SECURITIES AND EXCHANGE COMMISSION

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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

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (''SEC'' or ''Commission'') is adopting amendments to Exchange Act rules 3a71–3 and 3a71–5 that address the application of the *de minimis* exception to security-based swap transactions connected with a non-U.S. person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such person located in a U.S. branch or office, or by personnel of such person's agent, located in a U.S. branch or office.

DATES: *Effective Date:* April 19, 2016. *Compliance Date:* The later of (a) February 21, 2017 or (b) the SBS Entity Counting Date, as defined in Section VII of the Supplementary Information.

FOR FURTHER INFORMATION CONTACT: Carol McGee, Assistant Director, Richard Gabbert, Senior Special Counsel, or Margaret Rubin, Special Counsel, Office of Derivatives Policy, at 202–551–5870, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–7010.

SUPPLEMENTARY INFORMATION: The Commission is amending Exchange Act rule 3a71–3 (addressing the cross-border implementation of the *de minimis* exception to the ''security-based swap dealer'' definition and the definition of certain terms) and Exchange Act rule 3a71–5 (regarding availability of an exception from the dealer *de minimis* analysis for cleared anonymous transactions that fall within rule 3a71–3(b)(1)(iii)(C)).

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I. Background

A. Scope of This Rulemaking

In April 2015, the Commission proposed to amend certain rules and to re-propose a rule regarding the application of Title VII of the Dodd-Frank Act [1] (''Title VII'') to cross-border security-based swap transactions and persons engaged in those transactions.[2] The proposed amendments included rules regarding the application of the *de minimis* exception to the dealing activity of non-U.S. persons carried out, in relevant part, by personnel located in the United States,[3] and the application of Regulation SBSR [4] to such transactions and to transactions effected by or through a registered broker-dealer, along with certain related issues. We also re-proposed a rule regarding the application of business conduct requirements to the foreign business and U.S. business of registered security-based swap dealers.[5]

In this release, we are adopting rule amendments relating specifically to the first of these issues: The application of the *de minimis* exception to non-U.S. persons that are engaged in dealing activity with other non-U.S. persons using personnel located in the United States. Consistent with the proposal, these amendments focus on the activity of the person or persons acting in a dealing capacity in the transaction. Specifically, Exchange Act rule 3a71–3(b)(1)(iii)(C) requires a non-U.S. person to include in its *de minimis* calculation

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[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.

[2] Application of Certain Title VII Requirements to 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, Exchange Act Release No. 74834 (April 29, 2015), 80 FR 27443 (May 13, 2015) (''U.S. Activity Proposing Release'').

[3] In this release, unless otherwise noted, we use the terms ''personnel located in the United States'' or ''personnel located in a U.S. branch or office'' interchangeably to refer to personnel of the non-U.S. person engaged in security-based swap dealing activity who are located in a U.S. branch or office, or to personnel of an agent of such non-U.S. person who are located in a U.S. branch or office.

[4] Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information; Final Rule, Exchange Act Release No. 74244 (February 11, 2015), 80 FR 14563 (March 19, 2015) (''Regulation SBSR Adopting Release'').

[5] Each of these issues had previously been considered in our May 23, 2013 proposal, in which we proposed rules regarding the application of Title VII in the cross-border context more generally. *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 30967 (May 23, 2013) (''Cross-Border Proposing Release'').

any transaction with a non-U.S.-person counterparty that is, in connection with its dealing activity, arranged, negotiated, or executed by personnel of the non-U.S. person located in a U.S. branch or office or by personnel of the non-U.S. person's agent located in a U.S. branch or office. This test (''U.S. Activity Test'') focuses on the location of the personnel acting on behalf of the non-U.S. person engaged in dealing activity. This approach focuses on the activities of non-U.S. persons that are most likely to raise the types of concerns addressed by Title VII security-based swap dealer regulation. At the same time, it avoids the unnecessary complexity of the initially proposed application of the *de minimis* exception to transactions between two non-U.S. persons based on the location of dealing activity. The final rules do not require a non-U.S. person engaging in dealing activity to consider the location of any activity carried out by or on behalf of its counterparty in determining whether the transaction needs to be included in its own *de minimis* calculation.

