures to the counterparties of the non-U.S. person; and
- The non-U.S. person would be subject to the margin and capital requirements of a "listed jurisdiction."

For the reasons set forth below, the Commission preliminarily believes that an exception that incorporates those elements would apply security-based swap dealer requirements to arranging, negotiating or executing activity in the United States, allow for Commission access to related books and records, and eliminate incentives to alter transaction booking practices to avoid security-based swap dealer registration, in a manner that appropriately addresses the scope of the regulatory concerns raised by this type of U.S. activity.[105]

The Commission preliminarily believes that this type of arranging, negotiating or executing conduct associated with security-based swap transactions also would generally constitute "broker" activity under the Exchange Act. Entities engaged in such conduct accordingly would be required to register with the Commission as brokers unless they can avail themselves of an exception from broker status, such as the exception for bank brokerage activity, or an exemption from broker registration.[106]

1. U.S. Activity Conducted by a Majority-Owned Registered Security-Based Swap Dealer Affiliate

Under Alternative 1, the arranging, negotiating and executing activity by U.S. personnel that otherwise would need to be counted but for the exception must be conducted by such

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105 The conditional exception would address only the Rule 3a71-3(b)(1)(iii)(C) requirement that non-U.S. persons count transactions that involve dealing activity in the United States. Rule 3a71-3 would continue to require non-U.S. persons to count all of their security-based swap dealing transactions with U.S. counterparties, and all of their security-based swap dealing transactions that are guaranteed by their U.S. affiliates.

106 See generally note 21, supra (addressing application of "broker" and "security" definitions in the security-based swap context).

personnel in their capacity as persons associated with an entity that is: (a) registered as a security-based swap dealer, and (b) a majority-owned affiliate[107] of the non-U.S. person relying on the exception.[108]

By requiring that the U.S. arranging, negotiating or executing activity be conducted by U.S. personnel in their capacity as associated persons of a registered security-based swap dealer, the proposed condition would help ensure that the U.S. activity would be subject to key security-based swap dealer requirements under Title VII, including requirements regarding supervision, books and records, trade acknowledgments and verifications, and business conduct, among other things.[109]

The registered security-based swap dealer must be a majority-owned affiliate of the non-U.S. person relying on the exception. As discussed above, concerns have been expressed that the existing counting standard could lead financial groups to relocate their U.S.-based personnel to avoid triggering security-based swap dealer registration. To the extent that such groups make

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107 Proposed paragraph (a)(10) would define the term "majority-owned affiliate" to encompass a relationship whereby one entity directly or indirectly owns a majority interest in another, or where a third party directly or indirectly owns a majority interest in both, where "majority interest" reflects voting power, the right to sell, or the right to receive capital upon dissolution or the contribution of capital.

108 See Alternative 1 – proposed paragraph (d)(1)(i) of Rule 3a71-3. Exchange Act Section 3(a)(70) defines the term "person associated with a security-based swap dealer or major security-based swap participant" to encompass, inter alia, partners, officers, directors, employees and persons controlling, controlled by, or under common control with a security-based swap dealer or major security-based swap participant.

Exchange Act Rule 3a71-2(e) provides for the voluntary registration of a person that chooses to be a security-based swap dealer, regardless of whether that person engages in dealing activity that exceeds the de minimis thresholds.

109 The relevant transactions also would remain subject to regulatory reporting and public dissemination requirements under Title VII. See note 52, supra. But see part III.D.10, infra (soliciting comment regarding whether to make a similar exception available in connection with the application of the "arranged, negotiated, or executed" test in connection with the regulatory reporting and public dissemination requirements of Regulation SBSR).

use of this exception in lieu of relocating U.S.-based personnel, the Commission would expect those groups to use affiliated entities to satisfy the conditions of the exception. Moreover, requiring that the arranging, negotiating or executing activity be performed by U.S. personnel associated with an affiliated registered security-based swap dealer would help guard against the risk that a financial group may seek to attenuate its responsibility for any shortcomings in the registered security-based swap dealer's compliance with the requirements applicable to registered security-based swap dealers.[110] The proposal makes use of a majority-ownership standard to achieve this goal – rather than other measures of affiliation such as a common control standard or alternative ownership thresholds – to help ensure that the financial group has a significant interest in the registered security-based swap dealer, including its compliance with the requirements applicable to security-based swap dealers (in addition to the non-U.S. person's interest in the registered security-based swap dealer complying with the conditions of the exception), to help promote appropriate compliance and oversight practices.[111]

Taken as a whole, those elements differentiate the proposal from the approach commenters previously suggested that would have excused the counting of such transactions when the relevant activity in the United States is performed by a registered broker-dealer or by a U.S. bank. When the Commission considered but rejected that type of approach in adopting the "arranged, negotiated, or executed" counting requirement, the Commission noted that the broker-dealer framework does not apply to banks engaged in certain activities, which may include a

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110 The registered security-based swap dealer's non-compliance with the conditions of the exception would make the exception unavailable to the non-U.S. person.

111 The Commission has used a majority-ownership standard as part of other rules implementing Title VII, including in a rule providing that inter-affiliate security-based swaps need not be considered in determining whether a person is a security-based swap dealer. See Exchange Act Rule 3a71-1(d).

significant proportion of security-based swap dealing activity, and stated that such an approach would effectively supplant Title VII security-based swap dealer regulation for a majority of dealing activity carried out in the United States with a "cobbled together" grouping of other requirements.[112] Alternative 1, in contrast, would apply Title VII security-based swap dealer regulation to arranging, negotiating or executing activity in the United States, regardless of whether that activity is conducted by banks or non-banks, consistent with the uniform security-based swap dealer framework anticipated by Title VII.

2. Compliance with Specific Security-Based Swap Dealer Requirements

a. Conditions Regarding Application of Specific Requirements

The proposal would incorporate provisions related to how Title VII requirements would apply to the registered security-based swap dealer's activities conducted on behalf of its non-U.S. affiliate. As noted, Alternative 1 would be conditioned on any U.S. personnel who arrange, negotiate or execute security-based swap transactions in the United States acting in their capacity as an associated person of a registered security-based swap dealer. Security-based swap dealers in general must comply with a variety of obligations, including those related to: financial responsibility; books, records and reports; trade acknowledgment and verification; supervision and chief compliance officers; and business conduct.[113] Security-based swap dealers also are subject to regulatory reporting and public dissemination requirements.[114]

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112 See ANE Adopting Release, 81 FR at 8619; see also part I.A.3, supra.

113 See generally Exchange Act Section 15F. The Commission has adopted final rules to implement certain security-based swap dealer requirements under Section 15F. See Business Conduct Adopting Release, 81 FR 29960 (final rules addressing business conduct, supervision and chief compliance officer requirements); Exchange Act Release No. 78011 (Jun. 8, 2016), 81 FR 39808 (Jun. 17, 2016) (final rules addressing trade acknowledgment and verification requirements) ("Trade Acknowledgment Adopting Release").

The Commission also has proposed rules to implement security-based swap dealer requirements regarding:

Absent additional conditions, however, the transactions that would be subject to the proposed exception would not necessarily be subject to certain of those security-based swap dealer requirements. In particular, several provisions of the Exchange Act and the rules thereunder impose obligations upon security-based swap dealers with regard to their activities that involve a "counterparty."[115] For transactions subject to the proposed exception, however, the registered security-based swap dealer that engages in arranging, negotiating and executing activity in the United States would not be a contractual party to the security-based swaps resulting from that arranging, negotiating or executing activity, and therefore would not be a "counterparty" to the transaction.

The Commission accordingly is proposing to condition the exception on the registered security-based swap dealer complying with the following requirements "as if" the counterparties

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(1) Capital, margin and segregation (see Exchange Act Release No. 68071, 77 FR 70214 (Nov. 23, 2012) ("Capital, Margin and Segregation Proposing Release"); Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194, 25254 (May 2, 2014));

(2) Recordkeeping and reporting (see Exchange Act Release No. 71958 (Apr. 17, 2014), 79 FR 25194 (May 2, 2014) ("Recordkeeping and Reporting Proposing Release"));

(3) Risk mitigation, including requirements relating to portfolio reconciliation, portfolio compression and trading relationship documentation (see Exchange Act Release No. 84861 (Dec. 19, 2018), 84 FR 4614 (Feb. 15, 2019) ("Risk Mitigation Proposing Release")); and

(4) The cross-border application of various Title VII requirements, including certain security-based swap dealer requirements (see Cross-Border Proposing Release, 78 FR 30968).

114 See generally Regulation SBSR, 17 CFR 242.900 et seq.

115 See, e.g., Exchange Act Rule 15Fh-3(a) (eligible counterparty verification); Rule 15Fh-3(b) (disclosure of risks, characteristics, incentives and conflicts; Rule 15Fh-3(c) (daily mark disclosure); Rule 15Fh-3(d) (clearing rights disclosure); Rule 15Fh-3(e) ("know your counterparty" requirement); Rule 15Fh-3(f) (suitability of recommendations); Rule 15Fh-3(g) (fair and balanced communications); Exchange Act Rule 15Fi-2(a) (trade acknowledgment and verification).

Certain of the Exchange Act provisions that underlie those rules also explicitly refer to activities involving a "counterparty." See Exchange Act Section 15F(h)(3)(A) (eligible counterparty verification); Sections 15F(h)(3)(B)(i), (ii) (disclosure of risks, characteristics, incentives and conflicts); Section 15F(h)(3)(B)(iii) (daily mark disclosure).

to the non-U.S. person relying on the exception also were counterparties to the registered security-based swap dealer:[116]

- Disclosure of risks, characteristics, material incentives and conflicts of interest. The registered security-based swap dealer must disclose information regarding the material risks and characteristics of the security-based swap, and regarding the material incentives or conflicts of interest of the security-based swap dealer, including the material incentives and conflicts of interest associated with the non-U.S. person relying on the exception.[117]
- Suitability of recommendations. The registered security-based swap dealer must comply with requirements regarding the suitability of any recommendations that its associated persons make.[118]
- Fair and balanced communications. The registered security-based swap dealer must comply with fair and balanced communication requirements.[119]
- Trade acknowledgment and verification. The registered security-based swap dealer must comply with trade acknowledgment and verification requirements.[120]
- Portfolio reconciliation requirements. The registered security-based swap dealer must comply with the portfolio reconciliation requirements applicable to security-based swap dealers for the security-based swap resulting from the transaction as if the security-based swap were being included in the security-based swap dealer's portfolio, but only the first

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116 See Alternative 1 – proposed paragraph (d)(1)(ii)(A) of Rule 3a71-3 (providing for "as if" compliance with certain specified requirements).

117 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*1*) of Rule 3a71-3 (citing the requirements for the disclosure of risks, characteristics, incentives and conflicts in Exchange Act Sections 15F(h)(3)(B)(i), (ii) and Rule 15Fh-3(b) thereunder). The underlying Rule 15Fh-3(b) requirement states that disclosure is required only so long as the identity of the counterparty is known to the security-based swap dealer "at a reasonably sufficient time prior to execution of the transaction" to permit compliance.

The proposed condition specifies that the disclosure should address not only the material incentives and the conflicts of interest of the registered security-based swap dealer engaged in the arranging, negotiating or executing activity in the United States, but also those of the affiliated non-U.S. person relying on the exception, which is intended to allow the counterparty to the transaction to be appropriately informed regarding incentives and conflicts of interest relevant to the transaction.

118 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*2*) of Rule 3a71-3 (citing the suitability requirements set forth in Rule 15Fh-3(f)).

119 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*3*) of Rule 3a71-3 (citing the fair and balanced communications requirement set forth in Exchange Act Section 15F(h)(3)(C) and Rule 15Fh-3(g) thereunder).

120 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*4*) of Rule 3a71-3 (citing the trade acknowledgment and verification requirement set forth in Exchange Act Rules 15Fi-1 and 15Fi-2).

time that the security-based swap would be reconciled by the security-based swap dealer.[121]

The Commission preliminarily believes that requiring the registered security-based swap dealer engaged in arranging, negotiating or executing activity in the United States to comply with the standards of conduct required by the above requirements in connection with the transactions at issue generally would not impose significant additional information-gathering or documentation burdens on that registered security-based swap dealer. At the same time, the Commission recognizes that certain of those requirements, particularly the disclosure and suitability requirements, in some cases may require the registered security-based swap dealer to undertake potentially significant additional efforts related to information-gathering and documentation. In the Commission's view, however, the customer protections provided by imposing those requirements would justify the associated burdens.

For example, disclosure of risks, characteristics, material incentives, and conflicts of interest will permit a counterparty to more effectively assess whether and under which terms to enter a transaction. Although the compliance burdens associated with that disclosure obligation may be significant, those burdens should be mitigated by the underlying provision stating that the requirement to disclose risks, characteristics, material incentives and conflicts of interest will apply only when the registered security-based swap dealer knows the identity of the counterparty at a reasonably sufficient time prior to execution of the transaction.[122]

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121 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*5*) of Rule 3a71-3 (citing the portfolio reconciliation requirement proposed to be set forth in Exchange Act Rule 15Fi-3). In practice, this condition would require the security-based swap dealer to establish, maintain, and follow written policies and procedures reasonably designed to ensure that it engages in the initial portfolio reconciliation for transactions for which it arranges, negotiates, or executes security-based swap transactions for its foreign affiliates. See Risk Mitigation Proposing Release (proposing Exchange Act Rule 15Fi-3).

122 See Exchange Act Rule 15Fh-3(b).

The burden of complying with the suitability requirement, including obtaining the required counterparty information and making a suitability assessment using that information, similarly may be significant in some cases, but the Commission preliminarily believes that those burdens are justified by the importance of the counterparty protections provided by the suitability requirement.[123] The Commission further notes that the suitability requirement would apply only when the registered security-based swap dealer makes a recommendation to the counterparty, and that the associated burdens may be lessened by the institutional suitability provisions of the requirement.[124] In this regard, moreover, we understand that in some cases, U.S. personnel currently manage trading or sales relationships with counterparties, and the registered security-based swap dealer accordingly may already possess the information needed to comply with obligations such as disclosure or suitability.[125]

The Commission is proposing to condition the exception on the registered security-based swap dealer complying with the trade acknowledgement and verification requirements to help assure that there are definitive written records of the terms of the resulting transactions and to help control legal and operational risks for the counterparties.[126]

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123 If the registered security-based swap dealer makes a recommendation in connection with the transaction – apart from a recommendation to a security-based swap dealer, swap dealer, major security-based swap participant, or major swap participant – the suitability rule would require the entity both to undertake reasonable diligence to understand the potential risks and rewards associated with a recommended security-based swap or trading strategy involving a security-based swap (see Rule 15Fh-3(f)(1)(i)), and to have a reasonable basis to believe that the recommended security-based swap or trading strategy involving a security-based swap is suitable for the counterparty (see Rule 15Fh-3(f)(1)(ii)).

124 In the case of recommendations to certain institutional counterparties, the security-based swap dealer may satisfy the counterparty-specific suitability requirement if it receives certain written representations and provides certain disclosures. See Rules 15Fh-3(f)(2) and (3).

125 The Commission is soliciting comment regarding the practicability of requiring compliance with the suitability condition in the circumstances at issue. See part III.D.5, infra.

126 See generally Trade Acknowledgment Adopting Release, 81 FR at 39809.

The proposal to condition the exception on the registered entity complying with the portfolio reconciliation requirements as if it were the counterparty to the transaction, but only for the initial reconciliation, should help advance two goals: helping to ensure the accuracy of the data reported to security-based swap data repositories ("SDRs"), and helping to facilitate the ability of registered SDRs to comply with requirements that they verify the information they receive.[127]

The Commission believes that the condition would promote those goals while imposing only minimal additional burdens on the registered entity, based in part on the understanding that

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This proposed condition has parallels to Exchange Act Rule 15a-6(a)(3), which provides a conditional exemption from broker-dealer regulation for foreign broker-dealers in connection with certain activities that are intermediated (or "chaperoned") by registered broker-dealers. Under Rule 15a-6(a)(3)(iii)(A)(*2*), the registered broker-dealer must issue all required confirmations and statements. In the present context the Commission would expect the registered security-based swap dealer to use the same general techniques, to obtain requisite information to satisfy the trade acknowledgment and verification condition, as registered broker-dealers use to obtain the information needed to satisfy the Rule 15a-6 confirmation condition. Given that the registered-security-based swap dealer would be affiliated with the non-U.S. person relying on the exception, the use of common back office platforms may help facilitate transfer of that information.

As further discussed in Section IV, the Commission is mindful that foreign blocking laws, privacy laws, secrecy laws and other foreign legal barriers may limit or prohibit firms from providing books and records directly to the Commission, Similarly, such laws may impede the transfer of relevant records among affiliates for purposes of complying with the exception. The Commission preliminarily believes that the exception should not be available if such impediments to transferring information precluded compliance with the trade acknowledgement and verification condition, given those requirements' importance in providing for definitive records and controlling risks.

127 In proposing the portfolio reconciliation requirements, the Commission explained that the requirements have been designed not only to help ensure that the counterparties to a transaction are and remain in agreement with respect to all material terms, but also to help ensure that the information reported to SDRs is complete and accurate. See Risk Mitigation Proposing Release, 84 FR at 4634. This objective is applicable to the transactions at issue because transactions that are arranged, negotiated, or executed by U.S. personnel of a registered security-based swap dealer are subject to Regulation SBSR based on that activity. See Regulation SBSR Rule 908(a)(1)(v).

The portfolio reconciliation requirement further may assist SDRs in satisfying their obligations under Section 13(n)(5)(B) of the Exchange Act and rule 13n-4(b)(3) thereunder to verify the terms of each security-based swap with both counterparties. See Risk Mitigation Proposing Release, 84 FR at 4633-4644.

the registered entity typically would have access to the necessary information because the registered entity is likely to report the transaction to the SDR on behalf of its non-U.S. affiliate (due to the registered entity being the only U.S. person involved in the transaction). Moreover, for these transactions the underlying proposed portfolio reconciliation rule focuses on there being reasonable policies and procedures in place,[128] meaning that the registered entity would not fall out of compliance with the condition merely because it has not been provided necessary counterparty information.

In addition, the Commission is conditioning the exception on the registered security-based swap dealer complying with fair and balanced communication requirements to promote investor protection, which prohibit registered entities from overstating the expected benefits or understating the expected risks of potential transactions in their communications with counterparties.[129]

Conversely, this proposed compliance condition would not extend to certain other "counterparty"-related requirements applicable to security-based swap dealers. In part, the proposed exception would not be conditioned on compliance with ECP verification

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128 In the Risk Mitigation Proposing Release, the Commission proposed that, with respect to transactions with persons who are not SBS Entities, security-based swap dealers would be required to establish, maintain, and follow written policies and procedures reasonably designed to ensure that it engages in portfolio reconciliation for those security-based swap transactions. As such, conditioning the exception on security-based swap dealers complying with the initial portfolio reconciliation requirements as if the security-based swap dealer were the counterparty to the transaction, will require that its required policies and procedures regarding reconciliation include transactions for which the security-based swap dealer arranges, negotiates or executes a security-based swap transaction on behalf of another person.

By contrast, the proposed rule expressly requires portfolio reconciliation to occur with respect to security-based swap transactions between two SBS Entities. See Risk Mitigation Proposing Release, 84 FR 4618-20.

129 See Business Conduct Adopting Release, 81 FR at 30001-02 ("we believe the requirement promotes investor protection by prohibiting SBS Entities from overstating the benefits or understating the risks to inappropriately influence counterparties' investment decisions").

requirements[130] and "know your counterparty" requirements[131] because the Commission preliminarily believes that in some circumstances the registered security-based swap dealer would have limited interaction with the counterparty to the transactions at issue, making it difficult to obtain the information needed to satisfy those requirements. For example, compliance with the "know your counterparty" requirement would be expected to necessitate the creation of documentation that may be infeasible for the registered security-based swap dealer.[132] Compliance with the ECP verification requirement would require the registered security-based swap dealer to verify that a counterparty meets the eligibility standards for an ECP before entering into a security-based swap with that counterparty – which could be problematic in this context given the diverse set of circumstances in which the registered security-based swap dealer may arrange, negotiate or execute transactions subject to the exception. To be clear, however, although the Commission is not proposing to condition the exception on compliance with security-based swap dealer ECP verification requirements, existing limitations on entering into security-based swaps with non-ECPs would remain in effect.[133]

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130 See Alternative 1 – proposed paragraph (d)(1)(ii)(C)(*1*) of Rule 3a71-3 (citing the eligible contract participant verification requirement set forth in Exchange Act Section 15F(h)(3)(A) and Rule 15Fh-3(a)(1) thereunder); see also Business Conduct Adopting Release, 81 FR at 29978-79.

131 See Alternative 1 – proposed paragraph (d)(1)(ii)(C)(*4*) of Rule 3a71-3 (citing the "know your counterparty" requirement is set forth in Rule 15Fh-3(e)); see also Business Conduct Adopting Release, 81 FR at 29993-94.

132 The scope of the "know your counterparty" requirement is in contrast the suitability requirements addressed above, which would apply only when the registered security-based swap dealer makes a recommendation.

133 See Exchange Act Section 6(l) (requiring security-based swaps with non-ECPs to be effected on a national securities exchange); Securities Act Section 5(e) (requiring registration of the offer and sale of security-based swaps to non-ECPs). The registered security-based swap dealer might use information obtained from its non-U.S. affiliate to verify that a counterparty to the security-based swap is in fact an ECP.

In addition, the proposed exception would not be conditioned on compliance with clearing rights disclosure requirements,[134] because the transactions at issue would not be expected to be subject to the underlying clearing rights.[135] Finally, the proposed exception would not be conditioned on compliance with daily mark disclosure requirements[136] and with certain risk mitigation rules[137] because those requirements are predicated on there being an ongoing relationship between the security-based swap dealer and the counterparty that may not be present in connection with the transactions at issue, and further would be linked to risk management functions that are likely to be associated with the entity in which the resulting security-based swap position is booked.

Separately, although the Exchange Act and Commission rules apply certain requirements to security-based swap dealers that act as advisors or counterparties to special entities,[138] the

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134 See Alternative 1 – proposed paragraph (d)(1)(ii)(C)(*3*) of Rule 3a71-3 (citing the clearing rights disclosure requirement set forth in Rule 15Fh-3(d)); see also Business Conduct Adopting Release, 81 FR at 29992-93.

135 See Exchange Act Section 3C(g)(5) (addressing clearing rights of transactions that have been "entered into" by security-based swap dealers).

136 See Alternative 1 – proposed paragraph (d)(1)(ii)(C)(*2*) of Rule 3a71-3 (citing the requirement for the disclosure of daily marks set forth in Exchange Act Section 15F(h)(3)(B)(iii) and Rule 15Fh-3(c) thereunder).

137 See Alternative 1 – proposed paragraphs (d)(1)(ii)(C)(*5*)-(*6*) of Rule 3a71-3. Those paragraphs cross-reference requirements regarding the following:

(1) Security-based swap portfolio compression (proposed Exchange Act Rule 15Fi-4). The proposed portfolio compression rule would address processes whereby counterparties terminate or change the notional value of security-based swap in the portfolio between the counterparties.

(2) Security-based swap trading relationship documentation (proposed Exchange Act Rule 15Fi-5). The proposed trading documentation rule would address the trading relationship between counterparties, including terms addressing payment obligations, netting, default or termination events and allocation of reporting obligations.

138 See generally Exchange Act Sections 15F(h)(4) and (5), and Exchange Act Rules 15Fh-3(a)(2), (3), 15Fh-4 and 15Fh-5.

Commission has defined the term "special entity" so as not to encompass non-U.S. persons.[139] Because the counterparties to the transactions that are the subject of this exception would not be U.S. persons, the special entity requirements would not apply to those transactions.

b. Application of Other Requirements

By virtue of being a registered security-based swap dealer, the entity engaged in arranging, negotiating or executing activity in the United States would have to comply with additional requirements applicable to security-based swap dealers, including, but not limited to requirements related to supervision, chief compliance officers, books and records and financial responsibility.

3. Commission Access to Relevant Books, Records and Testimony, and Related Obligations

Under the proposal, the non-U.S. person relying on the conditional exception would, upon request, promptly have to provide the Commission or its representatives with any information or documents within the non-U.S. person's possession, custody or control related to transactions under the exception, as well as making its foreign associated persons available for testimony, and providing assistance in taking the evidence of other persons, wherever located, related to those transactions.[140]

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139 See Exchange Act Rule 15Fh-2(d); see also Exchange Act Release No. 77617 (Apr. 14, 2016), 81 FR 29960, 30013 (May 13, 2016).

Exchange Act Section 15F(h)(4)(A)(iii) and Exchange Act Rule 15Fh-4(a)(3), which prohibit security-based swap dealers from engaging in any act, practice or course of business that is fraudulent, deceptive or manipulative, still would apply to those registered security-based swap dealers in connection with this exception, notwithstanding those provisions' basis in Section 15F(h)(4) (which mostly addresses a security-based swap dealer's obligations in dealing with special entities).

140 See Alternative 1 – proposed paragraph (d)(1)(iii)(A) of Rule 3a71-3. That proposed paragraph further would specify that the non-U.S. person must provide this information under request of the Commission or its representatives or pursuant to arrangements or agreements reached between

In addition, the registered security-based swap dealer engaged in that activity in the United States must create and maintain all required books and records relating to the transaction subject to the exception, including those required by Exchange Act Rules 17a-3 and 17a-4, or Rules 18a-5 and 18a-6, as applicable.[141] The condition further clarifies that this obligation would extend to books and records requirements related to the conditions, discussed above, requiring the registered security-based swap dealer to comply with Title VII requirements relating to: disclosure of risks, characteristics, incentives and conflicts; suitability; fair and balanced communications; trade acknowledgment and verification; and portfolio reconciliation.[142]

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any foreign securities authority, including any foreign government, and the Commission or the U.S. government.

Proposed paragraph (a)(11) of Rule 3a71-3 in general would define the term "foreign associated person" as a natural person domiciled outside the United States that is a partner, officer, director, branch manager or employee of the non-U.S. person taking advantage of the exception, or that controls, is controlled by or is under common control with that non-U.S. person.

141 See Alternative 1 – proposed paragraph (d)(1)(iii)(B)(*1*) of Rule 3a71-3. Under proposed books and records requirements, a registered security-based swap dealer would be required to comply with the books and records requirements of Exchange Act Rules 17a-3 and 17a-4 if it is dually registered as a broker-dealer, or the requirements of Rules 18a-5 and 18a-6 if it is not. See generally Recordkeeping and Reporting Proposing Release, 79 FR at 25298-302, 25307-13; Risk Mitigation Proposing Release, 84 FR at 4674-75.

Consistent with the provisions of those proposed books and records requirements, the registered entity would make and/or preserve the following types of records related to the transactions at issue: records of communications; written agreements; copies of trade acknowledgments; records related to transactions not verified in a timely manner; documents related to compliance with security-based swap dealer business conduct standards; and documents related to compliance with portfolio reconciliation requirements. Other types of records addressed by those proposed books and records requirements – e.g., inclusion of trades in financial ledgers – preliminarily would not appear to be required for the registered entity in connection with these transactions, as the registered entity would not have direct financial obligations under the transactions.

142 See Alternative 1 – proposed paragraph (d)(1)(iii)(B)(*1*) of Rule 3a71-3 (requiring creation and maintenance of books and records relating to the requirements specified in proposed paragraph (d)(1)(ii)(B)).

The registered security-based swap dealer further must obtain from the non-U.S. person relying on the exception, and maintain, documentation encompassing all terms governing the trading relationship between the non-U.S. person and its counterparty relating to the transactions subject to this exception, including terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, allocation of any applicable regulatory reporting obligations, governing law, valuation, and dispute resolution.[143]

In addition, the registered security-based swap dealer would have to obtain from the non-U.S. person relying on the exception written consent to service of process for any civil action brought by or proceeding before the Commission, specifying that process may be served on the non-U.S. person in the manner set forth in the registered security-based swap dealer's current Form SBSE, SBSE-A or SBSE-BD, as applicable.[144]

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143 See Alternative 1 – proposed paragraph (d)(1)(iii)(B)(*2*) of Rule 3a71-3. These records are consistent with those required by the Commission's proposed trading relationship documentation rule. See Risk Mitigation Proposing Release, 84 FR at 4673-74 (proposing Exchange Act Rule 15Fi-5).

As discussed above in connection with the implementation of the trade acknowledgment and verification condition (see note 126, supra), the Commission is mindful that foreign blocking laws, privacy laws, secrecy laws and other foreign legal barriers may impede the transfer of relevant records among affiliates for purposes of complying with this condition. Here too, the Commission preliminarily believes that the exception should not be available if such impediments to transferring information precluded compliance with the condition requiring the registered entity to obtain trading relationship documentation, given the need for the Commission to have a comprehensive view of the dealing activities connected with transactions relying on the proposed exception, to facilitate the Commission's ability to identify fraud and abuse in connection with transactions that have been arranged, negotiated or executed in the United States.

144 See Alternative 1 – proposed paragraph (d)(1)(iii)(B)(*3*) of Rule 3a71-3. Form SBSE addresses applications for registration as security-based swap dealers or major security-based swap participants. Form SBSE-A addresses such applications by persons that are registered or registering with the CFTC as swap dealers. Form SBSE-BD addresses such applications by persons that are registered broker-dealers. These forms may be found at https://www.sec.gov/forms.

Those proposed requirements – relating to Commission access to information of the non-U.S. person, the obligation of the registered security-based swap dealer to create and maintain information related to the transaction, and to obtain and maintain trading relationship documentation from the non-U.S. person, and the obligation of the non-U.S. person to consent to service of process – should help provide the Commission with a comprehensive view of the dealing activities connected with transactions relying on the proposed exception, and facilitate the Commission's ability to identify fraud and abuse in connection with transactions that have been arranged, negotiated or executed in the United States.[145]

The proposed condition related to access to information, documents or testimony further provides that if, despite the non-U.S. person's best efforts, the non-U.S. person is prohibited by applicable foreign law or regulations from providing such access to the Commission, the non-U.S. person may continue to rely on the exception until the Commission issues an order

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145 The proposed conditions regarding Commission access to information of the non-U.S. person, and regarding the need for the non-U.S. person to consent to service of process, are similar to the access and consent to service conditions in Exchange Act Rule 15a-6(a)(3). Rule 15a-6 in part provides a conditional exemption from broker-dealer regulation for foreign broker-dealers in connection with certain activities that are intermediated by registered broker-dealers. That rule in part requires that a foreign broker-dealer provide the Commission (upon request or pursuant to agreements reached between any foreign securities authority and the Commission or the U.S. Government) with any information or documents within the possession, custody, or control of the foreign broker or dealer, any testimony of foreign associated persons, and any assistance in taking the evidence of other persons, wherever located. See Exchange Act Rule 15a-6(a)(3)(i)(B), (c). The proposed conditions would modify the Rule 15a-6 access language to better describe the breadth of the access afforded under this condition – e.g., the proposed condition requires that the information be provided "promptly," and specifically references supervisory or enforcement memoranda of understanding and other arrangements with foreign authorities.

The proposed conditions regarding the obligation of the registered security-based swap dealer contains elements comparable to a condition of Rule 15a-6 that states that a registered broker-dealer must be responsible for maintaining required books and records relating to the transactions conducted pursuant to the exemption, including books and records required by applicable Exchange Act rules. See Exchange Act Rule 15a-6(a)(3)(iii)(A)(4). The proposal also incorporates language providing for the registered security-based swap dealer to obtain trading relationship documentation to further promote effective Commission access to relevant information.

modifying or withdrawing an associated "listed jurisdiction" determination.[146] As discussed below, proposed provisions relating to the "listed jurisdiction" condition to the exception in part would permit the Commission to withdraw a listed jurisdiction determination if the jurisdiction's laws or regulations have had the effect of preventing the Commission or its representatives from accessing such information, documents and testimony.[147]

4. Disclosures to Counterparties

The proposed exception further would be conditioned on the registered security-based swap dealer notifying the counterparties of the non-U.S. person relying on the exception that the non-U.S. person is not registered as a security-based swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable to the non-U.S. person in connection with the transaction, including provisions affording clearing rights to counterparties.[148] To promote effective disclosure, the registered security-based swap dealer would have to provide this information contemporaneously with and in the same manner (e.g., oral, electronic or otherwise) as the arranging, negotiating or executing activity at issue.[149]

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146 See Alternative 1 – proposed paragraph (d)(1)(iii)(A) of Rule 3a71-3 (referring to listed jurisdiction withdrawal provisions of paragraph (d)(2)(iii)).

That continued reliance provision is limited to circumstances in which the failure to provide access is due to applicable foreign law or regulations. Accordingly, a non-U.S. person's failure to provide the Commission with required information for any reason other than prohibition by applicable foreign law or regulations would cause the person to be in violation of the conditions to the exception, making the exception unavailable to that person.

147 See part III.B.5, infra.

148 See Alternative 1 – proposed paragraph (d)(1)(iv) of Rule 3a71-3; see also notes 134 and 135, supra, and accompanying text regarding clearing rights.

149 This disclosure requirement would not apply if the identity of that counterparty is not known to that registered security-based swap dealer at a reasonably sufficient time prior to the execution of the transaction to permit such disclosure. Id. Circumstances in which the registered security-based swap dealer engaged in relevant activity may not know the identity of the counterparty could include circumstances in which the registered security-based swap dealer provides only execution services, and does not arrange or negotiate the transactions at issue, as well as

This proposed condition is intended to help guard against counterparties assuming that the involvement of U.S. personnel in a arranging, negotiating or executing capacity as part of the transaction would be accompanied by all of the safeguards associated with Title VII security-based swap dealer regulation. Because the disclosure must be provided contemporaneously with, and in the same manner as, the activity at issue (e.g., via oral disclosure in the event that the market facing activity occurs via oral communications), the Commission does not believe that such disclosure reasonably could be provided via inclusion in standard trading documentation.

5. Applicability of Financial Responsibility Requirements of a Listed Jurisdiction

Finally, the proposed exception would be conditioned on the requirement that the non-U.S. person relying on the exception be subject to the margin and capital requirements of a "listed jurisdiction" when engaging in transactions subject to this exception.[150] The Commission conditionally or unconditionally may determine "listed jurisdictions" by order, in response to applications or upon the Commission's own initiative.[151]

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circumstances where personnel in the United States specify a trading strategy or techniques carried out through algorithmic trading or automated electronic execution of security-based swaps. See also note 117, supra (discussing a similar carveout in connection with the security-based swap dealer requirements for disclosure of risks, characteristics, material incentives and conflicts of interest).

150 See Alternative 1 – proposed paragraph (d)(1)(v) of Rule 3a71-3 (cross-referencing proposed the data access provisions of proposed paragraph (d)(1)(iii)(A)).

151 See Alternative 1 – proposed paragraph (d)(1) of Rule 3a71-3.

Proposed paragraph (a)(12) of Rule 3a71-3 would define the term "listed jurisdiction" to mean any jurisdiction which the Commission by order has designated as a listed jurisdiction for purposes of the exception.

The proposal also specifies that applications for listed jurisdiction status may be made by parties or groups of parties that potentially would rely on the exception from the counting rule, and by any foreign financial authorities supervising such parties. The proposal further states that such applications must be filed pursuant to the procedures specified in Exchange Act Rule 0-13. See Alternative 1 – proposed paragraph (d)(2)(i) of Rule 3a71-3. Rule 0-13 currently addresses substituted compliance applications, and the Commission is proposing to amend the caption of

The proposed listed jurisdiction condition is intended to help avoid creating an incentive for dealers to book their transactions into entities that solely are subject to the regulation of jurisdictions that do not effectively require security-based swap dealers or comparable entities to meet certain financial responsibility standards. Absent this type of condition, the exception from the de minimis counting requirement could provide a competitive advantage to non-U.S. persons that conduct security-based swap dealing activity in the United States without being subject to sufficient financial responsibility standards. More generally, the proposed condition is consistent with the belief the Commission expressed when it adopted the "arranged, negotiated, or executed" de minimis counting rule, that applying capital and margin requirements to such transactions between two non-U.S. persons can help mitigate the potential for financial contagion to spread to U.S. market participants and to the U.S. financial system more generally.[152] Commenters to the Commission's proposal for the "arranged, negotiated, or executed" counting requirement suggested that potential concerns regarding that type of outcome could be addressed by conditioning a broker-dealer-based alternative to the counting rule on the non-U.S. entity being regulated in a "local jurisdiction recognized by the Commission as comparable," or in a G-20 jurisdiction or in a jurisdiction where the entity would be subject to Basel capital

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that rule and make certain additions to the text of that rule so that it also references "listed jurisdiction" applications.

[152] See ANE Adopting Release, 81 FR at 8616. The Commission further has stated:

> Subjecting non-U.S. persons that engage in security-based swap dealing activity in the United States at levels above the dealer de minimis threshold to capital and margin requirements also should help reduce the likelihood of firm failure and the likelihood that that the failure of a firm engaged in dealing activity in the United States might adversely affect not only its counterparties (which may include other firms engaged in security-based swap dealing activity in the United States) but also other participants in that market.

Id. at 8617.

requirements.[153] The Commission, however, does not believe that concerns regarding potential risks associated with this type of exception would adequately be addressed by a "one size fits all" approach that is linked simply to a jurisdiction's membership in the G-20 or compliance with Basel standards, with no further opportunity to consider relevant regulatory practices and requirements.[154]

In considering a jurisdiction's potential status as a "listed jurisdiction" – whether upon the Commission's own initiative or in response to an application for an order – the Commission would consider whether the order would be in the public interest.[155] Factors would include consideration of the jurisdiction's applicable margin and capital requirements, and the effectiveness of the foreign regime's supervisory compliance program and enforcement authority in connection with those requirements, including in the cross-border context.[156]

The Commission further may by order, on its own initiative, modify[157] or withdraw a listed jurisdiction determination, after notice and opportunity for comment, if the Commission

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153 See note 23, supra, and accompanying text.

154 The Commission is mindful that a jurisdiction's membership in the G-20 or its compliance with Basel standards can be a positive indicator regarding the effectiveness of the jurisdiction's margin and capital regimes. At the same time, the Commission also recognizes that implementation and oversight practices may vary even among those jurisdictions. Accordingly, the Commission preliminarily believes that the proposed individualized "listed jurisdiction" assessment would provide us an appropriate degree of discretion to consider whether the jurisdiction has implemented appropriate financial responsibility standards and exercises appropriate supervision in connection with those standards, and whether the Commission as necessary could access relevant information.

155 See Alternative 1 – proposed paragraph (d)(2)(ii) of Rule 3a71-3.

156 See Alternative 1 – proposed paragraph (d)(2)(ii)(A), (B) of Rule 3a71-3.

157 As discussed below, the Commission may modify a listed jurisdiction designation by broadening or narrowing the application of listed jurisdiction status in connection with a particular class of market participants or an individual market participant within that jurisdiction.

determines that continued listed jurisdiction status would not be in the public interest.[158] The Commission may base that modification or withdrawal on the factors discussed above regarding the foreign jurisdiction's margin and capital requirements and associated supervisory and enforcement practices.[159] The Commission may also consider whether the jurisdiction's laws or regulations have had the effect of preventing the Commission or its representatives from promptly being able to obtain information regarding the non-U.S. persons relying on the exception.[160] This latter provision reflects the importance of the proposed exception's information access condition,[161] and the conclusion that it would be appropriate to modify or withdraw listed jurisdiction status if, in practice, the Commission or its representatives have been prevented from accessing information required under the exception due to the jurisdiction's laws or regulations.[162]

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158 See Alternative 1 – proposed paragraph (d)(2)(iii) of Rule 3a71-3. The Commission preliminarily expects that any such notice would be via publication in the Federal Register and on the Commission's website, to allow all interested parties the opportunity to comment, including persons that are located in the jurisdiction at issue and are relying on the exception.

159 See Alternative 1 – proposed paragraph (d)(2)(iii)(A) of Rule 3a71-3 (cross-referencing paragraph (d)(2)(ii)).

160 See Alternative 1 – proposed paragraph (d)(2)(iii)(B) of Rule 3a71-3. These would include potential barriers to the Commission's ability to obtain testimony of the non-U.S. person's foreign associated persons, and to obtain the assistance of the non-U.S. person in taking the evidence of other persons. Id.

161 As discussed, the proposed exception is conditioned in part on the non-U.S. person promptly making relevant information available to the Commission and its representatives. The access condition is intended to help ensure that the Commission and its representatives in practice can obtain a full view of the dealing activities connected with transactions at issue, to avoid impediments in identifying fraud and abuse in connection with transactions that have been arranged, negotiated or executed in the United States. See part III.B.3, supra.

162 Given the importance of the proposed access condition, the Commission does not believe that persons from a foreign jurisdiction should be able to continue relying on the exception if the jurisdiction's law or regulations prevent the Commission from obtaining access to relevant information.

At the same time, the Commission's initial consideration of whether to designate a particular jurisdiction as a "listed jurisdiction" would focus on the jurisdiction's applicable margin and

Because listed jurisdiction determinations may be conditional or unconditional, the Commission may modify a determination, among other circumstances, when: (1) certain market participants or classes of market participants in the jurisdiction are not required to comply with the financial responsibility requirements that underpin the designation; (2) the jurisdiction's supervisory or enforcement practices oversee certain market participants or classes of market participants differently than others; or (3) the jurisdiction's barriers to data access apply to certain market participants or classes of market participants but not others. In practice, the Commission's use of this authority may cause the exception to be unavailable to certain groups of market participants in a jurisdiction, or to individual market participants.[163]

Preliminarily – based on the Commission's understanding of relevant margin and capital requirements in those jurisdictions – the Commission anticipates that the initial set of listed jurisdiction determinations may include some or all of the following jurisdictions: Australia, Canada, France, Germany, Hong Kong, Japan, Singapore, Switzerland, and the United Kingdom. The Commission is soliciting comment as to whether listed jurisdiction status may be

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capital requirements and the foreign regime's supervisory compliance program and enforcement authority in connection with those requirements. This in part reflects the listed jurisdiction condition's core role in helping to ensure that non-U.S. persons that rely on the proposed exception are subject to adequate capital and margin requirements. More generally, this approach also reflects the expectation that, in practice, methods may be developed to help provide the Commission with access to requested information.

Separately, the Commission's decision to modify or withdraw listed jurisdiction status may be based on any other factor it determines to be relevant to whether continued status as a listed jurisdiction would be in the public interest. See Alternative 1 – proposed paragraph (d)(2)(iii)(C) of Rule 3a71-3.

163 For example, as discussed above in conjunction with the information access provision, if a non-U.S. person is prohibited by applicable foreign law or regulations from providing access to the Commission or its representatives, the non-U.S. person may continue to rely on the exception until the Commission issues an order modifying or withdrawing an associated "listed jurisdiction" determination. To the extent that such prohibitions apply in practice to a particular class of market participants, or to an individual market participant in that jurisdiction, a modification of a listed jurisdiction order may exclude that class of market participants or that individual market participant from reliance on the exception.

appropriate for any of those jurisdictions, based on those jurisdictions' financial responsibility requirements and associated supervisory and enforcement programs.[164] The Commission further anticipates that it may issue a set of listed jurisdiction orders in conjunction with its final action on this proposal, including orders addressing the jurisdictions specified above. As discussed above, however, if the Commission determines that the laws or regulations of a listed jurisdiction have prevented the Commission from obtaining relevant information required pursuant to this exception in relation to any person in the listed jurisdiction availing itself of the exception, the Commission may modify or withdraw a listed jurisdiction designation for that reason.

"Listed jurisdiction" applications may be expected to raise issues that are analogous to those that would accompany applications for substituted compliance in connection with margin and capital rules, in that both types of applications would require the Commission to consider the substance and implementation of foreign margin and capital standards.[165] Those two types of applications, however, would arise in materially distinct contexts. In particular, "listed jurisdiction" status would be relevant only with regard to non-U.S. persons whose dealing transactions with U.S.-person counterparties, if any, would be below the de minimis thresholds.

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164 See part III.D.3, infra.

165 The Commission has proposed to make a mechanism for substituted compliance orders generally available in connection with security-based swap dealer requirements under Exchange Act Section 15F. See "Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants" (May 1, 2013), 78 FR 30968, 31207-08 (May 23, 2013) (proposing substituted compliance rule for section 15F requirements; since then a mechanism for substituted compliance has been adopted via Exchange Act Rule 3a71-6 in connection with business conduct and trade acknowledgment and verification requirements). Those Section 15F requirements include security-based swap dealer margin and capital requirements. Substituted compliance provides a mechanism by which a non-U.S. security-based swap dealer may satisfy its requirements under Title VII via compliance with analogous requirements of a foreign regime, contingent in part on the Commission deeming the scope and objectives of the relevant foreign requirements to be comparable to analogous Title VII requirements. As proposed, substituted compliance would not be available in connection with the Commission's segregation requirements.

This de minimis cap on its dealing transactions with U.S. persons likely would attenuate – although not eliminate – the potential effect of the firm's failure on U.S. persons and markets. Substituted compliance, in contrast, would address the margin and capital requirements applicable to registered security-based swap dealers that may engage in dealing transactions with U.S. counterparties in amounts above the de minimis thresholds, and whose failure is likely to pose greater direct threats to U.S. persons and markets. Substituted compliance accordingly would be predicated on the foreign margin and capital regime producing regulatory outcomes that are comparable to the analogous requirements under Title VII. Similarly, although the Commission will also consider, in connection with a substituted compliance determination, the effectiveness with which a regime administers its supervisory compliance program and exercises its enforcement authority, the different purposes of these proposed exclusions and a substituted compliance determination mean that the Commission may reach different conclusions regarding these issues when considering a substituted compliance determination than it does when considering listed status.

C. Alternative 2 – Second Alternative Proposed Conditional Exception

Alternative 2 for the proposed conditional exception would share a number of elements with Alternative 1, but instead would allow the arranging, negotiating or executing activity in the United States to be conducted by an entity that is registered as a broker, without requiring that entity also to register as a security-based swap dealer.[166] Alternative 2 also would permit that

[166] Alternative 2 would not be satisfied if this arranging, negotiating or executing activity is conducted by a bank that has not registered as a broker due to the Exchange Act's "broker" definition's exceptions for bank brokerage activity, unless the bank is registered as a security-based swap dealer.

conduct to be conducted by a registered security-based swap dealer, consistent with the Alternative 1.[167]

Certain proposed conditions to Alternative 2 would be the same as those of Alternative 1, while others would be modified to reflect the potential for the activity in the United States to be conducted by a registered broker that is not also registered as a security-based swap dealer. Alternative 2 accordingly would make use of broker regulation to provide for oversight of the transactions at issue while adding certain conditions to fill gaps in regulation that otherwise may arise absent the involvement of a registered security-based swap dealer. Those conditions should help mitigate the previously expressed concerns that a broker-focused approach may effectively supplant Title VII security-based swap dealer regulation for a majority of dealing activity carried out in the United States.[168]

1. U.S. Activity Conducted by a Majority-Owned Registered Broker Affiliate or by a Security-Based Swap Dealer Affiliate

Under Alternative 2, the U.S.-based arranging, negotiating and executing activity that otherwise would trigger the counting requirement must be conducted by the U.S. personnel in their capacity as persons associated with an entity that: (a) is registered as a broker or a security-based swap dealer, and (b) is a majority-owned affiliate of the non-U.S. person relying on the exception.[169]

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167 For the reasons set forth above (see note 106, supra, and accompanying text), the Commission believes that such a security-based swap dealer also generally would be required to register as a broker unless it can avail itself of an exception or exemption from broker registration.

168 See part I.A.3, supra. Because Alternative 2 would not be satisfied by the use of a bank that is not registered as a broker, the Commission's previously expressed concerns regarding differences in oversight between brokers and banks should not be a concern here.

169 See Alternative 2 – proposed paragraph (d)(1)(i) of Rule 3a71-3. Exchange Act Section 3(a)(18) defines the terms "person associated with a broker or dealer" and "associated person of a broker or dealer" to encompass, inter alia, partners, officers, directors, employees and persons controlling, controlled by, or under common control with a broker or dealer.

Consistent with Alternative 1, the affiliation requirement is intended to help tailor the exception to reflect the proposed exception's objective of helping to avoid personnel relocation, and to also help ensure that the financial group has a significant financial interest in the registered entity's compliance with applicable requirements.[170]

2. Compliance with Certain Security-Based Swap Dealer Requirements

For a non-U.S. person to rely on Alternative 2, the registered broker or security-based swap dealer that conducts the arranging, negotiating or executing activity in the United States would be required to comply with certain security-based swap dealer requirements "as if": (a) the counterparties to the non-U.S. person relying on the exception also were counterparties to that entity, and (b) that entity were registered with the Commission as a security-based swap dealer (in the event the entity is registered only as a broker and not as a security-based swap dealer). As with Alternative 1, the Commission preliminarily believes that it would be appropriate to condition Alternative 2 on compliance by the registered entity with the following requirements applicable to security-based swap dealers: disclosure of risks, characteristics, incentives and conflicts; suitability of recommendations; fair and balanced communications; trade acknowledgment and verification; and portfolio reconciliation.[171]

As discussed in connection with Alternative 1, those requirements would impose standards of conduct in connection with the transactions at issue, but would not be expected to impose significant additional information-gathering or documentation burdens on the registered

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Alternative 2 shares, with Alternative 1, the definitions of "majority-owned affiliate," "foreign associated person" and "listed jurisdiction."

170 See part III.A, supra.

171 See Alternative 2 – proposed paragraphs (d)(1)(ii)(A), (B) of Rule 3a71-3.

entity.[172] While recognizing that certain of the Title VII security-based swap dealer requirements have similarities to the requirements applicable to broker-dealers, the Commission preliminarily believes that the arranging, negotiating or executing security-based swap activity of U.S. personnel should be carried out pursuant to standards of conduct imposed under Title VII, regardless of whether the ultimate counterparties are U.S. or non-U.S. persons.

Alternative 2, like Alternative 1, also would provide that the exception would not be conditioned on the registered entity's compliance with eligible contract participant verification, clearing rights disclosure, "know your counterparty," daily mark disclosure and certain proposed risk mitigation requirements.[173] As discussed above, the fact that the proposal would not be conditioned on compliance with the ECP verification requirement would not affect existing limitations on entering into security-based swaps with non-ECPs.[174]

By virtue of being a registered broker, the registered entity also would be subject to all other applicable broker-dealer requirements under the federal securities laws and self-regulatory organization ("SRO") rules.

3. Other Conditions

Consistent with Alternative 1, and for the same reasons, Alternative 2 further would encompass conditions related to: Commission access to books, records and testimony of the non-U.S. person relying on the exception; the registered entity's maintenance of trading

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172 See part III.B.2.a, supra.

173 See second alternative – proposed paragraph (d)(1)(ii)(C) of Rule 3a71-3; see also notes 130 through 137, supra, and accompanying text. Those particular Title VII requirements would be at issue only if the entity is registered as a security-based swap dealer.

174 See note 133, supra, and accompanying text.

relationship documentation; consent to service of process[175]; disclosures to counterparties; and the non-U.S. person being subject to the financial responsibility requirements of a listed jurisdiction.[176]

4. Carveout from De Minimis Counting Requirements

In adopting the "arranged, negotiated, or executed" counting requirement, the Commission recognized that arranging, negotiating or executing conduct by personnel in the United States could constitute dealing activity in the United States, regardless of the fact that the parties to the transactions are not U.S. persons.[177] To avoid ambiguity regarding whether a registered broker's U.S. activity under this alternative independently must be counted against the applicable de minimis thresholds – and hence potentially require the registered broker also to register as a security-based swap dealer – Alternative 2 would provide that the persons that engage in such conduct pursuant to the exception would not have to count the associated security-based swap transactions against the de minimis thresholds.[178] Absent such an exception, the Commission is concerned that Alternative 2 potentially would be ineffective due to the reluctance of entities that are not registered as security-based swap dealers to engage in the arranging, negotiating or executing conduct envisioned by the proposed alternative.

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175 Because the registered entity under Alternative 2 may be a registered broker, Alternative 2 allows for process to be served on the non-U.S. person in the manner set forth in the registered entity's Form BD (or, consistent with Alternative 1, in the manner set forth in the registered entity's Forms SBSD, SBSE-A or SBSE-BD).

176 See Alternative 2 – proposed paragraphs (d)(1)(iii) through (d)(1)(v), (d)(2) and (d)(3) of Rule 3a71-3; see also parts III.B.3 - III.B.5, supra.

177 See ANE Adopting Release, 81 FR at 8621.

178 See Alternative 2 – proposed paragraph (d)(4) of Rule 3a71-3.

D. Solicitation of Comments Regarding the Proposed Amendment to Rule 3a71-3

The Commission requests comment on all aspects of the proposed amendment to Rule 3a71-3, including the following issues:

1. Involvement of U.S. Personnel in Arranging, Negotiating and Executing Transactions Between Non-U.S. Counterparties

To what extent do U.S. personnel participate in arranging, negotiating or executing activities in connection with security-based swap dealing transactions involving two non-U.S. counterparties? Commenters particularly are invited to address the following:

a. What particular services do U.S. personnel typically provide as part of such activities?

b. What types of information do U.S. personnel typically communicate to an affiliate's security-based swap counterparties in connection with such activities?

c. To what extent are U.S. personnel typically involved in negotiating pricing or other terms of security-based swaps in connection with such activities?

d. What is the typical mode of communication (e.g., telephonic, written, in-person) used between those U.S. personnel and an affiliate's security-based swap counterparties in connection with such activities?

e. What types of instruments (e.g., securities issued by U.S. persons) typically underlie the security-based swaps that are the subject of such transactions involving arranging, negotiating or executing activity by U.S. personnel?

f. Are U.S. personnel involved in such arranging, negotiating or executing activities on behalf of non-U.S. persons that are not affiliates? If so, what services do U.S. personnel provide and what types of instruments are the subject of such activities by U.S. personnel on behalf of unaffiliated non-U.S. persons?

g. Are there particular categories of arranging, negotiating or executing activity that U.S. personnel typically perform, to facilitate a non-U.S. person's security-based swap dealing transactions with non-U.S. counterparties, that are so limited in scope that they may not trigger the concerns that led to the adoption of the "arranged, negotiated, or executed" counting standard?

h. To what extent do U.S. personnel typically provide the primary point of contact for managing sales and trading relationships with non-U.S. person counterparties on behalf of non-U.S. affiliates engaged in security-based swap dealing activity? Conversely, to what extent is the involvement of such U.S. personnel typically incidental to a relationship that the non-U.S. person dealer manages primarily from an office outside the United States, and what is the nature of any such incidental involvement?

i. To the extent U.S. personnel perform both types of functions – serving as a primary point of contact for some transactions and serving an incidental role for other transactions – are those functions determined on the basis of counterparty location, product characteristics, or on the basis of some other factors?