We are not addressing in this release any of the other elements of the April 2015 proposal. We anticipate addressing the remaining issues (including the application of business conduct standards, of Regulation SBSR to certain transactions, and the application of clearing and trade execution requirements more generally) in subsequent releases.[6]

Further, we note that these rules complete our rulemaking implementing the *de minimis* exception for security-based swap dealers. However, in the Intermediary Definitions Adopting Release we adopted rule 3a71–2 establishing a phase-in period in connection with a person's status as a security-based swap dealer and other regulatory requirements arising from dealer status.[7] We established a $3 billion notional threshold for the *de minimis* exception with respect to single-name credit default swaps (''CDS''), subject to a phase-in level of $8 billion.[8] During the phase-in period Commission staff will study the security-based swap market as it evolves under the new regulatory framework, resulting in a report that will consider the operation of the ''security-based swap dealer'' and ''major security-based swap participant'' definitions. As we explained in the Intermediary Definitions Adopting Release, at the end of the phase-in period, we will take into account the report, as well as public comment on the report, in determining whether to terminate the phase-in period or propose any changes to the rules implementing the *de minimis* exception, including any increases or decreases to both the $3 billion threshold for credit default swaps and the $150 million threshold for other types of security-based swaps.[9]

B. The Dodd-Frank Act

As we have previously noted, Title VII of the Dodd-Frank Act provides for a comprehensive new regulatory framework for swaps and security-based swaps.[10] Under this framework, the Commodity Futures Trading Commission (''CFTC'') regulates ''swaps'' while the Commission regulates ''security-based swaps,'' and the Commission and CFTC jointly regulate ''mixed swaps.'' Security-based swap transactions are largely cross-border in practice,[11] and the various market participants and infrastructures operate in a global market. A key part of this framework is the regulation of security-based swap dealers, which may transact extensively with counterparties established or located in other jurisdictions and, in doing so, may conduct sales and trading activity in one jurisdiction and book the resulting transactions in another. These market realities and the potential impact that these activities may have on U.S. persons and potentially the U.S. financial system have informed our consideration of these rules.

In developing these final rules, we have consulted and coordinated with the CFTC and the prudential regulators [12] in accordance with the consultation mandate of the Dodd-Frank Act.[13] We also have 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.[14] Through these discussions and the Commission staff's participation in various international task forces and working groups,[15] we have gathered information about foreign regulatory reform efforts and their impact 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.[16]

[6] *Cf.* Letter from Citadel, dated February 2, 2016, at 12 (urging the Commission to address the scope of the Title VII mandatory clearing or trading requirement ''in the context of those specific rulemakings, rather than in an overarching cross-border rule'').

[7] *See* 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 (April 27, 2012), 77 FR 30595, 30640 (May 23, 2012) (''Intermediary Definitions Adopting Release'').

[8] *See* Exchange Act rule 3a71–2. The threshold and phase-in levels for other types of security-based swaps are $150 million and $400 million, respectively. *See id.*

[9] *See* Intermediary Definitions Adopting Release, 77 FR 30640–41 and n.523.

[10] *See* U.S. Activity Proposing Release, 80 FR 27446.

[11] *See* Section II.A.3, *infra,* regarding the preponderance of cross-border activity in the security-based swap market.

[12] The term ''prudential regulator'' is defined in section 1a(39) of the Commodity Exchange Act, 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, 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.

[13] 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.'' *See* Letter from Managed Funds Association, dated July 13, 2015 (''MFA Letter''), at 4 (emphasizing need for Commission and its U.S. counterparts to develop a single, harmonized approach to cross-border derivatives regulation).