2. Implementation Issues Associated with the Existing "Arranged, Negotiated, or Executed" Counting Requirement

To what extent would a conditional exception from the "arranged, negotiated, or executed" counting requirement be appropriate to address implementation issues potentially associated with that requirement? Commenters particularly are invited to address the following:

a. What would be the expected consequences if the Commission does not adopt either proposed alternative for an exception to the de minimis counting requirement? For example, how many financial groups would expect to register one or more non-U.S. entities as security-based swap dealers absent an exception? How many non-U.S. entities

would such financial groups typically expect to have to register in those circumstances? Conversely, how many financial groups would be expected to register non-U.S. entities as security-based swap dealers in the presence of this type of exception?

b. What contingency plans, if any, have such financial groups drawn up to address the potential consequences associated with compliance with the "arranged, negotiated, or executed" counting standard?

c. In practice, would such financial groups be expected to relocate U.S. personnel and/or relocate functions out of the United States to avoid having to count security-based swap transactions pursuant to the "arranged, negotiated, or executed" counting standard?

3. "Listed Jurisdiction" Condition and Definition, and Potential Effect of Barriers to the Transfer of Information

Would the proposed "listed jurisdiction" condition and associated definition appropriately prevent the proposed exception from permitting persons that engage in security-based swap dealing activity in the United States from booking transactions into affiliated non-U.S. booking entities that are not subject to adequate financial responsibility oversight or that would not allow for sufficient access to information by the Commission? Commenters particularly are invited to address the following:

a. What criteria should the Commission use to help ensure that non-U.S. persons relying on the exception are subject to adequate financial responsibility requirements?

b. Would it be appropriate, as commenters previously suggested, to exclude transactions that are arranged, negotiated or executed by U.S. personnel if the non-U.S. dealer is located in a G-20 jurisdiction or is subject to the margin and capital requirements of a Basel-compliant jurisdiction?

c. Would "listed jurisdiction" status be appropriate for the following jurisdictions: Australia, Canada, France, Germany, Hong Kong, Japan, Singapore, Switzerland, and the United Kingdom?

- In this regard commenters particularly are invited to address whether listed jurisdiction status would be warranted in light of those jurisdictions' applicable margin and capital requirements, and the effectiveness of those jurisdictions' supervisory compliance program and enforcement authority in connection with those requirements, including in the cross-border context.
- Commenters also are invited to address potential impediments to the Commission's ability to promptly access information or documents regarding the activities of persons in those jurisdictions, to obtain the testimony of non-U.S. persons that are associated with those persons, and to obtain the assistance of persons relying on the exception in taking the evidence of other persons, wherever located.[179]

d. What criteria should the Commission use to help ensure that it can access information from non-U.S. persons relying on the exception? Commenters also are invited to address how potential impediments to the cross-border transfer of information may affect compliance with the information access condition and other conditions to the exception, including the effect of any such impediments on the registered entity's ability to comply with conditions related to the trade acknowledgment and verification, and to the registered entity's obligation to obtain trading relationship documentation from its non-U.S. affiliate.

4. Appropriate Counterparty Protections

What conditions are appropriate to afford protections to the counterparties to the security-based swap transactions at issue, consistent with by Title VII and its implementing regulations? Commenters particularly are invited to address the following issues, and, to the extent possible,

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[179] As discussed above (see notes 160 through 162, supra, and accompanying text), although the Commission preliminarily does not expect to consider impediments to information access as part of initial listed jurisdiction determinations, the Commission may modify or withdraw listed jurisdiction status in the event that, in practice, the Commission or its representatives have been prevented from accessing information due to the jurisdiction's laws and regulations.

address similarities and differences between the activities implicated by the proposed exception and the activities that unregistered foreign broker-dealers may conduct pursuant to the exemption provided by Exchange Act Rule 15a-6:[180]

a. Do the alternatives for the proposed exception appropriately distinguish between certain security-based swap dealer requirements that will be applied to the arranging, negotiating or executing activity in the United States as a condition to the exception (i.e., requirements related to disclosures of risks, characteristics, incentives and conflicts, suitability, fair and balanced communications, trade acknowledgement and verification, initial portfolio reconciliation, and books and records), and other requirements that the

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[180] Exchange Act Rule 15a-6 in part permits unregistered foreign broker-dealers to engage in certain activities in the United States in connection with major institutional investors represented by U.S. fiduciaries on an "unchaperoned" basis. See Rule 15a-6(a)(3). The Rule 15a-6(a)(3) exemption in part is conditioned on the requirement that a registered broker-dealer is responsible for effecting the resulting transactions, the requirement that an associated person of the registered broker-dealer be involved in all of the foreign entity's visits to defined U.S. institutional investors, and prohibitions against the involvement of statutorily disqualified foreign associated persons of the foreign-broker dealer.

Commission staff has provided statements regarding the operation of Rule 15a-6. For example, a 1997 staff no-action letter, inter alia, stated that the staff would not recommend enforcement action when foreign associated persons of a foreign broker-dealer: (i) engaged in oral communications from outside the U.S. with certain U.S. institutional investors outside of U.S. trading hours, so long as the foreign associated persons do not accept orders (other than those involving foreign securities); and (ii) have in-person visits with certain "major" U.S. institutional investors, so long as those contacts do not exceed 30 days a year and the foreign associated persons do not accept orders. That letter also provided a staff statement regarding the meaning of "major U.S. institutional investor." See Letter re Securities Activities of U.S.-Affiliated Foreign Dealers from Richard R. Lindsey, Director, Division of Market Regulation to Giovanni P. Prezioso, Cleary, Gottlieb, Steen & Hamilton, dated Apr. 9, 1997 ("Nine Firms Letter"), available at http://www.sec.gov/divisions/marketreg/mr-noaction/cleary040997.pdf. Staff guidance regarding the operation of Rule 15a-6 is summarized in "Frequently Asked Questions Regarding Rule 15a-6 and Foreign Broker-Dealers," available at https://www.sec.gov/divisions/marketreg/faq-15a-6-foreign-bd.htm.

In contrast to Rule 15a-6, which provides an exemption for foreign entities' transactions with activities involving U.S. person customers, the proposed exception to Rule 3a71-3 would permit foreign entities to make use of U.S. activity only in connection with security-based swaps with non-U.S. counterparties.

Commission is not proposing to apply to that activity as a condition to the exception (i.e., requirements related to ECP verification, daily mark disclosure, clearing rights disclosure, "know your counterparty" and proposed risk mitigation requirements)?

b. To the extent that commenters believe that there should be changes to the proposed allocation of security-based swap dealer requirements between those that are conditions to the exception, and those that are not, please explain how those requirements should be allocated for purposes of the exception, and describe how that alternative allocation would address concerns raised by the activity of the registered entity. Please also describe the practical challenges raised by the Commission's proposed allocation, how a different allocation would address those challenges, and whether there are any inconsistencies in the proposed allocation.

c. To what extent would the transactions at issue be subject to requirements in foreign jurisdictions that are analogous to the Title VII requirements that are proposed to be applied as conditions to the exception? To what extent would the transactions at issue be subject to requirements in foreign jurisdictions that are analogous to the Title VII requirements that are not proposed to be applied as conditions to the exception? To what extent would analogous FINRA requirements apply to these transactions if the registrant is registered as a broker?

d. As an alternative to the proposed conditions to this exception, should this exception instead be subject to conditions that are styled after the staff guidance that describes conditions under which foreign broker-dealers may operate in the United States pursuant to Exchange Act Rule 15a-6(a)(3)?[181] In this regard the Commission notes that foreign

[181] See note 180, supra.

broker-dealers relying on Rule 15a-6 differ from foreign dealers that would avail themselves of proposed exceptions in at least two respects: first, the former are permitted to engage in only limited activity inside the United States, while the latter would be arranging, negotiating, and executing transactions using U.S. personnel on an ongoing basis; second, the former exemption applies to transactions with U.S. persons while the latter exception would apply only to transactions with non-U.S. persons. How should those differences affect the scope of any relief provided and any conditions placed on that relief? Should compliance with any or all of the requirements that are a condition to the proposed exception be eliminated, either entirely or for certain "sophisticated" counterparties? If so, how should "sophisticated" be defined for these purposes? Should any eligible contract participant be considered "sophisticated," or should "sophisticated" encompass only a counterparty that meets a higher standard, such as a standard similar to the standards applicable to: (1) qualified institutional buyers under Rule 144A(a)(1)-(4)[182] under the Securities Act of 1933; (2) major institutional investors, as defined in Exchange Act Rule 15a-6 and discussed in subsequent staff guidance; or (3) the security-based swap dealer suitability requirement's institutional counterparty standard under Rule 15Fh-3(f)(4)?[183] Would this alternative type of approach appropriately balance the implementation concerns associated with the use of the "arranged, negotiated, or executed" test against the regulatory interests underlying the de minimis counting requirement?

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182 See 17 CFR 230.144A.

183 See note 180, supra.

e. Are additional conditions necessary to help ensure that the entity that engages in arranging, negotiating or executing activity in the United States appropriately would be subject to all relevant security-based swap dealer requirements, notwithstanding a lack of contractual privity with the counterparty to the transaction?

5. Issues Potentially Associated with Specific Conditions

Are there specific conditions to the proposed exception that may pose implementation issues, or that otherwise should be modified? Commenters particularly are invited to address the following:

a. Suitability – Are there any aspects of the suitability requirements applicable to security-based swap dealers that would raise implementation issues in the event that the entity engaged in arranging, negotiating or executing activity in the United States makes recommendations in connection with the transactions at issue? In this regard please describe the nature of the relationship between U.S. personnel operating pursuant to the exception and the foreign counterparties, and any challenges to obtaining the information necessary to comply with the suitability requirement. To what extent, if at all, is the suitability requirement necessary in light of the institutional nature of the market and the limited suitability requirements that apply to transactions with institutional counterparties? Could the concerns addressed by Rule 15Fh-3(f) be mitigated if the suitability condition to the exception were instead limited solely to the security-based swap dealer's compliance with Rule 15Fh-3(f)(2)(iii), which would require the security-based swap dealer to disclose that it is acting in its capacity as a counterparty, and is not undertaking to assess the suitability of the security-based swap or trading strategy for the counterparty?

b. Disclosure of risks, characteristics, material incentives and conflicts of interest – Are there implementation issues that may arise in connection with the proposed condition requiring the registered entity engaged in arranging, negotiating or executing activity in the United States to comply with requirements related to the disclosure of information regarding risks, characteristics, material incentives and conflicts of interest? Commenters particularly are invited to address whether there may be impediments related to the ability of the registered entity to disclose or gather information regarding material incentives and conflicts of interest associated with the non-U.S. person relying on the proposed exception, and regarding how to address any such potential impediments. For example, should the disclosure requirement be limited to information regarding material incentives and conflicts of interest associated with the registered entity engaged in such activity in the United States?

c. Disclosure that non-U.S. person is not registered – Are there implementation issues that may arise in connection with the proposed condition requiring disclosure that the non-U.S. person relying on this exception is not registered with the Commission as a security-based swap dealer, and that certain Exchange Act security-based swap requirements may not be applicable? Commenters particularly are invited to address whether disclosure of less information or additional information would be appropriate, and to address whether alternative approaches regarding the timing and manner of disclosure would be appropriate.

d. Trade Acknowledgment and Verification – Should the Commission, as is proposed under Alternatives 1 and 2, condition the exception on the registered entity that engages in arranging, negotiating or executing activity in the United States complying with trade

acknowledgment and verification requirements under Title VII as if they were a counterparty to the transaction? The trade acknowledgment and verification requirements apply in connection with a transaction in which a security-based swap dealer purchases or sells to any counterparty a security-based swap. For purposes of this exception, should the Commission treat the registered entity that arranges, negotiates, or executes a security-based swap as if it purchased or sold a security-based swap for purposes of the trade acknowledgment and verification requirements? Will a security-based swap dealer (under Alternative 1 or 2) or a registered broker-dealer (under Alternative 2) that provides limited services in connection with arranging, negotiating, or executing a transaction necessarily be able to comply with the trade acknowledgment and verification requirements as if it were a party to the transaction? Will the security-based swap dealer or registered broker-dealer necessarily have all the information required for a trade acknowledgment to which it is not a party? How will it obtain verification? Would there be potential impediments to the registered entity's ability to accurately reflect the terms of the transaction on the trade acknowledgement? Would it be sufficient to condition the exception on the broker-dealer complying with the transaction confirmation requirements of Exchange Act Rule 10b-10 as if the counterparty were the "customer" of the broker-dealer?[184] Would it be necessary to modify the information required to be confirmed under Exchange Act Rule 10b-10 to accommodate security-based swaps?

e. Affiliation condition – Are there implementation issues that would arise in connection with the proposed condition that would require the registered entity engaged in arranging,

[184] The transaction confirmation requirements apply when a broker-dealer "effect[s] for or with any customer any transaction in, or [induces] the purchase or sale by such customer" of securities. See Exchange Act Rule 10b-10(a).

negotiating or executing activity in the United States to be a majority-owned affiliate of the non-U.S. person relying on the exception? Commenters particularly are invited to address the appropriateness of an affiliation condition, the potential use of alternatives to a majority-ownership standard in connection with the condition (e.g., common control or "wholly owned" standards), and any technical or other implementation issues that may accompany the use of an affiliation standard.

f. Portfolio reconciliation condition – The Commission further requests comment regarding the proposed condition that would require the registered entity engaged in arranging, negotiating or executing conduct in the United States to perform the initial portfolio reconciliation required by proposed Exchange Act Rule 15Fi-3. Commenters particularly are invited to address implementation issues that may be associated with that proposed condition. Commenters also are invited to address the potential effectiveness of that proposed condition in helping registered security-based swap data repositories comply with their verification requirements.

6. Potential Additional Conditions

Should the proposed exception be subject to additional conditions? Commenters particularly are invited to address the following:

a. Should the exception be made unavailable in circumstances in which U.S. entities or their personnel manage the relationship with the non-U.S. counterparty to the transaction? Alternatively, should additional conditions (e.g., compliance with ECP verification and "know your counterparty" requirements) be applied to the exception in those circumstances?

b. Should the exception be conditioned on the registered entity complying with ECP verification and "know your counterparty" requirements "as if" the counterparties to the

non-U.S. person relying on the exception also were counterparties to the registered entity? In this regard, commenters are requested to discuss whether the registered entity reasonably would be expected to possess information regarding the counterparty to the transaction that is sufficient to permit compliance with those requirements.

c. Instead, should the treatment of ECP verification and "know your counterparty" requirements for purposes of the exception depend in part on whether the Commission also has issued "market color" guidance, as discussed in part II supra. For example, if the Commission issues "market color" guidance, would it be likely that non-U.S. persons would rely on the guidance when their U.S. personnel have only a peripheral involvement with the resulting transaction, and that non-U.S. persons would rely on the exception when their U.S. personnel engage with the counterparty more comprehensively? In that event, should the exception require compliance with the ECP verification and "know your counterparty" provisions, based on the assumption that the exception would be used when U.S. personnel have a comparatively comprehensive degree of engagement with the counterparty, which would allow for compliance with those conditions?

d. Alternatively, should the exception from the de minimis counting requirement be conditioned on "as if" compliance with those ECP verification and "know your counterparty" requirements, unless the registered entity has had no prior interactions with the counterparty, and there is no basis to believe that the registered entity would have further interactions with that counterparty?

e. Should the exception further be conditioned on the registered entity having to disclose information regarding clearing rights? Commenters particularly are invited to address the

expected application of the underlying clearing rights provisions in Exchange Act Section 3C(g)(5) to the transactions at issue.

f. Should the proposed exception be conditioned on the non-U.S. person relying on the condition having some involvement in the registered entity's arranging, negotiating or executing activity to the extent practicable, to help prevent the counterparties to these transactions from misconstruing the role of the registered entity and the application of Title VII safeguards to the transactions at issue.

g. Are there additional conditions that would be appropriate for incorporation into the exception?

7. Treatment of the Non-U.S. Person Relying on the Exception, including Commission Access to Information

To what extent would the absence of direct security-based swap dealer regulation of the non-U.S. person relying on the proposed exception – notwithstanding its use of U.S. personnel to conduct security-based swap dealing activity – raise concerns regarding gaps in the application of Title VII to transactions arising from security-based swap dealing in the United States?[185] Commenters particularly are invited to address the following:

a. What issues may arise due to the lack of Commission regulation of communications between the non-U.S. person and its counterparties? Could this lack of regulation potentially facilitate improper practices in connection with dealing transactions that occur in part in the United States?

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[185] Absent additional Commission action, see part III.D.10, infra, under the proposed exception the regulatory reporting and public dissemination requirements of Regulation SBSR still would apply directly to the security-based swap, by virtue of the transaction having been arranged, negotiated or executed in the United States, see Regulation SBSR Sections 908(a)(1)(v) and 908(b)(5) (and, under alternative 2, by virtue of the transaction having been effected by or through a registered broker-dealer, see Regulation SBSR Section 908(a)(1)(iv)).

b. What issues may arise due to the lack of direct Commission financial responsibility regulation of the non-U.S. person? How significant are associated concerns regarding spillovers and contagion arising from reputational effects that an affiliate's failure may have on other affiliates within the same corporate group?

c. Do the proposed provisions to (a) require the non-U.S. person relying on the exception to promptly provide the Commission with information, documents and testimony in connection with the transaction, and (b) require the registered entity to obtain and maintain related books and records, adequately provide for transparency into the dealing activities associated with transactions subject to the exception? Should the rules provide further specificity regarding the procedures for withdrawing the exception in the event of impediments to such access? Should the exception incorporate a notice provision to require the non-U.S. person relying on the exception (or the registered entity engaged in arranging, negotiating or executing activity in the United States) to inform the Commission as to the transactions being conducted in reliance on the exception? Are there modifications that would allow the Commission to obtain the necessary access to books and records at a lower cost to the non-U.S. person and the registered entity?

d. For purposes of the access provisions of proposed paragraph (d)(1)(iii)(A) of Rule 3a71-3 – which would require non-U.S. persons relying on the exception to promptly make their "foreign associated persons" available to the Commission for testimony – is the proposed "foreign associated person" definition in paragraph (a)(11) of the rule crafted appropriately? For example, should the proposed definition be limited so it applies only to persons who effect or who are involved in effecting security based swaps? If so, why?

8. Distinctions Between the Two Proposed Alternatives

Comparatively, to what extent would the two proposed alternatives for the conditional exception effectively address implementation concerns while continuing to preserve the principles that underpin the "arranged, negotiated, or executed" standard? Commenters particularly are invited to address the following:

a. Under the second alternative, what concerns may arise from applying Title VII business conduct requirements to brokers via condition in lieu of security-based swap dealer registration?

b. How would comparative security-based swap dealer capital requirements and broker-dealer capital requirements affect the implementation of the two alternatives?[186] Would those capital requirements limit the ability to use a stand-alone entity to engage in arranging, negotiating or executing conduct in the United States on behalf of a non-U.S. affiliate? Would those capital requirements affect the potential use of a registered entity that also engages in a separate security-based swap dealing business, or that is registered as a swap dealer or as a bank?[187]

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186 The proposed capital requirements applicable to those entities would depend on whether they are a stand-alone nonbank security-based swap dealer, a security-based swap dealer that is dually registered as a broker-dealer, a bank security-based swap dealer, or stand-alone broker-dealer. See Capital, Margin and Segregation Proposing Release, 77 FR at 70333 (proposing capital requirements for nonbank security-based swap dealers, including security-based swap dealers dually registered as broker-dealers); 80 FR 74840 (Nov. 30, 2015) (adopting capital requirements for bank security-based swap dealers); 17 CFR 240.15c3-1 (prescribing capital requirements for broker-dealers). Those existing and proposed capital requirements are tailored, among other reasons, based on the different types of entities (e.g., a bank, a security-based swap dealer, or a broker-dealer) and the activities those entities engage in. Therefore, two different types of entities may be subject to substantially different capital requirements.

187 For example, would the security-based swap dealer capital requirements associated with Alternative 1 effectively limit the use of that alternative to situations in which the arranging, negotiating or executing activity is conducted through a registered security-based swap dealer that engages in a separate security-based swap dealing business (apart from conducting arranging,

9. Effect on Booking Practices

The Commission requests comment regarding how the availability of the proposed exception would be expected to affect prospective booking practices by industry participants. Commenters particularly are invited to address the following:

a. Would the proposed exception incentivize U.S.-based dealing entities to bifurcate their dealing books by prospectively booking security-based swap transactions with non-U.S. counterparties into non-U.S. affiliates, to avoid having that portion of their security-based swap businesses being subject to Title VII security-based swap dealer requirements? If so, what would be the expected extent of such booking practices? What would be the expected economic consequences?[188]

b. Are the proposed conditions appropriate to help guard against any negative consequences (e.g., loss of business conduct protection, potential market fragmentation) that potentially would result from U.S.-based dealing entities using such booking practices to limit the application of Title VII to their dealing businesses involving non-U.S. counterparties? If not, what additional conditions – e.g., restrictions on the availability of the exception when the counterparty relationship is managed by U.S. personnel rather than by non-U.S. personnel of the booking entity – would be appropriate to help prevent those negative consequences?

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negotiating or executing activity on behalf of an affiliate), or that also engages in a swap dealing business, or that is a bank? Conversely, would Alternative 2 better accommodate the establishment of new registered entities to conduct arranging, negotiating or executing activity consistent with the conditions to the proposed exception?

[188] See part VII.A.7, infra (addressing potential number of U.S.-based dealing entities that may seek to use the exception in connection with those types of prospective booking practices).

c. Would a differently tailored application of the counting requirements to cross-border transactions be appropriate, instead of or in addition to the alternatives being proposed in this release? For example, should a non-U.S. person engaged in dealing activity be permitted to exclude certain transactions with a U.S.-person dealer from its de minimis calculations, subject to certain conditions? If so, please describe the conditions that should apply to such an exception. Alternatively, should a non-U.S. person engaged in dealing activity be permitted to avail itself of such an exception only to the extent that it is located in a "listed jurisdiction"?

10. Availability to Registered Security-Based Swap Dealers

As proposed, the exception not only would affect the set of dealing transactions that non-registered persons would consider when evaluating whether they fall under the security-based swap dealer de minimis thresholds, but also would be relevant to non-U.S. persons that are registered as security-based swap dealers but that wish to withdraw their registration based on their dealing activity over the prior 12 months.[189] Should the exception be made unavailable to registered security-based swap dealers in connection with the potential withdrawal of registration? Commenters particularly are invited to address whether the rationale that underpins the proposed exception, related in large part to the consequences of actions that non-U.S. persons otherwise may take to avoid security-based swap dealer registration, would also be relevant in connection with non-U.S. persons that have registered with the Commission.

[189] See note 101, supra (discussing application of proposal to registered security-based swap dealers).

11. Other Uses of "Arranged, Negotiated, or Executed" Criteria

Should similar exceptions also be made available in connection with other Title VII requirements that in part rely on "arranged, negotiated, or executed" test? Commenters particularly are invited to address the following:

a. Regulation SBSR

Commenters are invited to address the application of "arranged, negotiated, or executed" criteria in connection with the cross-border application of the regulatory reporting and public dissemination requirements of Regulation SBSR. Regulation SBSR requires reporting and dissemination of transactions, connected with a non-U.S. person's security-based swap dealing activity, that have been "arranged, negotiated, or executed" by U.S. personnel of the non-U.S. person, or by U.S. personnel of the non-U.S. person's agent.[190] In adopting Regulation SBSR, the Commission determined that requiring those transactions to be reported to a registered swap data repository would "enhance the Commission's ability to oversee relevant security-based swap activity within the United States as well as to evaluate market participants for compliance with specific Title VII requirements" and monitor for fraudulent activity.[191] The Commission further stated that public dissemination of those transactions would "contribute to price discovery and price competition in the U.S. security-based swap market" by providing a "more comprehensive view of activity in the U.S. market."[192]

The Commission is soliciting comment regarding those prior conclusions. Commenters particularly are invited to address whether the existing requirements related to the cross-border

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190 See Regulation SBSR Sections 908(a)(1)(v) and 908(b)(5); see also note 14, supra. Regulation SBSR was adopted pursuant to the regulatory reporting and public dissemination requirements set forth in Exchange Act Sections 13(m)(1)(C), 13(m)(1)(G) and 13A(a)(1).

191 81 FR at 53591.

192 Id. at 53592.

application of Regulation SBSR could cause non-U.S. person counterparties to avoid transacting with foreign dealers who use U.S. personnel to arrange, negotiate or execute security-based swap transactions.

In this regard, commenters are invited to address whether there should be any modifications to existing provisions of Regulation SBSR (and, if so, which) regarding the application of regulatory reporting and public dissemination requirements to transactions arranged, negotiated or executed in the United States. Commenters also are invited to provide their views as to whether, for a security-based swap where a non-U.S. person engages in dealing activity but relies on an exception from having to count that transaction against its de minimis threshold, Regulation SBSR should be amended to re-assign the duty to report that transaction from the non-U.S. person engaged in dealing activity to its affiliated U.S. entity (be it a registered broker-dealer or registered security-based swap dealer) that is conducting the arranging, negotiating or executing activity in the United States.

Commenters further are invited to comment on possible alternative compliance mechanisms for the regulatory reporting and public dissemination requirements. For example, should Regulation SBSR be amended to conditionally permit the transaction to be reported pursuant to the requirements of the foreign jurisdiction which applies its reporting requirements to the affiliated non-U.S. person? If so, what conditions should apply to such an approach (e.g., limiting the approach to circumstances where that jurisdiction's reporting and dissemination requirements and practices meet certain criteria), and how should the Commission or market participants determine whether a jurisdiction meets any relevant criteria for this purpose? Alternatively, is the availability of substituted compliance in connection with the regulatory reporting and public dissemination requirements sufficient to address concerns regarding

regulatory burdens potentially associated with this use of an "arranged, negotiated, or executed" test?[193]

b. Additional Title VII requirements

Commenters also are invited to address the use of an "arranged, negotiated, or executed" test in connection with the cross-border application of certain security-based swap dealer business conduct requirements.[194] Here too, the Commission particularly requests comment regarding the potential relevance of Exchange Act Rule 15a-6(a)(3), which in part conditionally allows unregistered foreign broker-dealers to communicate with U.S. institutional investors and major institutional investors without having to register with the Commission as broker-dealers.[195] Would it be appropriate to provide conditional relief – akin to the proposed exception from the de minimis counting requirement or to the conditional broker-dealer registration exemption set forth in Rule 15a-6(a)(3) – from relevant business conduct requirements for registered foreign security-based swap dealers in security-based swap transactions with non-U.S. persons that the foreign dealers arrange, negotiate, or execute using personnel located within the United States? If so, should such relief be conditioned on the sophistication of the counterparty or its advisor or compliance with any other conditions?

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193 Rule 908(c) of Regulation SBSR provides that the Title VII requirements for regulatory reporting and public dissemination of security-based swaps may be satisfied by compliance with the rules of a foreign jurisdiction that the Commission has found to have requirements that are comparable to those of Title VII.

194 Exchange Act Rule 3a71-3(c) states that a registered security-based swap dealer is not subject to certain business conduct requirements "with respect to its foreign business." The "foreign business" definition (Rule 3a71-3(a)(9)) references the definition of "U.S. business," which in relevant part includes transactions of foreign security-based swap dealers that have been arranged, negotiated or executed by personnel located in a U.S. branch or office. See Exchange Act Rule 3a71-3(a)(8)(i)(B).

195 See note 180, supra.

In addition, commenters are invited to address the application of "arranged, negotiated, and executed" criteria in connection with the exception from the de minimis counting requirement related to the dealing transactions of non-U.S. persons with counterparties that are foreign branches of registered security-based swap dealers.[196] To the extent that this counting test raises operational or other challenges, are these addressed by the guidance that the Commission has proposed to provide in Part II above regarding the scope of activity that is encompassed by the terms "arranging" and "negotiating" under the test? Alternatively, should the definition of "transaction conducted through a foreign branch" in Exchange Act Rule 3a71-3(b)(1)(iii)(A) be modified to incorporate exceptions similar to those being proposed here? Would such an exception from that aspect of the de minimis counting requirement potentially lead to unlimited involvement of U.S.-based personnel in such transactions? If so, how could the exception be tailored appropriately to avoid such a result?

Commenters also are invited to address the use of those criteria in connection with rules regarding the cross-border application of requirements applicable to major security-based swap participants.[197]

12. Additional Issues

The Commission further requests comment regarding any additional issues associated with the proposed exception, or regarding other potential approaches toward addressing issues associated with the "arranged, negotiated, or executed" counting standard.

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196 See note 81, supra.

197 See note 82, supra.

IV. Proposed Guidance and Amendments related to the Certification and Opinion of Counsel Requirements

A. Discussion

Since the adoption of the registration rules for SBS Entities,[198] the Commission staff has received a number of questions regarding the scope of the certification and opinion of counsel requirement in Exchange Act Rule 15Fb2-4.[199] Certain of these questions related to issues raised by foreign blocking laws, privacy laws, secrecy laws and other foreign legal barriers that may limit or prohibit firms from: (i) providing books and records directly to the Commission; or (ii) submitting to an onsite inspection or examination by SEC staff.[200] Specifically, firms have requested guidance as to whether the certification and opinion of counsel may take into account different approaches available under foreign blocking laws, privacy laws, secrecy laws or other legal barriers that may facilitate firms' ability to provide books and records to the Commission and submit to an examination or inspection by Commission staff in a manner consistent with a particular foreign legal requirement.

The Commission recognizes that foreign blocking laws, privacy laws, secrecy laws or other legal barriers may vary in purpose and scope, among other aspects. For example, while some foreign laws may affect the ability of a Commission registrant to provide personal data to the Commission, other laws may prevent a Commission registrant from providing any information to the Commission or submitting to an onsite visit without specific authorization from the foreign government. In light of the differences among foreign laws, the Commission

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198 See Registration Adopting Release.

199 See, e.g., IIB/SIFMA 8/26/2016 Letter; see also IIB 11/16/2016 Email.

200 See, e.g., Registration Adopting Release, 80 FR at 48981.

deems it appropriate to propose guidance to firms seeking clarification as to the Commission's requirements for the certification and opinion of counsel.

For example, firms have asked whether the required certification and opinion of counsel may take into account the ability in some jurisdictions for a firm to provide the Commission with access to books and records if the firm obtains the consent of the person whose information is documented in the books and records.[201] One commenter also asked that the Commission clarify that in certain circumstances the certification and opinion of counsel may be based on the assumption that the nonresident security-based swap dealer will provide the Commission access to its books and records through, and submit to on-site inspection and examination with the approval of, the relevant foreign regulatory authority.[202] In addition, firms have asked whether the certification and opinion of counsel should address only the laws of the "home country" of the nonresident SBS Entity (for example, its principal place of business or where it is incorporated), or if the Commission expects a nonresident SBS Entity to address applicable law

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201 See, e.g., Memorandum from the Division of Trading and Markets regarding a April 3, 2018 meeting with representatives of Societe Generale, April 3, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-3405388-162169.pdf; Memorandum from the Division of Trading and Markets regarding a April 4, 2018 meeting with representatives of Barclays, April 4, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-3405597-162172.pdf; Memorandum from the Division of Trading and Markets regarding a April 11, 2018 meeting with representatives of UBS, April 11, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-3461169-162204.pdf; Memorandum from the Division of Trading and Markets regarding a April 11, 2018 meeting with representatives of Morgan Stanley, April 11, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-4035093-168391.pdf; Memorandum from the Division of Trading and Markets regarding a April 30, 2018 meeting with representatives of UBS, April 30, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-4042895-168865.pdf; Memorandum from the Division of Trading and Markets regarding a June 4, 2018 meeting with representatives of Credit Suisse, June 5, 2018, available at https://www.sec.gov/comments/s7-08-12/s70812-3785770-162712.pdf; and Memorandum from the Division of Trading and Markets regarding a July 18, 2018 meeting with representatives of BNP Paribas, July 24, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-4107153-170272.pdf.

202 IIB/SIFMA 8/26/2016 Letter, at page 3.

in every jurisdiction in which the nonresident SBS Entity may conduct business or in which its counterparties, customers, or personnel may be located.[203] Firms also have asked if the certification and opinion of counsel are meant to cover Commission inspection and examination of books and records in the jurisdictions in which they are located.[204] The Commission has been considering these issues, and believes it would be appropriate to address certain of these concerns as described below.

The guidance set forth below regarding the certification and opinion of counsel requirements would also be relevant to Exchange Act Rule 3a71-6, which allows SBS Entities to comply with certain requirements under Section 15F of the Exchange Act through substituted compliance.[205] In particular, Paragraph (c)(2)(ii) of Rule 3a71-6 provides that substituted compliance applications by parties or groups of parties – other than foreign financial regulatory authorities – must include the certification and opinion of counsel associated with the SBS Entity registration requirements as if such party were subject to that requirement at the time of the request.[206] Recognizing the expected time necessary for the Commission to consider substituted compliance applications it receives, the Commission welcomes submission of such applications with respect to any of its final rules for which substituted compliance is potentially available.

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203 See note 201, supra.

204 See IIB/SIFMA 8/26/2016 Letter, at page 2.

205 Exchange Act Rule 3a71-6.

206 Separately, paragraph (c)(3) of Rule 3a71-6 provides that foreign financial regulatory authorities may make substituted compliance requests only if they provide adequate assurances that no law or policy of any relevant foreign jurisdiction would impede the ability of any entity that is directly supervised by the foreign financial regulatory authority and that may register with the Commission as an SBS Entity to provide the Commission with prompt access to the entity's books or records, or to submit to on-site inspection and examination by the Commission. The above guidance regarding the application of the certification and opinion of counsel requirements also will inform the Commission's assessment of whether a foreign financial regulatory authority has provided such adequate assurances as part of a substituted compliance application.

Consistent with this position, the Commission wishes to clarify that, during the pendency of this proposal, the Commission will consider all such applications, including those submitted without a certification or opinion of counsel, by parties or groups of parties who are not foreign regulatory authorities.[207] This clarification, however, does not mean that the Commission would grant any application for substituted compliance submitted by such parties or groups of parties until the required certification and opinion are filed.

1. Foreign Laws Covered by the Certification and Opinion of Counsel Requirements

The Commission understands that the security-based swap market and the security-based swap dealing activities of many firms are global in scope. In this market, the business of any single security-based swap dealer, whether a resident or nonresident of the United States, may span multiple jurisdictions. The certification and opinion of counsel requirement was intended to address distinct challenges that may arise with respect to a nonresident SBS Entity that, unlike a resident SBS Entity, is incorporated or has its principal place of business outside the United States. In particular, the requirement is intended to provide a level of assurance regarding the Commission's access to relevant books and records of a nonresident SBS Entity and its ability to inspect and examine them.

Given the underlying objective of this requirement, the Commission is proposing to provide guidance that it would be appropriate for the certification and opinion of counsel to address only the laws of the jurisdiction or jurisdictions in which the nonresident SBS Entity maintains the covered books and records as described in part IV.B.2, infra ("covered books and records"). Under this proposed guidance, the certification and opinion of counsel would not

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[207] The Commission does not require that applications submitted by foreign regulatory authorities be accompanied by a certification or opinion of counsel. Exchange Act Rule 3a71-6(c)(3).

need to cover other jurisdictions where customers or counterparties of the nonresident SBS Entity may be located or where the nonresident SBS Entity may have additional offices or conduct business. For example, if the nonresident SBS Entity maintains the covered books and records in the jurisdiction of its incorporation or principal place of business, the certification and opinion of counsel would address that jurisdiction. If the nonresident SBS Entity maintains its covered books and records in a jurisdiction or jurisdictions other than where it is incorporated or has its principal place of business (e.g., in a jurisdiction where it maintains a foreign branch office that conducts its security-based swap activities), the certification and opinion of counsel should address such jurisdiction or jurisdictions, provided that the laws of the jurisdiction where the firm is incorporated or jurisdictions in which it is doing business would not prevent the Commission from having direct access to the covered books and records, nor prevent the nonresident SBS Entity from promptly furnishing them to the Commission or opening them up to the Commission for an on-site inspection or examination.

The Commission preliminarily believes that a certification and opinion of counsel from a nonresident SBS Entity that covers the laws of the jurisdiction or jurisdictions where its covered books and records are located, rather than the laws of all possible jurisdictions where its customers or counterparties may be located or where it may conduct business, would provide the Commission with a sufficient level of assurance that it will be able to access the relevant books and records of nonresident SBS Entities registered with it.

2. Clarification on Covered Books and Records

One commenter requested that the Commission clarify that the scope of the certification and opinion of counsel requirement applies only to "U.S.-Related Records" (as defined by the commenter) and, for a nonresident security-based swap dealer subject to the Commission's

capital and margin regulations, "Financial Records" (as defined by the commenter).[208] The commenter also would limit the scope of the certification and opinion of counsel to on-site inspection and examination of books and records located at a U.S. branch or office of a nonresident security-based swap dealer or U.S. Related Records located at the nonresident security-based swap dealer's "U.S.-Related Foreign Locations" (as defined by the commenter).[209] Among other things, the commenter states that this would ensure Commission access to the types of records most relevant to the Commission's oversight responsibilities.[210]

The Commission believes that it would be beneficial to propose guidance on this issue to help firms that must comply with these rules understand the scope of what is covered by the certification and opinion of counsel. The Commission is proposing to provide guidance that the certification and opinion of counsel need only address: (1) books and records that relate to the "U.S. business" of the nonresident SBS Entity (as defined in 17 CFR 240.3a71-3(a)(8)); and (2) financial records necessary for the Commission to assess the compliance of the nonresident SBS Entity with capital and margin requirements under the Exchange Act and rules promulgated by

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208 See IIB/SIFMA 8/26/2016 Letter (proposing that "U.S.-Related Records" be defined to mean "books and records relating to security-based swap transactions entered into by the non-resident security-based swap dealer after the effective date of its registration (i) with U.S. persons, (ii) for which the nonresident [security-based swap dealer's] obligations are guaranteed by a U.S. person or (iii) arranged, negotiated or executed on behalf of the non-resident [security-based swap dealer] by personnel located in a U.S. branch or office of the non-resident [security-based swap dealer] or its agent. Where [a security-based swap dealer] maintains such books and records in multiple locations, the [security-based swap dealer] would designate the location that is relevant for purposes of the certification and opinion;" and "Financial Records" would be defined to mean "books and records necessary for the Commission to assess the non-resident [security-based swap dealer's] compliance with Commission capital and margin requirements.").

209 See id. (proposing that "U.S.-Related Foreign Locations" be defined to mean "non-U.S. branches and offices of the nonresident [security-based swap dealer] from which personnel arrange, negotiate or execute [security-based swap] transactions on behalf of the non-resident [security-based swap dealer] (i) with a counterparty that is a U.S. person or (ii) for which the non-resident [security-based swap dealer's] obligations are guaranteed by a U.S. person").

210 Id.

the Commission thereunder, if these capital and margin requirements apply to the nonresident SBS Entity.

While this formulation is similar to that suggested by commenters, the Commission preliminarily believes it would be appropriate to tie the scope of the books and records covered by the certification and opinion of counsel to a firm's "U.S. business" and relevant financial records, rather than to propose a new "U.S. Related Records" definition as suggested by the commenter. As the Commission explained in adopting a definition of "U.S business" in the Commission's Title VII cross-border rules, the intent is to encompass those transactions that appear particularly likely to affect the integrity of the security-based swap market in the United States and the U.S. financial markets more generally or that raise concerns about the protection of participants in those markets.[211] Accordingly, this approach would more effectively tailor the certification and opinion of counsel to the types of records the Commission would need to review, inspect or examine to determine compliance with applicable substantive requirements.

Even with such clarification, however, the Commission emphasizes that, as proposed, Exchange Act Rule 18a-6(g) would require that a nonresident SBS Entity must provide the Commission with direct access to its books and records - i.e., the nonresident SBS Entity must "furnish promptly to a representative of the Commission legible, true, complete, and current copies" of its books and records, and permit on-site inspections and examinations of its books and records.[212] The guidance above with respect to the certification and opinion of counsel would not reduce or eliminate these obligations as they are independent of, and in addition to, the certification and opinion of counsel requirement.

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211 See Business Conduct Adopting Release, 81 FR at 30065.

212 See proposed Rule 18a-6(g) and discussion in Recordkeeping and Reporting Proposing Release, 79 FR at 25220.

3. Consents

Firms have noted that certain jurisdictions' laws may permit a firm to promptly provide books and records directly to the Commission and to submit to an on-site inspection and examination at the offices of the firm located in the jurisdiction if the firm obtains consent from the natural person whose information is documented in the books and records.[213] In this case, the Commission preliminarily believes that it would be appropriate for the firm's certification and opinion of counsel to be predicated, as necessary, on the nonresident SBS Entity obtaining the prior consent of the persons whose information is or will be included in the books and records to allow the firm to promptly provide the Commission with direct access to its books and records and to submit to on-site inspection and examination.[214]

As noted above, the security-based swap recordkeeping rules as proposed would require that a nonresident SBS Entity must provide the Commission with direct access to its books and records. This requirement exists independently of, and in addition to, the certification and opinion of counsel requirements. Thus if a nonresident SBS Entity intends to rely on consents, it should obtain such consents prior to registering as an SBS Entity so that it will be able to provide Commission staff with direct access to its books and records while it is conditionally registered. The certification and opinion of counsel, if provided at a later date, would be able to rely on those consents in effect when they are provided. In addition, if a nonresident SBS Entity certifies that it may rely on consents, it should continue to obtain consents on an ongoing basis so that it can continue to provide the Commission with access to books and records. In determining whether to rely on consent, a nonresident SBS Entity may also seek to explore whether an

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213 See note 201, supra.

214 The firm's opinion of counsel should, as necessary, address all relevant considerations involving consent.

alternative basis exists under the foreign privacy laws that would permit the nonresident SBS Entity to collect and maintain the necessary data and to provide the information directly to Commission staff.

Before registering with the Commission, a nonresident SBS Entity should assess whether it would be able to meet these obligations and take appropriate steps to ensure that, if registered, it will be able to comply with them. For example, if a nonresident SBS Entity is unable to obtain consent from a customer or counterparty whose information will be documented in a book or record subject to these obligations or if a customer or counterparty provides a consent then later withdraws that consent, the firm may need to cease conducting a security-based swap business with that person in order to comply with the Exchange Act and the Commission's rules thereunder or to seek an alternative basis exists under the foreign laws that allows the nonresident SBS Entity to satisfy its obligations under the federal securities laws.

4. Open Contracts

Some firms have asked for clarification that the certification and opinion of counsel would not need to cover books and records related to open contracts,[215] and expressed concern it could require firms to re-negotiate those contracts. [216]

The Commission preliminarily believes that the certification and opinion of counsel need not address the books and records of security-based swap transactions that were entered into prior to the date on which a nonresident SBS Entity submits an application for registration

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215 For purposes of this guidance, the term "open contracts" would include any contract entered into by the SBS Entity prior to the date on which an SBS Entity submits an application for registration which the SBS Entity continues to hold on its books and records and under which it may have continuing obligations.

216 See notes 201 and 209, supra.

pursuant to Section 15F(b) of the Exchange Act and the rules thereunder.[217] The Commission recognizes that there may be practical impediments to obtaining consents with respect to open contracts because, for example, the counterparty is in a dispute with the nonresident SBS Entity. Further, there may be questions of fairness to the extent that any potential application to open contracts could undermine the expectations that the parties had when entering into the security-based swap.

5. Commission Arrangements with Foreign Regulatory Authorities or Approvals, Authorizations, Waivers or Consents

Firms have noted that while local laws or rules in some foreign jurisdictions may prevent a nonresident SBS Entity from providing the Commission with direct access to its books and records or submitting to onsite inspections or examinations, in some cases the relevant foreign regulatory authority may have entered into a Memorandum of Understanding ("MOU") or other arrangement with the Commission to facilitate Commission access to records of nonresident SBS Entities located in the jurisdiction.[218] Firms have requested guidance regarding whether the certification and opinion of counsel submitted by a nonresident SBS Entity can rely on MOUs or other arrangements foreign regulatory authorities may have entered into with the Commission to facilitate Commission access to records at the request of the SBS Entity.

The Commission preliminarily believes that it would be appropriate, under the factors discussed below, for the certification and opinion of counsel to take into account whether the relevant regulatory authority in the foreign jurisdiction has: (i) issued an approval, authorization,

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217 Cf. Business Conduct Adopting Release, 81 FR at 29969, in which the Commission stated that the business conduct rules generally would not apply to any security-based swap entered into prior to the compliance date of the rules, and generally would apply to any security-based swap entered into after the compliance date of these rules, including a new security-based swap that results from an amendment or modification to a pre-existing security-based swap.

218 See note 201, supra.

waiver or consent; or (ii) entered into an MOU or other arrangement with the Commission facilitating direct access to the books and records of SBS Entities located in that jurisdiction, including the Commission's inspections and examinations at the offices of SBS Entities located in that jurisdiction, provided that such an approval, authorization, waiver, consent or MOU or arrangement is necessary to address legal barriers to the Commission's direct access to books and records of the SBS Entities in that jurisdiction.

However, consideration of such an approval or MOU would need to be consistent with the registration program that has been adopted by the Commission. Specifically, the Commission stated when adopting the registration rules that it must be able to access directly the books and records of nonresident SBS Entities and inspect and examine them without going through a third party, such as a foreign regulatory authority, to effectively fulfill its regulatory oversight responsibilities. Thus, it would not be appropriate to take into account such an approval or MOU if it contemplates that the nonresident SBS Entity must provide the covered books and records, as described in Section IV.A.2. above, to the foreign regulatory authority in order for that body then to provide them to the Commission.

At the same time, it would be appropriate to take into consideration an MOU or other arrangement that provided for consultation or cooperation with a foreign regulatory authority in conducting onsite inspections and examinations at the foreign offices of nonresident SBS Entities. The Commission also believes it would be consistent with its registration program if the Commission is required to notify the relevant foreign regulatory authority, as described in Section IV.A.1. above, of its intent to conduct an onsite inspection or examination and staff from the foreign regulatory authority can accompany the Commission when it visits the foreign office of the nonresident SBS Entity. However, it would not be consistent with the Commission's

interpretation of the requirement to rely on an MOU or other arrangement if, whether by the terms of any relevant agreement, under provisions of local law, or in light of prior practice, consultation or cooperation with the foreign regulatory authority restricts the Commission's ability to conduct timely inspections and examinations of the books and records in the foreign office of the nonresident SBS Entity.

6. Proposed Amendment to Rule 15Fb2-1 Related to the Timing of Certification and Opinion of Counsel Required by Rule 15Fb2-4(c)(1)

As described in the SBS Entity Registration Adopting Release, an SBS Entity is conditionally registered with the Commission when it submits a complete application on Form SBSE, SBSE-A, or SBSE-BD, as appropriate, and the Form SBSE-C senior officer certifications.[219] To be complete, a Form SBSE, SBSE-A, or SBSE-BD would generally need to include the Schedule F certification and opinion of counsel. The Commission acknowledges that a nonresident SBS Entity may be unable to provide the certification or opinion of counsel required under Rule 15Fb2-4(c)(1) by the time the entity will be required to register because efforts to address legal barriers to the Commission's direct access to books and records are still ongoing. For example, the relevant regulatory authority in the foreign jurisdiction where the nonresident SBS entity maintains its covered books and records may be in the process of (i) issuing an approval, authorization, waiver or consent or (ii) negotiating an MOU or other arrangement with the Commission. The Commission recognizes that absent relief such nonresident SBS Entities will bear the cost of lowering or restructuring the market activity below

[219] 17 CFR 240.15Fb2-1(d).

the annual thresholds that would trigger registration requirements, an outcome that could create significant market disruptions.[220]

Accordingly, the Commission is proposing to amend Exchange Act Rule 15Fb2-1 to provide additional time for a nonresident SBS Entity to submit the certification and opinion of counsel required under Rule 15Fb2-4(c)(1). Specifically, the Commission is proposing new paragraphs (d)(2) and (e)(2) of Exchange Act Rule 15Fb2-1. Proposed paragraph (d)(2) would provide that a nonresident applicant that is unable to provide the certification and opinion of counsel required under Rule 15Fb2-4(c)(1) shall be conditionally registered for up to 24 months after the compliance date for Rule 15Fb2-1 if the applicant submits a Form SBSE-C and a Form SBSE, SBSE-A or SBSE-BD, as appropriate, that is complete in all respects but for the failure to provide the certification and the opinion of counsel required by Rule 15Fb2-4(c)(1). Proposed paragraph (e)(2) would provide that if a nonresident SBS Entity became conditionally registered in reliance on paragraph (d)(2), the firm would remain conditionally registered until the Commission acts to grant or deny ongoing registration, and that if the nonresident SBS Entity fails to provide the certification and opinion of counsel within 24 months of the compliance date for Rule 15Fb2-1, the Commission may institute proceedings to determine whether ongoing registration should be denied. As indicated in the Registration Adopting Release,[221] once an SBS Entity is conditionally registered, all of the Commission's rules applicable to registered SBS Entities will apply to the entity and it must comply with them. Further, this proposed relief would be available only for the duration of the 24 month period immediately following the compliance date for Rule 15Fb2-1.

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220 See Registration Adopting Release, 80 FR at 49008.

221 Registration Adopting Release, 80 FR at 48970 n.52.

B. Solicitation of Comments Regarding Proposed Guidance and Amendments related to the Certification and Opinion of Counsel Requirements

The Commission requests comment on all aspects of the proposed guidance and amendments.

1. Foreign Laws Covered by the Certification and Opinion of Counsel Requirements

a. If the scope of the certification and opinion of counsel requirements are limited as described above, are there situations in which a nonresident SBS Entity will nonetheless be unable to provide the required certification and opinion of counsel because the laws of another jurisdiction prevent a nonresident SBS Entity from providing the Commission with access to its books and records? If so, in what jurisdictions?

b. Are there any other types of foreign laws, regulations or requirements that may prevent a nonresident SBS Entity from providing Commission staff with access to its books and records or impede the staff's ability to conduct onsite examinations?

c. Could there be a situation where the laws of a jurisdiction where customers, counterparties or employees of a nonresident SBS Entity may be located, but where the nonresident SBS Entity maintains no books and records, could impose a legal barrier that would limit or prohibit the nonresident SBS Entity's ability to either collect personal or transactional data regarding a customer, counterparty or employee or provide that data directly to the Commission? If so, should a nonresident SBS Entity that has customers, counterparties or employees in such a jurisdiction also be required to include consideration of that jurisdiction or jurisdictions as part of its certification and opinion of counsel? In this situation, how could the Commission staff obtain adequate assurance that it would be able to access a nonresident registrant's books and records?

2. Clarification on Covered Books and Records

a. Does the proposed guidance adequately address the concerns raised by commenters? Would the guidance appropriately define the scope of the books and records covered by the certification and opinion of counsel to "U.S. business" as defined in Rule 3a71-3(a)(8) and the financial records of certain registrants? Should additional books and records be included? If so, which books and records and why? Alternatively, are there other books and records that should be excluded from the scope of what is covered by the certification and opinion of counsel? If so, which books and records and why?

b. Rather than using the U.S. business definition, should the Commission instead follow the approach suggested by the commenter – to establish definitions for "U.S. Related Records," "Financial Records," and "U.S. Related Foreign Locations" solely for the purpose of scoping records in or out of the requirements? If so why?

c. Would the proposed approach limit the Commission's ability to assess how a nonresident SBS Entity may address conflicts between the trades with a U.S. counterparty and other trades outside the U.S.? If so, are there any other methods the Commission could use to investigate those conflicts?

3. Consents

a. Does the proposed guidance adequately address the concerns raised by commenters?

b. Is reliance on consents a viable option to address not only data privacy, but secrecy and blocking laws or regulations?

c. Should the Commission allow nonresident SBS Entities to rely on consents if the person providing consent is able to later withdraw that consent? How do nonresident SBS Entities plan to address situations where a customer, counterparty, employee or other person later withdraws consent?

d. If a nonresident SBS Entity intends both to rely on consents as a basis for its certification and opinion of counsel and to delay the submission of the certification and opinion of counsel in reliance on proposed Rule 15Fb2-1(d)(2), should the nonresident SBS Entity be allowed to operate without consents in place until it provides the certification and opinion of counsel rather than when it is conditionally registered as contemplated by the proposed amendments?

e. If relying on consents as a basis for the certification and opinion of counsel, should a nonresident SBS Entity be required to notify the Commission, as well as make and keep current books and records to reflect these consents and whether a consent is later withdrawn?

f. Should nonresident SBS Entities obtain consents every time they enter into a new transaction with a counterparty or should a global consent in a master agreement be sufficient?

g. Is the consent mechanism a feasible long term solution for providing the Commission with direct access to an SBS Entity's books and records and submitting to onsite inspections and examinations? If not, what are the legal and regulatory challenges for a nonresident SBS Entity seeking to rely on consents? For example, how would nonresident SBS Entities subject to the European Union General Data Protection Regulation ("GDPR") plan to address guidance that, due to the nature of the relationship between employees and employers, employee consent may not be considered to be freely given under the GDPR,[222] and that consent might prove not to be a feasible long term solution for transfers to third countries under the GDPR?[223] Are there any other factors that should be considered such as, for example, the jurisdiction and the type of law at issue (e.g., privacy, secrecy, blocking statute, etc.)?

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222 See Article 29 Working Party, Guidelines on consent under Regulation 2016/679 (adopted Apr. 10, 2018), available at http://ec.europa.eu/newsroom/article29/item-detail.cfm?item_id=623051.

223 See European Data Protection Board, Guidelines 2/2018 on derogations of Article 49 under Regulation 2016/679 (adopted May 25, 2018), available at https://edpb.europa.eu/sites/edpb/files/files/file1/edpb_guidelines_2_2018_derogations_en.pdf.

4. Open Contracts

a. Would the guidance adequately address the concerns raised by commenters? Is the date on which a nonresident SBS Entity submits a registration the appropriate point from which to apply the certification and opinion of counsel requirement?

b. Should nonresident SBS Entities nonetheless be required to provide Commission staff with aggregated information, such as the number of open contracts, the total dollar value of open contracts, or percentage of open contracts for which it may have or lack consent to provide information to regulators?

c. Should the proposed guidance also exclude contracts open on the date a nonresident SBS Entity submits a registration where there is no renegotiation of terms and the position is simply serviced until it rolls off the firm's books and records? If so, why? Would that impair the Commission's ability to adequately regulate nonresident SBS Entities?

5. Reliance on Commission Arrangements with Foreign Regulatory Authorities

a. Does the guidance adequately address the concerns that have been raised in this regard? If not, why not and what additional guidance is needed?

b. Should arrangements with foreign regulatory authorities contain any special language or terms to assure that Commission staff has direct access to a nonresident SBS Entity's books and records and the ability to conduct onsite inspections or examinations?

c. Are there situations in which multiple foreign regulatory authorities would enter into an MOU or other arrangement?