[14] For example, senior representatives of authorities with responsibility for regulation of OTC derivatives have met on a number of occasions to discuss international coordination of OTC derivatives regulations. *See, e.g.,* Report of the OTC Derivatives Regulators Group to G20 Leaders on Cross-Border Implementation Issues November 2015 (November 2015), available at: *http://www.cftc.gov/idc/groups/public/@internationalaffairs/documents/file/odrgreportg20_1115.pdf.*

[15] Commission representatives participate in the Financial Stability Board's Working Group on OTC Derivatives Regulation (''ODWG''), both on the Commission's behalf and as the representative of the International Organization of Securities Commissions (''IOSCO''), which is co-chair of the ODWG. A Commission representative serves as one of the co-chairs of the IOSCO Task Force on OTC Derivatives Regulation. Commission representatives participate in joint working groups of the Committee on Payments and Market Infrastructures (''CPMI'') and IOSCO that examine key data elements of OTC derivatives transactions and participated in the Financial Stability Board's review of OTC derivatives trade reporting. Commission representatives also participate in international working groups that impact OTC derivatives financial market infrastructures, such as CPMI–IOSCO joint working groups that assess legal and regulatory frameworks for central counterparties and trade repositories and that examine central counterparty resilience and recovery.

[16] *See* Section 752(a) of the Dodd-Frank Act (providing 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

Continued

C. Relevant Proposing Releases

As discussed in further detail below, we have twice proposed rules related to the application of the dealer *de minimis* calculations to security-based swap transactions that involve activity in the United States. In both proposals, we discussed the global nature of the security-based swap market and explained our view that dealing activity carried out by a non-U.S. person through a branch, office, affiliate, or agent acting on its behalf in the United States may raise concerns that Title VII addresses, even if a significant proportion—or all—of those transactions involve non-U.S.-person counterparties.[17]

We initially proposed to require any non-U.S. person engaged in dealing activity to include in its *de minimis* calculation any ''transaction conducted within the United States.'' [18] Thus, under the Cross-Border Proposing Release, a non-U.S. person engaged in security-based-swap dealing activity would have been required to include in its *de minimis* calculation any dealing transaction entered into with another non-U.S. person that was conducted in the United States by either the non-U.S. person engaged in dealing activity or its counterparty. In our April 2015 proposal, we proposed a modified approach to applying the dealer *de minimis* exception to transactions between two non-U.S. persons based on activity in the United States that focused exclusively on the location of personnel engaged in relevant activity in connection with a non-U.S. person's dealing activity.[19]

D. Relevant CFTC Guidance

As discussed in our April 2015 proposal, the CFTC's Division of Swap Dealer and Intermediary Oversight issued a Staff Advisory (''CFTC Staff Advisory'') in November 2013 that addressed the applicability of the CFTC's transaction-level requirements to certain activity by non-U.S. registered swap dealers arranged, negotiated, or executed by personnel or agents of the non-U.S. swap dealer located in the United States.[20] The CFTC subsequently solicited and received public comment on various aspects of the CFTC Staff Advisory,[21] and we discussed these comments in our April 2015 proposal.[22] On August 13, 2015, the CFTC staff extended no-action relief related to the CFTC Staff Advisory until the earlier of September 30, 2016, or the effective date of any CFTC action addressing related issues.[23]

E. Overview of Comments Received

As we discuss in more detail below, we received fifteen comment letters in response to our U.S. Activity Proposing Release. These comment letters address a range of issues, including the scope of the proposed U.S. Activity Test and concerns about its use as a trigger for the counting of transactions toward the *de minimis* thresholds of non-U.S. persons, as well as other issues—such as external business conduct, regulatory reporting and public dissemination, and mandatory trade execution and clearing—that we anticipate addressing in subsequent releases. Several commenters expressed support for our proposed U.S. Activity Test, and one commenter expressed general support for the rules proposed in the U.S. Activity Proposing Release.[24] Several commenters, however, raised concerns about the use of the U.S. Activity Test to identify transactions that non-U.S. persons are required to include in their dealer *de minimis* calculations, arguing, among other things, that capturing these transactions would not advance the mitigation of risk, which commenters identified as the principal concern of Title VII dealer regulation,[25] would impose excessive costs on market participants,[26] and would cause market fragmentation and decreased liquidity for U.S. market participants.[27]