6. Proposed Amendment to Rule 15Fb2-1 Related to the Timing of Certification and Opinion of Counsel Required by Rule 15Fb2-4(c)(1)

a. Does 24 months from the compliance date for Rule 15Fb2-1 provide an appropriate time period to allow a nonresident SBS Entity to submit the required certification and opinion of counsel? Should the Commission shorten the time period? Should the Commission extend the time period? Should the Commission provide for a process by which an applicant can submit a request for an extension of time? For example, where good cause is shown, should the Commission or its staff be able to extend the time period upon request by a nonresident firm?

b. How would the 24 month period facilitate the ability of a nonresident SBS entity to submit the required certification and opinion of counsel when foreign blocking laws, privacy laws, secrecy laws and other foreign legal barriers exist in the jurisdiction where the offices of the nonresident SBS Entity are located? Are there circumstances other than those contemplated in Section IV under which a nonresident SBS Entity would be unable to submit the required certification and opinion of counsel? If so, would the 24 month period address such circumstances?

c. Proposed Rule 15Fb2-1(e)(2) provides that if an nonresident applicant is unable to provide the certification and opinion of counsel as required by Rule 15Fb2-4(c)(1) within the 24 month time period, the Commission may institute proceedings to determine

whether ongoing registration should be denied. Should the Commission adopt a different approach in cases where a nonresident application fails to provide the certification or opinion of counsel within the 24 month time period? If so, please explain why and provide a description of the approach. For example, should the Commission consider the application incomplete if the nonresident applicant is unable to provide the required certification and opinion of counsel within the 24 month time period, thereby automatically terminating the applicant's conditional registration and eliminating the need for the Commission to institute proceedings to determine whether the application should be denied? In the alternative, should the Commission require nonresident applicants to certify that if they do not provide the certification and opinion of counsel within the 24 month period, they will withdraw from registration and cease any security-based swap dealing activities that otherwise would require registration within a specified period after the 24 month period expires?[224] If so, what period would be reasonable?

d. Should SBS Entities that conditionally register without signing the Schedule F certification and providing an opinion of counsel be required to disclose to counterparties the risk that the Commission may institute proceedings to deny registration if the firm is, after 24 months, still unable to file with the Commission a complete Schedule F certification and opinion of counsel? Should the Commission impose any additional requirements on nonresident SBS Entities that are conditionally registered pursuant to proposed Rule 15Fb2-1(d)(2)? If so, which requirements and why?

e. Alternatively, should the Commission eliminate the certification and opinion of counsel requirements and instead rely solely on the underlying obligations of the registered nonresident SBS Entity to comply with all applicable regulatory requirements? Why or why not?

f. As an another alternative, should the Commission publish a list of nonresident SBS Entities registered with it on the Commission's public website and note the conditional registration status of any nonresident SBS Entities that have not yet provided a Schedule F certification and opinion of counsel? Why or why not? Would provision of this type of information be beneficial to counterparties?

V. Proposed Amendment to Commission Rule of Practice 194

A. Overview of Proposed Rule of Practice 194(c)(2)

In furtherance of the goal of more closely harmonizing Commission rules with the approach followed under the CFTC regime, and based on renewed concerns raised by certain

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224 In other contexts, the Commission has permitted the registration of a person that was not immediately eligible to register as an investment adviser, subject to an undertaking that the person will withdraw from registration if it did not meet the registration requirements within a specified period of time. See Rule 203A-2(c) under the Investment Advisers Act of 1940.

market participants,[225] the Commission is proposing new paragraph (c)(2) of Rule of Practice 194.[226] Proposed paragraph (c)(2) would provide an exclusion from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act for an SBS Entity with respect to an associated person who is a natural person who (i) is not a U.S. person[227] and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch[228] of a counterparty that is a U.S. person.[229]

However, an SBS Entity would not be able to avail itself of this exclusion if the associated person of that SBS Entity is currently subject to any order described in subparagraphs (A) and (B) of Section 3(a)(39) of the Exchange Act, with the limitation that an order by a foreign financial regulatory authority[230] as provided in subparagraphs (B)(i) and (B)(iii) of Section 3(a)(39) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located. By way of example, the

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225 See note 243, supra.

226 As discussed above, Exchange Act Section 15F(b)(6) provides that the Commission may establish exceptions to its statutory prohibition by "rule, regulation, or order." 15 U.S.C. 78o-10(b)(6). In addition, Exchange Act Section 15F(b)(4) provides the Commission with authority (other than certain inapplicable exceptions specified in Exchange Act Section 15F(b)(4)(d) and (e)) to "prescribe rules applicable to security-based swap dealers and major security-based swap participants." 15 U.S.C. 78o-10(b)(4).

227 The term "U.S. Person" is defined in Exchange Act Rule 3a71-3(a)(4). See 17 CFR 240.3a71-3(a)(4).

228 The term "transaction conducted through a foreign branch" is defined in Exchange Act Rule 3a71-3(a)(3). See 17 CFR 240.3a71-3(a)(3).

229 This relief, however, is not relevant to an associated person effecting or involved in effecting security-based swaps, to the extent that such person's "functions are solely clerical or ministerial," given that such persons are excluded from the definition of associated person under to 15 U.S.C. 78c(a)(70)(B) and, therefore, not subject to the prohibition in Section 15F(b)(6).

230 See 15 U.S.C. 78c(a)(52) (defining the term "foreign financial regulatory authority" to include, among other regulatory authorities, "foreign securities authorities" as defined in Exchange Act Section 3(a)(50) (15 U.S.C. 78c(a)(50)).

limitation concerning an associated person of an SBS Entity who is currently subject to an order described in subparagraphs (A) and (B) of Exchange Act Section 3(a)(39) would include, among other things, situations where the associated person of an SBS Entity has been barred or suspended from being associated with a member of an SRO[231] or is subject to an order by the Commission barring or suspending such person from being associated with certain regulated entities, including, but not limited to, SBS Entities and broker-dealers.[232] As discussed further below, this provision is meant to address situations where the Commission, CFTC, a SRO (e.g., FINRA), a registered futures association (the National Futures Association, "NFA"),[233] or a foreign financial regulatory authority has affirmatively made a determination to not allow an associated person to participate in, for example, the security-based swap market, some other sector of the U.S. securities markets (e.g., as broker-dealers or as investment advisers), some other sector of the U.S. financial market (e.g., the U.S. swap market) or some sector of the foreign financial markets.

Additionally, the exclusion would only apply to associated persons who are natural persons, as the Commission has separately within Rule of Practice 194 provided an exclusion for an SBS Entity from the prohibition in Exchange Act Section 15F(b)(6) with respect to all associated person entities—regardless of whether the associated person entity is located within or outside of the U.S.[234]

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231 See 15 U.S.C. 78c(a)(26) (defining the term "self-regulatory organization").

232 See, e.g., 15 U.S.C. 78c(a)(39)(A) and (B)(i)(II).

233 See 7 U.S.C. 21.

234 See 17 CFR 240.194(c); see also part I.C.3, supra (discussing the Rule of Practice 194 Adopting Release, 84 FR at 4906).

B. Comments Received Requesting that the Commission Provide Relief

Both before and after the Commission adopted its SBS Entity registration rules, commenters requested that the Commission provide an exclusion from or, in the alternative, narrow the scope of, the prohibition in Exchange Act Section 15F(b)(6) with respect to associated persons of SBS Entities who are not U.S. persons and who do not interact with U.S. persons.[235]

For example, in connection with the Commission proposing registration requirements for SBS Entities, a commenter stated that it was concerned that the statutory disqualification requirements in Exchange Act Section 15F(b)(6) would apply to a foreign registered SBS Entity on an entity-level, as opposed to as a transaction-level requirement, without regard to the identity of the counterparty and, therefore, would be applicable to all associated persons of the foreign registered SBS Entity that effect or are involved in effecting security-based swap transactions.[236] The commenter noted that this would result in situations where non-U.S. associated persons of non-U.S. SBS Entities who do not interact with U.S. customers would be subject to the statutory disqualification requirements in Exchange Act Rule 15Fb6-2(b) and, as a result, non-U.S. associated persons of non-U.S. SBS Entities would be required to submit to U.S. background checks for statutory disqualification purposes.[237] In support of the commenter's request that the Commission re-categorize the statutory disqualification requirements as a transaction-level requirement, the commenter noted that the Commission's current approach diverges from that

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235 See, e.g., Letter from IIB, dated Aug. 21, 2013 ("IIB 8/21/13 Letter") at 20, available at https://www.sec.gov/comments/s7-02-13/s70213-46.pdf; see also IIB/SIFMA 6/21/18 Letter at 2, 4, available at https://www.sec.gov/comments/s7-05-14/s70514-3938974-167037.pdf; IIB/SIFMA 8/26/16 Letter, at 3-5; Letter from SIFMA, dated Dec. 16, 2011 ("SIFMA 12/16/11 Letter") at 8, available at https://www.sec.gov/comments/s7-40-11/s74011-4.pdf.

236 See Registration Adopting Release, 80 FR at 48977 nn.109-11 (citing IIB 8/21/13 Letter at 20).

237 See IIB 8/21/13 Letter at 20.

adopted by the CFTC,[238] as well as the Commission's treatment of "foreign associated persons" of foreign broker-dealers.[239] The commenter also stated that a transaction-level approach would preserve the Commission's resources to better serve customer protection interests within the United States, and that the Commission's interests in protecting foreign customers are limited, while "foreign regulators have a strong interest in regulating such activity."[240] Finally, the commenter opined that limiting background checks to personnel interacting with U.S. persons would also help eliminate potential conflicts with local privacy laws, which in some cases may prohibit background checks for foreign employees.[241]

In response to the commenter, the Commission explained that the requirements in Rule 15Fb6-2(b) regarding questionnaires or applications and background checks are important elements of each SBS Entity's determination with respect to whether its associated persons that effect or are involved in effecting security-based swap transactions are subject to statutory disqualifications. The Commission also stated that it was not convinced, at the time, of the need or basis to provide an exclusion for SBS Entities from the statutory disqualification requirements with respect to certain of their associated persons, and made a determination to treat the statutory disqualification requirements as entity-level requirements, as opposed to a transaction-level

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238 See id. at 20 (noting that the CFTC does not apply its statutory disqualification requirements to associated persons of its registrants who engage in activity outside the United States and limit such activity to customers located outside the United States).

239 See id. (citing Rule 15a-6(b)(2) and stating that the Commission, in that rule, limited the definition of "foreign associated person" to those associated persons of a foreign broker or dealer who participate in the solicitation of certain U.S. investors).

240 Id.

241 See id.

requirement, applicable to all associated persons of the registered foreign SBS Entity that effect or are involved in effecting security-based swap transactions.[242]

More recently, market participants have raised the same concerns expressed in the comment letters outlined above.[243] For example, commenters have argued that, because most of the CFTC's rules have been in effect for several years, greater harmonization would "help facilitate prompt implementation of the Commission's Title VII regime with minimal disruption to the SBS market and robust protections and lower costs for investors and other end-users."[244] Relatedly, the Commission also received comments requesting that the Commission harmonize aspects of its Rule 15Fb6-2(b) with the CFTC's regulations or allow for substituted compliance.[245] As discussed above, Rule 15Fb6-2(b) requires an SBS Entity to obtain a questionnaire or application for employment—documents that are required under paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5—which would serve as a basis for a background check to verify that an associated person is not subject to statutory disqualification. However, as discussed below in Section VI.A., the proposed modification to proposed Rule 18a-5 would provide that a stand-alone or bank SBS Entity is not required to make and keep current a questionnaire or application for employment executed by an associated person if the SBS Entity is excluded from the statutory disqualification prohibition in Exchange Act Section 15F(b)(6)

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242 See Registration Adopting Release, 80 FR at 48978.

243 See, e.g., note 28, supra.

244 IIB/SIFMA 6/21/18 Letter at 1.

245 See IIB/SIFMA 8/26/16 Letter, at 3-5 (requesting that the Commission exclude associated persons employed or located in a non-U.S. branch or office of an SBS Entity or an affiliate from the requirement in Rule 15Fb6-2(b) to prepare and maintain a questionnaire or application for employment executed by such associated person where certain conditions are met, including that the associated person does not effect and is not involved in effecting security-based swaps with U.S. counterparties on behalf of the SBS Entity); see also IIB/SIFMA 6/21/18 Letter, at 2.

with respect to such associated person (e.g., the exclusion from the statutory disqualification prohibition in Section 15F(b)(6) provided by proposed Commission Rule of Practice 194(c)(2)).

C. Proposed Rule of Practice 194(c)(2)

Proposed Rule of Practice 194(c)(2) would more closely harmonize the Commission's rules with the CFTC's approach to statutory disqualification as it applies to the activities of non-domestic associated persons of CFTC registered Swap Entities. Under CEA Section 4s(b)(6), which parallels Exchange Act Section 15F(b)(6), and CFTC staff's related guidance[246] Swap Entities are not required to comply with the prohibition in CFTC Regulation 23.22(b) with respect to non-domestic associated persons who deal only with non-domestic swap counterparties.[247] Absent such relief, a Swap Entity would be subject to the prohibition in CFTC Regulation 23.22(b) even with respect to an associated person who engages in activity from a location outside the United States and even when such person limits their activity to counterparties located outside the United States.[248]

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246 Under the CFTC's and the NFA's current process for granting relief from CEA Section 4s(b)(6)—which is available through no-action relief granted by CFTC staff with respect to persons that are not exempt from Section 4s(b)(6) pursuant to CFTC Regulation 23.22(b)—a swap entity may make an application to the NFA, the sole registered futures association, to permit an associated person of a Swap Entity subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the swap entity. See CFTC Letter No. 12–15, at 5–8 (Oct. 11, 2012), available at http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-15.pdf.

247 See CFTC Letter No. 12-43 (Dec. 7, 2012) at 2-4, available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/12-43.pdf. Specifically, CFTC staff stated in the letter, in relevant part, that staff's no-action position was limited to associated persons who effect or are involved in effecting swaps from a location outside of the United States, its territories or possessions, and limit such activities to counterparties located outside the United States, its territories or possessions. CFTC staff also noted that the no-action positions provided in this letter represent the positions of CFTC staff only, and do not necessarily represent the positions of the CFTC or its Commissioners.

248 See id. at 4.

In proposing Rule of Practice 194(c)(2), the Commission is seeking to balance harmonization with the approach to regulating the activities that non-domestic associated persons of Swap Entities engage in under the CFTC regime and the attendant benefits and cost savings against the potential effect of certain risks, including financial, counterparty, compliance, and reputational risks of having statutorily disqualified associated persons effecting or involved in effecting security-based swap transactions for registered SBS Entities.

Given the high degree of integration between the swap and security-based swap markets,[249] more closely aligning with the existing baseline for disqualification of swap dealer personnel could result in certain benefits, such as reducing regulatory complexity and lessening costs on market participants that are dually-registered as Swap Entities with the CFTC. For example, as a result of the proposed exclusion, SBS Entities dually-registered as Swap Entities with the CFTC could experience economies of scope in employing non-U.S. natural persons in their swap and security-based swap businesses.[250] As discussed in the Rule of Practice 194 Adopting Release, the Commission estimates that approximately 46 out of 50 entities likely to register with the Commission as security-based swap dealers are already registered with the CFTC as swap dealers.[251] The proposed exclusion should, at least to some extent, reduce the likelihood of security-based swap dealers exiting the security-based swap business and, as a result, not registering with the Commission, which could affect competition in the provision of security-based swap dealing services.

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249 See part VII.D, infra (noting that the swap and security-based swap markets involve largely the same group of dealers and most of the same counterparties).

250 See part VII.D.1, infra.

251 See Rule of Practice 194 Adopting Release, 84 FR at 4935-36 (discussing the economic baseline for Rule of Practice 194 and stating that approximately 46 out of 50 entities likely to register with the Commission as security-based swap dealers are already registered with the CFTC as swap dealers).

Absent the proposed exclusion, SBS Entities would be unable to have an associated person subject to a statutory disqualification, who would be permitted to effect certain swap transactions under the CFTC's approach, also effect security-based swap transactions, unless the SBS Entity obtained relief from the Commission under Rule of Practice 194. This difference between the CFTC's approach and the Commission's rules would result in costs related to replacing or reassigning statutorily disqualified associated non-U.S. persons or applying to the Commission for relief. In addition, this difference could disrupt existing counterparty relationships across closely linked swap and security-based swap markets. However, under the proposed exclusion, non-U.S. person counterparties of SBS Entities would be able to continue interacting with the same non-U.S. associated persons of the same SBS Entities across interconnected markets without delays related to Commission review under Rule of Practice 194. As noted above, this may result in lower transaction costs for SBS Entities that, in turn, may flow to both their U.S. and non-U.S. person counterparties.

This proposal is consistent with exceptions the Commission provided in its business conduct rules for SBS Entities.[252] The Commission also notes that, in adopting the definition of "U.S. business"—which does not include transactions conducted through a foreign branch of a U.S. person[253]—the Commission stated that it is concerned principally with those transactions that appear particularly likely to affect the integrity of the security-based swap market in the United States and the U.S. financial markets more generally or that raise concerns about the

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252 Under Exchange Act Rule 3a71–3(c), a registered security-based swap dealer, with respect to its "foreign business" (as that term is defined in Rule 3a71–3(a)(9)), shall not be subject to requirements of the Commission's business conduct rules—other than the supervision requirements pursuant to Exchange Act Section 15F(h)(1)(B). See also Exchange Act Rule 3a67-10(d) (providing an analogous exclusion for registered U.S. major security-based swap participants).

253 See 17 CFR 3a71–3(a)(8)(i)-(ii).

protection of participants in those markets.[254] The Commission explained that this exception reflected its view at the time that transactions between the foreign branch of a U.S. person and a non-U.S. person, in which the personnel arranging, negotiating, and executing the transaction are all located outside the United States, are less likely to affect the integrity of the U.S. market and reflects the Commission's consideration of the role of foreign regulators in non-U.S. markets.[255] As the Commission has explained previously, the Dodd-Frank Act generally is concerned with the protection of U.S. markets and participants in those markets.[256]

The proposed amendment would exclude, subject to certain limitations, SBS Entities from the statutory disqualification prohibition in Exchange Act Section 15F(b)(6) with respect to their associated natural persons who (i) are not U.S. persons and (ii) do not effect and are not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person.

As the Commission discussed in the Rule of Practice 194 Adopting Release,[257] and in part VII.D.2 of the Economic Analysis below, the Commission appreciates that there is a dearth of research on the economic effect of statutory disqualification in derivatives markets, and the broader economic research on other markets is somewhat ambiguous. Nevertheless, some research suggests that increasing the ability of a statutorily disqualified person to continue to effect or be involved in effecting transactions on behalf of a registered SBS Entities may give

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254 See "Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants," Exchange Act Release No. 77617, (Apr. 14, 2016) 81 FR 29960, 30065 (May 13, 2016) ("Business Conduct Adopting Release").

255 See id. at 30065-66, n.1330 (citing the Cross-Border Proposing Release, 78 FR at 31017).

256 See id. at 30065.

257 See Rule of Practice 194 Adopting Release, 84 FR at 4941.

rise to higher compliance and counterparty risks, may increase adverse selection costs,[258] and may reduce competition among higher quality associated persons.[259] On the other hand, some research suggests that greater flexibility in employing disqualified persons may actually increase competition among SBS Entities and their associated persons and benefit counterparties.[260]

The Commission also notes that the scope of conduct that gives rise to disqualification is broad and includes conduct that may not pose ongoing risks to counterparties.[261] In addition, because the overwhelming majority of dealers and most counterparties transact across both swap and security-based swap markets, differential regulatory treatment of disqualification in swap and security-based swap markets may increase costs of intermediating transactions for some SBS Entities, which may be passed along to counterparties in the form of higher transaction costs, and may disrupt existing counterparty relationships.[262]

The potential for increased risk may be mitigated by other factors. For example, the proposed exclusion would not limit or otherwise affect the Commission's existing authority to institute proceedings under Exchange Act Section 15F(l)(3) to censure, place limitations on the activities or functions of such person, or suspend for a period not exceeding 12 months, or bar such person from being associated with an SBS Entity. [263] In addition, SBS Entities may choose

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258 See note 477, infra (noting that, with respect to a problem commonly known as adverse selection, when information about counterparty quality is scarce, market participants may be less willing to enter into transactions and the overall level of trading may fall).

259 See part VII.D, infra.

260 See id.; see also Jonathan Berk & Jules H. van Binsbergen, "Regulation of Charlatans in High-Skill Professions" (Stanford University Graduate School of Business, Research Paper No. 17-43, 2017), available at https://ssrn.com/abstract=2979134.

261 See id.

262 See id.

263 See 15 U.S.C. 78o-10(l)(3); see also 15 U.S.C. 78u–3 (authorizing cease-and-desist proceedings by the Commission). Accord Rule of Practice 194 Adopting Release, 84 FR at 4912 n.72 (discussing the same statutory authority).

not to use this proposed exclusion if the reputational and compliance risks associated with hiring and retaining statutorily disqualified persons may outweigh the costs SBS Entities may face if they decide to fire or replace statutorily disqualified persons who may otherwise have valuable skills, expertise, or counterparty relationships.[264] Furthermore, the security-based swap market is largely an institutional one,[265] and institutional counterparties (e.g., banks, pension funds and insurance companies) may be better able to mitigate or offset the potential for higher counterparty risks, including, by among other things, requesting, as a business practice, representations that the associated persons they deal with have not triggered an event giving rise to statutory disqualification.

Accordingly, the Commission is proposing an exclusion from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act for SBS Entities with respect to an associated person who is a natural person who: (i) is a not a U.S. person, and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person. The Commission also notes that, as discussed further below in Section VI.A., proposed modifications to proposed Rule 18a-5 would provide that a stand-alone or bank SBS Entity is not required to make and keep current a questionnaire or application for employment executed by an associated person if the SBS Entity is excluded from the statutory disqualification prohibition in Exchange Act Section 15F(b)(6)

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264 See part VII.D.1 and VII.D.2, infra.

265 See id. (citing the economic baseline in the Rule of Practice 194 Adopting Release, and noting that investment advisers, banks, pension funds, insurance companies, and ISDA-recognized dealers account for 99.8% of security-based swaps transaction activity).

with respect to such associated person (e.g., the exclusion proposed in Rule of Practice 194(c)(2)).

D. Limitation on Proposed Rule of Practice 194(c)(2)

The Commission also is proposing a limitation where an SBS Entity would not be able to avail itself of the exclusion from the prohibition in Exchange Act Section 15F(b)(6) as set forth in proposed paragraph (c)(2)—and would therefore need to use the process outlined in Rule of Practice 194 to seek relief from the statutory prohibition in Exchange Act Section 15F(b)(6).

Under the proposed limitation, an SBS Entity would not be able to avail itself of the exclusion if the associated person of that SBS Entity is currently subject to an order that prohibits such person from participating in the U.S. financial market, including the U.S. securities or swap market, or foreign financial markets. More specifically, an SBS Entity would not be able to avail itself of the exclusion from the prohibition in Exchange Act Section 15F(b)(6) set forth in proposed paragraph (c)(2) with respect to an associated person if that associated person is currently subject to an order described in subparagraphs (A) and (B) of Section 3(a)(39) of the Exchange Act, with the limitation that an order by a foreign financial regulatory authority described in subparagraphs (B)(i) and (B)(iii) of Section 3(a)(39) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located. For example, this would include current orders, which are still in effect, from the Commission, the CFTC, an SRO (e.g., FINRA), a registered futures association (e.g., the NFA), or a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located (e.g., the Financial Conduct Authority), that suspends or bars such person from being associated with any entity regulated by such authorities or otherwise places

limitations on the activities or functions of the associated person.[266] As another example, the exclusion from the prohibition in Exchange Act Section 15F(b)(6) would also not be available in cases where the CFTC, an SRO, a registered futures association, or a foreign financial regulatory authority where the associated person is employed or located has, as applicable, issued an order that that denies, revokes, cancels, suspends the membership, association, registration or listing as a principal with respect to the associated person.[267] In these circumstances, for example, the Commission, the CFTC, an SRO, a registered futures association or a foreign financial regulatory authority will have affirmatively made a determination to not allow an associated person to participate in the U.S. securities markets generally (e.g., as an associated person of a broker-dealer or investment adviser), some other sector of the U.S. financial market (e.g., the U.S. swap market), or some sector of the foreign financial markets. The Commission preliminarily believes that an SBS Entity should not be able to avail itself of the exclusion in proposed paragraph (c)(2) with respect to such associated persons given this prior determination by the relevant regulatory authorities.

E. Solicitation of Comments Regarding Proposed Amendment to Commission Rule of Practice 194

The Commission is requesting comment regarding all aspects of proposed paragraph (c)(2) of Rule of Practice 194, including any of the potential benefits, risks and costs outlined

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266 By way of example, Exchange Act Section 15F(l)(3) provides the Commission with authority to institute proceedings under to censure, place limitations on the activities or functions of such person, or suspend for a period not exceeding 12 months, or bar such person from being associated with an SBS Entity. See 15 U.S.C. 78o-10(l)(3).

267 For example, under Exchange Act Section 15A(g)(2), 15 U.S.C. 78o-3(g)(2), where it is necessary or appropriate in the public interest or for the protection of investors, the Commission may, by order, direct the SRO to deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification. Section 17(h) of the CEA provides for the CFTC to review certain NFA decisions, including the NFA's disciplinary actions and member responsibility actions, as do the CFTC's Part 171 Rules, 17 C.F.R. §§ 171.1-171.50.

above or in the Economic Analysis below, as well as any concerns, including investor protection concerns. The Commission also seeks comment on the specific questions below. The Commission particularly requests comment from entities that intend to register as SBS Entities and that anticipate making an application under proposed Rule of Practice 194, as well as counterparties to such SBS Entities. This information will help inform the Commission's consideration of proposed paragraph (c)(2) of Rule of Practice 194.

1. Are there other potential benefits to the exclusion provided in proposed Rule of Practice 194(c)(2) that are not outlined in the proposal? Are there other potential risks or costs to this proposed exclusion that are not outlined in the proposal? Does the exclusion provided in proposed Rule of Practice 194(c)(2) appropriately consider the potential benefits, risks and costs? In each instance, please explain why or why not.
2. Proposed Rule of Practice 194(c)(2) would apply to all SBS Entities, whether U.S. persons or nonresident SBS Entities. Do commenters agree with this approach? Why or why not?
3. Proposed Rule of Practice 194(c)(2) would apply to an associated person who is a natural person who (i) is not a U.S. person and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person. Do commenters agree with this approach? Why or why not?
4. Under Proposed Rule of Practice 194(c)(2), an SBS Entity would not be able to avail itself of the exclusion if the following limitation applies: if the associated person of that SBS Entity is currently subject to an order described in subparagraphs (A) and (B) of Section 3(a)(39) of the Exchange Act, with the limitation that an order by a foreign financial regulatory authority described in subparagraphs (B)(i) or (B)(iii) of Section 3(a)(39) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located. Do commenters agree with these limitations? Why or why not? Should the Commission require any additional conditions or limitations to the proposal? If so, please explain what additional conditions or limitations should apply.
5. Are there any other categories of associated persons of an SBS Entity for which the Commission should provide an exclusion from the statutory prohibition in Exchange Act Section 15F(b)(6)? If so, please specify the category and the reasons for requesting the Commission to exclude that category of associated person from the statutory prohibition.
6. Would the exclusion from the statutory disqualification prohibition for certain foreign associated persons under the proposed approach differ materially from relief provided with respect to the corresponding prohibition under the CEA or rules and regulations

thereunder? If so, please describe any differences, including any compliance or other challenges posed by such differences.

7. As described above, in the Registration Adopting Release the Commission included an interpretation of the scope of the phrase "involved in effecting security-based swaps," as that phrase is used in Exchange Act Section 15F(b)(6).[268] Based on this interpretation, are there additional categories of non-U.S. associated persons of an SBS Entity that should be excluded from the statutory disqualification prohibition in Section 15F(b)(6)? If so, please describe the functions carried out by such non-U.S. associated persons of an SBS Entity and why you believe those functions do not present the types of concerns addressed by the prohibition on associating with a statutorily disqualified person.

VI. Proposed Modifications to Proposed Rule 18a-5

A. Proposed Rule

The Commission proposed recordkeeping, reporting, and notification requirements applicable to SBS Entities, securities count requirements applicable to certain SBS Entities, and additional recordkeeping requirements applicable to broker-dealers to account for their security-based swap and swap activities.[269] The proposed requirements were modeled on existing broker-dealer requirements.[270] The Commission received a number of comments in response to these proposals.[271] Separately, the Commission proposed rules governing the cross-border treatment

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268 See Registration Adopting Release, 80 FR at 48974, 48976. Specifically, the Commission stated that the term "involved in effecting security-based swaps" generally means engaged in functions necessary to facilitate the SBS Entity's security-based swap business, including, but not limited to the following activities: (1) drafting and negotiating master agreements and confirmations; (2) recommending security-based swap transactions to counterparties; (3) being involved in executing security-based swap transactions on a trading desk; (4) pricing security-based swap positions; (5) managing collateral for the SBS Entity; and (6) directly supervising persons engaged in the above-described activities. See id.

269 See Recordkeeping and Reporting Proposing Release.

270 See id. at 25196-97 (proving the rationale for modeling the proposed requirements on the relevant broker-dealer requirements).

271 The comment letters are available at https://www.sec.gov/comments/s7-05-14/s70514.shtml.

of recordkeeping and reporting requirements with respect to SBS Entities.[272] The Commission received comments to the cross-border proposals as well.[273]

In the Recordkeeping and Reporting Proposing Release, the Commission proposed new Exchange Act Rule 18a-5 (patterned after Exchange Act Rule 17a-3 - the recordkeeping rule for registered broker-dealers), to establish recordkeeping standards for stand-alone and bank SBS Entities.[274] As part of that rulemaking, the Commission proposed to require that a stand-alone or bank SBS Entity make and keep current a questionnaire or application for employment for each associated person who is a natural person and, in the case of bank SBS Entities, whose activities relate to the bank SBS Entity's business as an SBS Entity. The proposal required that the questionnaire or application for employment include an associated person's identifying information, business affiliations for the past ten years, relevant disciplinary history, relevant criminal record, and place of business, among other things.[275] The Commission also proposed a definition of the term associated person that would include persons associated with an SBS Entity as defined under Section 3(a)(70) of the Exchange Act.[276]

One commenter requested that the Commission modify the proposed rule for foreign SBS Entities so that the questionnaire requirement would not apply to associated persons who effect or are involved in effecting security-based swap transactions with non-U.S. persons or foreign branches.[277] In a subsequent letter, the commenter also requested that the proposal be modified

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272 See Cross-Border Proposing Release.

273 The comment letters are available at https://www.sec.gov/comments/s7-02-13/s70213.shtml.

274 See Recordkeeping and Reporting Proposing Release, 79 FR at 25205.

275 Paragraph (b)(8) of proposed Rule 18a-5.

276 Paragraph (c) of proposed Rule 18a-5.

277 See SIFMA 9/5/2014 Letter.

to exclude from the questionnaire requirement an associated person employed or located in a non-U.S. branch, office, or affiliate of the firm in circumstances where: (1) applicable non-U.S. law prohibits the firm from conducting background checks on the associated person and consent does not cure the prohibition or may not be a condition of employment; (2) the associated person is not subject to a statutory disqualification that the firm actually knows about; (3) the associated person does not effect and is not involved in effecting security-based swaps with U.S. counterparties on behalf of the firm; and (4) the associated person complies with applicable registration and licensing requirements in the jurisdiction(s) where he or she effects or is involved in effecting security-based swaps on behalf of the firm.[278] This commenter also suggested that the proposal be modified to permit an SBS Entity to use alternative measures to confirm that a non-resident associated person is not subject to a statutory disqualification in situations where (1) using a standard U.S. questionnaire or application and background check would conflict with local law or the associated person does not interact with U.S. counterparties, and (2) the associated person complies with applicable registration or licensing requirements in the jurisdictions where the associated person is located.[279]

The Commission preliminarily believes that it is appropriate to provide flexibility with respect to the questionnaire requirement as applied to associated persons of both stand-alone and bank SBS Entities. Thus, the Commission is proposing to add two sets of exemptions under new paragraphs (a)(10) and (b)(8) to proposed Rule 18a-5.

- The first exemption would provide that an SBS Entity need not make and keep current a questionnaire or application for employment with respect to any associated person if the SBS Entity is excluded from the prohibition in Exchange Act 15F(b)(6). This could include, for example, a situation in which the SBS Entity relies on the exclusion pursuant

278 See IIB/SIFMA 8/26/2016 Letter.

279 See IIB/SIFMA 6/21/2018 Letter.

to proposed Rule of Practice 194(c)(2) as discussed above with respect to a non-U.S. associated person who does not effect and is not involved in effecting security-based swap transactions with or for a counterparty that is a U.S. person, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person.

- The second exemption would provide that a questionnaire or application for employment executed by an associated person that is not a U.S. person need not include certain information if the receipt of that information, or the creation or maintenance of records reflecting that information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located. In accordance with Rule 15Fb6-2, this exemption would be available with respect to non-U.S. associated persons that effect or are involved in effecting security-based transactions on behalf of the SBS Entity with counterparties that are U.S. persons, as well as counterparties that are not.

1. Exemption Based on the Exclusion from the Prohibition under Section 15F(b)(6)

The Commission is proposing to add new paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) to proposed Rule 18a-5. As discussed above, the questionnaire requirement is intended to serve as a basis for a background check of the associated person to verify that the person is not subject to statutory disqualification under Section 15(b)(6), and so to support the certification required under Rule 15Fb6-2(b). These new paragraphs would provide that a stand-alone or bank SBS Entity is not required to make and keep current a questionnaire or application for employment with respect to an associated person if the stand-alone or bank SBS Entity is excluded from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to that associated person. The proposed modifications would complement the Commission's proposal, discussed above in Section V.C., to amend Rule of Practice 194 to provide an exclusion from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to an associated person who is not a U.S. person and does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person, subject to certain conditions. Given that the proposed amendment to Rule of Practice 194 would allow an SBS

Entity to exclude such associated persons when making the certification required by Rule 15Fb6-2(a), the Commission preliminarily believes that it is unnecessary to require that the SBS Entity make and keep current the questionnaire or application for employment contemplated by proposed paragraphs 18a-5(a)(10)(i) and (b)(8)(i) with respect to those associated persons. Thus, under proposed Rule 18a-5 paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A), an SBS Entity generally would not be required to obtain the questionnaire or application for employment, otherwise required by proposed Rule 18a-5, with respect to any associated person who is not a U.S. person and who does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person). More broadly, proposed new paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) would provide that an SBS Entity need not make and keep current a questionnaire or application for employment with respect to any associated person if the SBS Entity is excluded from the prohibition in Exchange Act 15F(b)(6) with respect to that associated person.

2. Exemption Based on Local Law

The Commission also is proposing to add new paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to proposed Rule 18a-5 to address situations where the law of a non-U.S. jurisdiction in which an associated person is employed or located may prohibit a stand-alone or bank SBS Entity from receiving, creating or maintaining a record of any of the information mandated by the questionnaire requirement. Specifically, the provisions would apply to an associated person who is not a U.S. person (as defined in Exchange Act Rule 3a71-

3(a)(4)(i)(A)),[280] and would be available, in accordance with Rule 15Fb6-2, to non-U.S. associated persons who effect or are involved in effecting security-based swaps transactions on behalf of an SBS Entity. Paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to proposed Rule 18a-5 would permit the exclusion of certain information mandated by the questionnaire requirement with respect to those associated persons if the receipt of that information, or the creation or maintenance of records reflecting such information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located. Rather than fully excluding these associated persons from the questionnaire requirement, the provisions would provide that the stand-alone or bank SBS Entity need not record information mandated by the questionnaire requirement with respect to such associated persons if the receipt of that information, or the creation or maintenance of records reflecting such information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.[281]

This proposed change is designed to address commenters' concerns, and would provide SBS Entities with flexibility to not record information that might result in a violation of the law in the jurisdiction in which the associated person is employed or located, while continuing to require that they record information not restricted by the law in that jurisdiction. SBS Entities should still make and keep current information included in the questionnaire or application requirement that would not result in a violation of local law. In addition, if an SBS Entity would

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280 Exchange Act Rule 3a71-3(a)(4)(i)(A) defines the term U.S. person to mean, with respect to natural persons, "a natural person resident in the United States."

281 To the extent an nonresident SBS Entity is able to rely on either paragraph (a)(10)(iii)(A) or (b)(8)(iii)(A) with respect to a particular associated person, the firm would not need to also rely on the relief provided under (a)(10)(iii)(B) or (b)(8)(iii)(B) because the firm would be exempt from the questionnaire requirement with respect to that associated person.

be able to obtain the information required by the questionnaire or application requirement if it obtained the consent of the associated person, the SBS Entity generally should try to obtain such consent before relying on new paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B).[282]

As noted above, the questionnaire serves as a basis for a background check of the associated person to verify that the person is not subject to a statutory disqualification, which in turn supports the substantive prohibition in Section 15F(b)(6) of the Exchange Act and the related certification and background check requirements in Rule 15Fb6-2.[283] The Commission recognizes that there may be various means by which an SBS Entity could meet its obligations under Section 15F(b)(6) of the Exchange Act and Rule 15Fb6-2. In the release adopting Rule 15Fb6-2, the Commission did not prescribe a particular means by which an SBS Entity must conduct the required background check.[284] Rather, the Commission indicated that whatever steps are taken, the SBS Entity must have sufficient comfort to be able to comply with Section 15F(b)(6) of the Exchange Act, and make the certification required by Rule 15Fb6-2.[285] While an SBS Entity may be prohibited by local laws from obtaining certain information from an associated person, the SBS Entity may still be able to review public records (in foreign jurisdictions or in the U.S.) or take other steps to help provide it with sufficient comfort to

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282 However, we recognize that there may be other issues raised with respect to consents. See part IV.A.2, supra.

283 See 17 CFR 240.15Fb6-2(b); see also "Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants," 76 FR 65784 (Oct. 24, 2011), and the discussion regarding proposed Rule 15Fb6-1(b) at 65796. Proposed paragraph 15Fb6-1(b) was not adopted because it was duplicative of the requirement in the Recordkeeping and Reporting Proposing release. Specifically, the Commission stated in the Registration Adopting Release, "We do not believe that it would be efficient or necessary to repeat the same requirement for obtaining such questionnaires or applications in two separate Commission rules." See Registration Adopting Release, 80 FR at 48978.

284 See id. at 48977.

285 17 CFR 240.15Fb6-2.

comply with Section 15F(b)(6). The Commission emphasizes that every SBS Entity must still comply with Section 15F(b)(6) of the Exchange Act and Rule 15Fb6-2 with respect to every associated person that is not subject to an exclusion from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act.

B. Solicitation of Comments Regarding Proposed Modifications to Proposed Rule 18a-5

The Commission requests comment on all aspects of these proposed modifications to proposed Rule 18a-5 and the guidance described above.

1. Will the proposed modifications adequately address the concerns raised by the commenter? If not, why not, and what further modifications should the Commission make?
2. Are there processes that foreign regulators use in lieu of employing an equivalent to the questionnaire requirement? If so, please cite examples.
3. What information do entities that may seek to register as SBS Entities currently collect regarding their employees as part of their normal operations for various purposes (e.g., to pay employees, to pay taxes, to provide employees with other benefits, and to know what functions each employee performs and who supervises them)?
4. Section 15F(b)(6) generally makes it illegal to permit a person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of an SBS Entity if the SBS Entity "knew, or in the exercise of reasonable care should have known" of the statutory disqualification. Should the Commission provide guidance on the minimum level of due diligence in which an SBS Entity must engage to satisfy that "reasonable care" standard in the event that the receipt of information, or the creation or maintenance of records reflecting information that would otherwise be required under Rule 18a-5, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located? If so, what guidance should the Commission provide, and why?
5. Would the laws in jurisdictions other than the jurisdiction where an associated person is employed or located limit an SBS Entity's ability to make and retain information contained in the questionnaire or application for employment? If so, should proposed paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) be modified to instead focus on the laws of other jurisdictions? For instance, should these paragraphs instead focus on the law of the jurisdiction in which an SBS Entity is incorporated, or where the SBS Entity maintains its books and records? Why or why not? Or, should these proposed paragraphs be expanded to include other jurisdictions? Why or why not? Alternatively, should the rule be more narrowly focused on either where the associated person is "employed" or where the associated person is "located?" If so, why should one be used and the other excluded?

6. What role would consents play in terms of nonresident SBS Entities' ability to meet the questionnaire requirement?
7. Will the proposed addition of new paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) adequately address the concerns raised by the commenter by providing, as proposed, that a stand-alone or bank SBS Entity is not required to make and keep current a questionnaire or application for employment executed by an associated person if they are excluded from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to that associated person. If not, why not, and what further changes should the Commission make?

VII. Economic Analysis

The Commission is mindful of the economic effects, including the costs and benefits, of the proposed amendments and guidance. Section 3(f) of the Exchange Act provides that whenever the Commission is engaged in rulemaking pursuant to the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. [286] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition. [287] Exchange Act Section 23(a)(2) also provides that the Commission shall not adopt any rule which would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The analysis below addresses the likely economic effects of the proposed amendments and interpretive guidance, including the anticipated and estimated benefits and costs of the amendments and interpretive guidance and their likely effects on efficiency, competition, and capital formation. The Commission also discusses the potential economic effects of certain alternatives to the approaches taken in this proposal. Many of the benefits and costs discussed

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286 See 15 U.S.C. 78c(f).

287 See 15 U.S.C. 78w(a)(2).

below are difficult to quantify. For example, the Commission cannot quantify the costs that potentially could result from competitive disparities associated with either proposed Alternative 1 or proposed Alternative 2 to the exception to Rule 3a71-3 because these costs will depend, in part, on foreign regulatory requirements applicable to non-U.S. entities. This is because the extent to which a non-U.S. entity would need to develop or modify systems to allow it and its majority-owned affiliate to meet the conditions of the proposed exception likely depends on the extent to which the non-U.S. entity's local regulatory obligations differ from analogous conditions of the proposed exception. These potential costs could also depend on the business decisions of non-U.S. persons that may avail themselves of the proposed exception. Furthermore, the likelihood of a non-U.S. entity availing itself of the proposed exception under either alternative depends on whether the non-U.S. entity is regulated in a listed jurisdiction, a determination that, in turn, depends on the foreign regulatory regime. Also, in connection with the proposed amendments to Commission Rule of Practice 194, the Commission has no data or information allowing us to quantify the number of disqualified non-U.S. employees transacting with foreign counterparties or foreign branches of U.S. counterparties on behalf of U.S. and non-U.S. SBS Entities; the direct costs of relocating disqualified U.S. personnel outside of the United States for U.S. and non-U.S. SBS Entities; or reputational and compliance costs of U.S. and non-U.S. SBS Entities from continuing to transact through disqualified non-U.S. associated persons with foreign counterparties and foreign branches of U.S. counterparties. Therefore, while the Commission has attempted to quantify economic effects where possible, much of the discussion of economic effects is qualitative in nature.

A. Baseline

To assess the economic effects of the proposed amendments, the Commission is using as the baseline the security-based swap market as it exists at the time of this release, including

applicable rules the Commission has already adopted, but excluding rules the Commission has proposed but not yet finalized. The analysis includes the statutory provisions that currently govern the security-based swap market pursuant to the Dodd-Frank Act and rules adopted in the Intermediary Definitions Adopting Release, the Cross-Border Adopting Release, the SDR Rules and Core Principles Adopting Release,[288] and the Rule of Practice 194 Adopting Release.[289] Additionally, the baseline includes rules that have been adopted but for which compliance is not yet required, including the ANE Adopting Release, Registration Adopting Release,[290] Regulation SBSR Amendments Adopting Release,[291] and the Business Conduct Adopting Release,[292] as these final rules—even if compliance is not yet required—are part of the existing regulatory landscape that market participants expect to govern their security-based swap activity. The following sections discuss available data from the security-based swap market, security-based swap market participants and dealing structures, market-facing and non-market-facing activities of dealing entities, security-based swap market activity, global regulatory efforts, other markets and existing regulatory frameworks, current estimates of entities likely to incur assessment costs under rules adopted in the ANE Adopting Release, and an estimate of non-U.S. persons that could be affected by the proposed amendments and guidance.

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288 See Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 74246 (Feb. 11, 2015), 80 FR 14437 (Mar. 19, 2015) ("SDR Rules and Core Principles Adopting Release").

289 See Rule of Practice 194 Adopting Release, 84 FR at 4906.

290 See Registration Adopting Release, 80 FR at 48997-49003.

291 See Regulation SBSR–Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 78321 (Jul.14, 2016), 81 FR 53546 (Aug. 12, 2016) ("Regulation SBSR Amendments Adopting Release").

292 See Business Conduct Adopting Release, 81 FR at 30105.

1. Available Data from the Security-Based Swap Market

The Commission's understanding of the market is informed, in part, by available data on security-based swap transactions, though the Commission acknowledges that limitations in the data limit the extent to which it is possible to quantitatively characterize the market.[293] The Commission's analysis of the current state of the security-based swap market is based on data obtained from the DTCC Derivatives Repository Limited Trade Information Warehouse ("TIW"), especially data regarding the activity of market participants in the single-name CDS market during the period from 2008 to 2017. The details of this data set, including its limitations, have been discussed in a prior release.[294]

2. Security-Based Swap Market: Market Participants and Dealing Structures

a. Security-Based Swap Market Participants

Activity in the security-based swap market is concentrated among a relatively small number of entities that act as dealers in this market. In addition to these entities, thousands of other participants appear as counterparties to security-based swap contracts in the TIW sample, and include, but are not limited to, investment companies, pension funds, private (hedge) funds, sovereign entities, and industrial companies. A discussion of security-based swap market participants can be found in a prior release.[295]

b. Security-Based Swap Market Participant Domiciles

As depicted in Figure 1 below, domiciles of new accounts participating in the security-based swap market have shifted over time. It is unclear whether these shifts represent changes in

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293 The Commission also relies on qualitative information regarding market structure and evolving market practices provided by commenters and knowledge and expertise of Commission staff.

294 See Rule of Practice 194 Adopting Release, 84 FR at 4924.

295 See Rule of Practice 194 Adopting Release, 84 FR at 4925.

the types of participants active in this market, changes in reporting, or changes in transaction volumes in particular underliers. For example, the percentage of new entrants that are foreign accounts increased from 24.4% in the first quarter of 2008 to 32.3% in the last quarter of 2017, which may reflect an increase in participation by foreign account holders in the security-based swap market, though the total number of new entrants that are foreign accounts decreased from 112 in the first quarter of 2008 to 48 in the last quarter of 2017.[296] Additionally, the percentage of the subset of new entrants that are foreign accounts managed by U.S. persons increased from 4.6% in the first quarter of 2008 to 16.8% in the last quarter of 2017, and the absolute number rose from 21 to 25, which also may reflect more specifically the flexibility with which market participants can restructure their market participation in response to regulatory intervention, competitive pressures, and other stimuli.[297] At the same time, apparent changes in the percentage of new accounts with foreign domiciles may also reflect improvements in reporting by market participants to TIW, an increase in the percentage of transactions between U.S. and non-U.S. counterparties, and/or increased transactions in single-name CDS on U.S. reference entities by foreign persons.[298]

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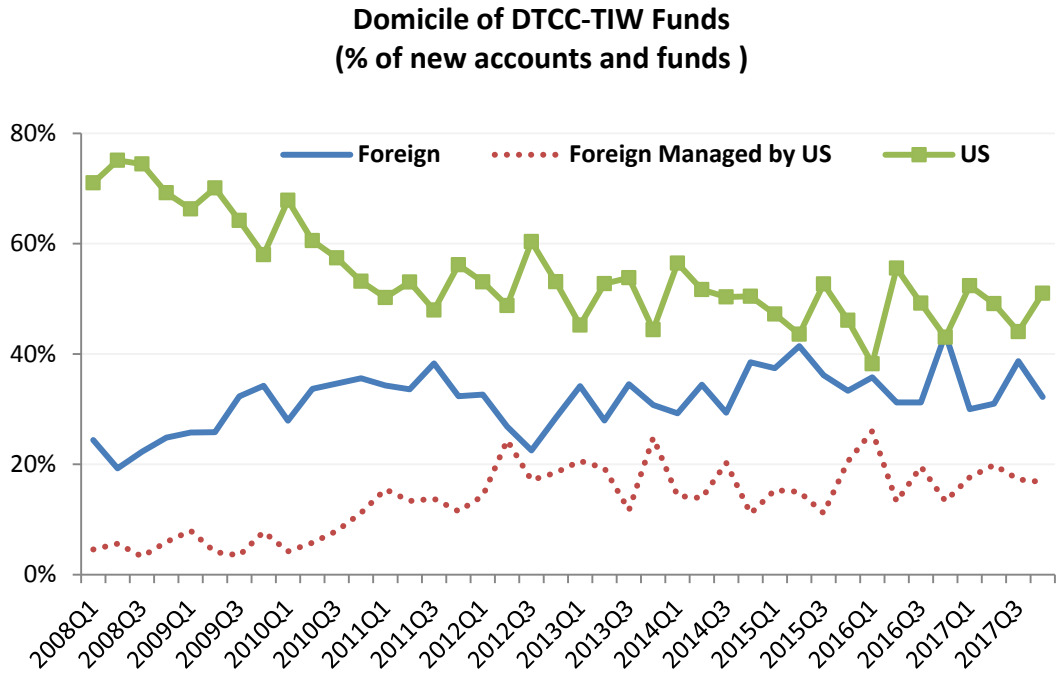
296 These estimates were calculated by Commission staff using TIW data.

297 See Charles Levinson, "U.S. banks moved billions in trades beyond the CFTC's reach," REUTERS, Aug. 21, 2015, available at http://www.reuters.com/article/2015/08/21/usa-banks-swaps-idUSL3N10S57R20150821. The estimates of 21 and 25 were calculated by Commission staff using TIW data.

298 The available data do not include all security-based swap transactions but only transactions in single-name CDS that involve either (1) at least one account domiciled in the United States (regardless of the reference entity) or (2) single-name CDS on a U.S. reference entity (regardless of the U.S.-person status of the counterparties). See note 294, supra, for a discussion of the TIW data set.

Figure 1: The percentage of (1) new accounts with a domicile in the United States (referred to as "US"), (2) new accounts with a domicile outside the United States (referred to below as "Foreign"), and (3) new accounts outside the United States but managed by a U.S. person, account of a foreign branch of a U.S. person, and accounts of a foreign subsidiary of a U.S. person (collectively referred to below as "Foreign Managed by US").[299] Unique, new accounts are aggregated each quarter and percentages are computed on a quarterly basis, from January 2008 through December 2017.



c. Market Centers

A market participant's domicile, however, does not necessarily correspond to where it engages in security-based swap activity. In particular, non-U.S. persons engaged in security-

[299] Following publication of the Warehouse Trust Guidance on CDS data access, DTCC-TIW surveyed market participants, asking for the physical address associated with each of their accounts (i.e., where the account is organized as a legal entity). This is designated the registered office location by the DTCC-TIW. When an account does not report a registered office location, the Commission has assumed that the settlement country reported by the investment adviser or parent entity to the fund or account is the place of domicile. This treatment assumes that the registered office location reflects the place of domicile for the fund or account.

based swap dealing activity operate in multiple market centers and carry out such activity with counterparties around the world.[300] Many market participants that are engaged in dealing activity prefer to use traders and manage risk for security-based swaps in the jurisdiction where the underlier is traded. Thus, although a significant amount of the dealing activity in security-based swaps on U.S. reference entities involves non-U.S. dealers, the Commission understands that these dealers tend to carry out much of the security-based swap trading and related risk-management activities in these security-based swaps within the United States.[301] Some dealers have explained that being able to centralize their trading, sales, risk management, and other activities related to U.S. reference entities in U.S. operations (even when the resulting transaction is booked in a foreign entity) improves the efficiency of their dealing business.

Consistent with these operational concerns and the global nature of the security-based swap market, the available data appear to confirm that participants in this market are in fact active in market centers around the globe. Although, as noted above, the available data do not permit us to identify the location of personnel in a transaction, TIW transaction records, supplemented with legal entity location data, indicate that firms that are likely to be security-based swap dealers operate out of branch locations in key market centers around the world, including New York, London, Paris, Zurich, Tokyo, Hong Kong, Chicago, Sydney, Toronto, Frankfurt, Singapore, and the Cayman Islands.[302]

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300 See ANE Adopting Release, 81 FR at 8604 n.56.

301 See id. note 58.

302 TIW transaction records contain a proxy for the domicile of an entity, which may differ from branch locations, which are separately identified in the transaction records. The legal entity location data are from Avox.

Given these market characteristics and practices, participants in the security-based swap market may bear the financial risk of a security-based swap transaction in a location different from the location where the transaction is arranged, negotiated, or executed, or where economic decisions are made by managers on behalf of beneficial owners. Market activity may also occur in a jurisdiction other than where the market participant or its counterparty books the transaction. Similarly, a participant in the security-based swap market may be exposed to counterparty risk from a counterparty located in a jurisdiction that is different from the market center or centers in which it participates.

d. Common Business Structures

A non-U.S. person that engages in a global security-based swap dealing business in multiple market centers may choose to structure its dealing business in a number of different ways. This structure, including where it books the transactions that constitute that business and how it carries out market-facing activities that generate those transactions, reflects a range of business and regulatory considerations, which each non-U.S. person may weigh differently.

A non-U.S. person may choose to book all of its security-based swap transactions, regardless of where the transaction originated, in a single, central booking entity. That entity generally retains the risk associated with that transaction, but it also may lay off that risk to another affiliate via a back-to-back transaction or an assignment of the security-based swap.[303] Alternatively, a non-U.S. person may book security-based swaps arising from its dealing business in separate affiliates, which may be located in the jurisdiction where it originates the risk associated with the security-based swap, or, alternatively, the jurisdiction where it manages

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[303] See Exchange Act Release No. 74834 (Apr. 29, 2015), 80 FR 27444, 27463 (May 13, 2015) ("U.S. Activity Proposing Release"); Cross-Border Proposing Release, 78 FR 30977-78.

that risk. Some non-U.S. persons may book transactions originating in a particular region to an affiliate established in a jurisdiction located in that region.[304] As discussed earlier,[305] a non-U.S. person may choose to book its security-based swap transactions in one jurisdiction in part to avoid triggering regulatory requirements associated with another jurisdiction.

Regardless of where a non-U.S. person determines to book its security-based swaps arising out of its dealing activity, it is likely to operate offices that perform sales or trading functions in one or more market centers in other jurisdictions. Maintaining sales and trading desks in global market centers permits the non-U.S. person to deal with counterparties in that jurisdiction or in a specific geographic region, or to ensure that it is able to provide liquidity to counterparties in other jurisdictions,[306] for example, when a counterparty's home financial markets are closed. A non-U.S. person engaged in a security-based swap dealing business also may choose to manage its trading book in particular reference entities or securities primarily from a trading desk that can utilize local expertise in such products or that can gain access to better liquidity, which may permit it to more efficiently price such products or to otherwise compete more effectively in the security-based swap market. Some non-U.S. persons prefer to centralize risk management, pricing, and hedging for specific products with the personnel responsible for carrying out the trading of such products to mitigate operational risk associated with transactions in those products.

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304 There is some indication that this booking structure is becoming increasingly common in the market. See, e.g., Catherine Contiguglia, "Regional swaps booking replacing global hubs," RISK.NET, Sep. 4, 2015, available at http://www.risk.net/risk-magazine/feature/2423975/regional-swaps-booking-replacing-global-hubs. Such a development may be reflected in the increasing percentage of new entrants that have a foreign domicile, as described above.