II. Economic Considerations and Baseline Analysis

These final rules will determine when a non-U.S. person engaged in dealing activity and whose obligations under a security-based swap are not guaranteed by a U.S. person and that is not a conduit affiliate is required to include in its dealer *de minimis* threshold calculations transactions with another non-U.S. person.[28] To provide context for understanding our final rules and the related economic analysis that follows, this section provides an overview of the current state of the security-based swap market and the existing regulatory framework; it also identifies economic considerations that we believe underlie the likely economic effects of these rules.

A. Baseline

To assess the economic impact of the final rules described in this release, we are using as our baseline the security-based swap market as it exists at the time of this release, including applicable rules we have already adopted but excluding rules that we have proposed but not yet finalized.[29] 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

of consistent international standards with respect to the regulation (including fees) of swaps.'').

[17] *See* Cross-Border Proposing Release, 78 FR 31000–01; U.S. Activity Proposing Release, 80 FR 27463.

[18] Cross-Border Proposing Release, 78 FR 30999–31000.

[19] *See* U.S. Activity Proposing Release, 80 FR 27459.

[20] *See* CFTC Staff Advisory No. 13–69, ''Division of Swap Dealer and Intermediary Oversight Advisory: Applicability of Transaction-Level Requirements to Activity in the United States'' (November 14, 2013), available at: *http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.*

In the Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations (July 17, 2013), 78 FR 45292 (July 26, 2013) (''CFTC Cross-Border Guidance''), the CFTC defined transaction-level requirements to include the following: (i) Required clearing and swap processing; (ii) margining (and segregation) for uncleared swaps; (iii) mandatory trade execution; (iv) swap trading relationship documentation; (v) portfolio reconciliation and compression; (vi) real-time public reporting; (vii) trade confirmation; (viii) daily trading records; and (ix) external business conduct standards. *See* CFTC Cross-Border Guidance, 78 FR 45333.

[21] *See* Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States, 79 FR 1347 (January 8, 2014) (''CFTC Request for Comment'').

[22] *See* U.S. Activity Proposing Release, 80 FR 27461–63.

[23] *See* Extension of No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers, CFTC Letter No. 15–48 (August 13, 2015), available at: *http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/15-48.pdf.*

[24] *See* Letter from Chris Barnard, dated June 26, 2015 (''Chris Barnard Letter''), at 2.

[25] *See, e.g.,* Letter from International Swaps and Derivatives Association (''ISDA''), dated July 13, 2015 (''ISDA Letter''), at 5–6.

[26] *See* Letter from Institute of International Bankers, dated July 13, 2015 (''IIB Letter''), at 7; ISDA Letter at 6; Letter from Securities Industry and Financial Markets Association and Financial Services Roundtable, dated July 13, 2015 (''SIFMA/FSR Letter''), at 6; Letter from HSBC, dated July 13, 2015 (''HSBC Letter''), at 1–3; Letter from Securities Industry and Financial Markets Association, dated January 13, 2015 (''SIFMA Sequencing Letter''), at 5.

[27] *See, e.g.,* SIFMA/FSR Letter at 2, 6; IIB Letter at 2; ISDA Letter at 5.

[28] Pursuant to Exchange Act rules 3a71–3(b)(1)(ii) and (iii)(B), any transaction of a non-U.S. person engaged in dealing activity and that is a conduit affiliate or whose counterparty to the security-based swap has rights of recourse against a U.S. person that is controlling, controlled by, or under common control with the non-U.S. person is already required to be counted toward the non-U.S. person's *de minimis* thresholds regardless of where personnel of the non-U.S. person arranges, negotiates, or executes the transactions.