305 See part III.B.4, supra.

306 These offices may be branches or offices of the booking entity itself, or branches or offices of an affiliated agent, such as, in the United States, a registered broker-dealer.

The non-U.S. person affiliate that books these transactions may carry out related market-facing activities, whether in its home jurisdiction or in a foreign jurisdiction, using either its own personnel or the personnel of an affiliated or unaffiliated agent. For example, the non-U.S. person may determine that another of its affiliates employs personnel who possess expertise in relevant products or who have established sales relationships with key counterparties in a foreign jurisdiction, making it more efficient to use the personnel of the affiliate to engage in security-based swap market-facing activity on its behalf in that jurisdiction. In these cases, the affiliate that books these transactions and its affiliated agent may operate as an integrated dealing business, each performing distinct core functions in carrying out that business.

Alternatively, the non-U.S. person affiliate that books these transactions may, in some circumstances, determine to engage the services of an unaffiliated agent through which it can engage in market-facing activity. For example, a non-U.S. person may determine that using an interdealer broker may provide an efficient means of participating in the interdealer market in its own, or in another, jurisdiction, particularly if it is seeking to do so anonymously or to take a position in products that trade relatively infrequently.[307] A non-U.S. person may also use unaffiliated agents that operate at its direction. Such an arrangement may be particularly valuable in enabling a non-U.S. person to service clients or access liquidity in jurisdictions in which it has no security-based swap operations of its own.

The Commission understands that non-U.S. person affiliates (whether affiliated with U.S.-based non-U.S. persons or not) that are established in foreign jurisdictions may use any of

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307 The Commission understands that interdealer brokers may provide voice or electronic trading services that, among other things, permit dealers to take positions or hedge risks in a manner that preserves their anonymity until the trade is executed. These interdealer brokers also may play a particularly important role in facilitating transactions in less-liquid security-based swaps.

these structures to engage in dealing activity in the United States, and that they may seek to engage in dealing activity in the United States to transact with both U.S.-person and non-U.S.-person counterparties. In transactions with non-U.S.-person counterparties, these foreign affiliates may affirmatively seek to engage in dealing activity in the United States because the sales personnel of the non-U.S.-person dealer (or of its agent) in the United States have existing relationships with counterparties in other locations (such as Canada or Latin America) or because the trading personnel of the non-U.S.-person dealer (or of its agent) in the United States have the expertise to manage the trading books for security-based swaps on U.S. reference securities or entities. The Commission understands that some of these foreign affiliates engage in dealing activity in the United States through their personnel (or personnel of their affiliates) in part to ensure that they are able to provide their own counterparties, or those of non-U.S. person affiliates in other jurisdictions, with access to liquidity (often in non-U.S. reference entities) during U.S. business hours, permitting them to meet client demand even when the home markets are closed. In some cases, such as when seeking to transact with other dealers through an interdealer broker, these foreign affiliates may act, in a dealing capacity, in the United States through an unaffiliated, third-party agent.

3. Market-Facing and Non-Market-Facing Activities

As discussed above, the activities of a security-based swap dealer involve both market-facing activities and non-market-facing activities.[308] Market-facing activities would include arranging, negotiating, or executing a security-based swap transaction. The terms "arrange" and "negotiate" indicate market-facing activity of sales or trading personnel in connection with a particular transaction, including interactions with counterparties or their agents. The term

[308] See part I.A.2, supra.

"execute" refers to the market-facing act that, in connection with a particular transaction, causes the person to become irrevocably bound under the security-based swap under applicable law. Non-market-facing activities include processing trades and other back-office activities; designing security-based swaps without communicating with counterparties in connection with specific transactions; preparing underlying documentation, including negotiating master agreements (as opposed to negotiating with the counterparty the specific economic terms of a particular security-based swap transaction); and clerical and ministerial tasks such as entering executed transactions on a non-U.S. person's books.

4. Security-Based Swap Market Activity

As already noted, firms that act as dealers play a central role in the security-based swap market. Based on an analysis of 2017 single-name CDS data in TIW, accounts of those firms that are likely to exceed the security-based swap dealer de minimis thresholds and trigger registration requirements intermediated transactions with a gross notional amount of approximately $2.9 trillion, approximately 55% of which was intermediated by the top five dealer accounts.[309]

These dealers transact with hundreds or thousands of counterparties. Approximately 21% of accounts of firms expected to register as security-based dealers and observable in TIW have entered into security-based swaps with over 1,000 unique counterparty accounts as of year-end 2017.[310] Another 25% of these accounts transacted with 500 to 1,000 unique counterparty

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309 The Commission staff analysis of TIW transaction records indicates that approximately 99% of single-name CDS price-forming transactions in 2017 involved an ISDA-recognized dealer.

310 Many dealer entities and financial groups transact through numerous accounts. Given that individual accounts may transact with hundreds of counterparties, the Commission may infer that entities and financial groups may transact with at least as many counterparties as the largest of their accounts.

accounts; 29% transacted with 100 to 500 unique accounts; and 25% of these accounts intermediated security-based swaps with fewer than 100 unique counterparties in 2017. The median dealer account transacted with 495 unique accounts (with an average of approximately 570 unique accounts). Non-dealer counterparties transacted almost exclusively with these dealers. The median non-dealer counterparty transacted with two dealer accounts (with an average of approximately three dealer accounts) in 2017.

Figure 2 below describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to TIW between January 2008 and December 2017, separated by whether transactions are between two ISDA-recognized dealers (interdealer transactions) or whether a transaction has at least one non-dealer counterparty. Figure 2 also shows that the portion of the notional volume of North American corporate single-name CDS represented by interdealer transactions has remained fairly constant through 2015 before falling from approximately 72% in 2015 to approximately 40% in 2017. This fall corresponds to the availability of clearing to non-dealers. Interdealer transactions continue to represent a significant fraction of trading activity, even as notional volume has declined over the past ten years,[311] from more than $6 trillion in 2008 to less than $700 billion in 2017.[312]

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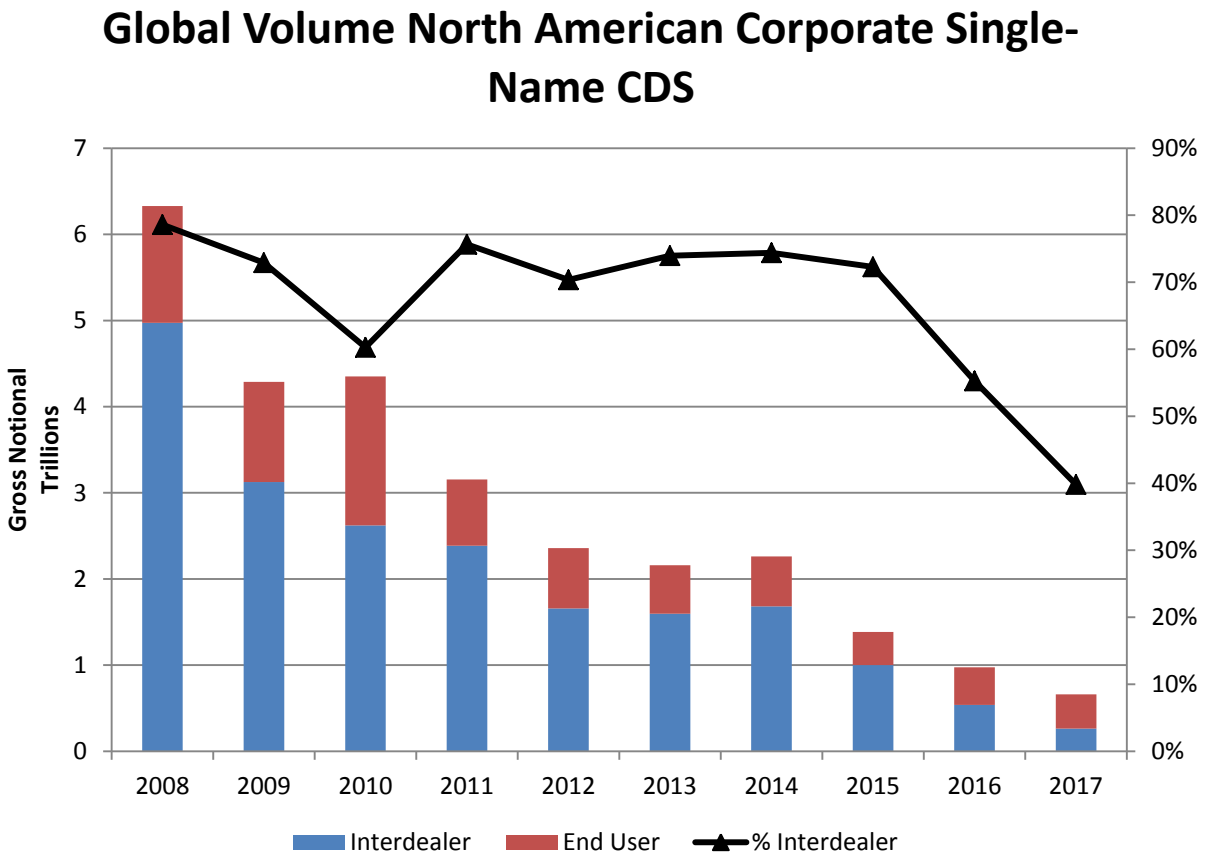
311 The start of this decline predates the enactment of the Dodd-Frank Act and the proposal of rules thereunder, which is important to note for the purpose of understanding the economic baseline for this rulemaking.

312 This estimate is lower than the gross notional amount of $4.6 trillion noted in note 294 above as it includes only the subset of single-name CDS referencing North American corporate documentation.

Figure 2: Global, notional trading volume in North American corporate single-name CDS by calendar year and the fraction of volume that is interdealer.



The high level of interdealer trading activity reflects the central position of a small number of dealers, each of which intermediates trades with many hundreds of counterparties. While the Commission is unable to quantify the current level of trading costs for single-name CDS, these dealers appear to enjoy market power as a result of their small number and the large proportion of order flow that they privately observe.

Against this backdrop of declining North American corporate single-name CDS activity, about half of the trading activity in North American corporate single-name CDS reflected in the set of data that the Commission analyzed was between counterparties domiciled in the United States and counterparties domiciled abroad, as shown in Figure 3 below. Using the self-reported

registered office location of the TIW accounts as a proxy for domicile, the Commission estimates that only 12% of the global transaction volume by notional volume between 2008 and 2017 was between two U.S.-domiciled counterparties, compared to 49% entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 39% entered into between two foreign-domiciled counterparties.[313]

If the Commission instead considers the number of cross-border transactions from the perspective of the domicile of the corporate group (e.g., by classifying a foreign bank branch or foreign subsidiary of a U.S. entity as domiciled in the United States), the percentages shift significantly. Under this approach, the fraction of transactions entered into between two U.S.-domiciled counterparties increases to 34%, and to 51% for transactions entered into between a U.S.-domiciled counterparty and a foreign-domiciled counterparty. By contrast, the proportion of activity between two foreign-domiciled counterparties drops from 39% to 15%. This change in respective shares based on different classifications suggests that the activity of foreign subsidiaries of U.S. firms and foreign branches of U.S. banks accounts for a higher percentage of security-based swap activity than U.S. subsidiaries of foreign firms and U.S. branches of foreign banks. It also demonstrates that financial groups based in the United States are involved in an overwhelming majority (approximately 85%) of all reported transactions in North American corporate single-name CDS.

Financial groups based in the United States are also involved in a majority of interdealer transactions in North American corporate single-name CDS. Of the 2017 transactions on North

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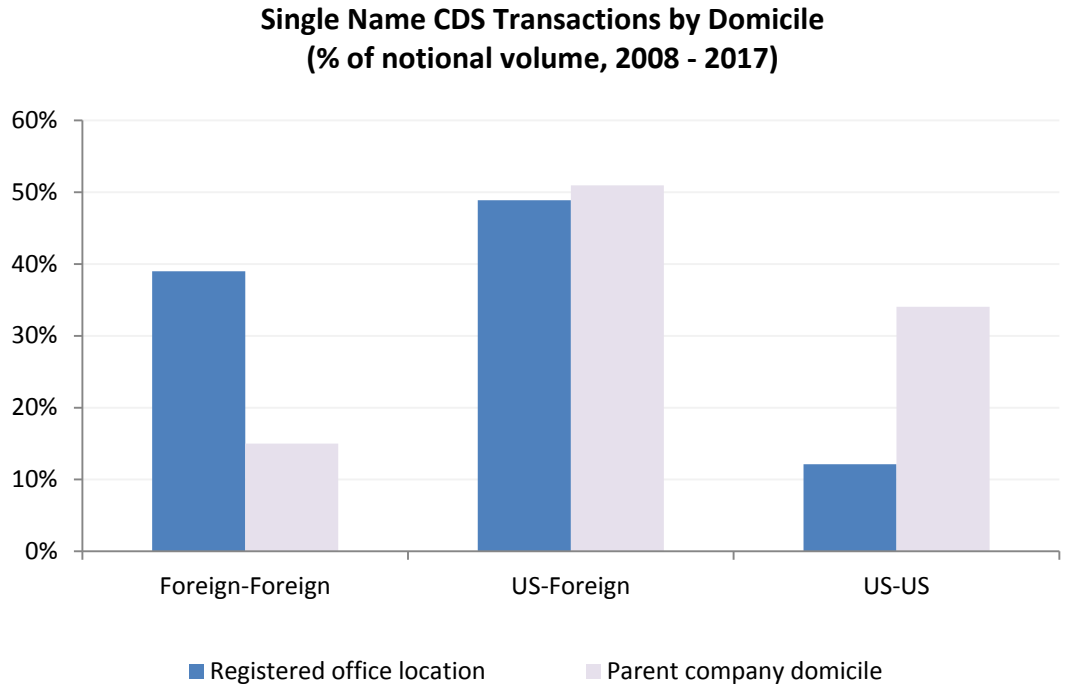
313 For purposes of this discussion, the Commission has assumed that the registered office location reflects the place of domicile for the fund or account, but the Commission notes that this domicile does not necessarily correspond to the location of an entity's sales or trading desk. ANE Adopting Release, 81 FR at 8607 n.83.

American corporate single-name CDS between two ISDA-recognized dealers and their branches or affiliates, 94% of transaction notional volume involved at least one account of an entity with a U.S. parent. The Commission notes, in addition, that a majority of North American corporate single-name CDS transactions occur in the interdealer market or between dealers and foreign non-dealers, with the remaining portion of the market consisting of transactions between dealers and U.S.-person non-dealers. Specifically, 60% of North American corporate single-name CDS transactions involved either two ISDA-recognized dealers or an ISDA-recognized dealer and a foreign non-dealer. Approximately 39% of such transactions involved an ISDA-recognized dealer and a U.S.-person non-dealer.

Figure 3: The fraction of notional volume in North American corporate single-name CDS between (1) two U.S.-domiciled accounts; (2) one U.S.-domiciled account and one non-U.S.-domiciled account; and (3) two non-U.S.-domiciled accounts, computed from January 2008 through December 2017.



5. Global Regulatory Efforts

In 2009, the G20 leaders –whose membership includes the United States, 18 other countries, and the European Union – addressed global improvements in the OTC derivatives market. They expressed their view on a variety of issues relating to OTC derivatives contracts. In subsequent summits, the G20 leaders have returned to OTC derivatives regulatory reform and encouraged international consultation in developing standards for these markets. [314]

Many security-based swap dealers likely will be subject to foreign regulation of their security-based swap activities that is similar to regulations that may apply to them pursuant to Title VII of the Dodd-Frank Act, even if the relevant foreign jurisdictions do not classify certain market participants as "dealers" for regulatory purposes. Some of these regulations may duplicate, and in some cases conflict with, certain elements of the Title VII regulatory framework.

Foreign legislative and regulatory efforts have generally focused on five areas: (1) moving OTC derivatives onto organized trading platforms, (2) requiring central clearing of OTC derivatives, (3) requiring post-trade reporting of transaction data for regulatory purposes and public dissemination of anonymized versions of such data, (4) establishing or enhancing capital requirements for non-centrally cleared OTC derivatives transactions, and (5) establishing or enhancing margin and other risk mitigation requirements for non-centrally cleared OTC derivatives transactions. Foreign jurisdictions have been actively implementing regulations in connection with each of these categories of requirements. A number of major foreign

[314] See, e.g., G20 Leaders' Final Declaration, November 2011, para. 24, available at https://g20.org/wp-content/uploads/2014/12/Declaration_eng_Cannes.pdf.

jurisdictions have initiated the process of implementing margin and other risk mitigation requirements for non-centrally cleared OTC derivatives transactions.[315]

Notably, the European Parliament and the European Council have adopted the European Market Infrastructure Regulation ("EMIR"), which includes provisions aimed at increasing the safety and transparency of the OTC derivatives market. EMIR mandates the European Supervisory Authorities ("ESAs") to develop regulatory technical standards specifying margin requirements for non-centrally cleared OTC derivatives contracts. The ESAs have developed, and in October 2016 the European Commission adopted, these regulatory technical standards.[316]

Several jurisdictions have also taken steps to implement the Basel III recommendations governing capital requirements for financial entities, which include enhanced capital charges for non-centrally cleared OTC derivatives transactions.[317] Moreover, as discussed above,

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315 In November 2018, the Financial Stability Board reported that 16 member jurisdictions participating in its thirteenth progress report on OTC derivatives market reforms had in force margin requirements for non-centrally cleared derivatives. A further 4 jurisdictions made some progress in implementation leading to a change in reported implementation status during the reporting period. See Financial Stability Board, "OTC Derivatives Market Reforms Thirteenth Progress Report on Implementation" (Nov. 2018), available at http://www.fsb.org/wp-content/uploads/P191118-5.pdf.

316 See EBA, EIOPA, and ESMA, "Regulatory Technical Standards (RTS) on risk mitigation techniques for OTC derivatives not cleared by a central counterparty (CCP)" (March 2016), available at https://www.eba.europa.eu/documents/10180/1398349/RTS+on+Risk+Mitigation+Techniques+for+OTC+contracts+%28JC-2016-+18%29.pdf/fb0b3387-3366-4c56-9e25-74b2a4997e1d; see also EC Delegated Regulation, supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (Oct. 4, 2016), available at http://ec.europa.eu/finance/financial-markets/docs/derivatives/161004-delegated-act_en.pdf. After the non-objection from the European Parliament and Council, Delegated Regulation (EU) 2016/2251 was published in the Official Journal of the European Union and entered into force on January 4, 2017.

317 In November 2018, the Financial Stability Board reported that 23 of the 24 member jurisdictions participating in its thirteenth progress report on OTC derivatives market reforms had in force interim standards for higher capital requirements for non-centrally cleared transactions. *See*

subsequent to the publication of the proposing release, the Basel Committee on Banking Supervision ("BCBS") and the Board of the International Organization of Securities Commissions ("IOSCO") issued the *Margin Requirements for Non-centrally Cleared Derivatives* ("WGMR Paper") that recommends minimum standards for margin requirements for non-centrally cleared derivatives.[318] The recommendations in the WGMR Paper included a recommendation that all financial entities and systemically important non-financial entities exchange variation and initial margin appropriate for the counterparty risk posed by such transactions, that initial margin should be exchanged without provisions for "netting" and held in a manner that protects both parties in the event of the other's default, and that the margin regimes of the various regulators should interact so as to be sufficiently consistent and non-duplicative.

6. Other Markets and Existing Regulatory Frameworks

The numerous financial markets are integrated, often attracting the same market participants that trade across corporate bond, swap, and security-based swap markets, among others. A discussion of other markets and existing regulatory frameworks can be found in a prior release.[319]

7. Estimates of Persons That May Use the Proposed Exception to Rule 3a71-3

To analyze the economic effects of the proposed exception to Rule 3a71-3, the Commission has analyzed 2017 TIW data to identify persons that may use the proposed

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Financial Stability Board, OTC Derivatives Market Reforms Thirteenth Progress Report on Implementation (Nov. 2018), available at http://www.fsb.org/wp-content/uploads/P191118-5.pdf.

318 See BCBS, IOSCO, "Margin Requirements for Non-centrally Cleared Derivatives" (Mar. 2015), available at http://www.bis.org/bcbs/publ/d317.pdf.

319 See Rule of Practice 194 Adopting Release, 84 FR at 4927.

exception. The Commission preliminarily believes that these persons fall into several categories, which we discuss below.

a. Non-U.S. Persons Seeking to Reduce Assessment Costs

One category of persons that may use the proposed exception are those non-U.S. persons that may need to assess the amount of their market-facing activity against the de minimis thresholds solely because of the inclusion of security-based swap transactions between two non-U.S. persons that are arranged, negotiated, or executed by personnel located in the U.S. for the purposes of the de minimis threshold analysis. These non-U.S. persons may have an incentive to rely on the proposed exception as a means of avoiding assessment and business restructuring if the cost of compliance associated with the proposed exception is less than assessment costs and the costs of business restructuring. In the ANE Adopting Release, the Commission provided an estimate of this category of persons.[320] However, in light of the reduction in security-based swap market activity since the publication of the ANE Adopting Release,[321] the Commission preliminarily believes that it would be appropriate to update that estimate to more accurately identify the set of persons that potentially may use the proposed exception. Analyses of the 2017 TIW data indicate that approximately five additional non-U.S. persons,[322] beyond those non-U.S. persons likely to incur assessment costs in connection with the other cross-border counting rules that the Commission previously had adopted in the Cross-Border Adopting Release,[323] are likely

320 See ANE Adopting Release, 81 FR at 8627.

321 See part VII.A.4, supra.

322 Adjustments to these statistics from the ANE Adopting Release reflect further analysis of the TIW data. Cf. ANE Adopting Release, 81 FR at 8627 (providing an estimate of 10 additional non-U.S. persons based on 2014 TIW data).

323 See note 13, supra.

to exceed the $2 billion threshold[324] the Commission has previously employed to estimate the number of persons likely to incur assessment costs under Exchange Act rule 3a71-3(b). These non-U.S. persons may have an incentive to rely on the proposed exception as a means of avoiding assessment if the cost of compliance associated with the proposed exception is less than the assessment costs.

b. Non-U.S. Persons Seeking to Avoid Security-Based Swap Dealer Regulation

Another category of persons that potentially may use the proposed exception are those non-U.S. persons whose dealing transaction volume would have fallen below the $3 billion de minimis threshold if their transactions with non-U.S. counterparties were not counted toward the de minimis threshold under the current "arranged, negotiated, or executed" counting requirement, but absent the exception, would have dealing transactions in excess of that threshold.[325] Such non-U.S. persons may choose to use the proposed exception if they expect the compliance cost associated with the proposed exception to be lower than the compliance cost associated with being subject to the full set of security-based swap dealer regulation and the cost of business restructuring. The Commission's analysis of 2017 TIW data indicates that there is one non-U.S. person whose transaction volume would have fallen below the $3 billion de minimis threshold if that person's transactions with non-U.S. counterparties were not counted toward the de minimis threshold under the current "arranged, negotiated, or executed" counting requirement.[326]

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324 See ANE Adopting Release, 81 FR at 8626.

325 The $3 billion threshold is being used to help identify potential impacts of the proposal. A phase-in threshold of $8 billion currently is in effect. See Exchange Act Rule 3a71-2(a)(1).

326 The analysis begins by considering the single-name CDS transactions of each of the non-U.S. persons against both U.S. person and non-U.S. person counterparties. The Commission then

c. U.S. Dealing Entities Considering Changes to Booking Practices

A third category of persons that potentially may use the conditional exception are those U.S. dealers that use U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties. If the proposed exception were available, such dealers may consider booking future transactions with non-U.S. counterparties to their non-U.S. affiliates, while still using U.S. personnel to arrange, negotiate, or execute such transactions. These U.S. dealers may have an incentive to engage in such booking practices in order to utilize the proposed exception to the extent that they wish to continue using U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties and the compliance cost associated with the proposed exception is less than the cost of compliance with Title VII requirements (if they choose not to book transactions to avail themselves of the proposed exception) and the cost of business restructuring (if they choose to both book transactions to their non-U.S. affiliates and also refrain from using U.S. personnel to arrange, negotiate or execute such transactions).[327] The Commission's analysis of 2017 TIW data indicates that there are six U.S. dealers who transact with non-U.S. counterparties, who are likely to register as security-based swap dealers,[328] and have non-U.S. affiliates that also transact in the CDS market. To the extent that these U.S.

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excluded transactions involving these non-U.S. persons and their non-U.S. person counterparties. For this analysis, we assume that all transactions between non-U.S. person dealers and non-U.S. counterparties are arranged, negotiated, or executed using U.S. personnel.

327 The Commission recognizes that this potential use of the proposed exception by U.S. dealing entities is distinct from the rationale underlying the proposed exception, which is to help avoid market fragmentation and operational risks resulting from the relocation of U.S. personnel by non-U.S. dealers. See part I.A.4, supra. Nonetheless, such changes in booking practices by U.S. dealing entities might be a consequence of the proposal.

328 To the extent that U.S. persons with transaction volumes that are insufficient to trigger dealer registration potentially might also make use of the proposed exception, this estimate would be a lower bound estimate of the number of U.S. persons that potentially may make use of the proposed exception.

dealers anticipate booking future transactions with non-U.S. counterparties that are arranged, negotiated, or executed by U.S. personnel to their non-U.S. affiliates, the Commission preliminarily believes that these U.S. dealers may potentially make use of the proposed exception.

d. Additional Considerations and Summary

Under Alternative 1,[329] the U.S. arranging, negotiating, and executing activity could be conducted by a registered security-based swap dealer. Under Alternative 2, the U.S. arranging, negotiating, and executing could be conducted by a registered broker.[330] The economic analysis of these alternatives depends, in part, on whether non-U.S. persons that might make use of the proposed exception have U.S. affiliates that are likely to register as security-based swap dealers (under Alternative 1) or that are registered broker-dealers (under Alternative 2). Of the six non-U.S. persons discussed above,[331] four have majority-owned affiliates that are registered broker-dealers. Of these non-U.S. persons, one has a majority-owned affiliate that is likely to register as a security-based swap dealer. Of the six U.S. persons discussed above, all have majority-owned affiliates that are registered broker-dealers, and all have majority-owned affiliates that are likely to register as security-based swap dealers. Of these 12 persons, eight are banks, and three are affiliated with banks. These estimates are summarized in Table 1 below. The Commission's analysis of 2017 TIW data indicates that these 12 persons transacted with 807 non-U.S. counterparties, of which 558 participate in the swap markets and 249 do not.

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329 See part III.B, supra.

330 See part III.C, supra.

331 Calculated as the 5 non-U.S. persons seeking to reduce assessment costs (part VII.A.7.a) + 1 non-U.S. person seeking to avoid security-based swap dealer regulation (part VII.A.7.b) = 6 non-U.S. persons.

Table 1: Affiliates of Persons That May Use the Proposed Exception

Persons identified in TIW data that may use the proposed exception	Non-U.S.	U.S.
Estimate	6	6
Breakdown:		
Has majority-owned registered broker-dealer affiliate	4	6
Has majority-owned registered security-based swap dealer affiliate	1	6
Is a bank	4	4
Is a bank affiliate	1	2

In summary, the Commission's analysis of 2017 TIW data indicates that 12 persons[332] may make use of the proposed exception. In light of the uncertainty associated with this estimate[333] and to account for potential growth of the security-based swap market, and consistent with the approach in the ANE Adopting Release, the Commission believes that it is reasonable to increase this estimate by a factor of two.[334] As a result, the Commission preliminarily estimates that up to 24 persons potentially may make use of the proposed exception. The Commission also doubles the number of non-U.S. counterparties discussed above and preliminarily estimates that persons that may make use of the proposed exception may transact with up to 1,614 non-U.S. counterparties, of which 1,116 participate in the swap markets and 498 do not.[335]

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332 Calculated as 5 non-U.S. persons seeking to reduce assessment costs (part VII.A.7.a) + 1 non-U.S. person seeking to avoid security-based swap dealer regulation (part VII.A.7.b) + 6 U.S. persons considering changes to booking practices (part VII.A.7.c) = 12 persons.

333 The estimate may be overinclusive, as it is unlikely that all transactions between two non-U.S. persons are arranged, negotiated, or executed by personnel located in a U.S. branch or office; it may also be underinclusive, as our TIW data do not include single-name CDS transactions between two non-U.S. entities written on non-U.S. underliers, some of which may be arranged, negotiated, or executed by personnel located in a U.S. branch or office, or transactions on other types of security-based swaps (including equity swaps) whether on U.S. or non-U.S. underliers. See ANE Adopting Release, 81 FR at 8627.

334 See ANE Adopting Release, 81 FR at 8627.

335 See part VII.B.3.a, infra where we use these estimates to calculate certain costs associated with an additional alternative.

8. Estimates of Persons that Potentially May be Affected by the Proposed Market Color Guidance

As discussed in part II supra, the "arranged, negotiated, or executed" test has been incorporated within the de minimis counting standard, the cross-border application of security-based swap dealer business conduct provisions, and the cross-border application of Regulation SBSR's regulatory reporting and public dissemination provisions. The Commission preliminarily believes that the persons that may rely on this proposed guidance fall into a number of categories, which we discuss below.

a. Non-U.S. Dealing Entities That Use Guidance in Connection with Counting, Business Conduct, and Regulatory Reporting and Public Dissemination Requirements

Because non-U.S. security-based swap dealers are entities that fall within the scope of the de minimis counting, business conduct, and regulatory reporting and public dissemination provisions due to their dealing activities and their obligations under these provisions depend in part on the "arranged, negotiated, or executed" test, the Commission preliminarily believes that non-U.S. security-based swap dealers would be persons that potentially may change their assessment with respect to compliance with security-based swap dealer regulation generally as a result of the proposed guidance. Based on 2017 TIW data, the Commission estimates that up to 22 non-U.S. persons[336] will register as security-based swap dealers.

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[336] This estimate is based on the number of accounts in TIW data with total notional volume in excess of de minimis thresholds, increased by a factor of two, to account for any potential growth in the security-based swap market, to account for the fact that the Commission is limited in observing transaction records for activity between non-U.S. persons to those that reference U.S. underliers, and to account for the fact that the Commission does not observe security-based swap transactions other than in single-name CDS. See Business Conduct Adopting Release, 81 FR at 30105 and note 1633 therein.

b. Non-U.S. Persons That Use Guidance in Connection with de minimis assessment

A second group of persons that may be affected by the proposed guidance are non-U.S. persons that may need to assess the amount of their market-facing activity against the de minimis thresholds solely because of the inclusion for the purposes of the de minimis threshold analysis of security-based swap transactions between two non-U.S. persons that are arranged, negotiated, or executed by personnel located in the U.S. As discussed elsewhere,[337] the Commission preliminarily believes that these non-U.S. persons will incur reporting obligations under Regulation SBSR in connection with security-based swap transactions with other non-U.S. persons that are arranged, negotiated, or executed by U.S. personnel. As discussed in part VII.A.7 above, this group consists of five non-U.S. persons based on the analysis of 2017 TIW data, which the Commission has increased by a factor of two to 10.

c. Non-U.S. Persons That Use Guidance in Connection with Assessing Regulatory Reporting and Public Dissemination Requirements

A third group of persons that may be affected by the proposed guidance are unregistered non-U.S. persons that will incur costs, under Rule 908(b)(5), to assess whether they engage in security-based swap transactions with non-U.S. persons that are arranged, negotiated, or executed by U.S. personnel, and if so, whether they will incur reporting duties under Rule 901(a)(2)(ii)(E).[338] The Commission preliminarily estimates that this group consists of five non-U.S. persons, [339] who are in addition to the non-U.S. persons described in part VII.A.8.b above.

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337 See Regulation SBSR Amendments Adopting Release, 81 FR 156 at 53614 & n.657.

338 See Regulation SBSR Amendments Adopting Release, 81 FR 156 at 53638.

339 The Commission has previously estimated that there are four unregistered non-U.S. persons that will incur assessment costs as a result of Rule 908(b)(5). See Regulation SBSR Amendments Adopting Release, 81 FR 156 at 53638 n.919. In light of the changes in the security-based swap

d. Non-U.S. Persons Affiliated with U.S. Dealing Entities That Consider Changes to Booking Practices

A fourth group of persons that may be affected by the proposed guidance are the non-U.S. persons affiliated with those U.S. dealers that may use U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties and book those transactions to the non-U.S. persons. As discussed in part VII.A.7 above, these U.S. dealers may have an incentive to engage in such booking practices in order to utilize the proposed exception to the extent that they wish to continue using U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties and the compliance cost associated with the proposed exception is less than the cost of compliance with Title VII requirements and the cost of business restructuring. As discussed in part VII.A.7 above, the Commission preliminarily estimates that up to 12 U.S. dealers[340] potentially may use the proposed exception. To the extent that each of these dealers chooses to book transactions subject to the proposed exception to one unregistered non-U.S. person affiliate, the Commission preliminarily believes that this fourth group of non-U.S. persons would consist of 12 unregistered non-U.S. persons. The Commission preliminarily believes that these non-U.S. persons may incur reporting duties under Rule 901(a)(2)(ii)(E)[341] and are in addition to the non-U.S. persons described in part VII.A.8.c above.

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market, as noted in part VII.A.4 supra, the Commission has updated the estimate using 2017 TIW data and preliminarily believes that there are five unregistered non-U.S. persons that will incur assessment costs as a result of Rule 908(b)(5). Because of the relatively low volume of transaction activity of these five entities during 2017 and the existence of affiliations with other entities expected to register as security-based swap dealers, the Commission preliminarily believes that, even after accounting for growth in the security-based swap market and acknowledging the limitations of the transaction data available for analysis, five is a reasonable estimate of the number of unregistered dealing entities likely to incur assessment costs as a result of Rule 908(b)(5).

340 This is calculated as the six U.S. dealers identified in 2017 TIW data increased by a factor of 2 to 12.

341 See Regulation SBSR Amendments Adopting Release, 81 FR 156 at 53638.

All told, the Commission preliminarily believes that up to 49 non-U.S. persons[342] potentially may be affected by the proposed guidance.

9. Statutory Disqualification

In the Rule of Practice 194 Adopting Release, the Commission analyzed, among others, data on the number of natural persons associated with SBS Entities, applications for review under parallel review processes, and relevant research on statutory disqualification. In that release, the Commission estimated that SBS Entities may file up to five applications per year with respect to their associated natural persons. A more detailed discussion of these data and estimates can be found in that release.[343] If associated natural persons who become statutorily disqualified are located outside of the U.S. and transact exclusively with foreign counterparties and foreign branches of U.S. counterparties, the proposal may decrease the number of these applications for relief and corresponding direct costs. Based on the Commission's experience with broker-dealers and on the Commission's understanding of current market activity in security-based swaps, the Commission preliminarily estimates that the proposed exclusion may reduce the number of applications under Rule of Practice 194 by between zero and two applications.

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342 Calculated as 22 non-U.S. dealing entities that use the proposed guidance in connection with counting, business conduct, and regulatory reporting and public dissemination requirements (part VII.A.8.a) + 10 non-U.S. persons that use the proposed guidance in connection with de minimis assessment (part VII.A.8.b) + 5 non-U.S. persons that use the proposed guidance in connection with assessing regulatory reporting and public dissemination requirements (part VII.A.8.c) + 12 non-U.S. persons affiliated with U.S. dealing entities that consider changes to booking practices (part VII.A.8.d) = 49 non-U.S. persons.

343 See Rule of Practice 194 Adopting Release, 84 FR at 4925.

10. Certification, Opinion of Counsel, and Employee Questionnaires

As a baseline matter, SBS Entity Registration rules, including Rule 15Fb2-1 and the certification and opinion of counsel requirements in Rule 15Fb2-4, have been adopted but compliance with registration rules is not yet required.

In addition, Rule 17a-3(a)(12) requires all broker-dealers, including broker-dealers that may seek to register with the Commission as SBS Entities, to make and keep current a questionnaire or application for employment for each associated person. In the Recordkeeping and Reporting Proposing Release, the Commission proposed a parallel requirement, in Rule 18a-5, for stand-alone and bank SBS Entities. The Commission is proposing modifications to proposed Rule 18a-5(a)(10) and Rule 18a-5(b)(8). Based on 2017 TIW data, of 22 non-U.S. persons that may register with the Commission as security-based swap dealers, the Commission estimates that approximately 12 security-based swap dealers will be foreign banks and another 3 will be foreign stand-alone security-based swap dealers that may be affected by these proposed modifications.

B. Proposed Amendment to Rule 3a71-3

This section discusses the potential costs and benefits associated with the proposed amendment to Rule 3a71-3, the effects of the proposed amendment on efficiency, competition, and capital formation, and alternative approaches to the proposed amendment. The Commission's analysis considers the costs and benefits of both Alternative 1 and Alternative 2. Because many of the conditions associated with the exception are the same in both proposed alternatives, the Commission expects them to produce many of the same economic consequences. Where the Commission believes those costs and benefits would be the same under either proposed alternative, they are discussed together. Where the costs and benefits may differ, they are discussed separately.

Under either Alternative 1 or Alternative 2, each person that engages in arranging, negotiating, and executing activity with non-U.S. counterparties using affiliated U.S.-based personnel would have two possible options for complying with the Commission's Title VII regulations regarding the cross-border application of the "security-based swap dealer" definition. The first option would be for the persons to follow current security-based swap dealer counting requirements without regard for the exception afforded by the proposed amendment (whichever alternative is adopted). Specifically, a person could opt to incur the assessment costs to determine (i) whether any portion of their security-based swap transaction activities must be counted against the dealer de minimis thresholds, and (ii) whether the total notional amount of relevant transaction activities exceeds the de minimis threshold.[344] If the amount of its activities crosses the de minimis thresholds, then the person would have to register as a security-based swap dealer and become subject to Title VII security-based swap dealer requirements. A person that chooses to comply in this manner would experience no incremental economic effects under the proposed alternative as compared to the baseline.

The second option would be to rely on the exception afforded by the proposed amendment (whichever alternative is adopted). Under the proposed amendment, a person could register one entity as a registered security-based swap dealer (under both proposed alternatives) or as a registered broker (only under Alternative 2)[345] to arrange, negotiate, or execute transactions with non-U.S. counterparties on its behalf using personnel located in a U.S. branch or office. Doing so could allow it to avoid the direct regulation of itself (or multiple affiliated

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344 See part I.A.2, supra.

345 Under Alternative 2, registration may not be required if, as discussed in part VII.A.7, supra, persons who may take advantage of this exception already have a registered broker-dealer affiliate and choose to use their existing registered broker-dealer affiliate to take advantage of the exception. See also part VII.B.1.a, infra.

entities) as a security-based swap dealer. A person that chooses to use this exception and incur the associated costs to meet the conditions of this exception, detailed below, likely would not incur assessment costs with respect to security-based swap transactions with non-U.S. counterparties that are arranged, negotiated, or executed by personnel located in the United States.

As discussed above, the Commission preliminarily believes that up to 24[346] persons potentially may use the proposed exception to the extent that the compliance costs associated with the proposed exception are lower than the compliance costs in the absence of the proposed exception.

1. Costs and Benefits of the Proposed Amendment

The Commission preliminarily believes that the proposed amendment would provide increased flexibility to security-based swap market participants to comply with the Title VII framework while preserving their existing business practices. This could reduce their compliance burdens, while supporting the Title VII regime's benefit of mitigating risks in foreign security-based swap markets that may flow into U.S. financial markets through liquidity spillovers. The Commission also preliminarily believes that the amendments could reduce market fragmentation and associated distortions. At the same time, and as detailed later in this section, the Commission acknowledges that the proposed amendment potentially limits certain other programmatic benefits of the Title VII regime by excusing security-based swap market participants that elect to use the exception from some of the Title VII requirements that would otherwise apply to their activity. The Commission preliminarily believes that the proposed amendment will result in compliance costs for persons that elect to use the exception, as

346 See part VII.A.7, supra.

described below. However, the Commission expects that persons will elect to incur those costs only where it would be less costly than either complying with the Title VII framework or restructuring to avoid using U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties.

a. Costs and Benefits for Persons That May Use the Proposed Amendment

The primary benefit of the proposed amendment is that it would permit a person further flexibility to opt into a Title VII compliance framework that is compatible with its existing business practices. While the registered U.S. person would be the entity adhering to most of the conditions set forth in the proposed amendment and the non-U.S. person would be responsible for complying with some of the other conditions,[347] for the purposes of this analysis, the Commission assumes that the costs of complying with these conditions will be passed on to the non-U.S. person affiliate. In the absence of the proposed amendment, a non-U.S. person could incur the cost of registering as a security-based swap dealer and a financial group may incur the cost of registering at least one security-based swap dealer[348] due to the "arranged, negotiated, or executed" counting test.[349] The non-U.S. person or group accordingly would incur the cost necessary for compliance with the full set of security-based swap dealer requirements by one or

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347 See, e.g., proposed Alternative 1 – proposed paragraph (d)(1)(iii)(A) of Rule 3a71-3.

348 The available data limit the Commission's ability to discern the multiple different legal entities each of which engages in security-based swap market-facing activity at levels above the de minimis thresholds because the way in which non-U.S. persons organize their dealing business may not align with the way their transaction volumes are accounted for in TIW. In particular, it is possible that some of the 10 non-U.S. persons identified in the TIW data as potential registrants aggregate transaction volumes of multiple non-U.S. person dealers. In such cases, the exclusion of transactions between these non-U.S. person dealers and non-U.S. counterparties from the de minimis calculations may result in multiple non-U.S. person dealers no longer meeting the de minimis threshold.

349 See id.

more registered security-based swap dealers. These burdens, contingent on exceeding the de minimis threshold, are in addition to the assessment costs that the non-U.S. person would incur to identify and count relevant market-facing activity toward the de minimis threshold.

As discussed in the ANE Adopting Release, such a non-U.S. person could respond to these costs by restructuring its security-based swap business to avoid using U.S. personnel to arrange, negotiate, or execute transactions with non-U.S. counterparties. Such a strategy would allow the non-U.S. person to avoid counting transactions between the non-U.S. person and its non-U.S. counterparties toward the non-U.S. person's de minimis threshold. In addition to reducing the likelihood of incurring the programmatic costs associated with the full set of security-based swap dealer requirements under Title VII, this response to current requirements could reduce the assessment costs associated with counting transactions toward the de minimis threshold and fully abrogate the need to identify transactions with non-U.S. counterparties that involve U.S. personnel.[350]

However, the Commission also noted in the ANE Adopting Release that restructuring is itself costly. To reduce the costs of assessment and potential dealer registration, a non-U.S. person may need to incur costs to ensure that U.S. personnel are not involved in arranging, negotiating, or executing transactions with non-U.S. counterparties. The Commission was able to quantify some, but not all of the costs of restructuring in the ANE adopting release.[351] As

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350 In 2016, the Commission estimated a cost of $410,000 per entity to establish systems to identify market-facing activity arranged, negotiated, or executed using U.S. personnel and $6,500 per entity per year for training, compliance and verification costs. See ANE Adopting Release, 81 FR at 8627. Adjusted for inflation, these amounts are approximately $435,000 and $6,900 in 2018 dollars.

351 In 2016, the Commission estimated it would cost approximately $28,300 per entity to establish policies and procedures to restrict communication between personnel located in the United States employed by non-U.S. persons or their agents, and other personnel involved in market-facing activity. See ANE Adopting Release, 81 FR at 8628. Adjusted for inflation, this is

discussed above in part VII.A.2.d, non-U.S. persons may make their location decisions based on business considerations such as maintaining 24-hour operations or the value of local market expertise. Thus, restructuring business lines or relocating personnel (or the activities performed by U.S. personnel) to avoid the United States could result in less efficient operations for non-U.S. persons active in the security-based swap market.

The proposed exception would benefit non-U.S. persons by offering them an alternative to costly relocation or restructuring that would still permit them to avoid some of the costs associated with assessing their market-facing activity while also reducing the likelihood that their market-facing activity crosses the de minimis threshold. As discussed in detail below, the availability of the proposed exception would be conditioned on the use of a registered entity and compliance with certain Title VII requirements designed to protect counterparties but not all Title VII requirements. To the extent that the costs of compliance with these proposed conditions as part of Alternative 1 and Alternative 2 are lower than the compliance costs in the absence of the proposed amendment and the costs of business restructuring, the exception could reduce the regulatory cost burden for the non-U.S. person or group.

The Commission recognizes that U.S.-based dealing entities may use the proposed exception by booking transactions with non-U.S. counterparties into non-U.S. affiliates, thereby avoiding the application of the full set of security-based swap dealer requirements to those transactions and the associated security-based swaps.[352] As discussed further in part VII.B.1.b

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approximately $30,000. The Commission notes that the foregoing is one of the ways in which a non-U.S. person might choose to restructure its business activities. Other restructuring methods, such as the relocation of U.S. personnel to locations outside the United States, potentially would be more costly.

[352] See parts III.A and VII.A.7, supra.

infra, U.S.-based dealing entities that use the conditional exception in this manner may benefit by incurring lower compliance costs when providing liquidity to non-U.S. counterparties.

The Commission's designation of a listed jurisdiction by order could signal to non-U.S. counterparties that a non-U.S. person was subject to a regulatory regime that, at a minimum, is consistent with the public interest in terms of financial responsibility requirements, the jurisdiction's supervisory compliance program, the enforcement authority in connection with those requirements, and other factors the Commission may consider. This process potentially provides a certification benefit to non-U.S. persons availing themselves of the proposed exception by demonstrating to non-U.S. counterparties the applicability of regulatory requirements that would be in the public interest.

Table 2 summarizes the quantifiable costs the Commission estimates non-U.S. persons could incur as a result of the conditions associated with the proposed exception. The per-entity cost estimates assume the de novo formation of a security-based swap dealer or broker-dealer. The Commission expects that these are likely upper bounds for per-entity costs for two reasons. First, non-U.S. persons may already be regulated by jurisdictions with similar requirements and, as a consequence of foreign regulatory requirements, may already have established infrastructure, policies, and procedures that would facilitate meeting the conditions of the proposed exception. For example, a non-U.S. person regulated by a jurisdiction with similar trade acknowledgement and verification requirements would likely already have an order management system in place capable of complying with Rule 15Fi-2, making development of a novel system for the purpose of taking advantage of the proposed exception unnecessary. Second, non-U.S. persons that already have an affiliated registered security-based swap dealer (under Alternative 1 or 2) or an affiliated registered broker-dealer (under Alternative 2) likely

would use their existing registered affiliates to rely on the proposed exception rather than register new entities.

Table 2: Estimates of Quantifiable Costs Associated With Proposed Amendment to Rule 3a71-3[353]

	Initial Costs		Ongoing Costs	
	Per entity	Aggregate	Per entity	Aggregate
Registered entity				
Security-based swap dealer registration	$514,000	$12,336,000	$2,705	$64,920
Security-based swap dealer capital requirement			$3,000,000	$72,000,000
Applicable SBSD requirements	$11,688,700	$280,528,800	$522,900	$12,549,600
Recordkeeping:				
• If registered entity is a registered security-based swap dealer and registered broker-dealer	$437,444	$10,498,656	$101,278	$2,430,672
• If registered entity is a stand-alone registered SBSD	$231,988	$5,567,712	$59,541	$1,428,984
• If registered entity is a bank registered SBSD	$178,534	$4,284,816	$42,952	$1,030,848
Trading relationship documentation	$3,000	$72,000	$3,528	$84,672
Consent to service of process	$409	$9,816		
Broker-dealer registration[354]	$291,500	$7,000,000	$53,000	$1,272,000
Broker-dealer capital requirement[355]			$35,300	$847,200
Non-U.S. entity				
Trading relationship documentation	$3,000	$72,000	$7,056	$169,344
Consent to service of process	$409	$9,816		
Disclosure of limited Title VII applicability	$29,715 and 100 hours	$713,160 and 2,400 hours		
"Listed jurisdiction" applications	$115,920	$347,760		

Under Alternative 1, if a non-U.S. person, or its affiliated group, seeks to utilize the exception, that person, or its affiliated group, would incur the cost of registering one U.S. based

353 Unless otherwise stated, cost estimates presented in Table 2 apply to both Alternatives 1 and 2.

354 Cost applicable only to Alternative 2.

355 Cost applicable only to Alternative 2.

entity as a security-based swap dealer (if there otherwise is not an affiliated security-based swap dealer present).[356] The Commission estimates per entity initial costs of registering a security-based swap dealer of approximately $514,000.[357] In addition, the non-U.S. person or its affiliated group would incur ongoing costs associated with its registered security-based swap dealer of approximately $2,705.[358] Based on the Commission's estimate that up to 24[359] persons might avail themselves of Alternative 1, the aggregate initial costs associated with registering security-based swap dealers under Alternative 1 would be approximately $12,336,000 and the aggregate ongoing costs would be approximately $64,920.[360] The U.S. person affiliate of such a non-U.S. person or affiliated group would also be required to meet minimum capital requirements as a registered security-based swap dealer.[361] At a minimum, the Commission

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356 This is a Title VII programmatic cost and is in addition to other Title VII programmatic costs discussed in part VII.B.1.b, infra.

357 These estimates incorporate quantifiable initial costs presented in the Registration Adopting Release, 80 FR at 48990-48995 and 49005-49006, adjusted for CPI inflation using data from the Bureau of Labor Statistics between 2015 and 2018. Specifically, per entity initial costs are estimated in 2015 dollars as $11,886 (filing Form SBSE) + $12,125 (senior officer certification) + $410,310 (associated natural person certifications) + $24,735 (associated entity person certifications) + $25,424.50 (initial filing of Schedule F) = $484,480.50, and adjusted by 1.06 to $513,549.30 or approximately $514,000 in current dollars.

358 These estimates incorporate quantifiable annual costs presented in the Registration Adopting Release, 80 FR at 48990-48995 and 49005-49006, adjusted for CPI inflation using data from the Bureau of Labor Statistics between 2015 and 2018. Specifically, ongoing costs are estimated in 2015 dollars as $849 (amending Form SBSE) + $1,373.25 (amending Schedule F) + $46.31 (retaining signature pages) + $283 (filing withdrawal form) = $2,551.56, and adjusted by 1.06 to $2,704.65 or approximately $2,705 in current dollars.

359 See part VII.A.7, supra.

360 Aggregate initial costs calculated as 24 x $514,000 = $12,336,000. Aggregate ongoing costs calculated as 24 x $2,705 = $64,920.

361 Under proposed rules, a registered non-bank security-based swap dealer may be subject to minimum fixed-dollar capital requirements of $20 million or $1 billion in net capital and $100 million or $5 billion in tentative net capital, depending in part on whether it is a stand-alone security-based swap dealer or a security-based swap dealer that is dually registered as a broker-dealer, and on whether it uses models to compute deductions for market and credit risk. See Capital, Margin and Segregation Proposing Release, 77 FR at 70329, 70333. Registered security-

estimates the ongoing cost of this capital to be approximately $3 million[362] per entity and $72 million in aggregate.[363] To the extent that this capital is held in liquid assets[364] that generate a positive return to the registered security-based swap dealer, that positive return could be used to offset, at least in part, the ongoing cost of capital.

In addition to registering security-based swap dealers, U.S. person affiliates of non-U.S. persons seeking to rely on Alternative 1 would be required to comply with applicable security-based swap dealer requirements, including those related to disclosures of risks, characteristics, incentives, and conflicts of interest, suitability, communications, trade acknowledgment and

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based swap dealers that have a prudential regulator must comply with capital requirements that the prudential regulators have prescribed. See 80 FR 74840 (Nov. 30, 2015) (adopting capital requirements for bank security-based swap dealers).

362 This estimation assumes that the registered entity must maintain a minimum of $20 million in net capital. See note 361, supra. The Commission estimated the cost of capital in two ways. First, the time series of average return on equity for all U.S. banks between the fourth quarter 1983 and the first quarter 2018 (see Federal Financial Institutions Examination Council (US), Return on Average Equity for all U.S. Banks [USROE], retrieved from FRED, Federal Reserve Bank of St. Louis on December 7, 2018, available at https://fred.stlouisfed.org/series/USROE), are averaged to arrive at an estimate of 11.26%. The cost of capital is calculated as 11.26% x $20 million = $2.252 million or approximately $2.3 million. The Commission preliminarily believes that use of the historical return on equity for U.S. banks adequately captures the cost of capital because of the 12 persons that potentially may use the proposed exception, eight are banks and three have bank affiliates. See part VII.A.7 supra. To the extent that this approach does not adequately capture the cost of capital of persons that are not banks or have no bank affiliates, the Commission supplements the estimation by also using the annual stock returns on financial stocks to calculate the cost of capital. With this second approach, the annual stock returns on a value-weighted portfolio of financial stocks from 1983 to 2017 (see Professor Ken French's website, available at http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html) are averaged to arrive at an estimate of 16.96%. The cost of capital is calculated as 16.96% x $20 million = $3.392 million or approximately $3.4 million. The final estimate of the cost of capital is the average of $2.3 million and $3.4 million = (2.3 + 3.4)/2 = $2.85 million or approximately $3 million.

363 Aggregate costs calculated as $3 million x 24 entities = $72 million.

364 See Capital, Margin and Segregation Proposing Release, 77 FR at 70219.

verification, and portfolio reconciliation.[365] The Commission estimates initial costs associated with these requirements of up to approximately $11,688,700 per entity,[366] or up to $280,528,800 in aggregate,[367] and ongoing costs associated with these requirements of approximately $522,900 per entity,[368] or up to $12,549,600 in aggregate.[369]

Under Alternative 1, the registered security-based swap dealer also would be responsible for creating and maintaining books and records related to the transactions subject to the exception that are required, as applicable, by Exchange Act Rules 18a-5 and 18a-6, including any books and records requirements relating to the provisions specified in proposed paragraph

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365 See proposed Rule 3a71-3(d)(1)(ii)(B). The costs of complying with applicable security-based swap dealer requirements under proposed Alternative 1 are Title VII programmatic costs and are in addition to other Title VII programmatic costs discussed in part VII.B.1.b, infra.

366 These estimates incorporate quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30092-30093, 30111, 30117, 30126, the Trade Acknowledgement and Verification Adopting Release, 81 FR at 39839, and the Risk Mitigation Proposing Release, 84 FR at 4658-4659, adjusted for CPI inflation, where applicable, using data from the Bureau of Labor Statistics between 2016 and 2018. Specifically, initial costs associated with disclosures, suitability, communications, and trade acknowledgement and verification are estimated in 2016 dollars as $906,666.67 (disclosures) + $ 523,640 (suitability) + $16,680 (communications) + $128,550 (trade acknowledgement and verification) = $1,575,536.67, and adjusted by 1.05 to $1,654,313.50 in current dollars. The cost associated with disclosures has been adjusted to account for the fact that the disclosures of clearing rights and daily mark are not part of proposed paragraph (d)(1)(ii)(B)(*1*) of Rule 3a71-3. Initial costs associated with portfolio reconciliation are estimated in current dollars as $10,034,360. Per entity initial costs = $1,654,313.50 + $10,034,360 = $11,688,673.50 or approximately $11,688,700.00.

367 Aggregate initial costs = Per entity initial costs of $11,688,700.00 x 24 entities = $280,528,800.

368 These estimates incorporate quantifiable ongoing costs presented in the Business Conduct Adopting Release, 81 FR at 30092-30093, 30111, 30126, the Trade Acknowledgement and Verification Adopting Release, 81 FR at 39839, and the Risk Mitigation Proposing Release, 84 FR at 4658-4659, adjusted for CPI inflation, where applicable, using data from the Bureau of Labor Statistics between 2016 and 2018. Specifically, ongoing costs associated with disclosures, communications, and trade acknowledgement and verification are estimated in 2016 dollars as $392,533.33 (disclosures) + $89,094 (trade acknowledgement and verification) = $481,627.33, and adjusted by 1.05 to $505,708.70 in current dollars. The cost associated with disclosures has been adjusted to account for the fact that the disclosures of clearing rights and daily mark are not part of proposed paragraph (d)(1)(ii)(B)(*1*) of Rule 3a71-3. Ongoing costs associated with portfolio reconciliation are estimated in current dollars as $17,180. Per entity ongoing costs = $505,708.70 + $17,180 = $522,888.70 or approximately $522,900.

369 Aggregate ongoing costs = Per entity ongoing costs of $522,900 x 24 entities = $12,549,600.

(d)(1)(iii)(B).[370] If the registered security-based swap dealer is also a registered broker-dealer, then it would need to comply with Exchange Act Rules 17a-3 and 17a-4. The Commission estimates the initial costs associated with these rules to be approximately $437,444 per entity,[371]

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370 See proposed paragraph (d)(1)(iii)(B) of Rule 3a71-3.

371 The per entity initial costs associated with proposed amendments to Exchange Act Rule 17a-3 (assuming the entity is not an ANC broker-dealer) = 150 hours x $283/hour national hourly rate for a compliance manager = $42,450 (See Recordkeeping Proposing Release, 79 FR at 25262 for burden hours). The $283 per hour figure for a compliance manager is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, as modified by Commission staff to account for an 1,800-hour work-year, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead. See Recordkeeping Proposing Release, 79 FR at 25295 n.1403.

To estimate the per entity initial costs associated with current Exchange Act Rule 17a-3, the Commission assumes these costs are proportional to the per entity ongoing costs associated with current Exchange Act Rule 17a-3. Further, the Commission assumes that this proportion is equal to the proportion of per entity initial costs to per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-3. As discussed in note 373 infra, the Commission estimates the per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-3 as $12,288. The proportion of per entity initial costs to per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-3 is $42,450/$12,288 or approximately 3.5. The per entity initial costs associated with current Exchange Act Rule 17a-3 is estimated as 3.5 x $53,880.83 (per entity ongoing costs associated with current Exchange Act Rule 17a-3, see note 373 infra) = $188,582.91.

The per entity initial costs associated with proposed amendments to Exchange Act Rule 17a-4 (assuming the entity is not an ANC broker-dealer) = 156 hours x $312/hour national hourly rate for a senior database administrator = $48,672. (See Recordkeeping Proposing Release, 79 FR at 25265 for burden hours). The $312 per hour figure for a senior database administrator is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, as modified by Commission staff to account for an 1,800-hour work-year, and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

To estimate the per entity initial costs associated with current Exchange Act Rule 17a-4, the Commission assumes these costs are proportional to the per entity ongoing costs associated with current Exchange Act Rule 17a-4. Further, the Commission assumes that this proportion is equal to the proportion of per entity initial costs to per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-4. As discussed in note 373 infra, the Commission estimates the per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-4 as $7,928. The proportion of per entity initial costs to per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-4 is $48,672/$7,928 or approximately 6.2. The per entity initial costs associated with current Exchange Act Rule 17a-4 is estimated as 6.2 x $21,448 (per entity ongoing costs associated with current Exchange Act Rule 17a-4, see note 373 infra) = $132,977.60.

The per entity initial costs associated with amendments to Exchange Act Rules 17a-3 and 17a-4 = $42,450 + $188,582.91 + 48,672 + $132,977.60 = $412,682.51, and adjusted by 1.06 CPI

or up to $10,498,656 in aggregate,[372] and ongoing costs associated with these rules of approximately $101,278 per entity,[373] or up to $2,430,672 in aggregate.[374] If the registered security-based swap dealer is a stand-alone registered security-based swap dealer, then it would need to comply with Exchange Act Rules 18a-5 and 18a-6. The Commission estimates the initial costs associated with these rules to be approximately $231,988 per entity,[375] or up to $5,567,712

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inflation between 2014 and 2018 (from the Bureau of Labor Statistics) to $437,443.46 in current dollars or approximately $437,444.

372 Aggregate initial costs = Per entity initial costs of $437,444 x 24 entities = $10,498,656.

373 The per entity ongoing costs associated with current Exchange Act Rule 17a-3 = 673.40 hours x $64/hour national hourly rate for a compliance clerk + per entity external costs of $10,783.23 = $53,880.83. Per entity ongoing burden hours = total burden hours of 2,763,612/4,104 broker-dealer respondents = 673.40 hours. Per entity external costs = total external costs of $44,254,361/4,104 broker-dealer respondents = $10,783.23. For number of respondents, total burden hours, and total external costs, see Commission, "Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-3" (Mar. 9, 2017), available at https://www.reginfo.gov/public/do/DownloadDocument?objectID=72125401. The $64 per hour figure for a compliance clerk is from SIFMA's Office Salaries in the Securities Industry 2013, as modified by Commission staff to account for an 1,800-hour work-year, and multiplied by 2.93 to account for bonuses, firm size, employee benefits, and overhead.

The per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-3 (assuming the entity is not an ANC broker-dealer) = 192 hours x $64/hour national hourly rate for a compliance clerk = $12,288 (See Recordkeeping Proposing Release, 79 FR at 25262 for burden hours).

The per entity ongoing costs associated with current Exchange Act Rule 17a-4 = 257 hours x $64/hour national hourly rate for a compliance clerk + per entity external costs of $5,000 = $21,448. See Commission, "Supporting Statement for the Paperwork Reduction Act Information Collection Submission for Rule 17a-4" (Oct. 19, 2016), available at https://www.reginfo.gov/public/do/DownloadDocument?objectID=68823501.

The per entity ongoing costs associated with proposed amendments to Exchange Act Rule 17a-4 (assuming the entity is not an ANC broker-dealer) = 72 hours x $64/hour national hourly rate for a compliance clerk + per entity external costs of $3,320 = $7,928 (See Recordkeeping Proposing Release, 79 FR at 25265 for burden hours and external costs).

The total per entity ongoing costs = $53,880.83 + $12,288 + $21,448 + $7,928 = $95,544.83, and adjusted by 1.06 CPI inflation between 2014 and 2018 (from the Bureau of Labor Statistics) to $101,277.52 in current dollars or approximately $101,278.

374 Aggregate ongoing costs = Per entity ongoing costs of $101,278 x 24 entities = $2,430,672.

375 The per entity initial costs associated with Exchange Act Rule 18a-5 (assuming that the stand-alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 320 hours x $283/hour national hourly

in aggregate,[376] and ongoing costs associated with these rules of approximately $59,541 per entity,[377] or up to $1,428,984 in aggregate.[378] The discussion in part VII.A.7 above suggests that a number of the persons that may make use of the proposed exception likely would be banks.[379] In light of this finding, the Commission also presents cost estimates associated with Exchange Act Rules 18a-5 and 18a-6 under the assumption that the registered security-based swap dealer is a bank registered security-based swap dealer. The Commission estimates the initial costs

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rate for a compliance manager + per entity external costs of $1,000 = $91,560 (See Recordkeeping Proposing Release, 79 FR at 25262 for burden hours and external costs). See note 371, supra, for a derivation of the national hourly rate for a compliance manager.

The per entity initial costs associated with Exchange Act Rule 18a-6 (assuming that the stand-alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 408 hours x $312/hour national hourly rate for a senior database administrator = $127,296 (See Recordkeeping Proposing Release, 79 FR at 25265 for burden hours). See note 371, supra, for a derivation of the national hourly rate for a senior database administrator.

The per entity initial costs associated with Exchange Act Rules 18a-5 and 18a-6 = $91,560 + 127,296 = $218,856, and adjusted by 1.06 CPI inflation between 2014 and 2018 (from the Bureau of Labor Statistics) to $231,987.36 in current dollars or approximately $231,988.

376 Aggregate initial costs = Per entity initial costs of $231,988 x 24 entities = $5,567,712.

377 The per entity ongoing costs associated with Exchange Act Rule 18a-5 (assuming that the stand-alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 400 hours x $64/hour national hourly rate for a compliance clerk + per entity external costs of $4,650 = $30,250 (See Recordkeeping Proposing Release, 79 FR at 25262 for burden hours and external costs). See note 373, supra, for a derivation of the national hourly rate for a compliance clerk.

The per entity ongoing costs associated with Exchange Act Rule 18a-6 (assuming that the stand-alone registered security-based swap dealer does not have a prudential regulator and is not an ANC stand-alone registered security-based swap dealer) = 310 hours x $64/hour national hourly rate for a compliance clerk + per entity external costs of $6,080 = $25,920. (See Recordkeeping Proposing Release, 79 FR at 25265 for burden hours and external costs).

The per entity ongoing costs associated with Exchange Act Rules 18a-5 and 18a-6 = $30,250 + 25,920 = $56,170, and adjusted by 1.06 CPI inflation between 2014 and 2018 (from the Bureau of Labor Statistics) to $59,540.20 in current dollars or approximately $59,541.

378 Aggregate ongoing costs = Per entity ongoing costs of $59,541 x 24 entities = $1,428,984.

379 See part VII.A.7, supra, stating that of the 12 persons identified in 2017 TIW data as potential users of the proposed exception, eight are banks.

associated with these rules to be approximately $178,534 per entity,[380] or up to $4,284,816 in aggregate,[381] and ongoing costs associated with these rules of approximately $42,952 per entity,[382] or up to $1,030,848 in aggregate.[383]

The registered security-based swap dealer also must obtain from the non-U.S. person relying on the exception, and maintain, documentation encompassing all terms governing the trading relationship between the non-U.S. person and its counterparty relating to the transactions subject to this exception, including, without limitation, terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of

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380 The per entity initial costs associated with Exchange Act Rule 18a-5 (assuming that the registered security-based swap dealer has a prudential regulator) = 260 hours x $283/hour national hourly rate for a compliance manager = $73,580 (See Recordkeeping Proposing Release, 79 FR at 25262 for burden hours). See note 371, supra, for a derivation of the national hourly rate for a compliance manager.

The per entity initial costs associated with Exchange Act Rule 18a-6 (assuming that the registered security-based swap dealer has a prudential regulator) = 304 hours x $312/hour national hourly rate for a senior database administrator = $94,848 (See Recordkeeping Proposing Release, 79 FR at 25265 for burden hours). See note 371, supra, for a derivation of the national hourly rate for a senior database administrator.

The per entity initial costs associated with Exchange Act Rules 18a-5 and 18a-6 = $73,580 + $94,848 = $168,428, and adjusted by 1.06 CPI inflation between 2014 and 2018 (from the Bureau of Labor Statistics) to $178,533.68 in current dollars or approximately $178,534.

381 Aggregate initial costs = Per entity initial costs of $178,534 x 24 entities = $4,284,816.

382 The per entity ongoing costs associated with Exchange Act Rule 18a-5 (assuming that the registered security-based swap dealer has a prudential regulator) = 325 hours x $64/hour national hourly rate for a compliance clerk = $20,800 (See Recordkeeping Proposing Release, 79 FR at 25262 for burden hours). See note 373, supra, for a derivation of the national hourly rate for a compliance clerk.

The per entity ongoing costs associated with Exchange Act Rule 18a-6 (assuming that the registered security-based swap dealer has a prudential regulator) = 230 hours x $64/hour national hourly rate for a compliance clerk + per entity external costs of $5,000 = $19,720. (See Recordkeeping Proposing Release, 79 FR at 25265 for burden hours and external costs).

The per entity ongoing costs associated with Exchange Act Rules 18a-5 and 18a-6 = $20,800 + 19,720 = $40,520, and adjusted by 1.06 CPI inflation between 2014 and 2018 (from the Bureau of Labor Statistics) to $42,951.20 in current dollars or approximately $42,952.

383 Aggregate ongoing costs = Per entity ongoing costs of $42,952 x 24 entities = $1,030,848.

obligations upon termination, transfer of rights and obligations, allocation of any applicable regulatory reporting obligations, governing law, valuation, and dispute resolution.[384] The Commission preliminarily believes that both the registered entity and its non-U.S. affiliate will incur costs to comply with this condition. However as discussed above, the Commission preliminarily believes that the costs incurred by the registered entity would be passed on to the non-U.S. affiliate.[385] For registered entities, the Commission estimates the initial costs associated with this condition to be approximately $3,000 per registered entity,[386] or up to $72,000 in aggregate,[387] and ongoing costs associated with this condition of approximately $3,528 per registered entity,[388] or up to $84,672 in aggregate.[389] For non-U.S. entities, the Commission estimates the initial costs associated with this condition to be approximately $3,000

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384 See note 370, supra.

385 See part VIII.A.4.e, infra.

386 Per entity initial costs = 10 hours x $283/hour national hourly rate for a compliance manager = $2,830. See note 371, supra, for a derivation of the national hourly rate for a compliance manager. Adjusting for CPI inflation using data from the Bureau of Labor Statistics between 2014 and 2018, the per entity initial costs in current dollars = $2,830 x 1.06 = $2,999.80 or approximately $3,000.

387 Aggregate initial costs = Per entity initial costs of $3,000 x 24 entities = $72,000.

388 Per entity ongoing costs = 1 hour x 52 weeks x $64/hour national hourly rate for a compliance clerk= $3,328. See note 373, supra, for a derivation of the national hourly rate for a compliance clerk. Adjusting for CPI inflation using data from the Bureau of Labor Statistics between 2014 and 2018, the per entity initial costs in current dollars = $3,328 x 1.06 = $3,527.68 or approximately $3,528.

389 Aggregate ongoing costs = Per entity ongoing costs of $3,528 x 24 entities = $84,672.

per non-U.S. entity,[390] or up to $72,000 in aggregate,[391] and ongoing costs associated with this condition of approximately $7,056 per non-U.S. entity,[392] or up to $169,344 in aggregate.[393]

The registered security-based swap dealer also would be responsible for obtaining from the non-U.S. person relying on this exception written consent to service of process for any civil action brought by or proceeding before the Commission, providing that process may be served on the non-U.S. person by service on the registered entity in the manner set forth in the registered entity's current Form SBSE, SBSE-A, or SBSE-BD, as applicable.[394] The Commission preliminarily believes that both the registered entity and its non-U.S. affiliate will incur one-time costs to comply with this condition.[395] For registered entities, the Commission estimates the one-time costs associated with this condition to be approximately $409 per registered entity,[396] or up to $9,816 in aggregate.[397] For non-U.S. entities, the Commission estimates the one-time costs associated with this condition to be approximately $409 per non-

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390 Per entity initial costs in current dollars = 10 hours x $283/hour national hourly rate for a compliance manager x 1.06 CPI inflation adjustment = $2,999.80 or approximately $3,000. See note 386, supra.

391 Aggregate initial costs = Per entity initial costs of $3,000 x 24 entities = $72,000.

392 Per entity ongoing costs in current dollars = 2 hours x 52 weeks x $64/hour national hourly rate for a compliance clerk x 1.06 CPI inflation adjustment = $7,055.36 or approximately $7,056. See note 388, supra.

393 Aggregate ongoing costs = Per entity ongoing costs of $7,056 x 24 entities = $169,344.

394 See proposed paragraph (d)(1)(iii)(B)(3) of Rule 3a71-3.

395 See part VIII.A.2.f, infra. The Commission assumes that the burden will be allocated equally between the registered entity and the non-U.S. affiliate.

396 Per entity initial costs = 1 hour x $409/hour for national hourly rate for an attorney = $409. The hourly cost figure is based upon data from SIFMA's Management & Professional Earnings in the Securities Industry 2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead).

397 Aggregate initial costs = Per entity initial costs of $409 x 24 entities = $9,816.

U.S. entity,[398] or up to $9,816 in aggregate.[399] To the extent both parties agree to use an industry-standard consent provision,[400] these costs may be limited.

Under Alternative 2, if a non-U.S. person, or its affiliated group, seeks to utilize the exception, that person, or its affiliated group, may incur the cost of registering one entity as a broker-dealer (if there otherwise is not an affiliated broker-dealer present) or as a security-based swap dealer. Because the conditions for using a security-based swap dealer to utilize the exception under Alternative 1 are identical to the conditions under Alternative 2, non-U.S. persons who avail themselves of the proposed exception by registering a security-based swap dealer under Alternative 2 would incur the same costs described above for registering a security-based swap dealer under Alternative 1.

Alternatively, a non-U.S. person could choose to use the exception permitted under Alternative 2 by using a registered broker-dealer to conduct U.S. activity. A non-U.S. person choosing this option could incur initial and ongoing costs associated with registering an affiliate as a broker-dealer. The Commission preliminarily estimates the costs of registering a new broker-dealer to be approximately $291,500,[401] and estimate ongoing costs of meeting registration requirements as a broker-dealer to be approximately $53,000[402] per year. Based on

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398 See note 396, supra.

399 See note 397 supra.

400 See part VIII.A.2.f, infra.

401 The Commission previously estimated that an entity would incur costs of $275,000 to register as a broker-dealer and become a member of a national securities association. See Crowdfunding, Exchange Act Release No. 76324 (October 30, 2015), 80 FR 71388 (November 16, 2015) ("Regulation Crowdfunding Adopting Release"), 80 FR at 71509. Accounting for CPI inflation between 2015 and 2018, the Commission now estimates that an entity would incur costs of $275,000 x 1.06 = $291,500 to register as a broker-dealer and become a member of a national securities association.

402 The Commission previously estimated that an entity would incur ongoing annual costs of $50,000 to maintain broker-dealer registration and membership of a national securities association. See

the Commission's estimate that up to 24[403] persons might avail themselves of the proposed exception and assuming that these persons choose to do so by using registered broker-dealers permitted under Alternative 2, the Commission preliminarily estimates the aggregate costs of broker-dealer registration to be approximately $7 million[404] and the aggregate ongoing costs of meeting broker-dealer registration requirements to be approximately $1.272 million[405] per year. Non-U.S. persons meeting the conditions of the proposed exception under Alternative 2 by using a registered broker-dealer would additionally incur the cost of complying with applicable requirements associated with the registered broker-dealer status, including maintaining a minimum level of net capital. The Commission estimates the ongoing cost of this capital to be approximately $35,300[406] per entity. If the up to 24 persons that might use the proposed

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Regulation Crowdfunding Adopting Release, 80 FR at 71509. Accounting for CPI inflation between 2015 and 2018, the Commission now estimates that an entity would incur ongoing annual costs of $50,000 x 1.06 = $53,000 to maintain broker-dealer registration and membership of a national securities association. The estimation of ongoing annual costs is based on the assumption that the entity would use existing staff to perform the functions of the registered broker-dealer and would not incur incremental costs to hire new staff. To the extent that the entity chooses to hire new staff, the ongoing annual costs may be higher.

403 See part VII.A.7, supra.

404 Aggregate broker-dealer registration costs calculated as $291,500 x 24 entities = $6,996,000 or approximately $7,000,000.

405 Aggregate ongoing costs of meeting broker-dealer registration requirements calculated as = $53,000 x 24 entities = $1,272,000.

406 The Commission assumes that the registered entity must maintain a minimum of $250,000 in net capital. See Exchange Act Rule 15c3-1. The Commission preliminarily believes that the methodology for estimating the cost of capital of a registered security-based swap dealer under proposed Alternative 1 is also appropriate for estimating the cost of capital of a registered broker-dealer under proposed Alternative 2 (see note 362, supra). Using the historical return on equity for all U.S. banks, the Commission calculated the cost of capital as 11.26% x $250,000 = $28,150 or approximately $28,200. The Commission preliminarily believes that use of the historical return on equity for U.S. banks adequately captures the cost of capital because of the 12 persons that potentially may use the proposed exception, 8 are banks and 3 have bank affiliates. See part VII.A.7 supra. To the extent that this approach does not adequately capture the cost of capital of persons that are not banks or have no bank affiliates, the Commission supplements the estimation by also using the annual stock returns on financial stocks to calculate the cost of capital. With this second approach, the Commission calculated the cost of capital as 16.96% x $250,000 = $42,400.

exception choose to do so by using registered broker-dealers permitted under Alternative 2, the estimated aggregate ongoing cost of capital is approximately $847,200[407]. To the extent that this capital is held in liquid assets[408] that generate a positive return to the registered broker-dealer, that positive return would offset, at least in part, the ongoing cost of capital.

All non-U.S. persons using the proposed exception under Alternative 2 would incur the cost of complying with security-based swap dealer requirements related to disclosures of risks, characteristics, incentives, and conflicts of interest, suitability, communications, trade acknowledgment and verification, and portfolio reconciliation;[409] and requirements related to providing the Commission access to books, records and testimony[410] quantified above in connection with Alternative 1, regardless of whether these persons meet the conditions of Alternative 2 using a registered broker-dealer or a registered security-based swap dealer.

To the extent that a non-U.S. person has an existing, registered broker-dealer affiliate[411] and uses that affiliate to rely on the conditional exception under Alternative 2, the non-U.S. person would not incur costs associated with registering a broker-dealer and the incremental compliance cost would be limited to costs associated with complying with the restricted set of security-based swap dealer requirements as discussed above.

The final estimate of the cost of capital is the average of $28,200 and $42,400 = (28,200 + 42,400)/2 = $35,300.

407 Aggregate ongoing cost of capital calculated as $35,300 x 24 entities = $847,200.

408 See Exchange Act Rule 15c3-1.

409 See Alternative 2 proposed paragraph (d)(1)(ii)(B) of Rule 3a71-3.

410 See Alternative 2 proposed paragraph (d)(1)(iii)(B) and (C) of Rule 3a71-3.

411 Analyses of 2017 TIW data indicate that of the six non-U.S. persons that potentially may use the proposed exception, four have majority-owned registered broker-dealer affiliates. See part VII.A.7, supra.

Although costly, the Commission preliminarily believes that the conditions associated with the proposed exception afford appropriate counterparty protections under Title VII and the Commission has considered the benefits of these specific Rule provisions in prior Commission releases.[412] In the context of the proposed exception, these conditions would benefit non-U.S. counterparties. Moreover, the registered entity that is a majority-owned affiliate of the non-U.S. person availing itself of the proposed exception under Alternative 1 or Alternative 2 would be required to disclose to non-U.S. counterparties, in connection with each transaction covered by the proposed exception, that the non-U.S. person is not registered with the Commission and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps do not apply in connection with the transaction. The Commission preliminarily believes that non-U.S. persons would incur an upfront cost of $713,160 and 2,400 hours[413] to develop appropriate disclosures, but that non-U.S. persons using the proposed exception would integrate these disclosures into existing trading systems so that the ongoing costs of delivering these disclosures would be insubstantial. Furthermore, disclosures are only required when the identity of the counterparty is known to the registered entity, so anonymous transactions would not be subject to this requirement.[414]

These required disclosures would benefit non-U.S. counterparties by informing them of the regulatory treatment of transactions under the proposed exception. To the extent that non-

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412 See Business Conduct Adopting Release, Trade Acknowledgement and Verification Adopting Release, Recordkeeping Proposing Release, and Risk Mitigation Proposing Release.

413 See part VIII.A.4.a and note 525, infra stating that each non-U.S. person would spend 100 hours and incur approximate costs of $29,715 to develop policies and procedures to help ensure that appropriate disclosures are provided. The aggregate upfront costs are = $29,715 x 24 entities = $713,160. The aggregate burden hours are = 100 x 24 entities = 2,400 hours.

414 See note 148, supra, for circumstances in which the registered entity engaged would not know the identity of the counterparty.

U.S. counterparties value elements of the Title VII regulatory framework that do not apply to transactions under the proposed exception, they may attempt to negotiate more favorable prices to compensate themselves for the additional risks they may perceive. Alternatively, non-U.S. counterparties that prefer transactions fully covered by the Commission's security-based swap regulatory framework could search for a registered security-based swap dealer willing to transact with all Title VII protections in place.

In connection with the proposal, a situation may arise where some jurisdictions are designated by order as listed jurisdictions before other jurisdictions, whether the designation is on the Commission's own initiative or in response to applications. To the extent that some jurisdictions become listed jurisdictions earlier than other jurisdictions, non-U.S. persons operating in jurisdictions that become listed jurisdictions earlier than other jurisdictions potentially could rely on the conditional exception sooner than, and may gain a competitive advantage over, non-U.S. persons operating in jurisdictions that become listed jurisdictions at a later date. In particular, non-U.S. persons operating in jurisdictions that become listed jurisdictions earlier than other jurisdictions and that rely on the exception may incur lower regulatory burdens[415] than non-U.S. persons operating in jurisdictions that become listed jurisdictions at a later date. That said, this cost advantage may be limited if non-U.S. persons operating in jurisdictions that currently are not listed jurisdictions could set up operations in a listed jurisdiction to rely on the exception.

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[415] These non-U.S. persons may incur lower regulatory burdens to the extent that they avoid the costs of assessing market-facing activity and the costs of compliance with conditions set forth under the proposed exception are lower than the compliance costs in the absence of the proposed amendment and the costs of business restructuring. In contrast, non-U.S. persons in unlisted jurisdictions may have to incur the costs of assessing market-facing activity. Further, for these non-U.S. persons, the costs of complying with the full set of security-based swap dealer requirements and business restructuring may be higher than compliance costs associated with the proposed exception.

An application for listed jurisdiction designation would be filed pursuant to Rule 0-13 and, like the proposed exception, is purely voluntary. Thus, the Commission expects that, to the extent that market participants submit applications for designation of one or more listed jurisdictions, non-U.S. persons would do so only to the extent that they believe that compliance with each relevant jurisdiction's regulatory regime, in combination with the other conditions of the proposed exception, was less burdensome than the alternatives of (i) incurring assessment costs related to de minimis calculations and potential compliance with the Title VII regulatory framework for dealers, and (ii) restructuring their security-based swap businesses to avoid arranging, negotiating, or executing transactions with non-U.S. counterparties using personnel located in the United States. The Commission estimates that three non-U.S. persons that seek to rely on the exception would file listed jurisdiction applications.[416] The Commission estimates the costs associated with each application to be approximately $115,920, or up to $347,760 in aggregate.[417] The Commission notes that any costs incurred by a non-U.S. person in filing an application for a listed jurisdiction may be obviated in part by the provision that permits a foreign financial regulatory authority or authorities supervising such a non-U.S. person or its security-based swap activities to file such an application. Further, to the extent that certain jurisdictions are designated as listed jurisdictions if this proposed amendment is adopted, the

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416 See part VIII.A.4.g, infra.

417 The Commission assumes that the costs associated with filing an application for a qualified jurisdiction designation are the same as the costs associated with filing a substituted compliance request with respect to business conduct requirements. See Business Conduct Adopting Release, 81 FR at 30097 and 30137 and part VIII.A.4.g , infra. The Commission estimates the per entity costs of filing an application in 2016 dollars as: $30,400 (internal counsel) + $80,000 (external counsel) = $110,400. Adjusted for CPI inflation from 2016 to 2018, the per entity costs of filing an application in current dollars are = $110,400 x 1.05 = $115,920. The aggregate costs of filing applications = Per entity costs of $115,920 x 3 entities = $347,760.

non-U.S. persons (or their financial regulatory authorities) in these jurisdictions may avoid the costs of filing an application.

b. Title VII Programmatic Costs and Benefits

The proposed exclusion of transactions that must be counted against the de minimis threshold will affect the set of registered security-based swap dealers subject to security-based swap dealer regulation and in turn determine the allocation and flow of programmatic costs and benefits arising from such regulation.

The Commission preliminarily believes that requiring a non-U.S. person that wishes to make use of the proposed exception to be subject to the margin and capital requirements of a listed jurisdiction when engaging in transactions subject to the proposed exception would support the Title VII regime's programmatic benefit of mitigating risks in foreign security-based swap markets that may flow into U.S. financial markets through liquidity spillovers.[418] Specifically, proposed Rule 3a71-3(d)(1)(v) under both alternatives would require a non-U.S. person relying on the proposed exception to be subject to the margin and capital requirements of a listed jurisdiction when engaging in transactions subject to the proposed exception. As discussed earlier,[419] the listed jurisdiction condition is intended to help avoid creating an incentive for dealers to book their transactions into entities that solely are subject to the regulation of jurisdictions that do not effectively require security-based swap dealers or comparable entities to

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418 As the Commission noted elsewhere, in a highly concentrated global security-based swap market, the failure of a key liquidity provider poses a particularly high risk of propagating liquidity shocks not only to its counterparties but to other participants, including other dealers. To the extent that U.S. persons are significant participants in the market, the liquidity shock may propagate to these U.S. persons, and from these U.S. persons to the U.S. financial system as a whole, even if the liquidity shock originates with the failure of a non-U.S. person liquidity provider. See ANE Adopting Release, 81 FR at 8611-12, 8630.

419 See III.B.5, supra.

meet certain financial responsibility standards. Absent this type of condition, non-U.S. persons that rely on the proposed exception could gain a competitive advantage because they would be able to conduct security-based swap dealing activity in the United States without being subject to even minimal financial responsibility standards and incurring the associated compliance costs. Such non-U.S. persons potentially could provide liquidity to market participants at more favorable prices, but potentially also at greater risk, compared to registered security-based swap dealers. Generally, this proposed condition would benefit non-U.S. counterparties by providing them with assurances that the non-U.S. person has sufficient financial resources to engage in security-based swap activity and that the non-U.S. person's risk exposures to other counterparties are appropriately managed, supporting the Title VII regime's programmatic benefit of preventing risks in foreign security-based swap markets from flowing into U.S. financial markets through liquidity spillovers.

The Commission preliminarily believes that another potential programmatic benefit of the proposed amendment is to reduce market fragmentation and associated distortions. In the ANE Adopting Release, the Commission noted that the "arranged, negotiated, or executed" counting requirement may cause non-U.S. dealers to restructure their operations to avoid using U.S. personnel in order to avoid triggering security-based swap dealer obligations. Such restructuring may result in market fragmentation. Nevertheless, to the extent that the restructuring costs incurred by non-U.S. dealers offset the benefits from avoiding dealer registration, the likelihood or extent of market fragmentation and associated distortions may be attenuated, but not eliminated.[420] The Commission believes that the proposed amendment, by permitting a non-U.S. person further flexibility to opt into a Title VII compliance framework that

[420] See ANE Adopting Release, 81 FR at 8630.

is compatible with its existing business practices, could further reduce the incentives of non-U.S. persons to restructure and further reduce the likelihood or extent of market fragmentation and associated distortions.

The above discussion notwithstanding, the Commission is mindful that the likelihood of market fragmentation and associated distortions might increase if U.S.-based dealing entities rely on the conditional exception by booking transactions with non-U.S. counterparties into non-U.S. affiliates, thereby avoiding the application of the full set of security-based swap dealer requirements to those transactions and the associated security-based swaps.[421] As discussed further below, U.S.-based dealing entities that use the conditional exception in this manner may incur lower compliance costs when providing liquidity to non-U.S. counterparties and may decide to limit their liquidity provision only to non-U.S. counterparties. To the extent that these U.S.-based dealing entities choose to provide liquidity only to non-U.S. counterparties, security-based swap liquidity may fragment into two pools: one pool that caters to U.S. counterparties and another pool that caters to non-U.S. counterparties.

The proposed amendment could promote competition in the security-based swap market to the extent that competitive effects arise from differences between the full set of requirements for registered security-based swap dealers (that otherwise would apply to the non-U.S. entity) and the conditions applicable to the registered U.S. entity under the proposed amendment. As discussed more fully below,[422] a non-U.S. person dealer that uses the exception may become more competitive in the market for liquidity provision because (a) the non-U.S. person dealer may incur lower compliance costs when providing liquidity to non-U.S. counterparties and (b)

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421 See parts III.A and VII.A.7, supra.

422 See part VII.B.2, infra.

non-U.S. counterparties may incur lower costs when transacting with the non-U.S. person dealer. The set of dealing entities that benefit from such competitive effects might expand to the extent that U.S.-based dealing entities that are primarily or wholly responsible for managing interactions with non-U.S. counterparties may rely on the conditional exception by booking transactions into non-U.S. affiliates.[423] Nevertheless, this competitive effect may be attenuated by the condition that makes the exception available only to non-U.S. persons that are subject to the margin and capital requirements of a listed jurisdiction.

The proposed amendment potentially could limit the programmatic benefits of Title VII regulation because the non-U.S. person taking advantage of the conditional exception would not be subject to the full suite of Title VII business conduct and financial responsibility requirements. This limitation of programmatic benefits might increase to the extent that U.S.-based dealing entities that primarily or wholly are responsible for managing interactions with non-U.S. counterparties may rely on the conditional exception by booking transactions into non-U.S. affiliates.[424] Because the non-U.S. person would not be subject to Title VII business conduct requirements, the associated Title VII counterparty protections would not apply to the non-U.S. person's communications with non-U.S. counterparties. The non-U.S. counterparties thus would not benefit from those protections in their dealings with the non-U.S. person relying on the exception, notwithstanding the U.S. arranging, negotiating, and executing activity that led to the transactions at issue.[425]

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423 See part III.A, supra.

424 See id.

425 As discussed in part III.A, supra, the antifraud provisions of the federal securities laws and certain relevant Title VII requirements would continue to apply to the transactions.

Similarly, Title VII financial responsibility requirements applicable to security-based swap dealers would not apply to the non-U.S. person, notwithstanding that the transactions would result from arranging, negotiating, and executing activity in the United States. To the extent that the financial responsibility requirements serve to prevent the spread to U.S. financial markets of financial contagion that originates from the failure of one or more non-U.S. persons engaged in arranging, negotiating, and executing activity in the United States,[426] the fact that these requirements would not apply to non-U.S. persons taking advantage of the conditional exception could limit the ability of the Title VII regulatory regime to protect U.S. financial markets from financial contagion. This concern would be mitigated by the condition that makes the exception available only to non-U.S. persons that are subject to the margin and capital requirements of a listed jurisdiction, which would afford the Commission flexibility to designate jurisdictions with appropriately robust financial responsibility requirements as listed jurisdictions. More generally, competitive disparities and limits to the programmatic effects of Title VII may be offset to the extent that non-U.S. counterparties value the protections afforded them by Title VII regulation and prefer to transact with dealing entities that are subject to the full scope of Title VII regulation, rather than with non-U.S. persons that rely on the conditional exception.

2. Effects on Efficiency, Competition, and Capital Formation

As discussed earlier, the proposed amendment could reduce the regulatory burden for non-U.S. persons that engage in security-based swap arranging, negotiating, and executing activity with non-U.S. counterparties using affiliated U.S.-based personnel because these non-U.S. persons could avail themselves of an additional, potentially lower-cost, means of engaging

426 See ANE Adopting Release, 81 FR at 8612.

in arranging, negotiating, and executing activity with non-U.S. counterparties.[427] To the extent that the regulatory burden for such non-U.S. persons is reduced as a result of the proposed amendment, resources could be freed up for investing in profitable projects, which would promote investment efficiency and capital formation. In addition, a reduction in regulatory burden for such non-U.S. persons could allow these persons to operate their security-based swap dealing business more efficiently. To the extent that these non-U.S. persons carry out security-based swap dealing activity with counterparties around the world[428] and choose to pass on cost savings flowing from their improved efficiency in the form of lower prices for liquidity provision, counterparties around the world could benefit by being able to transact at lower costs. A reduction in regulatory burden associated with the proposed amendment could lower entry barriers into the security-based swap market and increase the number of non-U.S. person dealers that are willing to provide liquidity to non-U.S. counterparties using affiliated U.S.-based personnel. An increase in the number of such non-U.S. person dealers may increase competition for liquidity provision to non-U.S. counterparties, which could lower transaction costs for these counterparties and improve their ability to hedge economic exposures. To the extent that non-U.S. person dealers focus their market-making activities on non-U.S. counterparties and avoid U.S. counterparties, the competition for liquidity provision to U.S. counterparties may decline, which could increase transaction costs for U.S. counterparties and impair their ability to hedge their economic exposures or to incur economic exposures. In addition, to the extent that increased transaction costs reduce the expected profits from trading on new information, market participants may be less willing to transact in the security-based swap market in response to new

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427 See part VII.B.1, supra.

428 See part VII.A.2.c, supra.

information. Such reduced participation in the security-based swap market might impede the incorporation of new information into security-based swap prices, reducing the informational efficiency of these markets.

The proposed amendment might generate certain competitive effects due to gaps between the full set of requirements for registered security-based swap dealers and the conditions applicable to the registered entity of the non-U.S. person under the proposed amendment, [429] though these effects will be tempered to the extent that the non-U.S. person dealer passes on compliance costs incurred by its U.S. registered entity to the non-U.S. counterparty. First, under proposed Rule 3a71-3(d)(1)(C), the exception would not be conditioned on the registered entity of the non-U.S. person dealer having to comply with requirements pertaining to ECP verification, daily mark disclosure, and "know your counterparty."[430] Thus, to the extent that the non-U.S. person adheres only to the provisions specifically required by the conditions set forth under the proposed amendment, the non-U.S. person dealer could incur lower compliance costs in providing liquidity to non-U.S. counterparties than under current rules, relative to the baseline. In that case, the non-U.S. person dealer might be able to lower the price at which it offers liquidity to a non-U.S. counterparty. However, under both alternatives the non-U.S. person must have a U.S. affiliate that is registered with the Commission. The extent to which the non-U.S. person dealer may offer a more competitive price would depend in part on whether the non-U.S. person dealer will pass on compliance costs incurred by its U.S. registered entity to the non-U.S. counterparty in the form of a higher price for providing liquidity to the non-U.S. counterparty.

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429 As context, the use of the "arranged, negotiated, or executed" counting standard was intended in part to avoid allowing competitive disparities between registered security-based swap dealers and entities that otherwise could engage in security-based swap market-facing activity in the United States without having to register as security-based swap dealers. See part I.A.2, supra.

430 See Business Conduct Adopting Release, part II.G.

To the extent that the non-U.S. person dealer offers liquidity to the non-U.S. counterparty at a price that fully recovers the compliance costs incurred by its U.S. registered entity, any price reduction that could be offered by the non-U.S. person dealer might be limited.

Second, a non-U.S. counterparty may prefer to enter into a security-based swap transaction with a non-U.S.-person dealer that takes advantage of the conditional exception, rather than a U.S. registered security-based swap dealer, not only because the non-U.S.-person dealer may offer more competitive prices, but also because the non-U.S. counterparty may itself avoid certain costs by transacting with a non-U.S. person dealer. For example, Title VII financial responsibility requirements applicable to security-based swap dealers would not apply to the non-U.S. person dealer under the proposed amendment, although the non-U.S. person dealer would be subject to the margin and capital requirements of a listed jurisdiction. To the extent that a non-U.S. counterparty has already established with the non-U.S. person dealer the necessary margin agreement that is compliant with the margin requirements of the listed jurisdiction, the non-U.S. counterparty could avoid the additional costs of negotiating and adhering to a new margin agreement that is compliant with the Commission's Title VII margin requirements, if the non-U.S. counterparty transacts with the non-U.S. person dealer.

These competitive effects may create an incentive for entities that carry out their security-based swap dealing business in a U.S.-person dealer with non-U.S. person counterparties to restructure a proportion of this business to be carried out in a non-U.S.-person dealer affiliate.

3. Additional Alternatives Considered

In developing these proposed amendments, the Commission considered a number of additional alternatives. This section outlines these alternatives and discusses the potential economic effects of each.

a. Requiring the Registered Entity to Comply with ECP Verification and "Know Your Counterparty"

When identifying the security-based swap dealer requirements that are applicable to a registered entity for purposes of this rulemaking, the Commission considered requiring the registered entity to comply with ECP verification and "know your counterparty" requirements, along with other security-based swap dealer requirements, even if the registered entity is not a party to the resulting security-based swap. Although this alternative would lead to greater conformity with the full set of security-based swap dealer requirements, the provisions in question may require knowledge that may not be readily available to the registered entity when it engages in limited arranging, negotiating, and executing activity in connection with the security-based swaps addressed by the proposed exception. These operational difficulties may prevent the registered entity from complying with the provisions or may require the registered entity to incur costs to ensure compliance. The Commission estimates that, if included as part of the conditions of the exception, the ECP verification and know your counterparty requirements would impose initial costs of approximately $2,919 per registered entity,[431] or $70,056 in aggregate,[432] and ongoing costs of approximately $91,770 per registered entity,[433] or $2,202,480 in aggregate.[434] Further, the non-U.S. counterparties transacting with the non-U.S. persons

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431 These estimates incorporate quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090-30092, 30110 adjusted for CPI inflation using data from the Bureau of Labor Statistics between 2016 and 2018. Specifically, per entity initial costs are estimated in 2016 dollars as $880 (ECP verification) + $1,900 (know your counterparty) = $2,780, and adjusted by 1.05 to $2,919 in current dollars.

432 Aggregate initial costs = Per entity initial costs of $2,919 x 24 entities = $70,056.

433 These estimates incorporate quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090-30092, 30110 adjusted for CPI inflation using data from the Bureau of Labor Statistics between 2016 and 2018. Specifically, per entity ongoing costs are estimated in 2016 dollars as $87,400, and adjusted by 1.05 to $91,770 in current dollars.

434 Aggregate initial costs = Per entity initial costs of $91,770 x 24 entities = $2,202,480.

making use of the proposed exception that are not also participating in swap markets and relying on industry established verification of status protocol may incur initial costs associated with the verification of status requirement and related adherence letters.[435] The Commission estimates these aggregate initial costs at approximately $460,152.[436] All non-U.S. counterparties (or their agents) transacting with the non-U.S. persons making use of the proposed exception would also be required to collect and provide essential facts to the registered entities to comply with the "know your counterparty" obligations for an aggregate initial cost of approximately $6,439,860.[437] To the extent that the knowledge needed to comply with these requirements may not be readily available to the registered entity and the registered entity has to expend additional resources to obtain that knowledge, the actual costs incurred by the registered entity to comply with these requirements may be higher. The Commission acknowledges that a non-U.S. person making use of the proposed exception potentially could mitigate the compliance costs of the

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435 In the Business Conduct Adopting Release, the Commission assumed that counterparties that are swap market participants likely already adhere to the relevant protocol and would not have any start-up or ongoing burdens with respect to verification. See 81 FR at 30091. The Commission continues to believe that this assumption is valid and thus, for purposes of this alternative, the Commission believes that only non-U.S. counterparties that are not swap market participants will incur verification-related costs. As discussed in part VII.A.7 supra, the Commission preliminarily estimates that up to 24 persons likely may use the proposed exception, and that their registered entity affiliates may arrange, negotiate, or execute transactions with up to 1,614 non-U.S. counterparties, of which 498 do not participate in swap markets.

436 This estimate incorporates quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090-30092, 30110 adjusted for CPI inflation using data from the Bureau of Labor Statistics between 2016 and 2018. Per counterparty initial costs are estimated in 2016 dollars as $500 (initial costs of disclosure of essential facts) + $380 (initial costs of adherence letters) = $880, and adjusted by 1.05 to $924 in current dollars. Aggregate initial costs = Per entity initial costs of $924 x 498 counterparties = $460,152.

437 This estimate incorporates quantifiable initial costs presented in the Business Conduct Adopting Release, 81 FR at 30090-30092, 30110 adjusted for CPI inflation using data from the Bureau of Labor Statistics between 2016 and 2018. Per counterparty initial costs are estimated in 2016 dollars as (In-house attorney at $380 per hour) x 10 hours = $3,800, and adjusted by 1.05 to $3,990 in current dollars. Aggregate initial costs = Per entity initial costs of $3,990 x 1,614 counterparties = $6,439,860.

registered entity by transacting only with non-U.S. counterparties that are known ECPs to the registered entity. By doing so, the registered entity could avoid expending additional resources to learn about the non-U.S. counterparties' ECP status. However, as a result of this approach, the non-U.S. person may have to forgo transacting with new non-U.S. counterparties whose ECP status is not known to the registered entity. The non-U.S. person would thus have to balance the cost savings associated with transacting only with a set of known non-U.S. counterparties against the revenues that may be forgone by not transacting with new non-U.S. counterparties whose ECP status is unknown to the registered entity.

As another alternative, the Commission considered requiring compliance with the ECP verification and "know your counterparty" requirements with a one-time carve out when the non-U.S. counterparty is unknown to the registered entity and there is no basis to believe that the registered entity would have further interactions with that non-U.S. counterparty. Although such a carve out may reduce compliance costs by excluding transactions that likely would pose the greatest operational difficulties in terms of obtaining knowledge needed for complying with the ECP verification and know your counterparty requirements, the Commission is also cognizant that the carve out may create new costs associated with assessing when the carve out would apply. The Commission is concerned that these new assessment costs may impose an additional burden on the registered entity and may offset any reduction in compliance costs associated with a one-time carve out. As with the previous alternative, a non-U.S. person making use of the proposed exception potentially could mitigate the compliance costs of the registered entity by transacting only with non-U.S. counterparties that are ECPs known to the registered entity. As discussed above, the non-U.S. person would thus have to balance the cost savings associated

with this approach against the revenues that may be forgone by not transacting with new non-U.S. counterparties whose ECP status is unknown to the registered entity.

In light of these compliance challenges and the fact that the proposed amendment does include conditions designed to impose a minimum standard of conduct upon security-based swap dealers in connection with their transaction-related activities, the Commission preliminarily believes that the proposed approach is preferable to these alternatives.

b. Requiring the Registered Entity to Comply with Daily Mark Disclosure

The Commission also considered requiring the registered entity to comply with daily mark disclosure, along with other security-based swap dealer requirements, even if the registered entity is not a party to the resulting security-based swap. Similar to the discussion of ECP verification and know your counterparty requirements above, this alternative would lead to greater conformity with the full set of security-based swap dealer requirements, but may require knowledge that may not be readily available to the registered entity when it engages in limited arranging, negotiating, and executing activity in connection with the security-based swaps addressed by the proposed exception. Further, the daily mark disclosure is predicated on the existence of an ongoing relationship between the security-based swap dealer and the counterparty that may not be present in connection with the transactions at issue, and would be linked to risk management functions that are likely to be associated with the entity in which the resulting security-based swap position is located.[438] These operational difficulties may prevent the registered entity from complying with the daily mark disclosure requirement or may require the registered entity to incur an unreasonably high cost to ensure compliance. In light of these

[438] See part III.B.2.a, supra.

compliance challenges and the fact that the proposed amendment does include conditions designed to impose a minimum standard of conduct upon security-based swap dealers in connection with their transaction-related activities, the Commission preliminarily believes that the proposed approach is preferable to this alternative.

c. Requiring a Limited Disclosure of Incentives and Conflicts

As an alternative to the disclosure requirements set forth under proposed Rule 3a71-3(d)(1)(ii)(B)(1), the Commission considered requiring the registered entity to disclose its own material incentives and conflicts of interest, but not requiring the registered entity to disclose the incentives and conflicts of interest of its non-U.S. affiliate. While this alternative might help to mitigate the costs associated with disclosing the incentives and conflicts of interest of the non-U.S. affiliate,[439] the benefits associated with such disclosures[440] may also decrease because non-U.S. counterparties would not know about the incentives and conflicts of interest of the non-U.S. affiliate prior to entering into security-based swaps with the non-U.S. affiliate. In light of this concern, the Commission preliminarily believes that the proposed approach is preferable to this alternative.

d. Requiring the Non-U.S. Person to be Domiciled in a G-20 Jurisdiction or in a Jurisdiction where the Non-U.S. Person would be subject to Basel Capital Requirements

As alternatives to proposed paragraph (d)(1)(v), the Commission considered proposing a requirement that the non-U.S. person be domiciled in a G-20 jurisdiction or in a jurisdiction where the non-U.S. person would be subject to Basel capital requirements as commenters have suggested. While the Commission acknowledges that these alternatives are clearly defined and

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439 See Business Conduct Adopting Release, 81 FR at 30112.

440 See Business Conduct Adopting Release, 81 FR at 30111-12.

would provide certainty to market participants, the Commission preliminarily believes these alternatives potentially could create opportunities for regulatory arbitrage whereby a non-U.S. person may relocate its operations to a jurisdiction that imposes lower financial responsibility standards. The non-U.S. person may thus enjoy a cost advantage relative to other dealers that operate under higher regulatory burdens, while not being subject to equally rigorous financial responsibility standards. Further, as discussed earlier,[441] the fact that a jurisdiction is a member of the G-20 or subscribes to Basel standards does not by itself provide assurance that the jurisdiction has implemented appropriate financial responsibility standards.

e. Not Requiring Notification to Counterparties of the Non-U.S. Person

In proposing the conditions that would apply to the non-U.S. person under Alternative 1 and Alternative 2, the Commission considered omitting the condition that non-U.S. counterparties of the non-U.S. person relying on the exception be notified contemporaneously by the registered entity that the non-U.S. person is not registered as a security-based swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable in connection with the transaction. The omission of this notification condition may reduce cost and thus regulatory burden for the non-U.S. persons that rely on the exception.

However, the absence of this notification condition potentially could reinforce the competitive disparity between the non-U.S. persons that make use of the exception and registered security-based swap dealers that comply with the full set of Title VII security-based

441 See part III.B.5, supra.

swap dealer requirements. As discussed above,[442] non-U.S. persons that avail themselves of the exception could bear lower costs compared to registered security-based swap dealers that have to comply with the full set of security-based swap dealer requirements.

To the extent that non-U.S. counterparties prefer to trade with dealers that are subject to the full set of Title VII security-based swap dealer requirements and the associated safeguards, in the absence of the notification condition, non-U.S. persons that rely on the exception could bear lower regulatory costs than registered security-based swap dealers but may nevertheless be regarded by non-U.S. counterparties to be no different than registered security-based swap dealers, at least with respect to Title VII safeguards. As a result, these non-U.S. persons potentially could capture the business of non-U.S. counterparties from registered security-based swap dealers that they otherwise might not have captured if the notification condition had been part of the exception. In light of this concern, the Commission preliminarily believes that requiring such notification to non-U.S. counterparties is preferable to this alternative.

f. "No Management of Relationship" Condition

When identifying the conditions of the proposed exception, the Commission considered making the exception unavailable where U.S. personnel manage the relationship with the non-U.S. counterparty to the security-based swap. Such a condition might help address concerns that U.S.-based dealers could use the proposed exception to rebook transactions, which are managed by U.S. personnel, to a non-U.S. affiliate to avoid triggering security-based swap dealer registration. However, the Commission recognizes that there may be challenges in articulating objective criteria to identify when the proposed exception would or would not be available under this type of approach. Even if objective criteria could be articulated, non-U.S. persons seeking to

442 See part VII.B.2, supra.

use the proposed exception may have to incur costs to satisfy these criteria on an ongoing basis. In light of these concerns, the Commission preliminarily believes that the proposed approach is preferable to this alternative.

g. Rule 10b-10 in Lieu of Trade Acknowledgement and Verification Requirement

In specifying the requirements that are applicable to the registered entity under Alternative 2, the Commission considered requiring the registered entity to comply with Rule 10b-10 in lieu of the security-based swap dealer trade acknowledgement and verification requirement (Rules 15Fi-1 and 15Fi-2), if the registered entity is a registered broker-dealer that is not also a security-based swap dealer. As discussed earlier,[443] if a non-U.S. person chooses to use a registered broker-dealer under Alternative 2, the non-U.S. person could incur costs associated with the registered broker status, including the cost of complying with Rule 10b-10. Additionally, the non-U.S. person would incur the cost of complying with certain security-based swap dealer requirements, including the trade acknowledgement and verification requirement. The alternative approach could reduce the regulatory burden on the non-U.S. person by obviating the need for its registered broker-dealer affiliate to comply with the trade acknowledgement and verification requirement. However, the Commission preliminarily believes that compliance with the trade acknowledgement and verification requirement may better support the regulation of the security-based swap market. First, the Rule 15Fi-2 requirement that a trade acknowledgement "must disclose all of the terms of the security-based swap transaction"[444] is tailored to the security-based swap market and is more likely to effectively communicate the relevant terms of the transaction to the counterparty. A more effective communication of transaction terms could

443 See part VII.B.1, supra.

444 See Exchange Act Rule 15Fi-2(c).

facilitate timely and accurate confirmations and in turn reduce the likelihood of a confirmation backlog and associated market, credit, settlement, and financial stability risks.[445] Second, while Rule 10b-10 requires only the registered broker-dealer to provide a trade confirmation to a customer, Rule 15Fi-2 requires a security-based swap dealer or major security-based swap participant to provide a trade acknowledgement to, as well as obtain a verification of that acknowledgement from, the counterparty. As discussed elsewhere,[446] unlike most other securities transactions, a security-based swap gives rise to ongoing obligations between transaction counterparties during the life of the transaction, including payments contingent on specific events, such as a corporate default. Consequently, the acknowledgement and verification of the terms of a security-based swap transaction help ensure that security-based swap market participants effectively measure and manage market and credit risk. Third, the trade acknowledgement and verification requirement would better promote a uniform regulatory framework for security-based swap transactions because the requirement would apply to all security-based swap transactions that are arranged, negotiated, or executed in the United States. In light of the foregoing, the Commission preliminarily believes that the proposed approach is preferable to this alternative.

C. Proposed Guidance Regarding the Scope of the "Arranged, Negotiated, or Executed" Test

As discussed in part II supra, the Commission is proposing guidance regarding the scope of the "arranged, negotiated, or executed" test. This guidance could have economic effects to the

445 See Trade Acknowledgement and Verification Adopting Release part VII.C.

446 See id., 81 FR at 39833.

extent that, in the absence of such guidance, some market participants may have understood the scope of the test differently.

As discussed in part VII.A.8 above, the Commission preliminarily believes that up to 49 non-U.S. persons could be affected by the proposed guidance. To the extent that some of these non-U.S. persons currently understand the scope of the "arranged, negotiated, or executed" test to be different from the scope of the test set forth in the proposed guidance, there might be certain potential economic effects associated with (1) counting toward the de minimis threshold for security-based dealer registration,[447] (2) cross-border application of security-based swap dealer business conduct provisions, and (3) cross-border application of Regulation SBSR's regulatory reporting and public dissemination provisions. The Commission discusses these potential economic effects below.

Under rules adopted in the Cross-Border Adopting Release, a non-U.S. person is permitted to exclude from the de minimis analysis certain dealing transactions conducted through a foreign branch of a counterparty that is a U.S. bank. For this exclusion to be effective, persons located within the United States cannot be involved in arranging, negotiating, or executing the transaction. Moreover, the counterparty U.S. bank must be registered as a security-based swap dealer,[448] unless the transaction occurs prior to 60 days following the effective date of final rules providing for the registration of security-based swap dealers.[449] Under rules adopted in the ANE Adopting Release, a non-U.S. person has to count toward its de minimis threshold, transactions with a non-U.S. counterparty that are arranged, negotiated, or executed by U.S. personnel. The

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447 See note 90, supra.

448 See Exchange Act Rule 3a71-3(b)(1)(iii)(A)(1).

449 See Exchange Act Rule 3a71-3(b)(1)(iii)(A)(2).

Commission preliminarily believes that the proposed guidance might have certain economic effects in connection with the application of the "arranged, negotiated, or executed" test to the de minimis threshold.