[29] We also considered, where appropriate, the impact of rules and technical standards promulgated by other regulators, such as the CFTC and the European Securities and Markets Authority, on practices in the security-based swap market.

Adopting Release,[30] the SDR Rules and Core Principles Adopting Release,[31] the SBS Entity Registration Adopting Release,[32] and the Regulation SBSR Adopting Release,[33] 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 describe current security-based swap market activity, participants, common dealing structures, counterparties, and patterns of cross-border and cross-market participation.

1. Available Data Regarding Security-Based Swap Activity

Our understanding of the market is informed in part by available data on security-based swap transactions, though we acknowledge that limitations in the data limit the extent to which we can quantitatively characterize the market.[34] Because these data do not cover the entire market, we have developed an understanding of market activity using a sample of transactions data that includes only certain portions of the market. We believe, however, that the data underlying our analysis here provide reasonably comprehensive information regarding single-name CDS transactions and the composition of participants in the single-name CDS market.

Specifically, our analysis of the state of the current 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 2014. According to data published by the Bank for International Settlements (''BIS''), the global notional amount outstanding in single-name CDS was approximately $9.04 trillion,[35] in multi-name index CDS was approximately $6.75 trillion, and in multi-name, non-index CDS was approximately $611 billion. The total gross market value outstanding in single-name CDS was approximately $366 billion, and in multi-name CDS instruments was approximately $227 billion.[36] The global notional amount outstanding in equity forwards and swaps as of December 2014 was $2.50 trillion, with total gross market value of $177 billion.[37] As these figures show (and as we have previously noted), although the definition of security-based swaps is not limited to single-name CDS, single-name CDS contracts make up a majority of security-based swaps, and we believe that the single-name CDS data are sufficiently representative of the market to inform our analysis of the state of the current security-based swap market.[38]

We note that the data available to us from TIW do not encompass those CDS transactions that both: (i) Do not involve U.S. counterparties; [39] and (ii) are based on non-U.S. reference entities. Notwithstanding this limitation, the TIW data should provide sufficient information to permit us to identify the types of market participants active in the security-based swap market and the general pattern of dealing within that market.[40]

One commenter recommended that we collect a more complete set of data to more precisely estimate the number of non-U.S. persons that would be affected by the proposed rules.[41] Given the absence of comprehensive reporting requirements for security-based swap transactions, and the fact that the location of personnel that arrange, negotiate, or execute a security-based swap transaction is not currently available in TIW, a more precise estimate of the number of non-U.S. persons affected by this rule is not currently feasible. However, because we assume that all transactions by dealers classified as non-U.S. persons with other persons classified as non-U.S. persons on U.S. reference entities are arranged, negotiated, or executed by personnel located in the United States, we believe our analysis of the available data reflects a reasonable estimate for identifying broad market effects and estimating the number of firms that would likely assess the location of their dealing activity.[42]

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[30] *See* Application of ''Security-Based Swap Dealer'' and ''Major-Security-Based Swap Participant'' Definitions to Cross-Border Security-Based Swap Activities, Exchange Act Release No. 72472 (June 25, 2014), 79 FR 47277 (August 12, 2014 (republication)) (''Cross-Border Adopting Release'').

[31] *See* Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 74246 (February 11, 2015), 80 FR 14437 (March 19, 2015) (''SDR Rules and Core Principles Adopting Release'').

[32] *See* Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 75611 (August 5, 2015), 80 FR 48963 (August 14, 2015) (''SBS Entity Registration Adopting Release'').

[33] *See* Regulation SBSR-Reporting and Dissemination of Security-Based Swap Information, Exchange Act Release No. 74244 (February 11, 2015), 80 FR 14563 (March 19, 2015) (''Regulation SBSR Adopting Release'').