First, the proposed guidance may cause a change in behavior of those non-U.S. persons, if any, who currently interpret the scope of the "arranged, negotiated, or executed" test to be different from the proposed guidance. To the extent that the proposed guidance reduces the likelihood of non-U.S. persons mistakenly believing they have exceeded the de minimis threshold, it would potentially eliminate costs that non-U.S. persons may otherwise incur related to security-based swap dealer registration and compliance. Specifically, the proposed guidance potentially could reduce the compliance burden of those non-U.S. persons that employ U.S. personnel to provide market color to non-U.S. counterparties or foreign branches of U.S. persons, and understood the provision of market color to fall within the scope of the "arranged, negotiated, or executed" test. In the absence of the proposed guidance, such a non-U.S. person could incur the cost of registering as a security-based swap dealer if it counts transactions involving the provision of market color by U.S. personnel toward the de minimis threshold, and as a consequence of this treatment, its market-facing activity exceeds the de minimis threshold. The non-U.S. person accordingly would incur the cost necessary for compliance with the full set of security-based swap dealer requirements by one or more registered security-based swap dealers. These burdens are in addition to the assessment costs that the non-U.S. person would incur to identify and count relevant market-facing activity toward the de minimis threshold.

To the extent that the proposed guidance reduces the likelihood of restructuring due to perceived regulatory burdens, it would potentially eliminate costs that non-U.S. persons may otherwise incur. In the absence of the proposed guidance, non-U.S. persons that employ U.S.

personnel to provide market color to non-U.S. counterparties or foreign branches of U.S. persons, and understand the provision of market color to fall within the scope of the "arranged, negotiated, or executed" test, may choose to avoid security-based swap dealer registration by relocating those U.S. personnel (or the activities performed by those U.S. personnel) to locations outside the United States or by restructuring operations to use non-U.S. personnel to provide market color to non-U.S. counterparties or foreign branches of U.S. persons. These forms of restructuring would impose costs on these non-U.S. persons associated with moving personnel outside the United States or forgoing the market knowledge and expertise of the U.S. personnel that provide market color. The proposed guidance, by clarifying that transactions involving the provision of market color by U.S. personnel would not fall within the scope of the arranged, negotiated, or executed counting test, may obviate the need for these forms of restructuring and potentially limit the associated costs for these non-U.S. persons.

The proposed guidance may affect the approach to assessment chosen by different market participants. In the ANE Adopting Release, the Commission noted that non-U.S. persons likely would consider three possible approaches to determine which transactions must be counted toward the de minimis threshold.[450] The Commission also discussed potential costs associated with each approach. The proposed guidance might affect such assessment costs to the extent that non-U.S. persons that employ U.S. personnel to provide market color to non-U.S. counterparties would have, in the absence of the proposed guidance, interpreted the provision of market color to fall within the scope of the "arranged, negotiated, or executed" test, and further to the extent that such persons would change their approach to assessment in light of the proposed guidance. The

[450] See ANE Adopting Release, 81 FR at 8627-28.

Commission preliminarily believes that a non-U.S. person may choose to make such a change if the associated benefits outweigh the associated costs.

In light of the proposed guidance, a non-U.S. person who has opted to perform assessments on a per-transaction basis[451] may modify its information system[452] to track transactions involving only the provision of market color by U.S. personnel, if the system does not already possess this capability. The potential benefit of such modifications would be to allow the non-U.S. person to avoid security-based swap dealer registration and the associated regulatory burdens by excluding transactions involving only the provision of market color by U.S. personnel from being counted toward the de minimis threshold. These costs likely would not be incurred to the extent that the non-U.S. person already employs an information system that can track transactions involving only the provision of market color by U.S. personnel.

Instead of performing assessments on a per-transaction basis, a non-U.S. person might: (1) restrict its U.S. personnel from arranging, negotiating, or executing security-based swaps with non-U.S. counterparties,[453] or (2) count transactions with other non-U.S. persons toward its de minimis threshold, regardless of whether counting them is required, to avoid the cost of

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451 See id. at 8627.

452 In the ANE Adopting Release, the Commission estimated the costs associated with developing and modifying information technology systems to track the location of persons with dealing activity. The Commission preliminarily believes that this approach also would be appropriate for estimating the costs incurred by the non-U.S. person to modify its information system in light of the proposed guidance. The Commission estimates that the average non-U.S. person will incur start-up costs of $410,000 to modify its information system to track transactions involving only the provision of market color by U.S. personnel. Further, the Commission preliminarily believes that non-U.S. persons would incur the cost of $6,500 per location per year on an ongoing basis for training, compliance, and verification costs (calculated as Internal Cost, 90 hours x $50 per hour = $4,500 plus Consulting Costs, 10 hours x $200 per hour = $2000, for a total cost of $6,500). See ANE Adopting Release, 81 FR at 8627.

453 See ANE Adopting Release, 81 FR at 8627-28.

assessing the locations of personnel involved with each transaction.[454] In light of the proposed guidance, a non-U.S. person that intends to take either approach likely would continue to use such approach to the extent that the costs associated with assessments on a per-transaction basis outweigh any potential cost savings from excluding transactions involving only the provision of market color by U.S. personnel from the de minimis threshold, and consequently avoiding having to register as a security-based swap dealer.

Under rules adopted in the Business Conduct Adopting Release, a non-U.S. security-based swap dealer has to comply with transaction-level business conduct requirements for transactions between the non-U.S. security-based swap dealer and non-U.S. counterparties that are arranged, negotiated, or executed by personnel of the non-U.S. security-based swap dealer located in a U.S. branch or office, or by personnel of its agent located in a U.S. branch or office.[455]

To the extent that the proposed guidance reduces the likelihood of non-U.S. security-based swap dealers mistakenly believing they will enter into security-based swaps that fall within the scope of the "arranged, negotiated, or executed" test in connection with transaction-level business conduct requirements, it would potentially eliminate costs that non-U.S. security-based swap dealers may otherwise incur. Specifically, the proposed guidance potentially could reduce the compliance burden of those non-U.S. security-based swap dealers that employ U.S. personnel to provide market color to non-U.S. counterparties, and that previously understood the provision of market color to fall within the scope of the "arranged, negotiated, or executed" test. In the absence of the proposed guidance, such a non-U.S. security-based swap dealer could incur the

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454 See ANE Adopting Release, 81 FR at 8628.

455 See Business Conduct Adopting Release, 81 FR at 30065; Exchange Act Rules 3a71-3(c) and 3a71-3(a)(8)(i).

cost of complying with transaction-level business conduct requirements (e.g., disclosure of material risks and characteristics) if it considers transactions involving the provision of market color by U.S. personnel to fall within the scope of the test. These burdens are in addition to the assessment costs that the non-U.S. security-based swap dealers would incur to identify transactions that fall within the scope of the test.[456]

Under Regulation SBSR, a security-based swap transaction between two non-U.S. persons that is arranged, negotiated, or executed using U.S. personnel may be subject to regulatory reporting and public dissemination. Rule 908(b)(2) of Regulation SBSR provides that a registered security-based swap dealer or major security-based swap participant will incur reporting obligations.[457] This rule covers both U.S. and non-U.S. registered entities. Rule 908(b)(5) imposes reporting obligations on a non-U.S. person that, in connection with the person's security-based swap dealing activity, arranged, negotiated, or executed the security-based swap using its personnel located in a U.S. branch or office, or using personnel of an agent located in a U.S. branch or office.[458] Rule 908(a)(1)(v)[459] provides that a security-based swap transaction shall be subject to regulatory reporting and public dissemination if the transaction is arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office. Rule 901(a)(2)(ii) assigns reporting duties for various types of uncleared security-based swap transactions including, but not limited to, transactions in which (a) one or both sides include a

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456 See Business Conduct Adopting Release, 81 FR at 30135.

457 See Exchange Act Rule 908(b)(2).

458 See Exchange Act Rule 908(b)(5).

459 See Exchange Act Rule 908(a)(1)(v).

registered security-based swap dealer and (b) both sides include unregistered non-U.S. persons and at least one side includes a non-U.S. person that falls within Rule 908(b)(5).

To the extent that the proposed guidance reduces the likelihood of non-U.S. persons (i.e., non-U.S. security-based swap dealers and unregistered non-U.S. dealing entities) mistakenly believing they have entered into security-based swaps that fall within the scope of the "arranged, negotiated, or executed" test in connection with Regulation SBSR regulatory reporting requirements, it would potentially eliminate costs that non-U.S. persons may otherwise incur. Specifically, the proposed guidance potentially could reduce the compliance burden of those non-U.S. persons that employ U.S. personnel to provide market color to non-U.S. counterparties and that previously understood the provision of market color to fall within the scope of the "arranged, negotiated, or executed" test. In the absence of the proposed guidance, such a non-U.S. person could incur the cost of complying with reporting requirements (e.g., reporting of an initial security-based swap transaction to a registered security-based swap data repository) if it considers transactions involving the provision of market color by U.S. personnel to fall within the scope of the test. These burdens are in addition to the assessment costs that unregistered non-U.S. dealing entities would incur to identify transactions that fall within the scope of the test and to determine if they will incur reporting duties under Rule 901(a)(2)(ii)(E).[460]

The proposed guidance may affect the incentives of those non-U.S. persons, if any, who currently interpret the scope of the "arranged, negotiated, or executed" test to be different from the proposed guidance, to request substituted compliance determinations for business conduct

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460 See Regulation SBSR Amendments Adopting Release, 81 FR 156 at 53638.

requirements and regulatory reporting and public dissemination requirements.[461] In the absence of the proposed guidance, a non-U.S. person could incur the cost of applying for a substituted compliance determination if it considers transactions involving the provision of market color by U.S. personnel to fall within the scope of the test and believes that the cost savings from complying with comparable foreign requirements for these transactions outweigh the costs of applying for a substituted compliance determination and complying with any conditions that the Commission may attach to the substituted compliance determination. To the extent that the proposed guidance reduces the likelihood of non-U.S. persons mistakenly believing that transactions involving the provision of market color by U.S. personnel fall within the scope of the test, it may reduce the incentive of non-U.S. persons to apply for substituted compliance determinations and the associated costs.

As discussed above, the proposed guidance could reduce the regulatory burden (including substituted compliance application costs, if any) of those non-U.S. persons that employ U.S. personnel to provide market color to non-U.S. counterparties, and who would otherwise have interpreted the provision of market color to fall within the scope of the "arranged, negotiated, or executed" test. Additionally, the proposed guidance may obviate the need for restructuring and potentially limit the associated costs for such non-U.S. persons that employ U.S. personnel to provide market color to non-U.S. counterparties. To the extent that the regulatory cost burden and restructuring costs for such non-U.S. persons are reduced as a result of the proposed guidance, resources could be freed up for investing in profitable projects, which would promote investment efficiency and capital formation. The non-U.S. persons alternatively could pass on

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[461] See Exchange Act Rule 3a71-6(d) (addressing substituted compliance for business conduct requirements) and Regulation SBSR Rule 908(c) (addressing substituted compliance for regulatory reporting and public dissemination requirements).

the reductions in regulatory cost burden and restructuring costs to their counterparties in the form of a lower price for liquidity provision (e.g., through posting narrower bid-ask spreads), thereby allowing the non-U.S. persons to compete more effectively in providing liquidity to market participants. Such actions in turn may increase competition in the market for liquidity provision if they prompt other liquidity providers to lower their prices for liquidity provision.

D. Proposed Amendment to Rule of Practice 194(c)(2)

Several key economic effects and tradeoffs inform the Commission's analysis of proposed Rule of Practice 194(c)(2).[462]

First, as the Commission discussed in the Rule of Practice 194 Adopting Release,[463] increasing the ability of statutorily disqualified persons to effect or be involved in effecting security-based swaps on behalf of SBS Entities may give rise to higher compliance and counterparty risks, increase costs of adverse selection, decrease market participation, and reduce competition among higher quality associated persons and SBS Entities.

Second, at the same time, the scope of conduct that gives rise to disqualification is broad and includes conduct that may not pose ongoing risks to counterparties.[464] In addition, as discussed in the Rule of Practice 194 Adopting Release and in greater detail below, strong disqualification standards can also reduce competition and the volume of service provision.

Third, public information about misconduct can give rise to capital market participants voting with their feet (reputational costs), and labor markets frequently penalize misconduct

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462 See Rule of Practice 194 Adopting Release, 84 FR at 4922-43.

463 See id.

464 As discussed in Section V.A. of the Rule of Practice 194 Adopting Release, the definition of disqualified persons, as applied in the statutory prohibition in Exchange Act Section 15F(b)(6), is broad. That definition disqualifies associated persons due to violations of the securities laws, but also for felonies and misdemeanors not related to the securities laws and/or financial markets, and certain foreign sanctions. See Rule of Practice 194 Adopting Release, 84 FR at 4922, 4929.

through firing or worse career outcomes in other settings, as discussed in the Rule of Practice 194 Adopting Release. If counterparties perceive the risks related to disqualified associated persons to be high, counterparties may choose to perform more in-depth due diligence related to their SBS Entity counterparties or to transact with SBS Entities without disqualified associated persons.

Fourth, an overwhelming majority of dealers and most counterparties transact across both swap and security-based swap markets, including in financial products that are similar or identical in their payoff profiles and risks. Differential regulatory treatment of disqualification in swap and security-based swap markets may disrupt existing counterparty relationships and may increase costs of intermediating transactions for some SBS Entities, which may be passed along to certain counterparties in the form of higher transaction costs.

Fifth, as discussed in the Rule of Practice 194 Adopting Release, market participants may value bilateral relationships with SBS Entities, including with SBS Entities dually-registered as Swap Entities, and searching for and initiating bilateral relationships with new SBS Entities may involve costs for counterparties. For example, security-based swaps are long-term contracts that are often renegotiated, and disruptions to existing counterparty relationships can reduce the potential future ability to modify a contract, which may be priced in widening spreads.[465]

1. Costs and Benefits of the Proposed Amendment

Once compliance with SBS Entity registration rules is required, registered SBS Entities will be unable to utilize any statutorily disqualified associated natural person, including natural persons with potentially valuable capabilities, skills, or expertise, to effect or be involved in effecting security-based swaps, absent exemptive relief, including an order under Rule of

[465] See Rule of Practice 194 Adopting Release, 84 FR at 4922.

Practice 194. This restriction would apply to all associated natural persons of all registered SBS Entities, with respect to all counterparties, and regardless of the nature of the conduct giving rise to disqualification. SBS Entities are, under the baseline regulatory regime, unable to rely on disqualified associated persons even if such persons are non-U.S. persons transacting exclusively with non-U.S. counterparties. However, absent the proposed Rule, SBS Entities would still be able to apply to the Commission for relief, and the Commission would still be able to grant relief, including under Rule of Practice 194.

Under the proposed Rule, unless a limitation applies, SBS Entities will be able to allow disqualified associated persons that are not U.S. persons to effect or be involved in effecting security-based swap transactions with non-U.S. counterparties and foreign branches of U.S. counterparties. The Commission preliminarily believes that the proposed Rule involves three groups of benefits.

First, SBS Entities may benefit from greater flexibility in hiring and managing non-U.S. employees transacting with foreign counterparties and foreign branches of U.S. counterparties. To the degree that such employees may have valuable skills, expertise, or counterparty relationships that are difficult to replace and outweigh the reputational and compliance costs of continued association, SBS Entities would be able to continue employing them without being required to apply for relief with the Commission. In addition, cross-registered SBS Entities would experience economies of scope in employing non-U.S. natural persons in their swap and security-based swap businesses. Specifically, SBS Entities will be able to rely on the same non-U.S. natural persons in transactions with the same counterparties across integrated swap and security-based swap markets. In addition, SBS Entities will no longer be required to apply for relief under Rule of Practice 194 with respect to non-U.S. persons transacting with foreign

counterparties and foreign branches of U.S. counterparties.[466]

Second, to the degree that SBS Entities currently pass along costs to counterparties in the form of, for example, higher transaction costs, the proposed amendment may benefit non-U.S. counterparties and foreign branches of U.S. counterparties through lower prices of available security-based swaps. In addition, such counterparties of SBS Entities would be able to continue transacting with the same non-U.S. associated persons of the same SBS Entities across interconnected markets without delays related to Commission review under Rule of Practice 194. The Commission notes that both the returns and the risks from security-based swap transactions by foreign branches of U.S. persons may flow to the U.S. business of U.S. persons, contributing to profits and losses of U.S. persons.

Third, the proposed amendment may benefit disqualified non-U.S. natural persons seeking to engage in security-based swap activity. Under the proposal, an SBS Entity would no longer be required to incur costs related to applying for exemptive relief under Rule of Practice 194 in order to allow a disqualified non-U.S. natural person to transact with foreign counterparties and foreign branches of U.S. counterparties. The proposal may reduce direct costs to SBS Entities of hiring and retaining disqualified non-U.S. employees. This may improve employment opportunities for disqualified non-U.S. natural persons in the security-based swap industry. However, research in other contexts points to large reputational costs from misconduct, and some papers show that employers may often fire and replace employees engaging in

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466 As discussed in the economic baseline, we preliminarily believe that the proposed exclusion may reduce the number of applications by between zero and two applications, resulting in potential cost savings of between zero and $24,540 (=2 x 30 hours x Attorney at $409 per hour). The hourly cost figure is based on data from SIFMA's Management & Professional Earnings in the Securities Industry 2013 (modified by the Commission staff to adjust for inflation and to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead). See Rule of Practice 194 Adopting Release, 84 FR at 4922.

misconduct to manage these reputational costs, as discussed in the Rule of Practice 194 Adopting Release.[467]

The proposed Rule would result in SBS Entities being less constrained by the general statutory prohibition in their security-based swap activity with foreign counterparties and foreign branches of U.S. counterparties. The Commission continues to recognize that associating with statutorily disqualified natural persons effecting or involved in effecting security-based swaps on behalf of SBS Entities may give rise to counterparty and compliance risks. For example, as the Commission discussed elsewhere, in other settings, individuals engaged in misconduct are significantly more likely to engage in repeated misconduct.[468] Data in the Rule of Practice 194 Adopting Release suggests that, in parallel disqualification review processes in swap and broker-dealer settings, the application rate is low, but there are incidences of repeated misconduct.[469] The Commission also continues to recognize that statutory disqualification and an inability to continue associating with SBS Entities creates disincentives against underlying misconduct for associated persons and that there may be spillover effects on other associated persons within the same SBS Entity.[470] Further, the Commission recognizes that, under the proposed amendment,

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467 See Rule of Practice 194 Adopting Release, 84 FR at 4932.

468 For a more detailed discussion, see Rule of Practice 194 Adopting Release, 84 FR at 4932.

469 See Rule of Practice 194 Adopting Release, 84 FR at 4928.

470 For example, as discussed in the Rule of Practice Adopting Release, Dimmock, Gerken, and Graham (2018) examine customer complaints against FINRA-registered representatives in 1999 through 2011, and argue that misconduct of individuals influences the misconduct of their coworkers. Using mergers of firms as a quasi-exogenous shock, the paper examines changes in an adviser's misconduct around changes to an employee's coworkers due to a merger. The paper estimates that an employee is 37% more likely to commit misconduct if her new coworkers encountered in the merger have a history of misconduct. The paper contributes to broader evidence on peer effects, connectedness, and commonality of misconduct, and can help explain the distributional properties in the prevalence of misconduct across firms documented in Egan, Matvos, and Seru (2017). See Stephen G. Dimmock, William C. Gerken, & Nathaniel P. Graham, "Is Fraud Contagious? Coworker Influence on Misconduct by Financial Advisors," 73 J.

the Commission would be unable to make an individualized determination about whether permitting a given non-U.S. associated natural person to effect or be involved in effecting security-based swaps on behalf of an SBS Entity is consistent with the public interest.

The Commission also notes that the proposed amendment would allow SBS Entities to rely on disqualified non-U.S. personnel in their transactions with both foreign counterparties and foreign branches of U.S. counterparties. To the degree that statutory disqualification may increase risks to counterparties, to the degree that SBS Entities may choose to rely on disqualified foreign personnel despite reputational and compliance costs of association, and to the extent that such counterparties do not move their business to other personnel or SBS Entity, this may increase risks to foreign branches of U.S. counterparties. Depending on the consolidation and ownership structure of counterparties, some of the returns as well as losses in foreign branches may flow through to some U.S. parent firms. However, the proposed approach provides for identical treatment of foreign counterparties and foreign branches of U.S. counterparties, reducing potential competitive disparities between them in security-based swap markets.

The Commission notes that, importantly, the proposed exclusion would more closely harmonize the Commission's approach with the approach already being followed with respect to foreign personnel of Swap Entities. As such, the Commission's assessment of the benefits and potential counterparty risks of the proposed relief discussed above is informed by experience and data with respect to CFTC/NFA statutory disqualification review in swap markets, including,

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FIN. 1417 (2018); see also Mark Egan, Gregor Matvos, & Amit Seru, "The Market for Financial Adviser Misconduct," 127 J. POL. ECON. 233 (2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2739170.

among others: (i) the low incidence of statutory disqualification of associated persons; (ii) the majority of applications arising out of non-investment related conduct by associated persons; (iii) absence of additional statutory disqualification forms filed by swap dealers to request NFA determination with respect to a new statutory disqualification for any of the individuals.[471] The Commission also notes that parallel swap markets remain large, with multi-name credit default swaps representing an increasing share of credit-default swap notional outstanding, and highly liquid.[472]

Three factors may reduce the magnitude of the above economic costs and benefits. First, the Commission will continue to be able, in appropriate cases, to institute proceedings under Exchange Act Section 15F(l)(3) to determine whether the Commission should censure, place limitations on the activities or functions of such person, suspend for a period not exceeding 12 months, or bar such person from being associated with an SBS Entity.[473]

Second, the security-based swap market is an institutional one, with investment advisers, banks, pension funds, insurance companies, and ISDA-recognized dealers accounting for 99.8% of transaction activity.[474] While security-based swaps may be more opaque than equity and bonds and may give rise to greater information asymmetries between dealers and non-dealer counterparties, institutional counterparties may be more informed and sophisticated compared to retail clients. However, given limited data availability on the domiciles of non-dealer

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471 See Rule of Practice Adopting Release, 84 FR at 4931.

472 See, e.g., Inaki Aldasoro & Torsten Ehlers, "The Credit Default Swap Market: What a Difference a Decade Makes," BIS Quarterly Review, June 2018, at 3 (Graph 1), available at https://www.bis.org/publ/qtrpdf/r_qt1806b.pdf, last accessed March 26, 2019; see also Richard Haynes & Lihong McPhail, "The Liquidity of Credit Default Index Swap Networks" (Working Paper, 2017).

473 See 15 U.S.C. 78o-10(l)(3).

474 See Rule of Practice 194 Adopting Release, Table 1 of the economic baseline.

counterparties, the Commission is unable to quantify how many non-institutional foreign counterparties may be affected by the proposed Rule.

Importantly, the concentrated nature of security-based swap market-facing activity may reduce the ability of counterparties to choose to transact with SBS Entities that do not rely on disqualified personnel. As the Commission estimated elsewhere, the top five dealer accounts intermediated approximately 55% of all SBS Entity transactions by gross notional, and the median counterparty transacted with 2 dealers in 2017. [475] While reputational incentives may flow from a customer's willingness to deal with an SBS Entity, the fact that the customer may not have many dealers to choose from weakens those incentives. However, the Commission also notes that market concentration is itself endogenous to market participants' counterparty selection. That is, counterparties trade off the potentially higher counterparty risk of transacting with SBS Entities that rely on disqualified associated persons against the attractiveness of security-based swaps (price and non-price terms) that they may offer. If a large number of counterparties choose to move their business to SBS Entities that do not rely on disqualified associated persons (including those SBS Entities that may currently have lower market share), market concentration itself can decrease.

Third, as discussed above, the exclusion will not be available with respect to an associated person if that associated person is currently subject to an order described in subparagraphs (A) and (B) of Section 3(a)(39) of the Exchange Act, with the limitation that an order by a foreign financial regulatory authority described in subparagraphs (B)(i) and (B)(iii) of Section 3(a)(39) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located. In such circumstances, affected

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475 See Rule of Practice 194 Adopting Release, 84 FR at 4925.

SBS Entities will be required to apply for relief under Rule of Practice 194 and will be unable to allow their disqualified associated person entities to effect or be involved in effecting security-based swaps on their behalf, pending review by the Commission.

2. Effects on Efficiency, Competition, and Capital Formation

The Commission has assessed the effects of the proposed amendment on efficiency, competition, and capital formation. As noted above, limiting the ability of statutorily disqualified persons to effect or be involved in effecting security-based swaps on behalf of SBS Entities may reduce compliance and counterparty risks and may facilitate competition among higher quality associated persons and SBS Entities, thereby enhancing integrity of security-based swap markets. At the same time, limits on the participation of disqualified employees in security-based swap markets may result in costs related to replacing or reassigning an employee to SBS Entities or applying to the Commission for relief. This may disrupt existing counterparty relationships across closely linked swap and security-based swap markets and increase transaction costs borne by counterparties, adversely effecting efficiency and capital formation in swap and security-based swap markets.

In addition, if more SBS Entities seek to avail themselves of the exclusion and retain, hire, or increase their reliance on disqualified foreign personnel in their transactions with foreign counterparties, a greater number of disqualified persons may seek employment and business opportunities in security-based swap markets. As discussed in the Rule of Practice 194 Adopting Release,[476] there is a dearth of economic research on these issues in derivatives markets, and the research in other settings cuts both ways. On the one hand, a greater number of disqualified persons active in security-based swaps could increase the "lemons" problem and related costs of

[476] See Rule of Practice 194 Adopting Release, 84 FR at 4923.

adverse selection,[477] since market participants may demand a discount from counterparties if they expect a greater chance that counterparties have employed disqualified persons that are involved in arranging transactions. This effect could lead to a reduction in informational efficiency and capital formation. On the other hand, more flexibility in employing disqualified persons may also increase competition and consumer surplus.[478]

The proposed amendment would preserve an equal competitive standing of U.S. and non-U.S. SBS Entities with disqualified foreign personnel as they compete for business with foreign counterparties and foreign branches of U.S. counterparties. Importantly, under the baseline, both U.S. and non-U.S. Swap Entities are able to transact with foreign counterparties relying on their foreign disqualified personnel without applying to the CFTC for relief from the statutory prohibition. As discussed in the economic baseline, the Commission expects extensive cross-registration of dealers across the two markets. As a result, dually registered U.S. SBS Entities would be able to rely on the same disqualified foreign personnel in transacting with the same counterparties in both swap (e.g., index CDS) and security-based swap (e.g., single-name CDS) markets.

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477 See, e.g., George A. Akerlof, "The Market for "Lemons": Quality Uncertainty and the Market Mechanism," 84 Q. J. ECON. 488 (1970). Informational asymmetry about quality can negatively affect market participation and decrease the amount of trading—a problem commonly known as adverse selection. When information about counterparty quality is scarce, market participants may be less willing to enter into transactions, and the overall level of trading may fall.

478 See Jonathan Berk & Jules H. van Binsbergen, "Regulation of Charlatans in High-Skill Professions" (Stanford University Graduate School of Business, Research Paper No. 17-43, 2017), available at https://ssrn.com/abstract=2979134. The paper models the costs and benefits of both disclosure and standards regulation of "charlatans" (professionals who sell a service they do not deliver) in high skill professions. When there is a mismatch between high demand for a skill and short supply of the skill, the presence of charlatans in a profession is an equilibrium outcome. Importantly, reducing the number of charlatans by regulation decreases consumer surplus in their model. Both standards and disclosure regulations drive charlatans out of the market, but the resulting reduction in competition amongst producers actually reduces consumer surplus. In turn, producers strictly benefit from such regulation.

The proposed amendment may create incentives for SBS Entities to relocate their personnel (or the activities performed by U.S. personnel) outside the U.S. to be able to avail themselves of the proposed exclusion and avoid being bound by the statutory prohibition. The cost of relocation will depend on many factors, such as the number of positions being relocated, the location of new operations, the costs of operating at the new location, and other factors. These factors will, in turn, depend on the relative volumes of market-facing activity that a firm carries out on different underliers and with counterparties in different jurisdictions. As a result of these dependencies, the Commission cannot reliably quantify the costs of these alternative approaches to compliance. However, the Commission believes that firms would seek to relocate their personnel (or the activities performed by U.S. personnel) only if they expect the relocations to be profitable.

Further, the proposed amendment may improve the employment and career outcomes of disqualified foreign personnel relative to disqualified U.S. personnel. As a result, disqualified personnel may seek to relocate outside the U.S. and seek employment by SBS Entities in their foreign business. To the degree that such relocation occurs, it may reduce the effective scope of application of the statutory prohibition. This may also lead to a separating equilibrium: it may decrease counterparty risks and adverse selection costs of security-based swaps in SBS Entities and in transactions with U.S. counterparties, and increase counterparty risks and adverse selection costs in transactions with foreign counterparties and foreign branches of U.S. counterparties.

3. Alternatives Considered

The Commission has considered several alternatives to the proposed amendment to Rule of Practice 194(c)(2).

a. Relief for All SBS Entities with Respect to Non-U.S. Personnel Transacting with Non-U.S. Counterparties but not with Foreign Branches of U.S. Counterparties

The Commission could have proposed an exclusion for all SBS Entities with respect to foreign personnel transacting with foreign counterparties, without making the exclusion available to foreign personnel transacting with foreign branches of U.S. counterparties. As discussed above, a history of statutorily disqualifying conduct may signal higher ongoing risks to counterparties. SBS Entities may choose to replace disqualified foreign personnel due to reputational and compliance costs. In addition, the security-based swap market is institutional in nature, and better informed institutional counterparties may choose to move their business to another employee or another SBS Entity without disqualified personnel. To the degree that SBS Entities do not replace disqualified personnel and counterparties do not move their business, the alternative may decrease risks to foreign branches of U.S. counterparties relative to the proposed approach. Since both potential returns and potential risks of foreign branches may flow through to some U.S. parents (depending on the counterparty's ownership and organizational structure), the alternative could reduce the returns and risks of such U.S. counterparties' parents.

At the same time, the alternative approach would involve unequal effects on foreign counterparties and foreign branches of U.S. counterparties. Specifically, under the alternative, foreign counterparties would be able to choose between transacting with those SBS Entities that employ statutorily disqualified personnel and those that do not, whereas foreign branches of U.S. counterparties would only be able to transact with SBS Entities that do not employ statutorily disqualified personnel. If SBS Entities with disqualified personnel compensate for potentially higher counterparty risks with, for example, more attractive terms of security-based swaps, the alternative may introduce disparities in access and cost of security-based swaps available to foreign counterparties as compared to those available to foreign branches of U.S. counterparties.

b. Relief for Non-U.S. Person SBS Entities with Respect to Non-U.S. Personnel Transacting with Non-U.S. Counterparties and Foreign Branches of U.S. Counterparties.

The Commission has considered a narrower alternative exclusion limited to non-U.S. person SBS Entities relying on non-U.S. personnel in their transactions with foreign counterparties and foreign branches of U.S. counterparties. The alternative exclusion would be subject to the same limitation as the proposal, discussed above: an SBS Entity would not be able to rely on the exclusion with respect to an associated person currently subject to an order that prohibits such person from participating in the U.S. financial markets, including the securities or swap market, or foreign financial markets.

Relative to the proposed amendment, this alternative would broaden the effective scope of application of the statutory prohibition and might reduce ongoing compliance and counterparty risks for foreign counterparties and foreign branches of U.S. counterparties. Under the alternative, disqualified foreign personnel of U.S. SBS Entities would be unable to transact without the costs and delays related to applications for relief. This might decrease the number of disqualified foreign personnel transacting in security-based swap markets and seeking to associate with U.S. SBS Entities. Lower market participation of disqualified personnel on behalf of U.S. SBS Entities in their foreign transactions may reduce the costs of adverse selection and increase foreign counterparty willingness to transact with U.S. SBS Entities in security-based swaps.

At the same time, it would result in a disparate competitive standing between U.S. SBS Entities and non-U.S. person SBS Entities as they are competing for business with foreign counterparties and foreign branches of U.S. counterparties. This alternative would allow non-U.S. SBS Entities to enjoy flexibility in hiring, retaining, and replacing non-U.S. personnel and in staffing foreign offices with personnel engaged in transactions with foreign counterparties.

However, U.S. SBS Entities would be unable to rely on the exclusion and would have to either replace an employee or apply under Rule of Practice 194, incurring related costs and delays. To the degree that SBS Entities pass along costs to their counterparties, relative to the proposed exclusion, this narrower alternative may result in somewhat lower availability or worse terms of security-based swaps and may somewhat reduce the choice of dealers for foreign counterparties and foreign branches of U.S. counterparties. Finally, this approach would be inconsistent with the CFTC's relief for Swap Entities. Given expected extensive cross-registration and active cross-market participation by counterparties, a lack of comparable treatment of disqualification across swaps and security-based swaps would make it harder for the same U.S. SBS Entities to transact relying on the same foreign personnel with the same foreign counterparties in related markets.

Further, under the alternative, foreign personnel of U.S. SBS Entities would not have the same competitive standing as foreign personnel of non-U.S. SBS Entities when engaging in business with the same foreign counterparties. The Commission also notes that the definition of a U.S. person is based on a natural person's residency in the United States. As discussed above, excluding foreign personnel of foreign SBS Entities creates incentives for all disqualified U.S. personnel employed by foreign SBS Entities to be transferred to a foreign office in order to legally become non-U.S. personnel eligible for the alternative exclusion. Of course, the choice made by a non-U.S. SBS Entity to transfer disqualified U.S. personnel abroad will reflect the value of an employee's skills and expertise, costs to reputation with counterparties, the number of positions being moved, and internal organizational structures of a non-U.S. SBS Entity. However, SBS Entities are commonly part of large financial groups with many domestic and

foreign regional offices. Therefore many non-U.S. SBS Entities may be able to relocate statutorily disqualified U.S. personnel to foreign offices and rely on the exclusion.

Under this alternative, however, disqualified personnel of U.S. SBS Entities would be unable to relocate to a foreign office and rely on the exclusion, adding to the competitive disparities between disqualified personnel of U.S. and foreign SBS Entities transacting with the same foreign counterparties. As a result, under the alternative, statutorily disqualified personnel of U.S. SBS Entities may seek employment with foreign SBS Entities and continue to transact with the same foreign counterparties on behalf of non-U.S. SBS Entities.

The Commission continues to recognize that, due to adverse selection costs and compliance risks related to hiring and retaining disqualified persons, many SBS Entities may choose not to hire or may fire and replace statutorily disqualified employees. However, this incentive may be weaker with respect to personnel whose conduct giving rise to disqualification occurred in jurisdictions where statutory disqualification is not public information.

c. Relief for Non-U.S. SBS Entities with Respect to Both U.S. and Non-U.S. Personnel Transacting with Foreign Counterparties and Foreign Branches of U.S. Counterparties.

The Commission has considered excluding from the statutory prohibition both U.S. and foreign disqualified personnel, but limiting the relief to non-U.S. person SBS Entities transacting exclusively with foreign counterparties or foreign branches of U.S. counterparties. The alternative exclusion would be subject to the same limitation as the proposal, discussed above: an SBS Entity would not be able to rely on the exclusion with respect to an associated person currently subject to an order that prohibits such person from participating in the U.S. financial markets, including the securities or swap market, or foreign financial markets.

Under the alternative, non-U.S. SBS Entities would enjoy full flexibility in hiring, retaining, and replacing personnel and in staffing both U.S. and non-U.S. offices with personnel

engaged in transactions with foreign counterparties. To the degree that non-U.S. SBS Entities pass along costs to their counterparties, this may result in somewhat higher availability or improved terms of security-based swaps for foreign counterparties. Further, under the alternative, disqualified U.S. personnel would have the same competitive standing as disqualified foreign personnel with similar skills and expertise transacting on behalf of non-U.S. SBS Entities with the same foreign counterparties. For example, disqualified U.S. personnel transacting with foreign counterparties and foreign branches of U.S. counterparties would not need to relocate to a foreign office of a foreign SBS Entity to avail themselves of the exclusion.

Relative to the proposed Rule, this alternative would increase the competitive gap between U.S. and non-U.S. SBS Entities in their ability to hire, retain, and locate disqualified personnel as they compete for business with foreign counterparties. To the degree that U.S. SBS Entities may wish to begin or continue to associate with disqualified personnel despite potential reputation costs, U.S. SBS Entities would be required to apply with the Commission and disallow disqualified personnel from effecting security-based swaps pending Commission action. At the same time, foreign SBS Entities would be able to freely hire and retain disqualified personnel in the U.S. and allow them to engage in security-based swap transactions with foreign counterparties and foreign branches of U.S. counterparties.

As noted in the economic baseline, this alternative approach is inconsistent with the relief from the CFTC's requirements that is available to both U.S. and non-U.S. SBS Entities with respect to only foreign personnel. Given expected extensive cross-registration and active cross-market participation by counterparties, differential treatment of disqualification may disrupt counterparty relationships between the same dually registered SBS Entities transacting with the same foreign counterparties in related markets.

Under the alternative and relative to the proposed amendment, disqualified U.S. personnel of non-U.S. SBS Entities may enjoy better employment and career outcomes, which may increase the number of disqualified personnel transacting in security-based swap markets and seeking to associate with SBS Entities. Greater market participation of disqualified personnel on behalf of non-U.S. SBS Entities, particularly in jurisdictions where conduct giving rise to disqualification is not public or easily accessible information, may increase the costs of adverse selection and decrease counterparty willingness to transact with non-U.S. SBS Entities in security-based swaps. As a result, some foreign counterparties may choose to move their transaction activity from non-U.S. to U.S. SBS Entities.

The magnitude of the above economic effects of the alternative approach may be limited by three factors. First, many non-U.S. SBS Entities may choose to locate personnel transacting with foreign counterparties in foreign offices if most of their business is in foreign underliers trading in foreign jurisdictions.[479] As a result, some non-U.S. SBS Entities may already locate personnel, including statutorily disqualified personnel, dedicated to transacting with foreign counterparties outside the United States.

Second, due to reputational and adverse selection costs and compliance risks related to hiring and retaining disqualified persons, many SBS Entities may choose not to hire, or may fire and replace disqualified employees. The incentive to disassociate is strongest in jurisdictions in which conduct giving rise to statutory disqualification is public information (as in the U.S). As a result, it is not clear how often non-U.S. SBS Entities would choose to hire or continue to

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[479] As discussed in part VII.A.2.c, supra, we understand that many market participants engaged in market-facing activity prefer to use traders and manage risk for security-based swaps in the jurisdiction where the underlier is traded.

employ disqualified U.S. personnel even if they were able to rely on an exclusion and avoid applying for relief under Rule of Practice 194.

Third, the Commission notes that the primary difference between the proposed approach and the alternative is in the treatment of U.S. SBS Entity personnel. Specifically, under the proposal, U.S. SBS Entities may permit non-U.S. personnel to transact with foreign counterparties and foreign branches of U.S. counterparties, whereas under the alternative they may not. With respect to non-U.S. SBS Entities, the proposal provides relief for foreign personnel only; the alternative provides relief with respect to both U.S. and foreign personnel. As discussed above, the definition of a U.S. person in Rule 3a71-3(a)(4)(i)(A) under the Exchange Act with respect to a natural person is based on residency in the United States. Under the proposal, non-U.S. SBS Entities may be able to simply transfer statutorily disqualified U.S. personnel transacting with foreign counterparties to a foreign office in order to become eligible for the proposed exclusion. Of course, each non-U.S. SBS Entity's choice to continue to employ disqualified U.S. personnel and relocate them abroad would likely reflect the value of an employee's skills and expertise, reputational costs of continued association, the number of positions being moved, and internal organizational structures of each entity, among others. However, non-U.S. SBS Entities are commonly members of large financial groups with many domestic and foreign regional offices, and such relocation is likely to be feasible for some non-U.S. SBS Entities. As a result, depending on the ease and costs of such relocation and the value of disqualified personnel to the non-U.S. SBS Entity, the scope of this alternative with respect to non-U.S. SBS Entities may be similar to the effective scope of the proposed exclusion with respect to non-U.S. SBS Entities.

d. Relief for All SBS Entities with Respect to All Personnel Transacting with Non-U.S. Counterparties and Foreign Branches of U.S. Counterparties.

The Commission has considered an exclusion for both U.S. and foreign SBS Entities with respect to all personnel transacting with foreign counterparties and foreign branches of U.S. counterparties. The alternative exclusion would be subject to the same limitation as the proposal, discussed above: an SBS Entity would not be able to rely on the exclusion with respect to an associated person currently subject to an order that prohibits such person from participating in the U.S. financial markets, including the securities or swap market, or foreign financial markets.

This alternative would allow both non-U.S. and U.S. SBS Entities to enjoy full flexibility in hiring, retaining, and replacing personnel, and in staffing both U.S. and non-U.S. offices with personnel engaged in transacting with foreign counterparties and foreign branches of U.S. counterparties. To the degree that SBS Entities currently pass along costs to their counterparties or to the degree disqualified personnel may have superior skills or expertise, this may benefit the terms of security-based swaps and choice of dealers available to foreign counterparties. Further, disqualified U.S. personnel would have the same competitive standing as disqualified foreign personnel with similar skills and expertise transacting on behalf of SBS Entities with the same foreign counterparties.

Relative to the proposed exclusion, this alternative provides more relief from the statutory prohibition and may, thus, increase ongoing compliance and counterparty risks for foreign counterparties and foreign branches of U.S counterparties. Since all disqualified personnel of all SBS Entities transacting with foreign counterparties and foreign branches of U.S. counterparties would be excluded from the statutory prohibition, more disqualified personnel may seek to associate with both U.S. and foreign SBS Entities and to transact with foreign counterparties and foreign branches of U.S. counterparties. However, as discussed

elsewhere in this release and in the Rule of Practice 194 Adopting Release, one of the key disincentives against continued association with disqualified personnel may be reputational. To the degree that information about the disqualifying conduct by U.S. personnel may be public and institutional customers perceive disqualification as increasing counterparty risk, counterparties may move their business, and SBS Entities may simply replace disqualified U.S. personnel. As a result, it is not clear that SBS Entities would significantly increase their reliance on disqualified personnel in transactions with foreign counterparties and foreign branches of U.S. counterparties relative to the baseline or the proposed approach. Nevertheless, to the degree that they may do so, greater market participation of disqualified personnel may increase adverse selection costs and decrease such counterparties' willingness to participate in security-based swap markets.

As noted above, a natural person's residency in the United States is endogenous. As a result, any exclusion for foreign personnel, but not U.S. personnel, transacting with foreign counterparties may result in SBS Entities simply transferring disqualified U.S. personnel to a foreign office. As the Commission recognized above, this decision by an SBS Entity will reflect the uniqueness and value of an employee's skills, expertise, and client relationships relative to the reputational costs and compliance risks of continuing to employ disqualified personnel and directs costs of personnel transfers. However, SBS Entities that belong to large global financial groups are less likely to be constrained by the location of disqualified personnel that they prefer to retain. As a result, the economic effects of this alternative may be similar to those of the proposed approach.

e. Relief for All SBS Entities with Respect to non-U.S. Personnel Effecting and Involved in Effecting Security-Based Swaps with U.S. and non-U.S. Counterparties.

The Commission has also considered alternatives excluding from the statutory prohibition non-U.S. associated persons involved in effecting security-based swaps with both

U.S. and non-U.S. counterparties in general, or under certain circumstances. For example, the Commission has considered excluding from the statutory prohibition non-U.S. associated persons involved in effecting security-based swaps with U.S. counterparties, if such activity is limited in level or scope (e.g., collateral management).

As discussed in the economic baseline, security-based swap markets are global and many SBS Entities actively participate across U.S. and non-U.S. markets. Due to economies of scale and scope, some SBS Entities may choose not to separate customer facing and / or operational activities, such as collateral management and clearing, related to security-based swaps with U.S. and non-U.S. counterparties. To the degree that some SBS Entities rely on the same personnel across their U.S. and non-U.S. business, they are currently unable to hire and retain statutorily disqualified personnel absent exemptive relief by the Commission. As discussed above, SBS Entities may face reputational costs from retaining disqualified employees. To the degree that SBS Entities would prefer to hire and retain certain disqualified employees due to their superior expertise, skills, and abilities, and despite such reputational costs, the alternative would provide beneficial flexibility in personnel decisions without necessitating an SBS Entity to completely separate the operational side of their U.S and non-U.S. businesses (and more flexibility relative to the proposal). Some of these benefits may flow through to counterparties in the form of more efficient execution of security-based swaps and related services, or better price and non-price terms.

To the degree that statutory disqualification of associated persons may increase compliance and counterparty risks, the alternative may involve greater risks to U.S. counterparties of SBS Entities relative to the proposal. The Commission continues to note that the scope of conduct that gives rise to statutory disqualification is broad and includes conduct

that is not related to investments or financial markets. Moreover, the security-based swap market is an institutional one, and conduct that gives rise to statutory disqualification in the U.S. is generally public. U.S. counterparties that believe statutory disqualification is a meaningful signal of quality may vote with their feet and choose to transact with non-disqualified personnel or SBS Entities that do not rely on disqualified personnel.

The Commission notes that the alternative would provide broader relief compared to CFTC's requirements in swap markets and would not result in a harmonized regulatory regime with respect to statutory disqualification. Importantly, the full costs and benefits of an alternative that provides broader relief from the statutory prohibition in security-based swaps compared to the relief available in swap markets may not be realized. Specifically, to the degree that market participants transact across swap and security-based swap markets with the same SBS Entity counterparties, SBS Entities may continue to rely on the same personnel who are allowed to effect or be involved in both swaps and security-based swap transactions.

E. Certification, Opinion of Counsel, and Employee Questionnaires

In addition, the Commission is proposing certain guidance on requirements regarding the certification and opinion of counsel under Rule 15Fb2-4, amendments to registration Rule 15Fb2-1, and modifications to the requirement to obtain employee questionnaires under proposed Rules 18a-5(a)(10) and (b)(8).

1. Guidance Regarding Rule 15Fb2-4 and Proposed Amendments to Rule 15Fb2-1

a. Background

The Commission's proposal retains the adopted certification and opinion of counsel requirements, but proposes additional guidance regarding the scope of the requirements. Specifically, the guidance would clarify that the requirement applies only with respect to the

foreign laws of the jurisdiction or jurisdictions in which the nonresident SBS Entity maintains the covered books and records and that covered records include only records that relate to the "U.S. business" of the nonresident SBS Entity and financial records necessary for the Commission to assess compliance with its capital and margin rules (if applicable). In addition, the proposed guidance would clarify that the certification and opinion of counsel can be predicated on the consent of persons whose information is or will be included in the books and records, and can consider, under certain circumstances, whether the relevant regulatory authority in the foreign jurisdiction has previously approved or consented to the Commission requesting and obtaining documents from, and conducting on-site inspections or examinations at office of, nonresident SBS Entities located in the jurisdiction. Finally, the proposed guidance would clarify that the certification and opinion of counsel requirements would not need to address open contracts predating the filing of the registration application. In addition, the proposal would amend Rule 15Fb2-1 and establish a conditional registration regime discussed in Section IV.A.5 above.

b. Costs, Benefits, and Effects on Efficiency, Competition, and Capital Formation

(1) Proposed Guidance

As the Commission stated in the Registration Adopting Release, the Commission's access to books and records and the ability to inspect and examine registered SBS Entities facilitates Commission oversight of security-based swap markets.[480] To the degree that the certification and opinion of counsel requirements provide assurances regarding the Commission's ability to oversee and inspect and examine nonresident SBS Entities, the baseline

[480] See 80 FR at 48972.

rules may reduce counterparty and compliance risks and adverse selection. However, certain nonresident entities may lack clarity concerning the certification and opinion of counsel requirements.

The recent passage of the EU General Data Protection Regulation (GDPR), as well as the potential exit of the United Kingdom from the European Union may create significant uncertainty for market participants currently intermediating large volumes of security-based swaps regarding their ability to comply with the certification and opinion of counsel requirements, as well as the background check recordkeeping requirements discussed below. In addition, since the adoption of SBS Entity registration rules, the Commission has received questions regarding specific aspects of the certification and opinion of counsel requirements and is aware of concerns about the ability of some nonresident market participants to comply with these requirements.[481]

The Commission estimates that nonresident SBS Entities currently intermediating approximately 59.8% of all security-based swap notional are subject to foreign privacy and secrecy laws, blocking statutes, and other legal barriers that may make it difficult or create uncertainty about their ability to provide certification and opinion of counsel and / or to be

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[481] See, e.g., IIB/SIFMA 8/26/2016 Letter; see also IIB 11/16/2016 Email; Memo to File dated July 24, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-4107153-170272.pdf; Memo to File dated June 5, 2018, available at https://www.sec.gov/comments/s7-08-12/s70812-3785770-162712.pdf; Memo to File dated April 30, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-4042895-168865.pdf; Memo to File dated April 30, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-4042895-168865.pdf; Memo to file dated April 11, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-4035093-168391.pdf; Memo to file dated April 4, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-3405597-162172.pdf; Memo to file dated April 3, 2018, available at https://www.sec.gov/comments/s7-05-14/s70514-3405388-162169.pdf.

subject to inspections and examinations by the Commission.[482] To that extent, such nonresident SBS entities may be less likely to apply or become unable to register as SBS Entities when compliance with SBS Entity registration rules is required. As a result, some nonresident SBS Entities currently intermediating large volumes of security-based swap transactions may cease transaction activity or be forced to relocate certain operations, books, and records. This may result in disruptions to valuable counterparty relationships or increased costs to counterparties (to the degree that nonresident SBS Entities may pass along the costs of such restructuring in the form of higher transaction costs or less attractive security-based swaps). In addition, depending on whether and which SBS Entities step in to intermediate the newly available market share, there may be significant competitive effects.

The proposed approach could benefit some nonresident entities currently intermediating security-based swap markets by reducing uncertainty, allowing them to more easily comply with the certification and opinion of counsel requirements, and register with the Commission while avoiding disruptions to counterparty relationships and potential competitive effects to security-

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[482] Since we expect a large number of U.S. SBS Entities will have dually registered as Swap Entities, to inform our analysis we considered foreign jurisdictions where CFTC staff previously provided no-action relief for trade repository reporting requirements as they apply to swap dealers (available at http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/15-01.pdf). This estimate was also informed by a legal analysis of the EU General Data Protection Regulation, foreign blocking statutes, bank secrecy and employment laws, jurisdiction specific privacy laws, and other legal barriers that may inhibit compliance with regulatory requirements. These jurisdictions were matched to the domicile classifications of TIW accounts likely to trigger requirements to register with the Commission as SBS Entities when compliance with registration requirements becomes effective, using 2017 DTCC-TIW data. If foreign jurisdictions amend their data privacy and blocking laws, provide guidance, or enter into international agreements that would facilitate compliance with Commission SBS Entity registration requirements before compliance with SBS Entity registration rules becomes effective, or if SBS Entities choose to restructure their operations and / or relocate their books and records to other jurisdictions (for example, in response to the potential exit of the U.K. from the E.U. or GDPR restrictions), this figure may over- or under-estimate the security-based swap market share impacted by the proposed guidance.

based swap markets. For example, based on an analysis of foreign privacy and secrecy laws, blocking statutes, and other legal barriers and information from market participants, the proposed guidance regarding consent may help SBS Entities currently intermediating approximately 47.2% of all security-based swap notional intermediated by SBS Entities to comply with the certification and opinion of counsel requirements, to the extent that those entities would otherwise have understood that the certification and opinion of counsel cannot be predicated on customer consent.[483]

To the extent that aspects of the proposed guidance may reduce the scope of the certification and opinion of counsel by nonresident SBS Entities relative to their baseline understanding of Rule 15Fb2-4, the proposed guidance may decrease the burden on nonresident SBS Entities and the assurances that the Commission will be able to effectively and efficiently oversee, inspect, and examine nonresident SBS Entities. However, as discussed above, the proposed amendment to Rule 15Fb2-1 regarding the certification and opinion of counsel requirements would not reduce or eliminate independent ongoing obligations of nonresident SBS Entities to provide the Commission with direct access to their books and records and to permit onsite inspections and examinations.

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[483] This estimate is based on an analysis of 2017 DTCC TIW account-level data on the transaction activity of entities likely to trigger requirements to register with the Commission as SBS Entities when compliance with registration requirements becomes effective. We note that customer consent may serve as a part of a broader legal basis for the opinion of counsel, and the proposed guidance may help those nonresident SBS Entities that are subject to foreign privacy, but not necessarily foreign secrecy laws, to comply with the certification and opinion of counsel requirements. If foreign jurisdictions amend their data privacy and blocking laws, provide guidance, or enter into international agreements that would facilitate compliance with the opinion of counsel requirement before compliance with SBS Entity registration rules become effective, or if SBS Entities choose to restructure their operations and / or relocate their books and records to other jurisdictions (for example, in response to the potential exit of the U.K. from the E.U. or GDPR restrictions), this figure may over- or under-estimate the security-based swap market share impacted by the proposed guidance.

Importantly, the Commission recognizes that the magnitude of the economic effects of the proposed guidance is influenced by how market participants currently understand the scope of the certification and opinion of counsel requirements. Specifically, the proposed guidance will only have the economic effects discussed below, to the extent that SBS Entities and their counterparties have a broader baseline understanding of the scope of existing rules. If market participants are currently interpreting the scope of the certification and opinion of counsel requirements in a manner similar to that provided by the proposed guidance, the economic effects of the proposed guidance may be de minimis.

(2) Proposed Conditional Registration

The proposal would also amend Exchange Act Rule 15Fb2-1 to allow applicants unable to provide the certification and opinion of counsel to become conditionally registered for up to 24 months after the compliance date for registration rules. Under the proposal, if an entity fails to provide the requisite certification and opinion of counsel within 24 months, the Commission may institute proceedings to determine whether ongoing registration should be denied.

The Commission is cognizant of the fact that SBS Entity Registration rules and other elements of the Title VII regime will apply to an active market. As analyzed in the economic baseline, the Commission recognizes that security-based swap markets involve extensive cross-border activity, and nonresident SBS Entities intermediate a large percentage of security-based swaps. The Commission preliminarily believes that the nonresident SBS entities that may face uncertainty about their ability to comply with certification and opinion of counsel requirements, and are likely to utilize conditional registration, are those SBS Entities located in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers described above.

The conditional registration element of the proposal may provide SBS Entities currently active in security-based swap markets with beneficial flexibility and time to relocate some of their operations and / or books and records around the constraints of foreign privacy and secrecy laws, blocking statutes, and other legal barriers, without disrupting ongoing counterparty relationships and market activity. In addition, the proposal may facilitate smooth functioning of active security-based swap markets as compliance with the Commission's Title VII rules becomes required, may benefit both SBS Entities and counterparties by preserving SBS Entity – counterparty relationships, and may enhance efficiency and capital formation in security-based swaps.

However, conditional registration may reduce the assurances of the certification and opinion of counsel regarding the Commission's ability to inspect and examine some SBS Entities during the 24-month period. In addition, 24 months may not be sufficient for the more complex SBS Entities to relocate and restructure their security-based swap market activity outside the reach of foreign privacy and secrecy laws, blocking statutes, and other legal barriers, particularly as foreign laws, statutes and legal barriers evolve. Thus, under the proposal there may still be a risk of disruptions to counterparty relationships and market activity if conditionally registered SBS Entities having large market shares, and transacting with hundreds and thousands of counterparties, are unable to meet the certification and opinion of counsel requirements within the 24-month period. Moreover, counterparties that may rely on the Commission's ability to inspect and examine a registered SBS Entity as a signal of higher quality may reduce their participation in security-based swap markets, which may increase adverse selection. Alternatively, they may vote with their feet and shift business from conditionally registered SBS Entities to non-conditionally registered SBS Entities. This may enhance competition between

conditionally registered and non-conditionally registered SBS Entities and may create a market incentive for conditionally registered SBS Entities to provide the certification and opinion of counsel.

c. Alternatives Considered

The Commission considered alternative approaches to the proposed guidance and amendments regarding the certification and opinion of counsel requirements. Specifically, the Commission considered proposing some, but not other, aspects of the above relief. For example, the Commission considered proposing only elements of the guidance concerning covered foreign laws and covered records. The Commission has also considered proposing guidance about covered foreign laws and covered records, as well as open contracts and timing of certification, but not aspects of the relief allowing certification and opinion of counsel to be predicated on customer consent or arrangements with foreign regulators. The Commission has also considered shortening the conditional registration period (e.g., to 12 or 18 months). Relative to the proposal, these alternatives would provide less relief and greater uncertainty to nonresident entities that may seek to register with the Commission as an SBS Entity, which may increase the likelihood of disruptions of counterparty relationships and risks of adverse effects on market activity in security-based swaps. At the same time, these alternatives may increase the scope, strength, and / or timeliness of the certification and opinion of counsel requirement, which may give the Commission further assurances regarding its ability to oversee security-based swap activity of nonresident entities applying for registration. Importantly, regardless of the certification and opinion of counsel requirement, all nonresident SBS Entities would continue to have independent ongoing obligations to provide the Commission with access to their books and records and to permit on-site inspections and examinations.

The Commission has considered an alternative under which all conditionally registered SBS Entities would be required to provide disclosures to U.S. counterparties or to all counterparties regarding their conditional registration. Such disclosures may help inform counterparties regarding the conditional registration status of SBS Entities with which they may wish to transact. To the degree that counterparties may consider conditional registration as a signal of lower quality or may seek to build long-term relationships with non-conditionally registered SBS Entity counterparties, and to the degree such counterparties are otherwise uninformed about SBS Entities' registration status, this alternative may facilitate more efficient counterparty selection. The alternative may also create reputational incentives for conditionally registered SBS Entities to provide the requisite certification and opinion of counsel to the Commission, to the degree that some counterparties may interpret conditional registration as a signal of reduced quality.

However, such disclosure requirements would involve burdens on SBS Entities related to the preparation and production of such disclosures. Related costs may be partly or fully passed along to SBS Entities' counterparties in the form of more expensive security-based swaps. As noted above, the Commission preliminarily believes that nonresident SBS Entities most likely to utilize conditional registration are those SBS Entities that face uncertainty regarding their ability to comply with certification and opinion of counsel requirements due to privacy and secrecy laws, blocking statutes, and other legal barriers in their foreign jurisdictions. Based on the analysis of 2017 TIW data, the Commission estimates that there are approximately 9,611 unique relationships (pairs of counterparties and accounts likely to trigger SBS Entity registration requirements with registered office locations in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers) or approximately 72.6% of all unique dealer–

counterparty pairs active in security-based swap market that may become subject to the disclosure requirement.[484] Limiting such disclosure requirements to relationships between dealer accounts in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers and U.S. non-dealer counterparties may affect 4,322 unique dealer – U.S. counterparty relationships. Since many of the dealer accounts belong to large financial groups, the Commission can also use the domicile of the parent organization to categorize dealers at the level of the financial group (at the firm-level) instead of at the level of the dealer (at the account-level). Using this more conservative approach, there may be 779 unique dealer-counterparty ties (or 25.7% of all ties) that may be affected by foreign privacy and secrecy laws, blocking statutes, and other legal barriers and the alternative disclosure requirement. The Commission also notes that, as a baseline matter, SBS Entity registration forms are public and the Commission may, in the course of Commission business, publish a list of registered SBS Entities and note the conditional registration status of such entities on the Commission's public website.

As an alternative, the Commission has also considered lengthening the conditional registration period (to, e.g., 5 or 10 years) or eliminating the certification and opinion of counsel requirements. As discussed in prior sections, the Commission continues to believe that access to books and records and the ability to inspect and examine registered SBS Entities facilitates Commission oversight of security-based swap markets. These alternatives may limit the scope of assurances provided to the Commission by SBS Entity applicants regarding the Commission's ability to inspect and examine SBS Entities. To the degree that some nonresident SBS Entities

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484 This estimate includes unique dealer-counterparty pairs where the counterparty is another dealer. Excluding dealer-dealer pairs reduces the estimate by 279, with an estimate of 9,332 unique pairs between non-dealer counterparties and dealer accounts with registered office locations in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers (or approximately 70.5% of all unique dealer-counterparty pairs).

may be unable to provide certification or opinion of counsel due to their inability to become subject to Commission inspections and examinations (as a result of, for example, foreign privacy and secrecy laws, blocking statutes, and other legal barriers), these alternatives may reduce the extent of Commission inspections and examinations. However, these alternatives would reduce or eliminate certification and opinion of counsel burdens, related uncertainty, and liability risk. Importantly, under these alternatives, all nonresident SBS Entities would continue to have independent ongoing obligations to provide the Commission with access to their books and records and to permit onsite inspections and examinations. The Commission preliminarily believes that the proposed approach better balances these competing considerations and that 24 months is sufficient time for nonresident SBS Entities to comply with the certification and opinion of counsel requirements (and relocate their books, records, and other operations, if needed).

2. Proposed Modifications to Proposed Rules 18a-5(a)(10) and (b)(8)

a. Background

As discussed in the economic baseline, in the Recordkeeping and Reporting Proposing Release, the Commission proposed a background questionnaire recordkeeping requirement for stand-alone and bank SBS Entities that parallels similar broker-dealer recordkeeping requirements. The Commission is proposing modifications to the proposed questionnaire recordkeeping requirement, which would modify proposed Rules 18a-5(a)(10) and 18a-5(b)(8). The proposed modifications would tailor the proposed questionnaire requirement in two ways. First, under the proposed modifications, an SBS Entity would not be required to make and keep current questionnaires if the SBS Entity is excluded from the statutory prohibition in Section 15F(b)(6) with respect to the associated person. Second, the questionnaire or application for employment executed by an associated person who is not a U.S. person need not include certain

information if the law of the jurisdiction where the associated person is located or employed prohibits the receipt of that information or the creation or maintenance of records reflecting that information.

b. Costs, Benefits, and Effects on Efficiency, Competition, and Capital Formation

The proposed questionnaire recordkeeping requirements are intended to support Commission oversight and entity compliance with the substantive requirements of Rule 15Fb6 regarding statutory disqualification. The proposed modifications to proposed Rule 18a-5 eliminate the questionnaire requirement with respect to associated persons excluded from the statutory prohibition. These modifications are unlikely to adversely affect Commission oversight of SBS Entity compliance with the statutory prohibition since those associated persons are already excluded from the statutory prohibition. At the same time, the proposed modifications may involve modest reductions to corresponding paperwork burdens. To the degree that SBS Entities may pass along these burdens to counterparties, the proposed modifications may also result in some benefits to counterparties of these SBS Entities.

As discussed in section VIII.B, the Commission estimates that the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) to proposed Rule 18a-5 would reduce initial costs associated with proposed rule 18a-5 by $51,943 and ongoing costs by $64,622. [485] Therefore, the cost savings to SBS Entities and counterparties from this proposed modification are likely to be modest.

[485] Initial cost reduction for all stand-alone and bank SBS Entities reduction: (127 x Attorney at $409 per hour)=$51,943. Ongoing cost reduction for all stand-alone and bank SBS Entities reduction: (158 x Attorney at $409 per hour) = $64,622.

In addition, as discussed above, the Commission is proposing to modify, by adding paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B), the questionnaire requirement with respect to non-U.S. associated persons of SBS Entities if the receipt of that information, or the creation or maintenance of records reflecting that information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located. The primary intended benefit of this proposed modification is to enable certain nonresident SBS Entities to continue intermediating transactions with their counterparties. Specifically, due to the existence of foreign privacy and secrecy laws, blocking statutes, and other legal barriers, the proposed tailoring of the questionnaire requirement can enable more nonresident market participants to register as SBS Entities without a potentially costly relocation or business restructuring of certain operations and records to jurisdictions outside the reach of such laws. This may also reduce costs for counterparties (as nonresident SBS Entities may pass along related costs to counterparties in the form of more expensive security-based swaps) and may preserve valuable counterparty relationships.

In addition, this proposed modification may also involve some modest burden reductions. As discussed in section VIII.B, the proposed modification to add paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to proposed Rule 18a-5 is expected to decrease the initial costs associated with proposed rule 18a-5 by $25,767 and ongoing costs by $32,311. [486] In aggregate, as estimated in section VIII.B, under both of the proposed modifications, initial and ongoing costs of all stand-

[486] Initial cost reduction for all stand-alone and bank SBS Entities reduction: (63 x Attorney at $409 per hour)=$25,767. Ongoing cost reduction for all stand-alone and bank SBS Entities reduction: (79 x Attorney at $409 per hour) = $32,311.

alone and bank SBS Entities related to complying with proposed Rule 18a-5 are estimated at $233,130 and $291,617 respectively.[487]

The Commission continues to recognize that certain recordkeeping requirements may facilitate compliance and Commission oversight of SBS Entities. In proposing a tailored questionnaire requirement with respect to non-U.S. associated persons, the Commission has considered the value of such recordkeeping for compliance with Rule 15Fb6-2 and related oversight, as well as the costs and potential disruptions to counterparty relationships and market activity that may result when foreign jurisdictions do not allow nonresident SBS Entities to receive, create, or maintain such records. Importantly, as discussed above, the Commission continues to note that the proposed tailoring of the requirement in (a)(10)(iii)(B) and (b)(8)(iii)(B) does not eliminate or affect the scope of all SBS Entities' ongoing obligations to comply with Section 15F(b)(6) of the Exchange Act and Rule 15Fb6-2, with respect to every associated person that effects or is involved in effecting security-based swaps and is not subject to an exclusion from the statutory disqualification prohibition in Section 15F(b)(6) of the Exchange Act.

Finally, the proposed approach involves a disparate treatment of broker-dealer SBS Entities and stand-alone and bank SBS Entities. Based on an analysis of 2017 TIW data and filings with the Commission, out of 50 participants likely to register with the Commission as security-based swap dealers, the Commission estimates that 16 market participants have already registered with the Commission as broker-dealers; 9 market participants will be stand-alone

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[487] Initial costs for all stand-alone and bank SBS Entities reduction under the proposed modifications to proposed Rule 18a-5(a)(10) and (b)(8): ((760-127-63) x Attorney at $409 per hour) = $233,130. Ongoing costs for all stand-alone and bank SBS Entities reduction: ((950-158-79) x Attorney at $409 per hour) = $291,617.

security-based swap dealers, and up to 25 participants will be bank security-based swap dealers.[488]

Under the proposal, SBS Entities that are not stand-alone or bank SBS Entities would be required to make and keep current a questionnaire or application for employment for associated persons with respect to whom the broker-dealer SBS Entity is excluded from the prohibition in Exchange Act 15F(b)(6), incurring corresponding compliance burdens, albeit modest, estimated above. In addition, to the extent that some SBS Entities that are not stand-alone or bank SBS Entities are heavily reliant on employees in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers in their security-based swap business, they may be unable to comply with the employee questionnaire requirement and register with the Commission. These SBS Entities would be unable to register without a relocation or restructuring of various records and or operations, involving costs for such SBS Entities – costs that may be passed along to counterparties or disrupt existing counterparty relationships. This may reduce the competitive standing of SBS Entities cross-registered as broker-dealers and their employees in certain foreign jurisdictions and improve the competitive standing of stand-alone and bank SBS Entities and their employees in foreign data privacy jurisdictions.

The Commission notes that broker-dealer SBS Entities are already subject to a questionnaire requirement under Rule 17a-3(a)(12). The Commission preliminarily believes that such entities are making and keeping current employment questionnaires and applications for all of their associated persons in their normal course of business. In addition, the Commission

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488 We note that these figures are based on current market activity in security-based swaps. We are unable to quantify the number of market participants currently expected to register as broker-dealer, bank, or stand-alone security-based swap dealers that may choose to restructure their U.S. security-based swap market participation in response to the pending substantive requirements of Title VII, such as capital and margin requirements.

preliminarily believes that such SBS Entities have already structured their security-based swap business in a manner that would enable them to comply with this requirement without disrupting transaction activity or ongoing counterparty relationships. The sunk cost nature of such structuring of broker-dealers' security-based swap business may partly mitigate the above competitive effects.

c. Alternatives Considered

The Commission has considered an alternative approach, which would provide the same relief (by also amending Rule 17a-3(a)(12) and providing the same relief to broker-dealer SBS Entities) with respect to: (i) exemption based on the non-U.S. associated SBS Entity's exclusion from the prohibition under Section 15F(b); and (ii) exemption based on local law.

The alternative would benefit a greater number of SBS Entities and counterparties by extending the proposed relief (with its benefits discussed above) to all SBS Entities in their security-based swap business. Moreover, the alternative would eliminate the competitive disparities between broker-dealer and stand-alone and bank SBS Entities discussed above.

However, the Commission continues to recognize that recordkeeping requirements are essential to the inspection and examination process and facilitate effective oversight of the markets the Commission regulates. Importantly, as discussed above, broker-dealer SBS Entities are already subject to a questionnaire requirement under Rule 17a-3(a)(12). The Commission preliminarily believes that broker-dealer SBS Entities have already located and structured their security-based swap business in a way that would allow them to comply with the questionnaire requirement. At the same time, the Commission understands that stand-alone and bank SBS Entities active in security-based swap markets are not currently subject to similar recordkeeping requirements and that the questionnaire requirement, as proposed, may require these entities to relocate their security-based swap business and staff to other jurisdictions. This may disrupt

counterparty relationships and ongoing business transactions between stand-alone and bank SBS Entities and their customers.

The Commission also understands that broker-dealer SBS Entities are routinely making and keeping current employment questionnaires and applications for all of their associated persons, which may reduce the benefits of the above alternative. However, if such baseline behavior of broker-dealer SBS Entities is a result of Rule 17a-3 currently in effect and not of compliance practices optimal for each broker-dealer SBS Entity, the alternative may reduce burdens[489] and provide beneficial flexibility in recordkeeping practices for broker-dealer SBS Entities with respect to associated persons excluded from the statutory prohibition. The Commission continues to note that the proposed recordkeeping requirement in Rule 18a-5 is intended to support substantive obligations with respect to statutory disqualification and that such substantive obligations would no longer exist with respect to associated persons of broker-dealer SBS Entities effecting or involved in effecting security-based swaps and exempt from the statutory prohibition under, for instance, proposed Rule of Practice 194(c)(2).

F. Request for Comment

The Commission requests comment on all aspects of the economic analysis of the proposed amendment to Rule 3a71-3. To the extent possible, the Commission requests that commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting the proposed amendment or any reasonable alternatives. In particular, the Commission asks commenters to consider the following questions:

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[489] As acknowledged above, the overall burdens of compliance with proposed Rule 18a-5 are relatively modest; however, fixed costs may be more significant for smaller entities.

1. Are there costs and benefits associated with the proposed amendment that the Commission has not identified? If so, please identify them and if possible, offer ways of estimating these costs and benefits.
2. In the commenter's view, what are the costs and benefits associated with Alternative 1, and what are the costs and benefits associated with Alternative 2?
3. Are there effects on efficiency, competition, and capital formation stemming from the proposed amendment that the Commission has not identified? If so, please identify them and explain how the identified effects result from the proposed amendment.
4. Are there data sources or data sets that can help the Commission refine its estimates of the costs and benefits associated with the proposed amendment? If so, please identify them.
5. Are there alternatives to the proposed amendment that the Commission has not considered? If so, please identify and describe them.
6. In the commenter's view, is the estimation of the initial costs of current Exchange Act Rules 17a-3 and 17a-4, including the assumptions used, appropriate? If not, please explain how the estimation can be improved.
7. In the commenter's view, is the estimation of the ongoing costs of meeting registration requirements as a broker-dealer,[490] including the assumption used, appropriate? If not, please explain how the estimation can be improved.

The Commission also requests comment on all aspects of the economic analysis of the proposed guidance regarding the scope of the "arranged, negotiated, or executed" test. To the extent possible, the Commission requests that commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting the proposed guidance. In addition, the Commission asks commenters to consider the following questions:

8. Are there costs and benefits associated with the proposed guidance that the Commission has not identified? If so, please identify them and if possible, offer ways of estimating these costs and benefits.
9. Are there effects on efficiency, competition, and capital formation stemming from the proposed guidance that the Commission has not identified? If so, please identify them and explain how the identified effects result from the proposed amendment.
10. Are there data sources or data sets that can help the Commission refine its estimates of the costs and benefits associated with the proposed guidance? If so, please identify them.

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490 See part VII.B.1.a, supra.

11. Are there alternatives to the proposed guidance that the Commission has not considered? If so, please identify and describe them.

The Commission also requests comment on all aspects of the economic analysis of the proposed amendment to Rule of Practice 194. To the extent possible, the Commission requests that commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting the proposed amendment or any reasonable alternatives. In addition, the Commission asks commenters to consider the following questions:

12. What additional qualitative or quantitative information should the Commission consider as part of the baseline for its economic analysis of the proposed Rule of Practice 194(c)(2)? To what extent do entities likely to register with the Commission as SBS Entities rely on non-U.S. personnel dealing with U.S. versus non-U.S. counterparties?
13. Has the Commission accurately characterized the costs and benefits of proposed Rule of Practice 194(c)(2)? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should the Commission take into account? Would entities likely to register with the Commission as SBS Entities choose not to register or deregister if Rule of Practice 194(c)(2) is not adopted? If possible, please offer ways of estimating these costs and benefits. What additional considerations can the Commission use to estimate the costs and benefits of the proposed amendment?
14. Has the Commission accurately characterized the effects on competition, efficiency, and capital formation arising from proposed Rule of Practice 194(c)(2)? If not, why not?
15. Has the Commission accurately characterized the costs, benefits, and effects on competition, efficiency, and capital formation of the above alternatives to the proposed Rule of Practice 194(c)(2)? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should the Commission take into account?

16. Are there other reasonable alternatives to the proposed Rule of Practice 194(c)(2) that the Commission should consider? What are the costs, benefits, and effects on competition, efficiency, and capital formation of any other alternatives?

The Commission also requests comment on all aspects of the economic analysis of the proposed guidance and amendments related to certification and opinion of counsel, conditional registration, and the employee questionnaire requirements. To the extent possible, the Commission requests that commenters provide supporting data and analysis with respect to the benefits, costs, and effects on competition, efficiency, and capital formation of adopting the proposed amendment or any reasonable alternatives. In addition, the Commission asks commenters to consider the following questions:

17. What additional qualitative or quantitative information should the Commission consider as part of the baseline for its economic analysis of these amendments? Which jurisdictions and security-based swap market participants are affected by foreign privacy and secrecy laws, blocking statutes, and other legal barriers? To what extent do entities likely to register with the Commission as bank, stand-alone, or broker-dealer SBS Entities rely on nonresident personnel located or employed in jurisdictions with foreign privacy and secrecy laws, blocking statutes, and other legal barriers? To what extent do such personnel transact across reference security and security-based swap markets, and with institutional versus retail clientele?
18. Has the Commission accurately characterized the costs and benefits of the proposed conditional registration in Rule 15Fb2-1 and guidance regarding the certification and opinion of counsel requirements in Rule 15Fb2-4? Has the Commission accurately characterized the costs and benefits of the proposed modifications to the questionnaire recordkeeping requirement in Rule 18a-5(a)(10) and Rule 18a-5(b)(8)? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should the Commission take into account? Would entities likely to register with the Commission as SBS Entities choose not to register or deregister without the proposed conditional registration in Rule 15Fb2-1 or guidance regarding Rule 15Fb2-4? If

possible, please offer ways of estimating these costs and benefits. What additional considerations can the Commission use to estimate the costs and benefits of the proposed guidance?

19. Has the Commission accurately characterized the effects on competition, efficiency, and capital formation arising from proposed guidance, amendments, and modifications regarding Rules 15Fb2-1 and 15Fb2-4, and proposed Rule 18a-5? If not, in what way?
20. Has the Commission accurately characterized the costs, benefits, and effects on competition, efficiency, and capital formation of the above alternatives to the proposed guidance and amendments regarding conditional registration, certification and opinion of counsel, and employee questionnaires? If not, why not? Should any of the costs or benefits be modified? What, if any, other costs or benefits should the Commission take into account?
21. Has the Commission accurately characterized the costs, benefits, and effects on competition, efficiency, and capital formation of alternatives to the proposed guidance, amendments, and modifications regarding conditional registration, certification and opinion of counsel, and employee questionnaires? Are there other reasonable alternatives the Commission should consider? What are the costs, benefits, and effects on competition, efficiency, and capital formation of any other alternatives?

VIII. Paperwork Reduction Act

Certain provisions of the proposed amendments and modifications to Exchange Act Rules 3a71-3 and 18a-5 contain "collection of information"[491] requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"), and the Commission is submitting the

[491] 44 U.S.C. 3502(3).

proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The title of the new collection of information associated with the proposed changes to Rule 3a71-3 is "Rule 3a71-3(d) – Conditional Exception from De Minimis Counting Requirement in Connection with Certain Transactions Arranged, Negotiated or Executed in the United States."[492] OMB has not yet assigned a control number to this new collection of information.

The title and OMB control number for the collection of information the Commission is proposing to modify is Rule 18a-5 – Records to be made by certain security-based swap dealers and major security-based swap participants, OMB Control Number 3235-0745. The Commission's earlier PRA assessments have been revised to reflect the modifications to proposed Rule 18a-5 from those that were proposed in the Recordkeeping and Reporting Proposing Release.

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[492] This new collection of information is distinct from an existing collection of information related to Exchange Act Rule 3a71-3(c), which provides an exception from the application of certain business conduct requirements in connection with a security-based swap dealer's "foreign business." See generally Business Conduct Adopting Release, 81 FR at 30082.

A. Proposed amendment to Rule 3a71-3

1. Summary of the Collection of information[493]

a. Disclosure of limited Title VII applicability

Both alternatives to the proposed exception to Rule 3a71-3 would be conditioned in part on the registered entity engaged in arranging, negotiating or executing activity in the United States notifying the counterparties of the non-U.S. person relying on the exception, contemporaneously with and in the same manner as the conduct at issue, that the non-U.S. person is not registered with the Commission as a security-based swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable in connection with the transaction. This disclosure would be required only so long as the identity of the counterparty is known to that registered entity at a reasonably sufficient time prior to the execution of the transaction to permit the disclosure.[494]

b. Business conduct condition

Alternative 1 would be conditioned in part on the registered security-based swap dealer that engages in arranging, negotiating or executing activity in the United States in connection with the transactions at issue complying with certain security-based swap dealer business conduct requirements – related to: disclosure of material risks, characteristics, incentives and

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493 Because the proposed amendment to Rule 3a71-3 would require the use of a registered security-based swap dealer or a registered broker in connection with the transactions at issue, the proposed amendment also would implicate collections of information associated with security-based swap dealer or broker status (apart from the collections associated with the specific conditions of the exception). Separate collections of information address the registration of security-based swap dealers and brokers, as well as the requirements associated with those registered entities as a matter of course, including recordkeeping requirements applicable to such registered entities. The separate collections of information associated with requirements of general applicability for registered security-based swap dealers and brokers are not addressed as part of this rulemaking, and instead are addressed by the collections of information associated with those separate requirements.

494 See Alternatives 1 and 2 – proposed paragraph (d)(1)(iv) of Rule 3a71-3.

conflicts of interest; suitability of recommendations; and fair and balanced communications – "as if" the counterparty to the non-U.S. person relying on the exception also were a counterparty to that registered security-based swap dealer.[495] Each of those underlying business conduct requirements itself is associated with a collection of information.[496]

Alternative 2 would be conditioned in part on the registered broker or a registered security-based swap dealer that engages in such activity in the United States in connection with the transaction at issue complying with those same business conduct requirements, "as if" the counterparty to the non-U.S. person relying on the exception also were a counterparty to that registered entity.[497]

c. Trade acknowledgment and verification condition

Alternative 1 would be conditioned in part on the registered security-based swap dealer that engages in arranging, negotiating or executing activity in the United States in connection with the transactions at issue complying with trade acknowledgment and verification requirements – which themselves are associated with collections of information[498] – "as if" the counterparty to the non-U.S. person relying on the exception also were a counterparty to that registered security-based swap dealer.[499]

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495 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*1*)-(*3*) of Rule 3a71-3.

496 See Business Conduct Adopting Release, 81 FR at 30083-85 (discussing collections of information regarding security-based swap dealer requirement for disclosure of information regarding material risks, characteristics, incentives and conflicts of interest, suitability of recommendations, and fair and balanced communications).

497 See Alternative 2 – proposed paragraph (d)(1)(ii)(B)(*1*)-(*3*) of Rule 3a71-3.

498 See Business Conduct Adopting Release, 81 FR at 30083-85 (discussing collections of information regarding security-based swap dealer requirement for disclosure of information regarding material risks, characteristics, incentives and conflicts of interest, disclosure of information regarding clearing rights, suitability of recommendations, and fair and balanced communications).

499 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*4*) of Rule 3a71-3.

Alternative 2 would be conditioned in part on the registered broker or security-based swap dealer that engages in such activity in the United States in connection with the transactions at issue complying with those trade acknowledgment and verification requirements "as if" the counterparty to the non-U.S. person relying on the exception also were a counterparty to that registered entity.[500]

d. Portfolio reconciliation condition

Alternative 1 would be conditioned in part on the registered security-based swap dealer that engages in arranging, negotiating or executing activity in the United States in connection with the transactions at issue complying with proposed portfolio reconciliation requirements, but only with respect to the initial portfolio reconciliation required by the rule, "as if" the counterparty to the non-U.S. person relying on the exception also is a counterparty to that registered security-based swap dealer.[501] That underlying proposed portfolio reconciliation requirement itself is associated with a collection of information.[502]

Alternative 2 for the exception would be conditioned in part on the registered broker or security-based swap dealer that engages in such activity in the United States in connection with the transactions at issue complying with the proposed portfolio reconciliation requirement with regard to the initial reconciliation "as if" that registered entity is a counterparty to the non-U.S. person's counterparty (and "as if" that entity is registered as a security-based swap dealer if it is not so registered).[503]

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500 See Alternative 2 – proposed paragraph (d)(1)(ii)(B)(*4*) of Rule 3a71-3.

501 See Alternative 1 – proposed paragraph (d)(1)(ii)(B)(*5*) of Rule 3a71-3.

502 See Risk Mitigation Proposing Release, 83 FR at 4640 (discussing collection of information regarding proposed security-based swap dealer portfolio reconciliation requirement).

503 See Alternative 2 – proposed paragraph (d)(1)(ii)(B)(5) of Rule 3a71-3.

e. Recordkeeping condition

Both proposed alternatives would be conditioned in part on the registered entity engaged in arranging, negotiating or executing activity in the United States obtaining from the non-U.S. person relying on the exception, and maintaining, trading relationship documentation involving the counterparty to the transaction.[504]

f. Consent to service condition

Both proposed alternatives for the exception to Rule 3a71-3 would be conditioned in part on the registered entity engaged in arranging, negotiating or executing activity in the United States obtaining from the non-U.S. person relying on the exception written consent to service of process for any civil action brought by or proceeding before the Commission, providing that process may be served on the non-U.S. person by service on the registered entity in the manner set forth in the registered entity's current Form BD, SBSE, SBSE-A or SBSE-BD, as applicable.[505]

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504 See Alternatives 1 and 2 – proposed paragraph (d)(1)(iii)(B)(*2*) of Rule 3a71-3.

The proposed exception also would be conditioned in part on the registered entity engaged in market facing activity in the United States creating and maintaining books and records relating to the transactions subject to this exception that are required, as applicable, by Rule 17a-3 and 17a-4, or Rule 18a-5 and 18a-6, including books and records relating to: disclosure of risks, characteristics, incentives and conflicts; suitability; fair and balanced communications; trade acknowledgment and verification; and portfolio reconciliation. See Alternatives 1 and 2 – proposed paragraph (d)(1)(iii)(B) of Rule 3a71-3 (requiring creation and maintenance of books and records relating to the requirements specified in proposed paragraph (d)(1)(ii)(B).

Because that part of the condition subsumes the collection of information that the Commission would expect to be associated with the final rules adopting those security-based swap dealer books and records requirements, it does not constitute a separate collection of information attributable to this proposed exception. See note 493, supra.

505 See Alternatives 1 and 2 – proposed paragraph (d)(1)(iii)(B)(*3*) of Rule 3a71-3.

g. "Listed jurisdiction" condition

Both proposed alternatives for the exception to Rule 3a71-3 would be conditioned in part on the non-U.S. person relying on the exception being subject to the margin and capital requirements of a "listed jurisdiction."[506] The proposal specifies that applications for orders requesting listed jurisdiction status may be made by persons that may rely on the exception, or by foreign financial authorities, or made on the Commission's own initiative, and must be filed pursuant to the procedures set forth in Exchange Act Rule 0-13.[507]

2. Use of Information

a. Disclosure of limited Title VII applicability

The proposed disclosure condition is intended to help guard against counterparties reasonably presuming that the involvement of U.S. personnel in an arranging, negotiating or executing capacity as part of the transaction would be accompanied by the safeguards associated with Title VII security-based swap dealer regulation applying to the non-U.S. person.

b. Business conduct condition

The use of the information associated with the business conduct condition would be the same as the use of information associated with the currently extant security-based swap dealer business conduct requirements, given that the relevant condition simply would expand the existing requirements to apply to transactions where they currently do not apply. Accordingly, the condition requiring the registered entity to comply with requirements for the disclosure of risks, characteristics, incentives and conflicts, particularly would assist the counterparty in assessing the transaction by providing it with a better understanding of the expected performance

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506 See Alternatives 1 and 2 – proposed paragraph (d)(1)(v) of Rule 3a71-3.

507 See Alternatives 1 and 2 – proposed paragraph (d)(2)(i) of Rule 3a71-3.

of the security-based swap, and provide additional transparency and insight into pricing.[508] The condition requiring the registered entity to comply with requirements regarding the suitability of recommendations would assist the registered entity in making appropriate recommendations.[509] The condition requiring the registered entity to comply with fair and balanced communication requirements in part would better equip the counterparty to make more informed investment decisions.[510]

c. Trade acknowledgment and verification condition

The use of the information associated with the trade acknowledgement and verification condition would be the same as the use of information associated with the currently extant security-based swap dealer trade acknowledgment and verification requirements, given that the relevant condition simply would expand the existing requirements to apply to transactions where they currently do not apply. In general, the trade acknowledgment would serve as a written record by which the counterparties to the transaction may memorialize the terms of a transaction, and the verification requirements are intended to ensure that the written record of the transaction accurately reflects the terms of the transaction as understood by the respective counterparties.[511]

d. Portfolio reconciliation condition

The use of the information associated with the portfolio reconciliation condition would be the same as the use of information associated with the proposed security-based swap dealer portfolio reconciliation requirement. In general, that proposed requirement is intended to help ensure the accuracy of the data reported to SDRs, and to help facilitate the ability of registered

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508 See Business Conduct Adopting Release, 81 FR at 30088.

509 See id.

510 See id.

511 See Trade Acknowledgement Adopting Release, 81 FR at 39830.

security-based swap data repositories to comply with requirements that they verify the information they receive.[512]

e. Recordkeeping condition

The proposed condition requiring the registered entity to obtain and maintain trading relationship documentation involving the non-U.S. person relying on the exception and its counterparty is intended to help the Commission obtain a full view of the dealing activities connected with transactions relying on the proposed exception, including such activities that occur in the non-U.S. person taking advantage of the exception. Absent such access, the Commission may be impeded in identifying fraud and abuse in connection with transactions that have been arranged, negotiated or executed in the United States, where such fraud or abuse may be apparent only in light of relevant information obtained from the non-U.S. person relying on the exception or its associated persons.

f. Consent to service condition

The proposed use of the consent to service condition is to facilitate the Commission's ability to serve process on the non-U.S. person relying on the exception, to assist the Commission in efficiently taking action to address potential violations of the federal securities laws in connection with the transactions at issue.

g. "Listed jurisdiction" condition

The proposed use of information provided by applicants in connection with "listed jurisdiction" applications is to assist the Commission in evaluating the effectiveness of the financial responsibility requirements of jurisdictions regulating non-U.S. persons taking advantage of the exception. This is intended to help avoid creating an incentive for persons

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[512] See Risk Mitigation Proposing Release, 83 FR at 4641.

engaged in a security-based swap dealing business in the United States to book their transactions into entities that solely are subject to the regulation of jurisdictions that do not effectively require security-based swap dealers or comparable entities to meet certain financial responsibility standards. That should help avoid providing an unwarranted competitive advantage to non-U.S. persons that conduct security-based swap dealing activity in the United States without being subject to strong financial responsibility standards. The condition also is consistent with the view that applying financial responsibility requirements to such transactions between two non-U.S. persons can help mitigate the potential for financial contagion to spread to U.S. market participants and to the U.S. financial system more generally.

3. Respondents

As discussed above, the Commission preliminarily estimates that up to 24 entities that engage in security-based swap dealing activity may rely on the proposed conditional exception from having to count dealing transactions with non-U.S. counterparties against the de minimis thresholds.[513] To satisfy the proposed exception, each of those up to 24 entities would make use of an affiliated registered security-based swap dealer and/or registered broker that would be required to comply with – and incur collections of information in connection with – conditions

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[513] This estimate is based on data (see part VII.A.7, supra) indicating that: (1) Six U.S. entities are engaged in security-based swap dealing activity above the de minimis thresholds may have the incentive to book future security-based swaps with non-U.S. counterparties into U.S. affiliates to make use of the proposed exception in connection with those transactions. (2) One non-U.S. entity would fall below the $3 billion de minimis threshold if its transactions with non-U.S. counterparties were not counted. (3) The "arranged, negotiated, or executed" counting standard would result in five additional non-U.S. entities incurring assessment costs in connection with the de minimis exception.

The analysis has doubled those numbers – to up to twelve U.S. persons that may change its booking practices involving security-based swaps to make use of the exception, plus up to twelve additional non-U.S. persons – to address potential growth of the security-based swap market and to account for uncertainty associated with the availability of data, leading to the final estimate of 24 entities. See id.

related to compliance with relevant Title VII security-based swap dealer requirements related to business conduct, trade acknowledgment and verification, and portfolio reconciliation. Each of those up to 24 registered entities also would have to provide disclosures to counterparties of the non-U.S. persons relying on the exception, to obtain and maintain trading relationship documentation involving the non-U.S. persons relying on the proposed exception and their counterparties, and to comply with the condition that the registered entity obtain from the non-U.S. person a consent to service of process.

Applications for listed jurisdiction determinations may be submitted by the up to 24 non-U.S. persons that would rely on the proposed exception. In practice the Commission expects that the greater portion of such listed jurisdiction applications will be submitted by foreign financial authorities, given their expertise in connection with the relevant financial responsibility requirements and information access provisions, and in connection with their supervisory and enforcement oversight with regard to the financial responsibility requirements.[514]

4. Total annual reporting and recordkeeping burdens (summarized in Table 3)

a. Disclosure of limited Title VII applicability

The Commission preliminarily estimates that the up to 12 U.S. entities that may book transactions into their non-U.S. affiliates to make use of the proposed conditional exception in the aggregate would annually engage in nearly 76,000 security-based swap dealing transactions with non-U.S. counterparties.[515] Here – and in connection with the other two groups addressed

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514 As discussed below, the Commission estimates that three non-U.S. persons will submit listed jurisdiction applications.

515 Available data indicates that the six U.S. entities that are engaged in security-based swap dealing activity above the de minimis thresholds in the aggregate annually engage in 37,827 transactions with non-U.S. counterparties. To address potential growth in the market and data-related

below – the analysis doubles that amount to estimate the number of total disclosures, recognizing that there will be situations in which the registered entity engaged in arranging, negotiating or executing activity in the United States makes the required disclosures but a transaction does not result.[516]

The Commission also preliminary estimates that the two non-U.S. persons that may fall below the de minimis thresholds due to the proposed conditional exception in the aggregate would annually engage approximately 20,000 security-based swap dealing transactions with non-U.S. counterparties,[517] doubled here to account for disclosures that are not followed by a transaction.[518]

The Commission further preliminarily estimates that the additional ten non-U.S. entities that may rely on the proposed conditional exception in the aggregate would annually engage in approximately 2100 security-based swap dealing transactions, with non-U.S. persons, that may be subject to the proposed exception,[519] doubled here to account for disclosures that are not followed by a transaction.[520]

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uncertainty, the analysis doubles that estimate to 75,654 transactions annually (and, as noted above, have doubled the estimated number of entities).

516 This produces an estimate of 151,308 (75,654 × 2) annual disclosures pursuant to the proposed condition.

517 Available data indicates that the one non-U.S. entity that would fall below the de minimis thresholds due to the exception annually engages in 10,064 transactions with non-U.S. counterparties. To address potential growth in the market and data-related uncertainty, the analysis doubles that estimate to 20,128 transactions annually (and, as noted above, have doubled the estimated number of entities).

518 This produces an estimate of 40,256 (20,128 × 2) annual disclosures pursuant to the proposed condition.

519 Available data indicates that would result in five additional non-U.S. persons that would be expected to incur assessment costs due to the "arranged, negotiated, or executed" counting standard engage in a total of 1056 annual security-based swap transactions with non-U.S. counterparties. To address potential growth in the market and data-related uncertainty, the

In light of the limited contents of those contemporaneous disclosures, the Commission preliminarily believes that each such disclosure on average would be expected to take no more than five minutes.[521] Accordingly, the Commission preliminarily estimates that the 12 U.S. entities that may book transactions into their non-U.S. affiliates to make use of the proposed conditional exception in the aggregate will annually spend a total of approximately 12,609 hours to provide the disclosures required by the conditions.[522] The Commission further preliminarily estimates that the two non-U.S. entities that may fall below the de minimis thresholds due to the exception in the aggregate will annually spend a total of approximately 3355 hours to provide the disclosures required by the conditions,[523] while the other ten non-U.S. entities that may rely on the proposed conditional exception in the aggregate will annually spend a total of approximately 352 hours to provide the disclosures required by the conditions.[524]

The Commission also preliminarily believes that each of those 24 total entities would initially spend 100 hours and incur approximate costs of $29,715 to develop policies and procedures to help ensure that appropriate disclosures are provided.[525]

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analysis doubles that estimate to 2112 transactions annually (and have doubled the estimated number of entities).

520 This produces an estimate of 4224 (2112 × 2) annual disclosures pursuant to the proposed condition.

521 Given that the disclosure must be provided contemporaneously with the market-facing activity by the registered entity engaged in market-facing activity in the United States, the disclosure could not reasonably be provided via inclusion in standard trading documentation and would require the creation of specific disclosure documentation.

522 151,308 aggregate annual disclosures × 5 minutes per transaction. This averages to approximately 1050.75 hours for each of those 12 firms.

523 40,256 aggregate annual disclosures × 5 minutes per transaction. This averages to approximately 1677 hours for each of those two firms.

524 4224 aggregate annual disclosures × 5 minutes per transaction. This averages to 35.2 hours for each of those ten firms.

525 Applied to the estimated 24 entities at issue here, this would amount to 2400 hours and $713,160.

b. Business conduct condition

The Commission estimated the reporting and recordkeeping burdens associated with the relevant security-based swap dealer business conduct requirements under Title VII when it adopted those requirements. The Commission believes that those estimates are instructive for calculating the per-entity reporting and recordkeeping burdens associated with the proposed business conduct condition, given that the condition in effect would require compliance with those business conduct requirements.

- Disclosures of material risks, characteristics, and conflicts and incentives. When the Commission earlier considered the compliance burdens associated with those disclosure requirements (along with clearing rights and daily mark disclosure requirements not applicable under this proposal),[526] the Commission estimated that implementation of those requirements: (i) initially would require three persons from trading and structuring, three persons from legal, two persons from operations and four persons from compliance, for 100 hours each[527]; (ii) half of those persons would be required to spend 20 hours annually to re-evaluate and modify disclosures and systems requirements[528]; and (iii) those entities would require eight full-time persons for six months of systems development, programming and testing,[529] along with two full-time persons annually for maintenance of this system.[530]

These estimates are based on prior estimates, made in connection with the adoption of the "arranged, negotiated, or executed" counting standard, that non-U.S. persons would incur 100 hours and $28,300 to establish policies and procedures to restrict communications with U.S. personnel in connection with the non-U.S. persons' dealing activity. See ANE Adopting Release, 81 FR at 8628. That $28,300 estimate has been adjusted to $29,715 in current dollars (28,300 × 1.05).

526 See Business Conduct Adopting Release, 81 FR at 30091-92. In connection with those prior estimates, the Commission noted that entities that are dually registered with the CFTC already provide their counterparties with similar disclosures.

527 Applied to the 24 entities at issue here, this would amount to an aggregate initial burden of 28,800 hours (24 entities × 12 persons × 100 hours).

528 Applied to the 24 entities at issue here, this would amount to an aggregate annual burden of 2880 hours (24 entities × 6 persons × 20 hours).

529 Applied to the 24 entities at issue here, this would amount to an aggregate initial burden of 192,000 hours (24 entities × 8 persons × 1000 hours).

530 Applied to the 24 entities at issue here, this would amount to an aggregate annual burden of 96,000 hours (24 entities × 2 persons × 2000 hours).

- Suitability of recommendations. When the Commission previously analyzed the burdens associated with the security-based swap dealer recommendation suitability requirement, it estimated that most security-based swap dealers would obtain representations from counterparties to comply with the institutional suitability provisions of the requirement.[531] The Commission further particularly estimated: (i) that for security-based swap market participants that also are swap market participants, most of the requisite representations have been drafted for the swaps context, and that to the extent that any modifications are necessary to adapt those representations to the security-based swap context, each market participant would require two hours to assess the need for modifications and make any required modifications[532]; and (ii) other market participants (apart from special entities not relevant here) would require five hours for each market participant to review and agree to the relevant representations.[533]

In adopting those disclosure requirements, the Commission also incorporated an estimate of one hour per security-based swap for an entity to evaluate whether more particularized disclosures are necessary and to develop additional disclosures. See Business Conduct Adopting Release, 81 FR at 30092. The Commission does not believe that particular category of costs would be applicable in the context of the transactions at issue here.

Under the proposed exception, the disclosure condition extends not only to incentives and conflicts of the registered entity, but also disclosures and conflicts of its non-U.S. affiliate. The Commission believes, however, that the existing burden estimates are sufficient to account for this aspect of the disclosure, given that the two entities' affiliation should facilitate the transfer of any relevant incentive and conflict information for the registered entity to convey.

531 See id. at 30092-93.

532 Analysis of current data indicates that the six U.S. entities engaged in security-based swap dealing activity above the de minimis thresholds in the aggregate have 161 unique non-U.S. counterparties that are swap market participants, and 70 unique non-U.S. counterparties that are not swap market participants. The one non-U.S. entity that may fall below the de minimis threshold due to the exception has 391 unique non-U.S. counterparties that are swap market participants, and 178 unique non-U.S. counterparties that are not swap market participants. The five additional non-U.S. persons that would be expected to incur assessment costs in connection with the "arranged, negotiated, or executed" counting standard in the aggregate have six unique non-U.S. counterparties that are swap market participants, and one unique non-U.S. counterparty that are not swap market participants. Adding together those estimates and then doubling them (in light of the uncertainty associated with the estimate and to account for potential growth of the security-based swap market) produces a total estimate of 1116 unique non-U.S counterparties that are swap market participants, and 498 that are not. Only non-U.S. counterparties are relevant for purposes of this analysis because the proposed exception does not address security-based swap transactions involving U.S. person counterparties.

Consistent with these assumptions, the potential burden associated with such modifications in connection with the proposed condition would amount to 2232 hours (1116 non-U.S. security-based swap market participants that also are swap market participants × two hours).

533 Consistent with the above assumptions, the potential burden associated with such modifications in connection with the proposed condition would amount to 2490 hours (498 non-U.S. security-based swap market participants that are not also swap market participants × five hours).

- Fair and balanced communications. The Commission's earlier analysis of the burdens associated with the fair and balanced communications requirement[534] took the view that each registered entity would incur: (i) $6000 in initial legal costs to draft or review statements of potential opportunities and corresponding risks in marketing materials[535]; (ii) an additional initial six hours for internal review of other communications such as emails and Bloomberg messages[536]; and (iii) $8400 in initial legal costs associated with marketing materials for more bespoke transactions.[537]

c. Trade acknowledgment and verification condition

The Commission estimated the reporting and recordkeeping burdens associated with the trade acknowledgment and verification requirements under Title VII when it adopted those requirements.[538] The Commission believes that those estimates are instructive for calculating the per-entity reporting and recordkeeping burdens associated with the proposed trade acknowledgment and verification condition, given that the condition in effect would require compliance with that trade acknowledgment and verification requirement by additional persons and/or in additional circumstances.

When the Commission earlier considered the compliance burdens associated with the trade acknowledgement and verification requirements, the Commission estimated that each applicable entity would incur: (i) 355 hours initially to develop an internal order and trade

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534 See Business Conduct Adopting Release, 81 FR at 30093.

535 In connection with the proposed exception, the potential burden associated with such drafting or review would amount to $151,200 (24 entities × $6000 × 1.05 adjustment to current dollars).

536 In connection with the proposed exception, the potential burden associated with such internal review would amount to 144 hours (24 entities × 6 hours).

537 In connection with the proposed exception, the potential burden associated with such drafting or review would amount to $211,680 (24 entities × $8400 × 1.05 adjustment to current dollars).

In adopting the fair and balanced communication requirement, the Commission also incorporated an estimate of ongoing compliance costs (associated with review of email communications sent to counterparties) over the term of the security-based swap. See Business Conduct Adopting Release, 81 FR at 30093. Those costs are not incorporated into this estimate because the registered entity that engaged in market-facing activity in the United States in connection with the transactions at issue here would not be expected to have ongoing communications with the counterparty to the security-based swap.

538 See id. at 39830-31.

management system[539]; (ii) 436 hours annually for day-to-day technical support, as well as amortized annual burden associated with system or platform upgrades and updates[540]; (iii) 80 hours initially for the preparation of written policies and procedures to obtain verification of transaction terms[541]; and (iv) 40 hours annually to maintain those policies and procedures.[542]

d. Portfolio reconciliation condition

The Commission estimated the recordkeeping burdens associated with the portfolio reconciliation requirements under Title VII when it proposed those requirements.[543] The Commission believes that those estimates are instructive for calculating the per-entity recordkeeping burdens associated with the proposed portfolio reconciliation condition, given that the condition in effect would require compliance with that portfolio reconciliation requirement by additional persons and/or in additional circumstances.

When the Commission considered the recordkeeping burden associated with the portfolio reconciliation requirement, it estimated that each respondent on average would incur an annual burden of 190 hours in connection with proposed Rule 15Fi-3(a), which addresses portfolio reconciliation obligations in connection with transactions where the counterparty to the registered entity is a security-based swap dealer and major security-based swap participant.[544]

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539 In connection with the proposed exception, the potential burden associated with such system development would amount to 8520 hours (24 entities × 355 hours).

540 In connection with the proposed exception, the potential annual burden associated with such support and updates would amount to 10,464 hours (24 entities × 436 hours).

541 In connection with the proposed exception, the potential burden associated with such preparation would amount to 1920 hours (24 entities × 80 hours).

542 In connection with the proposed exception, the potential annual burden associated with such policies and procedures would amount to 960 hours (24 entities × 40 hours).

543 See Risk Mitigation Proposing Release, 84 FR at 4642-43.

544 See Risk Mitigation Proposing Release, 84 FR at 4642. That was based on estimates regarding the time to perform each reconciliation, and the number of counterparties associated with each

The Commission further estimated that each respondent on average would incur an annual burden of 227.5 hours in connection with proposed Rule 15Fi-3(b), which addresses portfolio reconciliation obligations in connection with transactions where the counterparty to the registered entity is not a security-based swap dealer and major security-based swap participant,[545] for a total of 417.5 hours.

While recognizing that the proposed condition requires only the initial reconciliation of any particular instrument, the Commission nonetheless believes that these estimates provide a useful upper bound for the per-entity burden associated with this condition.[546]

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required frequency of portfolio reconciliation (i.e., daily reconciliations for portfolios with more than 500 security-based swaps, weekly reconciliations for portfolios with more than 50 but fewer than 500 security-based swaps, and quarterly reconciliations for portfolios with no more than 50 security-based swaps).

545 See id. at 4642-43. That was based on estimates regarding the time to perform each reconciliation, and the number of counterparties associated with each required frequency of portfolio reconciliation (i.e., quarterly reconciliations for portfolios with more than 100 security-based swaps, and annual reconciliations for portfolios with no more than 100 security-based swaps).

546 In connection with the proposed exception, the estimated aggregate annual burden associated with this condition would be 10,020 hours (24 entities × 417.5 hours).

The Commission believes that the above estimate of 10,020 appropriately reflects the burden associated with the portfolio reconciliation condition. At the same time, the Commission recognizes that, depending on the applicable facts and circumstances, the registered entity engaged in arranging, negotiating or executing conduct in the United States may need to obtain, from the non-U.S. affiliate relying on the transaction, information needed to perform the initial portfolio reconciliation. The Commission typically would not expect such transfers of information to constitute an independent collection of information, because the registered entity generally would be expected to possess that information to comply with regulatory reporting obligations pursuant to Regulation SBSR (leading any resulting burdens to be subsumed within the collection of information associated with Regulation SBSR).

Nonetheless, in the event that the registered entity is not otherwise subject to regulatory reporting obligations pursuant to Regulation SBSR, such transfers of information from the non-U.S. affiliate to the registered entity may constitute an independent collection of information. In those circumstances, and consistent with the Paperwork Reduction Act analysis associated with Regulation SBSR, the Commission anticipates that the upper bound on the initial burden for each non-U.S. affiliate to construct an infrastructure to provide for the transfer of this information would amount to 1394 hours (see Exchange Act Release No. 74244 (Feb. 11, 2015), 80 FR 14564, 14676 (Mar. 19, 2015)), or 33,456 hours in the aggregate (24 non-U.S. entities × 1394

e. Recordkeeping condition

To comply with the proposed condition that the affiliated registered entity obtain from the non-U.S. person, and maintain, copies of trading relationship documentation the registered entity and the non-U.S. person jointly would need to develop policies and procedures to provide for the identification of such records and for their transfer to the registered affiliate. For each use of the proposed exception, the Commission preliminarily estimates that such policies and procedures would impose require a one-time initial burden of 20 hours.[547]

The Commission also preliminarily estimates that the non-U.S. person relying on this exception also would need to expend two hours per week to identify such records and to electronically convey the records to its registered affiliate.[548] The Commission further preliminarily estimates that the registered affiliate would need to expend one hour per week in connection with the receipt and maintenance of those records.[549]

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hours). Also, based on prior estimates that it would take 0.005 hours to report each security-based swap transaction (see id.), and the estimate that this proposed exception in the aggregate would address 97,894 transactions annually (see notes 515, 517 and 519 supra), the Commission estimates that the upper bound on the aggregate annual burden associated with such transfers of information would amount to approximately 489 hours (97,894 transactions × 0.005 hours).

Such burdens likely would be mitigated if, for example, the registered entity and its non-U.S. affiliate jointly make use of unified back-office systems, or if the counterparty relationship largely is managed by personnel of the registered entity, or if the non-U.S. entity independently is subject to Regulation SBSR or has developed similar types of systems to comply with foreign reporting requirements.

547 Across the 24 potential uses of the proposed exception, this would amount to a total of 480 hours (24 entities × 20 hours).

548 Across the 24 potential uses of the proposed exception, this would amount to a total of 2496 hours annually (24 entities × 2 hours × 52 weeks).

549 Across the 24 potential uses of the proposed exception, this would amount to a total of 1248 hours annually (24 entities × 1 hour × 52 weeks).

The recordkeeping condition also specifies that, for the exception to be available, the registered entity must create and maintain books and records as required by applicable rules, including any books and records requirements relating to the provisions specified in paragraph (d)(1)(ii)(B) (i.e., relating to disclosure of risks, characteristics, incentives and conflicts; suitability; fair and

f. Consent to service condition

To comply with the proposed condition that the affiliated registered entity obtain from the non-U.S. person relying on the exception written consent to service of process for civil actions, one or the other of those parties would have to draft such a consent or use an industry-standard consent provision, and the registered entity must obtain that consent from the non-U.S. person. The Commission preliminarily estimates that the parties jointly must expend **[**two**]** hours in connection with this process.[550]

g. "Listed jurisdiction" condition

The Commission believes that burden estimates associated with applications for substituted compliance determinations are instructive with regard to the burdens that would be associated with applications by market participants in connection with "listed jurisdiction" status.[551]

When the Commission initially adopted Rules 0-13 and 3a71-6, providing for substituted compliance in connection with security-based swap dealer business conduct requirements, the Commission concluded that the "great majority" of substituted compliance applications would be submitted by foreign authorities, and that "very few" applications would be submitted by security-based swap dealers (or major security-based swap participants), and the Commission

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balanced communications; trade acknowledgment and verification; and portfolio reconciliation). Because that part of the condition subsumes the collection of information that we would expect to be associated with the final rules adopting those security-based swap dealer books and records requirements, it does not constitute a separate collection of information. See note 493, supra.

550 Across the 24 expected uses of the proposed exception, this would amount to a total of 48 hours (24 entities × 2 hours).

551 Notwithstanding the substantive differences between the standards associated with listed jurisdiction determinations and substituted compliance assessments, see part III.B.5, supra, the two sets of applications will be submitted pursuant to Rule 0-13 and may be expected to address certain analogous elements.

concluded that three such registered entities would submit substituted compliance applications.[552] The Commission further estimated that the one-time paperwork burden associated with preparing and submitting all three substituted compliance requests in connection with those requirements would be approximately 240 hours, plus $240,000 for the services of outside professionals.[553] The Commission subsequently relied on those estimates in connection with the paperwork burdens associated with amendments to Rule 3a71-6 related to trade acknowledgement and verification.[554]

The Commission similarly believes that the majority of "listed jurisdiction" applications would be made by foreign authorities rather than by the up to 24 non-U.S. persons that potentially would rely on the exception. Consistent with the estimates in connection with the substituted compliance rule, moreover, the Commission estimates that three non-U.S. persons that seek to rely on the exception would file listed jurisdiction applications, and that in the aggregate those three persons would incur initial paperwork burdens, associated with preparing and submitting the requests, of approximately 240 hours, plus $252,000 for the services of outside professionals (incorporating a five percent addition to reflect current dollars).