[34] We also rely on qualitative information regarding market structure and evolving market practices provided by commenters, both in letters and in meetings with Commission staff, and knowledge and expertise of Commission staff.

[35] The global notional amount outstanding represents the total face amount used to calculate payments under outstanding contracts. The gross market value is the cost of replacing all open contracts at current market prices.

[36] *See* semi-annual OTC derivatives statistics at December 2014, Table 19, available at *http://www.bis.org/statistics/dt1920a.pdf* (accessed July 29, 2015).

[37] These totals include both swaps and security-based swaps, as well as products that are excluded from the definition of ''swap,'' such as certain equity forwards.

[38] While other repositories may collect data on transactions in total return swaps on equity and debt, we do not currently have access to such data for these products (or other products that are security-based swaps). Consistent with the Cross-Border Proposing Release, we believe that data related to single-name CDS provide reasonably comprehensive information for purposes of this analysis, as such transactions appear to constitute roughly 74 percent of the security-based swap market as measured on the basis of gross notional outstanding. *See* Cross-Border Proposing Release, 78 FR 31120 n.1301.

Also consistent with our approach in that release, with the exception of the analysis regarding the degree of overlap between participation in the single-name CDS market and the index CDS market (cross-market activity), our analysis below does not include data regarding index CDS as we do not currently have sufficient information to classify index CDS as swaps or security-based swaps.

[39] Following publication of the Warehouse Trust Guidance on CDS data access, 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 physical address is designated the registered office location by TIW. When an account reports a registered office location, we have assumed that the registered office location reflects the place of domicile for the fund or account. When an account does not report a registered office location, we have assumed that the settlement country reported by the investment adviser or parent entity to the fund or account is the place of domicile. Thus, for purposes of this analysis, we have classified accounts as ''U.S. counterparties'' when they have reported a registered office location in the United States. We note, however, that this classification is not necessarily identical in all cases to the definition of ''U.S. person'' under Exchange Act rule 3a71–3(a)(4).

[40] The challenges we face in estimating measures of current market activity stem, in part, from the absence of comprehensive reporting requirements for security-based swap market participants. The Commission has adopted rules regarding trade reporting, data elements, and public reporting for security-based swaps that are designed to, when fully implemented, provide the Commission with additional measures of market activity that will allow us to better understand and monitor activity in the security-based swap market. *See* Regulation SBSR Adopting Release, 80 FR 14699–14700.

[41] *See* ISDA Letter at 3, 7 (arguing that the Commission lacks complete data to estimate the number of non-U.S. persons that use U.S. personnel to arrange, negotiate, or execute security-based swap transactions or the number of registered U.S. broker-dealers that intermediate these transactions and that this ''makes it difficult or impossible for the Commission to formulate a useful estimate of the market impact, cost and benefits of the Proposal''; suggesting that the Commission ''gather[ ] more robust and complete data prior to finalizing a rulemaking that will have meaningful impact on a global market.'').

[42] *See* Section V.A.1, *infra.*

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 our sample, and include, but are not limited to, investment companies, pension funds, private (hedge) funds, sovereign entities, and industrial companies. We observe that most non-dealer users of security-based swaps do not engage directly in the trading of swaps, but trade through banks, investment advisers, or other types of firms acting as dealers or agents. Based on an analysis of the counterparties to trades reported to the TIW, there are 1,875 entities that engaged directly in trading between November 2006 and December 2014.[43]

As shown in Table 1, below, close to three-quarters of these entities (DTCC-defined ''firms'' shown in TIW, which we refer to here as ''transacting agents'') were identified as investment advisers, of which approximately 40 percent (about 30 percent of all transacting agents) were registered as investment advisers under the Investment Advisers Act of 1940 (''Investment Advisers Act'').[44] Although investment advisers comprise the vast majority of transacting agents, the transactions they executed account for only 11.5 percent of all single-name CDS trading activity reported to the TIW, measured by number of transaction-sides (each transaction has two transaction sides, *i.e.,* two transaction counterparties). The vast majority of transactions (83.7 percent) measured by number of transaction-sides were executed by ISDA-recognized dealers.