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552 See Business Conduct Adopting Release, 81 FR at 30097.

553 This was based on the estimate that each request would require approximately 80 hours of in-house counsel time, plus $80,000 for the services of outside professionals (based on 200 hours of outside time × $400/hour). See id.

554 See Trade Acknowledgement Adopting Release, 81 FR at 39832.

Table 3. Proposed Rule 3a71-3 Amendment – Summary of Paperwork Reduction Act Burdens

	Initial burden		Annual burden	
Burden type	**Per-firm**	**Aggregate**	**Per-firm**	**Aggregate**
Disclosure of limited Title VII applicability*				
disclosure by 12 U.S. dealing entities (A)			1050.75 hr.	12609 hr.
disclosure by 2 non-U.S. dealing entities (B)			1677.3 hr.	3355 hr.
disclosure by other non-U.S. entities (C)			35.2 hr.	352 hr.
related policies and procedures	100 hr.	2400 hr.		
(same)	$29,715	$713,160		
Disclosure of risks, characteristics et al.				
structuring, legal, operations, compliance	1200 hr.	28,800 hr.		
re-evaluation and modification			120 hr.	2880 hr.
systems development, programming, testing	8000 hr.	192,000 hr.		
system maintenance			4000 hr.	96,000 hr.
Suitability				
reps. by participants also in swap market	2 hr.	2232 hr.		
representations by other counterparties	5 hr.	2490 hr.		
Fair and balanced communications				
statement drafting	$6300	$151,200		
additional internal review	6 hr.	144 hr.		
legal costs	$8820	$211,680		
Trade acknowledgement and verification				
internal order and trade mgt. systems	355 hr.	8520 hr.		
daily tech. support/amortized upgrades			436 hr.	10,464 hr.
initial preparation of policies and procedures	80 hr.	1920 hr.		
maintenance of policies and procedures			40 hr.	960 hr.
Portfolio reconciliation				
initial reconciliation of transactions			417.5 hr.	10,020 hr.
Copies of trading relationship documentation				
joint development of policies/procedures	20 hr.	480 hr.		
non-US entity identification and conveyance			104 hr.	2496 hr.
registered entity receipt and maintenance			52 hr.	1248 hr.
Consent to service of process				
joint drafting/transfer to registered entity	2 hr.	48 hr.		
"Listed jurisdiction" applications				
applications by non-regulators	80 hr.	240 hr.		
(same)	$84,000	$252,000		

* (A) Twelve U.S. dealing entities may book future security-based swaps with non-U.S. counterparties into non-U.S. affiliates. (B) Two non-U.S. entities may fall below the de minimis threshold if "arranged, negotiated, or executed" transactions are not counted. (C) Ten additional non-U.S. entities may make use of the exception to avoid incurring assessment costs in connection with the "arranged, negotiated, or executed" de minimis test.

5. Collection of Information is Mandatory

The collections of information associated with the proposed amendments to Rule 3a71-3 are mandatory to the availability of the exception.

6. Confidentiality

Any disclosures to be provided in connection with the arranging, negotiating or executing of a registered security-based swap dealer or of a registered broker (depending on the alternative adopted) in compliance with the requirements of the proposed exception would be provided to the non-U.S. counterparties of the non-U.S. person relying on this exception; therefore, the Commission would not typically receive confidential information as a result of this collection of information. To the extent that the Commission receives records related to such disclosures from a registered security-based swap dealer or registered broker through the Commission's examination and oversight program, or through an investigation, or some other means, such information would be kept confidential, subject to the provisions of applicable law.

Any applications for listed jurisdiction status will be made public.

7. Retention Period of Recordkeeping Requirements

By virtue of being registered as a security-based swap dealer and/or as a broker (depending on the alternative), the entity-engaged in market facing conduct in the United States will be required to retain the records and information required under the proposed amendment to Rule 3a71-3 for the retention periods specified in Exchange Act Rules 17a-4 and 18a-6, as applicable.[555]

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[555] The registered entity would have to create and/or maintain certain records in connection with the following proposed conditions (in conjunction with proposed Commission books and record rules and rule amendments related to Title VII): disclosure of limited Title VII applicability; business conduct; trade acknowledgement and verification; portfolio reconciliation; obtaining and maintaining relationship documentation and questionnaires; consent to service of process.

The proposed conditions do not require the non-U.S. person relying on the exception to make or retain any particular types of records (although that non-U.S. person will be required to convey existing trading relationship documentation to its registered affiliate).

B. Proposed modifications to Proposed Rule 18a-5

1. Summary of Collections of Information to be Modified

The Commission is proposing to modify proposed Rule 18a-5 – which is modeled on Exchange Act Rule 17a-3, as amended – with respect to the requirement that stand-alone and bank SBS Entities make and keep current certain records.[556] The proposed modifications to proposed Rule 18a-5 would reduce the burden associated with Rule 18a-5, as originally proposed, by providing generally that a stand-alone or bank SBS Entity need not: (i) make and keep current a questionnaire or application for employment for an associated person if the SBS Entity is excluded from the prohibition under Exchange Act Section 15F(b)(6) with respect to such associated person (e.g., the exclusion proposed in Rule of Practice 194(c)(2)), and (ii) include the information generally required to be included on the questionnaire or application for employment executed by an associated person if the associated person is not a U.S. person and the receipt of that information, or the creation or maintenance of records reflecting that information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located.

2. Use of Information

Proposed Rule 18a-5, as proposed to be modified, is designed, among other things, to promote the prudent operation of SBS Entities, and to assist the Commission, SROs, and state securities regulators in conducting effective examinations.[557] Thus, the collections of

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556 See proposed Rule 18a-5, Recordkeeping and Reporting Proposing Release.

557 As noted above, proposed Rule 18a-5 is patterned after Exchange Act Rule 17a-3, the recordkeeping rule for registered broker-dealers. See, e.g., Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 47910 (Oct. 26, 2001), 66 FR 55818 (Nov. 2, 2001) ("The Commission has required that broker-dealers create and maintain certain records so that, among other things, the Commission, [SROs],

information under proposed Rule 18a-5 are expected to facilitate inspections and examinations of SBS Entities.

3. Respondents

The Commission estimated the number of respondents in the Recordkeeping and Reporting Proposing Release. The Commission received no comment on these estimates and continues to believe they are appropriate.

Consistent with the Recordkeeping and Reporting Proposing Releases, based on available data regarding the single-name CDS market – which the Commission believes will comprise the majority of security-based swaps – the Commission estimates that the number of major security-based swap participants likely will be five or fewer and, in actuality, may be zero.[558] Therefore, to capture the likely number of major security-based swap participants that may be subject to the collections of information for purposes of this PRA, the Commission estimates for purposes of this PRA that five entities will register with the Commission as major security-based swap participants. Also consistent with the Recordkeeping and Reporting Proposing Release, the Commission estimates that approximately four major security-based swap participants will be stand-alone entities.[559]

Consistent with prior releases, the Commission estimates that 50 or fewer entities ultimately may be required to register with the Commission as security-based swap dealers, of

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and State Securities Regulators . . . may conduct effective examinations of broker-dealers" (footnote omitted)).

558 See Recordkeeping and Reporting Proposing Release, 79 FR at 25260; see also Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants; Final Rule, 80 FR at 48990; Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant" Exchange Act Release No. 66868 (Apr. 27, 2012), 77 FR 30596 at 30727 (May 23, 2012).

559 See Recordkeeping and Reporting Proposing Release, 79 FR at 25260.

which 16 are broker-dealers that will likely seek to register as security-based swap-dealers.[560] [561] The Commission continues to estimate that approximately 75% of the 34 non-broker-dealer security-based swap dealers (i.e., 25 firms) will register as bank security-based swap dealers, and the remaining 25% (i.e., 9 firms) will register as stand-alone security-based swap dealers.[562]

Further, the Commission continues to estimate that each security-based swap dealer will employ approximately 420 associated persons that are natural persons and each major security-based swap participant will employ approximately 62 associated persons that are natural persons.[563] The Commission has no data regarding how many associated persons of SBS Entities who are non-U.S. natural persons may: (a) not effect or be involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person); (b) effect or be involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, but who may be employed or located in jurisdictions where the receipt of information required by the questionnaire or employment application, or the creation or maintenance of records reflecting that information, would result in a violation of

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560 See Recordkeeping and Reporting Proposing Release, 79 FR at 25260.

561 See Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants; Final Rule, 80 FR at 79002.

562 See Recordkeeping and Reporting Proposing Release, 79 FR at 25261. The Commission does not anticipate that any firms will be dually registered as a broker-dealer and a bank.

563 Id.

563 See Rule of Practice 194 Adopting Release, 84 FR at 4926. Commission staff also checked with the staff at the National Futures Association regarding an approximate number of associated persons employed by registered swap dealers. NFA staff provided anecdotal information indicating that the number of natural persons that are associated persons of swap dealers is substantially similar to Commission staff estimates. NFA staff further indicated that they believe about half of the total number of natural persons that are associated persons of swap dealers are located in the U.S. and the other half are located in foreign jurisdictions.

applicable law; or (c) effect or be involved in effecting security-based swap transactions with or for counterparties that are U.S. persons, who are employed or located in jurisdictions where local law would not restrict the receipt, creation or maintenance of information required by the questionnaire or employment application. Given that, the Commission will estimate, for purposes of this Paperwork Reduction Act analysis, that non-U.S. associated persons are evenly split into each of these categories.

4. Total Initial and Annual Recordkeeping and Reporting Burden

As indicated in the Recordkeeping and Reporting Proposing Release, proposed Rule 18a-5 will impose collection of information requirements that result in initial and annual burdens for SBS Entities. The proposed modifications to Rule 18a-5 will decrease these burdens for certain SBS Entities.

In the Recordkeeping and Reporting Proposing Release, the Commission indicated that proposed Rule 18a-5 would require that stand-alone SBS Entities make and keep current 13 types of records, including records on associated persons,[564] and estimated that those 13 paragraphs would impose on each firm an initial burden of 260 hours and an ongoing annual burden of 325 hours.[565] In addition, the Commission indicated that proposed Rule 18a-5 would require that bank SBS Entities make and keep current 10 types of records, including records on

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564 See paragraph (a)(10) of proposed Rule 18a-5, Recordkeeping and Reporting Proposing Release, 79 FR at 25308.

565 See Recordkeeping and Reporting Proposing Release, 79 FR at 25264. Of these total initial and ongoing annual burdens for the 13 types of records a firm would be required to make and keep current under paragraph (a)(10) of proposed Rule 18a-5, Commission staff believes that the burdens associated with making and keeping current questionnaires or applications for employment would be an initial burden of 20 hours (or 260/13) and an ongoing burden of 25 hours (or 325/13).

associated persons,[566] and estimated that these ten paragraphs will impose on each firm an initial burden of 200 hours per firm and an ongoing burden of 250 hours per firm.[567] The Commission further stated that while proposed Rule 18a-5 would impose a burden to make and keep current these records, it would not require the firm to perform the underlying task.[568]

The Commission received no comments regarding its hour and cost burden estimates for proposed Rule 18a-5 and continues to believe they are appropriate.

The proposed modifications to paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5 would (a) exempt stand-alone and bank SBS Entities from the requirement to make and keep current a questionnaire or application for employment for an associated person if the SBS Entity is excluded from the prohibition in section 15F(b)(6) of the Exchange Act with respect to the associated person (e.g., the exclusion proposed in Rule of Practice 194(c)(2)), and (b) allow SBS Entities to exclude certain information from their associated person records if receipt of that information or the creation or maintenance of records reflecting that information would result in a violation of applicable law in the jurisdiction where the associated person is employed or located.

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566 See paragraph (b)(8) of proposed Rule 18a-5; Recordkeeping and Reporting Proposing Release, 79 FR at 25309-10.

567 See id. at 25264. Of these total initial and ongoing annual burdens for the 10 types of records a firm would be required to make and keep current under paragraph (b)(8) of proposed Rule 18a-5, Commission staff believes that the burdens associated with making and keeping current questionnaires or applications for employment would be an initial burden of 20 hours (or 200/10) and an ongoing burden of 25 hours (or 250/10).

568 In estimating the burden associated with Rule 18a-5, the Commission recognizes that entities that will register stand-alone SBS Entities likely make and keep current some records today as a matter of routine business practice, but the Commission does not have information about the records that such entities currently keep. Therefore, the Commission assumes that these entities currently keep no records when it estimates the PRA burden for these entities.

Proposed Addition of Paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) -

The Commission estimates that the proposed modification to add paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) to proposed Rule 18a-5 would eliminate the paperwork burden for stand-alone and bank security-based swap dealers and major security-based swap participants associated with making and keeping current questionnaires or applications for employment records, otherwise required by proposed Rule 18a-5, with respect to any associated person if the SBS Entity is excluded from the prohibition in Exchange Act Section 15F(b)(6), including the exclusion proposed in Rule of Practice 194(c)(2) with respect to a natural person who is (i) not a U.S. person and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that is a U.S. person).

As indicated above, the Commission estimates that there will be approximately 4 stand-alone major security-based swap participants, 9 stand-alone security-based swap dealers and 25 bank security-based swap dealers. Further, as indicated above, each security-based swap dealer would have approximately 420 associated persons and half of those associated persons, or 210, would not be employed or located in the U.S. The Commission estimates that stand-alone and bank SBS dealers would not need to obtain the questionnaire or application for employment for one third of those associated persons, or 70, because proposed Rule of Practice 194(c)(2) would provide an exclusion from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to associated persons who are not located in the U.S. and do not effect and are not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (other than a security-based swap transaction conducted through a foreign branch of a counterparty that

is a U.S. person).[569] Similarly, as indicated above, each major security-based swap participant would have approximately 62 associated persons and half of those associated persons, or 31, would not be employed or located in the U.S. The Commission estimates that stand-alone and bank major security-based swap participants would not need to obtain the questionnaire or application for employment for one third of those associated persons, or 10, because proposed Rule of Practice 194(c)(2) would provide an exclusion from the prohibition in Section 15F(b)(6) of the Exchange Act with respect to those associated persons.[570]

Given this, the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) to proposed Rule 18a-5 would reduce the initial burden associated with proposed Rule 18a-5 by 127 hours[571] and it would reduce the ongoing burden associated with proposed Rule 18a-5 by 158 hours.[572]

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569 70 associated persons/420 associated persons per security-based swap dealer = a reduction of approximately 16.7%. Security-based swap dealers would be able to utilize this paragraph relative to other exclusions from the requirements of Exchange Act Section 15F(b)(6) that the Commission may provide, however the analysis is focusing solely on the exclusion provided by proposed new paragraph (c)(2) to Rule of Practice 194 for purposes of the Paperwork Reduction Act estimate.

570 10 associated persons / 62 associated persons per major security-based swap participant = a reduction of approximately 16.1%. Major security-based swap participants would be able to utilize this paragraph relative to other exclusions from the requirements of Exchange Act Section 15F(b)(6) that the Commission may provide, however the analysis is focusing solely on the exclusion provided by proposed new paragraph (c)(2) to Rule of Practice 194 for purposes of this Paperwork Reduction Act estimate.

571 Initial burden hours associated with paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5 for stand-alone and bank security-based swap dealers and major security-based swap participants, as proposed –
20 hours x [9 stand-alone security-based swap dealers + 25 bank security-based swap dealers] = 20 hours x 34 security-based swap dealers = 680 initial burden hours for security-based swap dealers.
20 hours x 4 stand-alone major security-based swap participants = 80 initial burden hours for major security-based swap participants.

Initial burden hour reduction:
680 initial burden hours for security-based swap dealers x 16.7% (see supra note 569) = 114 hours. 80 initial burden hours for major security-based swap participants x 16.1% (see supra note 570) = 13 hours. A 114 hour reduction in the initial burden for security-based swap dealers + a 13 hour reduction in the initial burden for major security-based swap participants = a 127 hour

Proposed Addition of Paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B)

The Commission estimates that the proposed modification to add paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to proposed Rule 18a-5 would decrease the paperwork burden for stand-alone and bank SBS Entities by permitting the exclusion of certain information mandated by the questionnaire requirement with respect to associated natural persons who effect or are involved in effecting security-based swap transactions with U.S. counterparties where the receipt of that information, or the creation or maintenance of records reflecting such information, would result in a violation of applicable law in the jurisdiction where the associated person is employed or located.

As indicated above, the Commission estimates that there will be approximately 4 stand-alone major security-based swap participants, 9 stand-alone security-based swap dealers and 25 bank security-based swap dealers. Further, as indicated above, each security-based swap dealer would have approximately 420 associated persons and half of those associated persons, or 210, would not be employed or located in the U.S. The Commission estimates that these new

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reduction in initial burden hours across all entities able to rely on paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5.

572 Ongoing burden hours associated with paragraph (a)(10) and (b)(8) of proposed Rule 18a-5 for stand-alone and bank security-based swap dealers and major security-based swap participants, as proposed –
25 hours x [9 stand-alone security-based swap dealers + 25 bank security-based swap dealers] = 20 hours x 34 security-based swap dealers = 850 ongoing burden hours for security-based swap dealers.
25 hours x 4 stand-alone major security-based swap participants = 100 ongoing burden hours for major security-based swap participants.

Ongoing burden hour reduction:
850 ongoing burden hours for security-based swap dealers x 16.7% (see supra note 569) = 142 hours. 100 ongoing burden hours for major security-based swap participants x 16.1% (see supra note 570) = 16 hours. A 142 hour reduction in the ongoing burden for security-based swap dealers + a 16 hour reduction in the ongoing burden for major security-based swap participants = a 158 hour reduction in ongoing burden hours across all entities able to rely on paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5.

paragraphs would permit stand-alone and bank security-based swap dealers to exclude certain information mandated by the questionnaire requirement for approximately one third of those associated persons, or 70.[573] Similarly, as indicated above, each major security-based swap participant would have approximately 62 associated persons and half of those associated persons, or 31, would not be employed or located in the U.S. The Commission estimates that these new paragraphs would permit stand-alone and bank major security-based swap participants to exclude certain information mandated by the questionnaire requirement for approximately one third of those associated persons, or 10.[574]

The Commission estimates that this will reduce the burdens associated with obtaining the information specified in the questionnaire requirement by 50% for the affected associated persons. Given this, the addition of paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) to proposed Rule

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573 See note 569, supra.

574 See note 570, supra.

18a-5 would reduce the initial burden associated with proposed Rule 18a-5 by 63 hours[575] and would reduce the ongoing burden associated with proposed Rule 18a-5 by 79 hours.[576]

Thus, in total, the addition of both paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) and paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) would reduce the initial burden associated with the

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575 Initial burden hours associated with paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5 for stand-alone and bank security-based swap dealers and major security-based swap participants, as proposed –
20 hours x [9 stand-alone security-based swap dealers + 25 bank security-based swap dealers] = 20 hours x 34 security-based swap dealers = 680 initial burden hours for security-based swap dealers.
20 hours x 4 stand-alone major security-based swap participants = 80 initial burden hours for major security-based swap participants.

Initial burden hour reduction:
[680 initial burden hours for security-based swap dealers x 16.7% (see supra note 569 x 50%] = 57 hours. [80 initial burden hours for major security-based swap participants x 16.1% (see supra note 570) x 50%] = 6 hours. A 57 hour reduction in the initial burden for security-based swap dealers + a 6 hour reduction in the initial burden for major security-based swap participants = a 63 hour reduction in initial burden hours across all entities able to rely on paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5.

576 Ongoing burden hours associated with paragraph (a)(10) and (b)(8) of proposed Rule 18a-5 for stand-alone and bank security-based swap dealers and major security-based swap participants, as proposed –
25 hours x [9 stand-alone security-based swap dealers + 25 bank security-based swap dealers] = 20 hours x 34 security-based swap dealers = 850 ongoing burden hours for security-based swap dealers.
25 hours x 4 stand-alone major security-based swap participants = 100 ongoing burden hours for major security-based swap participants.

Ongoing burden hour reduction:
[850 ongoing burden hours for security-based swap dealers x 16.7% (see supra note 569) x 50%] = 71 hours. [100 ongoing burden hours for major security-based swap participants x 16.1% (see supra note 570) x50%] = 8 hours. A 71 hour reduction in the ongoing burden for security-based swap dealers + a 8 hour reduction in the ongoing burden for major security-based swap participants = a 79 hour reduction in ongoing burden hours across all entities able to rely on paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5.

questionnaire requirement in proposed Rule 18a-5 by 190 hours,[577] and the ongoing burden associated with the questionnaire requirement in proposed Rule 18a-5 by 237 hours.[578]

5. Collection of Information Is Mandatory

The collections of information pursuant to the proposed modifications to the proposed new rule would be mandatory, as applicable, for SBS Entities.

6. Confidentiality

Information that an SBS Entity would be required to make and keep current under proposed Rule 18a-5 would be maintained by the firm. To the extent that the Commission collects such records during an inspection or examination of a registered SBS Entity, or through some other means, such records would generally be kept confidential, subject to the provisions of applicable law.[579]

7. Retention Period for Recordkeeping Requirements

Proposed Rule 18a-6 would establish the required retention periods for SBS Entities to maintain records collected in accorded with proposed Rule 18a-5.[580] Under paragraph (d)(1) of proposed Rule 18a-6, an SBS Entity would be required to maintain and preserve in an easily accessible place the records required under paragraphs (a)(10) and (b)(8) of proposed Rule 18a-5

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577 A 127 hour reduction in initial burden hours associated with the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) and a 63 hour reduction in initial burden hours associated with the addition of paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) = a 190 hour reduction in initial burden hours.

578 A 158 hour reduction in ongoing burden hours associated with the addition of paragraphs (a)(10)(iii)(A) and (b)(8)(iii)(A) and a 79 hour reduction in ongoing burden hours associated with the addition of paragraphs (a)(10)(iii)(B) and (b)(8)(iii)(B) = a 237 hour reduction in ongoing burden hours.

579 See, e.g., 5 U.S.C. 552 et seq.; 15 U.S.C. 78x (governing the public availability of information obtained by the Commission).

580 See proposed Rule 18a-6, Recordkeeping and Reporting Proposing Release.

until at least three years after the associated person's employment and any other connection with the SBS Entity has terminated.

C. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comment to:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the Commission's functions, including whether the information shall have practical utility;
- Evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information;
- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

In addition, the Commission requests comment, including empirical data in support of comments, in response to the following questions:

- Are the Commission's estimates regarding the numbers of respondents relative to the proposed modifications to proposed Rule 18a-5 accurate? If so, please provide empirical support for the Commission's estimate. If not, please provide a suggested estimate and empirical support for it.
- Are the Commission's estimates regarding the amount of time it would take to make and keep current the questionnaire or application for employment or other related records accurate? If so, please provide empirical support for the Commission's estimate. If not, please provide a suggested estimate and empirical support for it.
- Do stand-alone SBS Entities already have established record making and record preservation systems? If so, please explain those systems so they can be taken into account in the Commission's burden estimates.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090, with reference to File Number S7-

07-19. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File Number S7-07-19 and be submitted to the Securities and Exchange Commission, Office of FOIA/PA Services, 100 F Street NE., Washington, DC 20549–2736. As OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

IX. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA")[581] the Commission requests comment on the potential effect of this proposal on the United States economy on an annual basis. The Commission also requests comment on any potential increases in costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

X. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act of 1980 ("RFA")[582] requires the Commission to undertake an initial regulatory flexibility analysis of the impact of the proposed rule amendments on small entities unless the Commission certifies that the rule, if adopted, would not have a significant impact on a substantial number of "small entities."[583]

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581 Public Law 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

582 5 U.S.C. 603(a).

583 5 U.S.C. 605(b).

For purposes of Commission rulemaking in connection with the RFA,[584] a small entity includes: (1) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less;[585] or (2) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[586] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[587] Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) for entities engaged in credit intermediation and related activities, entities with $175 million or less in assets;[588] (ii) for entities engaged in non-depository credit intermediation and certain other activities, entities with $7 million or less in annual receipts;[589] (iii) for entities engaged in financial investments and related activities, entities with $7 million or

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584 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 under the Exchange Act, 17 CFR 240.0-10. See Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982) (File No. AS-305).

585 See 17 CFR 240.0-10(a).

586 See 17 CFR 240.17a-5(d).

587 See 17 CFR 240.0-10(c).

588 See 13 CFR 121.201 (Subsector 522).

589 See id. at Subsector 522.

less in annual receipts;[590] (iv) for insurance carriers and entities engaged in related activities, entities with $7 million or less in annual receipts;[591] and (v) for funds, trusts, and other financial vehicles, entities with $7 million or less in annual receipts.[592]

For purposes of the proposed exception to Exchange Act rule 3a71-3, the Commission continues to believe that the types of entities that would engage in more than a de minimis amount of dealing activity involving security-based swaps would not be "small entities" for purposes of the RFA.[593] Moreover, based on feedback from market participants and information about the security-based swap markets, the Commission expects that all of the firms that are likely to make use of the proposed exception to Rule 3a71-3 – are part of large financial institutions that exceed the thresholds defining "small entities" as set forth above.[594]

As discussed, the proposed exception to Exchange Act Rule 3a71-3 would be subject to conditions requiring arranging, negotiating or executing activity to be conducted by affiliated registered security-based swap dealers (under alternatives 1 or 2) or by affiliated registered brokers or security-based swap dealers (under alternative 2) that are affiliated with the non-U.S. persons relying on the exception. It is possible that some non-U.S. persons may set up new security-based swap dealers or new brokers to make use of the exception, while recognizing that other non-U.S. persons that seek to make use of the proposed exception instead may make use of

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590 See id. at Subsector 523.

591 See id. at Subsector 524.

592 See id. at Subsector 525.

593 See Cross-Border Adopting Release, 79 FR at 47368.

594 See part VII.A.7, supra (discussing persons potentially likely to use the proposed exception to Rule 3a71-3); see also U.S. Activity Proposing Release, 80 FR at 27508 ("we believe that firms that are likely to engage in security-based swap dealing activity at levels that may lead them to perform de minimis calculations under the "security-based swap dealer" definition are large financial institutions that exceed the thresholds defining "small entities").

affiliated security-based swap dealers that have an additional business of engaging in dealing activity above the de minimis thresholds with U.S. counterparties (under either alternative), or would make use of existing affiliated registered broker-dealers (under alternative 2).[595] By definition, any such affiliated existing or new broker-dealer would not be a "small entity."[596] Moreover, even in the unlikely event that some non-U.S. persons were to satisfy the exception's conditions via the use of affiliated registered security-based swap dealers that fall within the definition of "small entity" for purposes of the RFA,[597] the Commission preliminarily believes that there would not be a substantial number of such entities.[598]

Based on feedback from industry participants about the security-based swap markets, the Commission continues to believe that entities that will qualify as SBS Entities exceed the thresholds defining "small entities." Thus, the Commission believes that any SBS Entities that may seek to rely on the proposed amendment to Rule 15Fb2-1 would not be "small entities" for purposes of the RFA. [599]

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595 See part VII.A.7, supra (discussing likely broker-dealer or security-based swap dealer affiliates of persons expected to rely on exemption).

596 The "small entity" definition applied to broker-dealers excludes broker-dealers that are affiliated with a person that is not a "small entity." See Exchange Act Rule 0-10(c)(2), (i)(1) (basing affiliation on an 25 percent ownership standard that is narrower than the majority ownership standard used in connection with this proposed conditional exception). Because the non-U.S. persons relying on this exception would not be "small entities," any such affiliated broker also would not be a "small entity."

597 As noted, if the person engaged in market-facing activity in the United States is a registered security-based swap dealer (as required by alternative 1 and permitted by alternative 2) that has an additional business of engaging in dealing activity above the de minimis thresholds with U.S. counterparties, the Commission preliminarily believes that the person would not be a "small entity."

598 Similarly, the Commission preliminarily believes that there would not be a significant number of "small entities" that may file "listed jurisdiction" applications pursuant to the proposed amendments to Exchange Act Rule 0-13. This conclusion reflects the same reasons, as well as the expectation that the majority of such applications would be filed by foreign authorities.

599 See Registration Adopting Release, 80 FR at 49013.

The Commission also continues to believe that any SBS Entities – i.e., registered security-based swap dealers and registered major security-based swap participants – with associated persons that may be the subject of the proposed amendments to Rule of Practice 194 would not be "small entities" for purposes of the RFA.[600]

The Commission further continues to believe that it is unlikely that the requirements applicable to SBS Entities that would be established under the proposed modifications to proposed Rule 18a-5 would have a significant economic impact on any small entity because no SBS Entity will be a small entity.[601]

Accordingly, the Commission preliminarily believes that it is unlikely that the proposed amendments regarding the security-based swap dealer cross-border de minimis counting requirement and regarding associated persons of SBS Entities would have a significant economic impact on a substantial number of small entities.[602]

For the foregoing reasons, the Commission certifies that the proposed amendments to Exchange Act Rules 3a71-3, 15Fb2-1, 0-13, and Rule of Practice 194 and the proposed modifications to proposed Rule 18a-5would not have a significant economic impact on a substantial number of small entities for purposes of the RFA. The Commission encourages

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600 We previously have concluded, based on feedback from market participants and the Commission's information regarding the security-based swap market, that the types of entities that may have security-based swap positions above the level required to register as SBS Entities would not be "small entities" for purposes of the RFA. See Cross-Border Adopting Release, 79 FR at 47368; see also "Applications by Security-based Swap Dealers or Major Security-Based Participants for Statutorily Disqualified Associated Persons to Effect or Be Involved in Effecting Security-Based Swaps," 80 FR 51684 (Aug 25, 2015), at 51718, and Rule of Practice 194 Adopting Release, 84 FR at 4944.

601 See Recordkeeping and Reporting Proposing Release, 79 FR at 25296.

602 See also parts VI (Economic Analysis) and VII (Paperwork Reduction Act) (discussing, among other things, the economic impact, including the estimated compliance costs and burdens, of the amendments).

written comments regarding this certification, and requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

XI. Statutory Basis and Text of Proposed Rules

Pursuant to the Exchange Act, 15 U.S.C. 78a et seq., and particularly Sections 3(a)(71), 3(b), 15F (as added by Section 764(a) of the Dodd-Frank Act), 17(a), 23(a), and 30(c) thereof, and Section 761(b) of the Dodd-Frank Act, the Commission is proposing to amend Rule of Practice 194 and Rules 0-13, 3a71-3, 15Fb2-1, and proposing to modify proposed Rule 18a-5 under the Exchange Act.

List of Subjects

17 CFR Part 201

Administrative practice and procedure, Brokers, Claims, Confidential business information, Equal access to justice, Lawyers, Penalties, Securities.

17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

Text of Proposed Rules

For the reasons stated in the preamble, the SEC is proposing to amend Title 17, Chapter II of the Code of the Federal Regulations as follows:

PART 201 – RULES OF PRACTICE

1. The general authority citation for Subpart D is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77h-1, 77j, 77s, 77u, 77sss, 77ttt, 78(c)(b), 78d-1, 78d-2, 78l, 78m, 78n, 78o(d), 78o-3, 78o-10(b)(6), 78s, 78u-2, 78u-3, 78v, 78w, 80a-8, 80a-9, 80a-37, 80a-38, 80a-39, 80a-40, 80a-41, 80a-44, 80b-3, 80b-9, 80b-11, 80b-12, 7202, 7215, and 7217.

* * * * *

2. Amend § 201.194 by re-designating paragraph (c) as paragraph (c)(1), adding a new heading to paragraph (c) and paragraph (c)(2) to read as follows:

§ 201.194. Applications by Security-Based Swap Dealers or Major Security-Based Swap Participants for Statutorily Disqualified Associated Persons To Effect or Be Involved In Effecting Security-Based Swaps.

* * * * *

(c) *Exclusions.* (1) * * *

(2) *Exclusion for Certain Associated Natural Persons*. A security-based swap dealer or major security-based swap participant shall be excluded from the prohibition in Section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)) with respect to an associated person who is a natural person who (i) is not a U.S. person (as defined in 17 CFR 240.3a71-3(a)(4)(i)(A)) and (ii) does not effect and is not involved in effecting security-based swap transactions with or for counterparties that are U.S. persons (as defined in 17 CFR 240.3a71-3(a)(4)), other than a security-based swap transaction conducted through a foreign branch (as that term is defined in 17 CFR 240.3a71-3(a)(3)) of a counterparty that is a U.S. person; *provided, however*, that this exclusion shall not be available if the associated person of that security-based swap dealer or major security-based swap participant is currently subject to any order described in subparagraphs (A) and (B) of Section 3(a)(39) of the Exchange Act, with the limitation that an order by a foreign financial regulatory authority described in subparagraphs (B)(i) and (B)(iii) of Section 3(a)(39) (15 U.S.C. 78c(a)(39)(B)(i) and (B)(iii)) shall only apply to orders by a foreign financial regulatory authority in the jurisdiction where the associated person is employed or located.

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for part 240 continues to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq.; and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1887 (2010); and secs. 503 and 602, Pub. L. 112-106, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

4. Amend § 240.0-13 by revising the heading and paragraphs (a), (b) and (e) to read as follows:

§ 240.0-13 Commission procedures for filing applications to request a substituted compliance or listed jurisdiction order under the Exchange Act.

(a) The application shall be in writing in the form of a letter, must include any supporting documents necessary to make the application complete, and otherwise must comply with § 240.0-3. All applications must be submitted to the Office of the Secretary of the Commission, by a party that potentially would comply with requirements under the Exchange Act pursuant to a substituted compliance or listed jurisdiction order, or by the relevant foreign financial regulatory authority or authorities. If an application is incomplete, the Commission may request that the application be withdrawn unless the applicant can justify, based on all the facts and circumstances, why supporting materials have not been submitted and undertakes to submit the omitted materials promptly.

(b) An applicant may submit a request electronically. The electronic mailbox to use for these applications is described on the Commission's Web site at www.sec.gov in the “Exchange Act Substituted Compliance and Listed Jurisdiction Applications” section. In the event electronic mailboxes are revised in the future, applicants can find the appropriate mailbox by accessing the “Electronic Mailboxes at the Commission” section.

* * * * *

(e) Every application (electronic or paper) must contain the name, address, telephone number, and email address of each applicant and the name, address, telephone number, and email address of a person to whom any questions regarding the application should be directed. The Commission will not consider hypothetical or anonymous requests for a substituted compliance or listed jurisdiction order. Each applicant shall provide the Commission with any supporting documentation it believes necessary for the Commission to make such determination, including information regarding applicable requirements established by the foreign financial regulatory authority or authorities, as well as the methods used by the foreign financial regulatory authority or authorities to monitor and enforce compliance with such rules. Applicants should also cite to and discuss applicable precedent.

* * * * *

5. Amend § 240.3a71-3 by adding paragraphs (a)(10), (a)(11), and (a)(12), amending paragraph (b)(1)(iii)(C), and adding paragraph (d) to read as follows:

§ 240.3a71-3 Cross-border security-based swap dealing activity.

(a) * * *

(10) An entity is a majority-owned affiliate of another entity if the entity directly or indirectly owns a majority interest in the other, or if a third party directly or indirectly owns a majority interest in both entities, where "majority interest" is the right to vote or direct the vote of a majority of a class of voting securities of an entity, the power to sell or direct the sale of a majority of a class of voting securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership.

(11) Foreign associated person means a natural person domiciled outside the United States who – with respect to a non-U.S. person relying on the exception set forth in paragraph (d) of this section – is a partner, officer, director, or branch manager of such non-U.S. person (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such non-U.S. person, or any employee of such non-U.S. person.

(12) Listed jurisdiction means any jurisdiction that the Commission by order has designated as a listed jurisdiction for purposes of the exception specified in paragraph (d) of this section.

(b) * * *

(1) * * *

(iii) * * *

(C) Except as provided in paragraph (d) of this section, or unless such person is a person described in paragraph (a)(4)(iii) of this section, security-based swap transactions connected with such person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office; and

* * *

Alternative 1

(d) Exception from counting certain transactions. The counting requirement described by paragraph (b)(1)(iii)(C) of this section will not apply to the security-based swap dealing transactions of a non-U.S. person if the conditions of paragraph (d)(1) of this section have been satisfied.

(1) Conditions. (i) Entity conducting U.S. activity. All activity that otherwise would cause a security-based swap transaction to be described by paragraph (b)(1)(iii)(C) of this section – namely, all arranging, negotiating or executing activity that is conducted by personnel of the entity (or its agent) located in a branch or office in the United States – is conducted by such U.S. personnel in their capacity as persons associated with an entity that:

(A) Is registered with the Commission as a security-based swap dealer; and

(B) Is a majority-owned affiliate of the non-U.S. person relying on this exception.

(ii) Compliance with specified security-based swap dealer requirements. (A) Compliance required. In connection with such transactions, the registered entity described in paragraph (d)(1)(i) of this section complies with the requirements described in paragraph (d)(1)(ii)(B) of this section as if the counterparties to the non-U.S. person relying on this exception also were counterparties to the registered entity.

(B) Applicable requirements. The compliance obligation described in paragraph (d)(1)(ii)(A) of this section applies to the following provisions of the Act and the rules and regulations thereunder:

(*1*) Section 15F(h)(3)(B)(i), (ii) and rule 15Fh-3(b) thereunder, including in connection with material incentives and conflicts of interest associated with the non-U.S. person relying on the exception;

(*2*) Rule 15Fh-3(f);

(*3*) Section 15F(h)(3)(C) of the Act and rule 15Fh-3(g) thereunder;

(*4*) Rules 15Fi-1 and 15Fi-2; and

(*5*) Rule 15Fi-3, provided, however, that the registered entity described in paragraph (d)(1)(i) of this section will not be required to comply with rule 15Fi-3 in connection with the

transaction following the initial portfolio reconciliation of the security-based swap resulting from the transaction.

(C) Other compliance requirements. The compliance obligation described in paragraph (d)(1)(ii)(A) of this section does not apply to the following provisions of the Act and the rules and regulations thereunder:

(*1*) Section 15F(h)(3)(A) of the Act and rule 15Fh-3(a)(1) thereunder;

(*2*) Section 15F(h)(3)(B)(iii) and rule 15Fh-3(c) thereunder; and

(*3*) Rule 15Fh-3(d);

(*4*) Rule 15Fh-3(e);

(*5*) Rule 15Fi-4; and

(*6*) Rule 15Fi-5.

(iii) Commission access to books, records and testimony. (A) The non-U.S. person relying on this exception promptly provides representatives of the Commission (upon request of the Commission or its representatives or pursuant to a supervisory or enforcement memorandum of understanding or other arrangement or agreement reached between any foreign securities authority, including any foreign government, as specified in section 3(a)(50) of the Act, and the Commission or the U.S. Government) with any information or documents within the non-U.S. person's possession, custody, or control, promptly makes its foreign associated persons available for testimony, and provides any assistance in taking the evidence of other persons, wherever located, that the Commission or its representatives requests and that relates to transactions subject to this exception, provided, however, that if, after exercising its best efforts, the non-U.S. person is prohibited by applicable foreign law or regulations from providing such information, documents, testimony, or assistance, the non-U.S. person may continue to rely on this exception

until the Commission issues an order modifying or withdrawing an associated "listed jurisdiction" determination pursuant to paragraph (d)(2)(iii) of this section.

(B) The registered entity described in paragraph (d)(1)(i) of this section:

(*1*) Creates and maintains books and records relating to the transactions subject to this exception that are required, as applicable, by rules 17a-3 and 17a-4, or by rules 18a-5 and 18a-6, including any books and records requirements relating to the provisions specified in paragraph (d)(1)(ii)(B) of this section;

(*2*) Obtains from the non-U.S. person relying on the exception, and maintains, documentation encompassing all terms governing the trading relationship between the non-U.S. person and its counterparty relating to the transactions subject to this exception, including, without limitation, terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, allocation of any applicable regulatory reporting obligations, governing law, valuation, and dispute resolution; and

(*3*) Obtains from the non-U.S. person relying on this exception written consent to service of process for any civil action brought by or proceeding before the Commission, providing that process may be served on the non-U.S. person by service on the registered entity in the manner set forth in the registered entity's current Form SBSE, SBSE-A or SBSE-BD, as applicable.

(iv) Disclosures. In connection with the transaction, the registered entity described in paragraph (d)(1)(i) of this section notifies the counterparties of the non-U.S. person relying on this exception that the non-U.S. person is not registered with the Commission as a security-based swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable in connection with the transaction, including

provisions affording clearing rights to counterparties. Such disclosure shall be provided contemporaneously with, and in the same manner as, the arranging, negotiating, or executing activity at issue. This disclosure will not be required if the identity of that counterparty is not known to that registered entity at a reasonably sufficient time prior to the execution of the transaction to permit such disclosure.

(v) Subject to regulation of a listed jurisdiction. The non-U.S. person relying on this exception is subject to the margin and capital requirements of a listed jurisdiction when engaging in transactions subject to this exception.

(2) Order for listed jurisdiction designation. The Commission by order, may conditionally or unconditionally determine that a foreign jurisdiction is a listed jurisdiction for purposes of this section. The Commission may make listed jurisdiction determinations in response to applications, or upon the Commission's own initiative.

(i) Applications. Applications for an order requesting listed jurisdiction status may be made by a party or group of parties that potentially would seek to rely on the exception provided by paragraph (d) of this section, or by any foreign financial regulatory authority or authorities supervising such a party or its security-based swap activities. Applications must be filed pursuant to the procedures set forth in § 240.0-13.

(ii) Criteria considered. In considering a foreign jurisdiction's potential status as a listed jurisdiction, the Commission may consider factors relevant for purposes of assessing whether such an order would be in the public interest, including:

(A) Applicable margin and capital requirements of the foreign financial regulatory system; and

(B) The effectiveness of the supervisory compliance program administered by, and the enforcement authority exercised by, the foreign financial regulatory authority in connection with such requirements, including the application of those requirements in connection with an entity's cross-border business.

(iii) Withdrawal or modification of listed jurisdiction status. The Commission may, on its own initiative, by order after notice and opportunity for comment, modify or withdraw a jurisdiction's status as a listed jurisdiction, if the Commission determines that continued listed jurisdiction status no longer would be in the public interest, based on:

(A) The criteria set forth in paragraph (d)(2)(ii) of this section;

(B) Any laws or regulations that have had the effect of preventing the Commission or its representatives, on request, to promptly access information or documents regarding the activities of persons relying on the exception provided by this paragraph (d), to obtain the testimony of foreign associated persons, and to obtain the assistance of persons relying on this exception in taking the evidence of other persons, wherever located, as described in paragraph (d)(1)(iii)(A) of this section; and

(C) Any other factor the Commission determines to be relevant to whether continued status as a listed jurisdiction would be in the public interest.

Alternative 2

(d) Exception from counting certain transactions. The counting requirement described by paragraph (b)(1)(iii)(C) of this section will not apply to the security-based swap dealing transactions of a non-U.S. person if the conditions of paragraph (d)(1) of this section have been satisfied.

(1) Conditions. (i) Entity conducting U.S. activity. All activity that otherwise would cause a security-based swap transaction to be described by paragraph (b)(1)(iii)(C) of this section – namely, all arranging, negotiating or executing activity that is conducted by personnel of the entity (or its agent) located in a branch or office in the United States – is conducted by such U.S. personnel in their capacity as persons associated with an entity that:

(A) Is registered with the Commission as a broker or as a security-based swap dealer; and

(B) Is a majority-owned affiliate of the non-U.S. person relying on this exception.

(ii) Compliance with specified security-based swap dealer requirements. (A) Compliance required. In connection with such transactions, the registered entity described in paragraph (d)(1)(i) of this section complies with the requirements described in paragraph (d)(1)(ii)(B) of this section: (a) as if the counterparties to the non-U.S. person relying on this exception also were counterparties to that entity; and (b) as if that entity were registered with the Commission as a security-based swap dealer, if it is not so registered.

(B) Applicable requirements. The compliance obligation described in paragraph (d)(1)(ii)(A) of this section applies to the following provisions of the Act and the rules and regulations thereunder:

(*1*) Section 15F(h)(3)(B)(i), (ii) and rule 15Fh-3(b) thereunder, including in connection with material incentives and conflicts of interest associated with the non-U.S. person relying on the exception;

(*2*) Rule 15Fh-3(f);

(*3*) Section 15F(h)(3)(C) of the Act and rule 15Fh-3(g) thereunder;

(*4*) Rules 15Fi-1 and 15Fi-2; and

(*5*) Rule 15Fi-3, provided, however, that the registered entity described in paragraph (d)(1)(i) will not be required to comply with rule 15Fi-3 in connection with the transaction following the initial portfolio reconciliation of the security-based swap resulting from the transaction.

(C) Other compliance requirements. The compliance obligation described in paragraph (d)(1)(ii)(A) of this section does not apply to the following provisions of the Act and the rules and regulations thereunder:

(*1*) Section 15F(h)(3)(A) of the Act and rule 15Fh-3(a)(1) thereunder;

(*2*) Section 15F(h)(3)(B)(iii) and rule 15Fh-3(c) thereunder;

(*3*) Rule 15Fh-3(d);

(*4*) Rule 15Fh-3(e);

(*5*) Rule 15Fi-4; and

(*6*) Rule 15Fi-5.

(iii) Commission access to books, records and testimony. (A) The non-U.S. person relying on this exception promptly provides representatives of the Commission (upon request of the Commission or its representatives or pursuant to a supervisory or enforcement memorandum of understanding or other arrangement or agreement reached between any foreign securities authority, including any foreign government, as specified in section 3(a)(50) of the Act, and the Commission or the U.S. Government) with any information or documents within the non-U.S. person's possession, custody, or control, promptly makes its foreign associated persons available for testimony, and provides any assistance in taking the evidence of other persons, wherever located, that the Commission or its representatives requests and that relates to transactions subject to this exception, provided, however, that if, after exercising its best efforts, the non-U.S.

person is prohibited by applicable foreign law or regulations from providing such information, documents, testimony, or assistance, the non-U.S. person may continue to rely on this exception until the Commission issues an order modifying or withdrawing an associated "listed jurisdiction" determination pursuant to paragraph (d)(2)(iii) of this section.

(B) The registered entity described in paragraph (d)(1)(i) of this section:

(*1*) Creates and maintains books and records relating to the transactions subject to this exception that are required, as applicable, by rules 17a-3 and 17a-4, or by rules 18a-5 and 18a-6, including any books and records requirements relating to the provisions specified in paragraph (d)(1)(ii)(B) of this section;

(*2*) Obtains from the non-U.S. person relying on the exception, and maintains, documentation encompassing all terms governing the trading relationship between the non-U.S. person and its counterparty relating to the transactions subject to this exception, including, without limitation, terms addressing payment obligations, netting of payments, events of default or other termination events, calculation and netting of obligations upon termination, transfer of rights and obligations, allocation of any applicable regulatory reporting obligations, governing law, valuation, and dispute resolution; and

(*3*) Obtains from the non-U.S. person relying on this exception written consent to service of process for any civil action brought by or proceeding before the Commission, providing that process may be served on the non-U.S. person by service on the registered entity in the manner set forth in the registered entity's current Form BD, SBSE, SBSE-A or SBSE-BD, as applicable.

(iv) Disclosures. In connection with the transaction, the registered entity described in paragraph (d)(1)(i) of this section notifies the counterparties of the non-U.S. person relying on this exception that the non-U.S. person is not registered with the Commission as a security-based

swap dealer, and that certain Exchange Act provisions or rules addressing the regulation of security-based swaps would not be applicable in connection with the transaction, including provisions affording clearing rights to counterparties. Such disclosure shall be provided contemporaneously with, and in the same manner as, the arranging, negotiating, or executing activity at issue. This disclosure will not be required if the identity of that counterparty is not known to that registered entity at a reasonably sufficient time prior to the execution of the transaction to permit such disclosure.

(v) Subject to regulation of a listed jurisdiction. The non-U.S. person relying on this exception is subject to the margin and capital requirements of a listed jurisdiction when engaging in the transactions subject to this exception.

(2) Order for listed jurisdiction designation. The Commission by order, may conditionally or unconditionally determine that a foreign jurisdiction is a listed jurisdiction for purposes of this section. The Commission may make listed jurisdiction determinations in response to applications, or upon the Commission's own initiative.

(i) Applications. Applications for an order requesting listed jurisdiction status may be made by a party or group of parties that potentially would seek to rely on the exception provided by paragraph (d) of this section, or by any foreign financial regulatory authority or authorities supervising such a party or its security-based swap activities. Applications must be filed pursuant to the procedures set forth in § 240.0-13.

(ii) Criteria considered. In considering a foreign jurisdiction's potential status as a listed jurisdiction, the Commission may consider factors relevant for purposes of assessing whether such an order would be in the public interest, including:

(A) Applicable margin and capital requirements of the foreign financial regulatory system; and

(B) The effectiveness of the supervisory compliance program administered by, and the enforcement authority exercised by, the foreign financial regulatory authority in connection with such requirements, including the application of those requirements in connection with an entity's cross-border business.

(iii) Withdrawal or modification of listed jurisdiction status. The Commission may, on its own initiative, by order after notice and opportunity for comment, modify or withdraw a jurisdiction's status as a listed jurisdiction, if the Commission determines that continued listed jurisdiction status no longer would be in the public interest, based on:

(A) The criteria set forth in paragraph (d)(2)(ii) of this section;

(B) Any laws or regulations that have had the effect of preventing the Commission or its representatives, on request, to promptly access information or documents regarding the activities of persons relying on the exception provided by this paragraph (d), to obtain the testimony of their foreign associated persons, and to obtain the assistance of persons relying on this exception in taking the evidence of other persons, wherever located, as described in paragraph (d)(1)(iii)(A) of this section; and

(C) Any other factor the Commission determines to be relevant to whether continued status as a listed jurisdiction would be in the public interest.

(4) Exception for person that engages in arranging, negotiating or executing activity as agent. The registered entity described in paragraph (d)(1)(i) of this section need not count, against the de minimis thresholds described in § 240.3a71-2(a)(1), the transactions described by paragraph (d) of this section.

* * * * *

6. Amend Section 240.15Fb2-1 by revising paragraphs (d) and (e) to read as follows:
The additions read as follows.

§ 240.15Fb2-1. Registration of security-based swap dealers and major security-based swap participants

* * * * *

(d) *Conditional registration*. (1) An applicant that has submitted a complete Form SBSE-C (§ 249.1600c of this chapter) and a complete Form SBSE (§ 249.1600 of this chapter) or Form SBSE-A (§ 249.1600a of this chapter) or Form SBSE-BD (§ 249.1600b of this chapter), as applicable, in accordance with paragraph (b) within the time periods set forth in § 240.3a67-8 (if the person is a major security-based swap participant) or § 240.3a71-2(b) (if the person is a security-based swap dealer), and has not withdrawn its registration shall be conditionally registered.

(2) Notwithstanding paragraph (d)(1) of this section, an applicant that is a nonresident security-based swap dealer or nonresident major security-based swap participant (each as defined in Rule 15Fb2-4(a)) that is unable to provide the certification and opinion of counsel required by Rule 15Fb2-4(c)(1) shall be conditionally registered, for up to 24 months after the compliance date for Rule 15Fb2-1, if the nonresident applicant submits a Form SBSE-C (§ 249.1600c of this chapter) and a Form SBSE (§ 249.1600 of this chapter), SBSE-A (§ 249.1600a of this chapter) or SBSE-BD (§ 249.1600b of this chapter), as applicable, in accordance with paragraph (b) within the time periods set forth in Rule 3a67-8 (if the person is a major security-based swap participant) or Rule 3a71-2(b) (if the person is a security-based swap dealer), that is complete in all respects but for the failure to provide the certification and the opinion of counsel required by Rule 15Fb2-4(c)(1), and has not withdrawn from registration.

(e) Commission decision. (1) The Commission may deny or grant ongoing registration to a security-based swap dealer or major security-based swap participant based on a security-based swap dealer's or major security-based swap participant's application, filed pursuant to paragraph (a) of this section. The Commission will grant ongoing registration if it finds that the requirements of Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) are satisfied. The Commission may institute proceedings to determine whether ongoing registration should be denied if it does not or cannot make such finding or if the applicant is subject to a statutory disqualification (as described in Sections 3(a)(39)(A) through (F) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(39)(A)-(F)), or the Commission is aware of inaccurate statements in the application. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing. At the conclusion of such proceedings, the Commission shall grant or deny such registration.

(2) If an applicant that is a nonresident security-based swap dealer or nonresident major security-based swap participant (each as defined in Rule 15Fb2-4(a)) has become conditionally registered in reliance on paragraph (d)(2) of this section and provides the certification and opinion of counsel required by Rule 15Fb2-4(c)(1) within 24 months of the compliance date for Rule 15Fb2-1, the applicant will remain conditionally registered until the Commission acts to grant or deny ongoing registration in accordance with (e)(1) of this section. If such applicant fails to provide the certification and opinion of counsel required by Rule 15Fb2-4(c)(1) within 24 months of the compliance date for Rule 15Fb2-1, the Commission may institute proceedings to determine whether ongoing registration should be denied, in accordance with paragraph (e)(1) of this section.

7. Section 240.18a-5, as proposed to be added at 79 FR 25193, May 2, 2014, is further amended by adding paragraphs (a)(10)(iii) and (b)(8)(iii) to read as follows:

§ 240.18a-5. Records to be made by certain security-based swap dealers and major security-based swap participants

* * * * *

(a) * * *

(10) * * *

(iii) Notwithstanding paragraph (a)(10)(i) of this section:

(A) a security-based swap dealer or major security-based swap participant is not required to make and keep current a questionnaire or application for employment executed by an associated person if the security-based swap dealer or major security-based swap participant is excluded from the prohibition in Section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)) with respect to such associated person; and

(B) a questionnaire or application for employment executed by an associated person who is not a U.S. person (as that term is defined in § 240.3a71-3(a)(4)(i)(A)) need not include the information described in paragraphs (a)(10)(i)(A) through (H) of this section if the receipt of that information, or the creation or maintenance of records reflecting that information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located; *provided, however*, the security-based swap dealer or major security-based swap participant must comply with Section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)).

* * *

(b) * * *

(8) * * *

(iii) Notwithstanding paragraph (b)(8)(i) of this section;

(A) a security-based swap dealer or major security-based swap participant is not required to make and keep current a questionnaire or application for employment executed by an associated person if the security-based swap dealer or major security-based swap participant is

excluded from the prohibition in Section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)) with respect to such associated person; and

(B) a questionnaire or application for employment executed by an associated person who is not a U.S. person (as that term is defined in § 240.3a71-3(a)(4)(i)(A)) need not include the information described in paragraphs (b)(8)(i)(A) through (H) of this section if the receipt of that information, or the creation or maintenance of records reflecting that information, would result in a violation of applicable law in the jurisdiction in which the associated person is employed or located; *provided, however*, the security-based swap dealer or major security-based swap participant must comply with Section 15F(b)(6) of the Exchange Act (15 U.S.C. 78o-10(b)(6)).

By the Commission.

Dated: May 10, 2019.

Vanessa A. Countryman
Acting Secretary