TABLE 1—THE NUMBER OF TRANSACTING AGENTS BY COUNTERPARTY TYPE AND THE FRACTION OF TOTAL TRADING ACTIVITY, FROM NOVEMBER 2006 THROUGH DECEMBER 2014, REPRESENTED BY EACH COUNTERPARTY TYPE [45]

Transacting agents	Number	Percent	Transaction share
Investment Advisers	1,425	76.0	11.5%
—*SEC registered*	*571*	*30.5*	*7.7%*
Banks	252	13.4	4.3%
Pension Funds	27	1.4	0.1%
Insurance Companies	38	2.0	0.2%
ISDA-Recognized Dealers [46]	17	0.9	83.7%
Other	116	6.2	0.2%
Total	1,875	99.9	100%

Principal holders of CDS risk exposure are represented by ''accounts'' in the TIW.[47] The staff's analysis of these accounts in TIW shows that the 1,875 transacting agents classified in Table 1 represent 10,900 principal risk holders. Table 2, below, classifies these principal risk holders by their counterparty type and whether they are represented by a registered or unregistered investment adviser.[48] For instance, banks in Table 1 allocated transactions across 327 accounts, of which 23 were represented by investment advisers. In the remaining 304 instances, banks traded for their own accounts. Meanwhile, ISDA-recognized dealers in Table 1 allocated transactions across 75 accounts.

[43] These 1,875 entities, which are presented in more detail in Table 1, below, include all DTCC-defined ''firms'' shown in TIW as transaction counterparties that report at least one transaction to TIW as of December 2014. The staff in the Division of Economic and Risk Analysis classified these firms, which are shown as transaction counterparties, by machine matching names to known third-party databases and by manual classification. *See, e.g.,* Cross-Border Proposing Release, 78 FR 31120 n.1304. Manual classification was based in part on searches of the EDGAR and Bloomberg databases, the SEC's Investment Adviser Public Disclosure database, and a firm's public Web site or the public Web site of the account represented by a firm. The staff also referred to ISDA protocol adherence letters available on the ISDA Web site.

[44] *See* 15 U.S.C. 80b1–80b21. Transacting agents participate directly in the security-based swap market, without relying on an intermediary, on behalf of principals. For example, a university endowment may hold a position in a security-based swap that is established by an investment adviser that transacts on the endowment's behalf. In this case, the university endowment is a principal that uses the investment adviser as its transacting agent.

[45] Adjustments to these statistics from the proposal reflect updated classifications of counterparties and transactions classification resulting from further analysis of the TIW data.

[46] For the purpose of this analysis, the ISDA-recognized dealers are those identified by ISDA as belonging to the G14 or G16 dealer group during the period: JP Morgan Chase NA (and Bear Stearns), Morgan Stanley, Bank of America NA (and Merrill Lynch), Goldman Sachs, Deutsche Bank AG, Barclays Capital, Citigroup, UBS, Credit Suisse AG, RBS Group, BNP Paribas, HSBC Bank, Lehman Brothers, Société Générale, Credit Agricole, Wells Fargo and Nomura. *See, e.g., http://www.isda.org/c_and_a/pdf/ISDA-Operations-Survey-2010.pdf.*

[47] ''Accounts'' as defined in the TIW context are not equivalent to ''accounts'' in the definition of ''U.S. person'' provided by Exchange Act rule 3a71–3(a)(4)(i)(C). They also do not necessarily represent separate legal persons. One entity or legal person may have multiple accounts. For example, a bank may have one DTCC account for its U.S. headquarters and one DTCC account for one of its foreign branches.

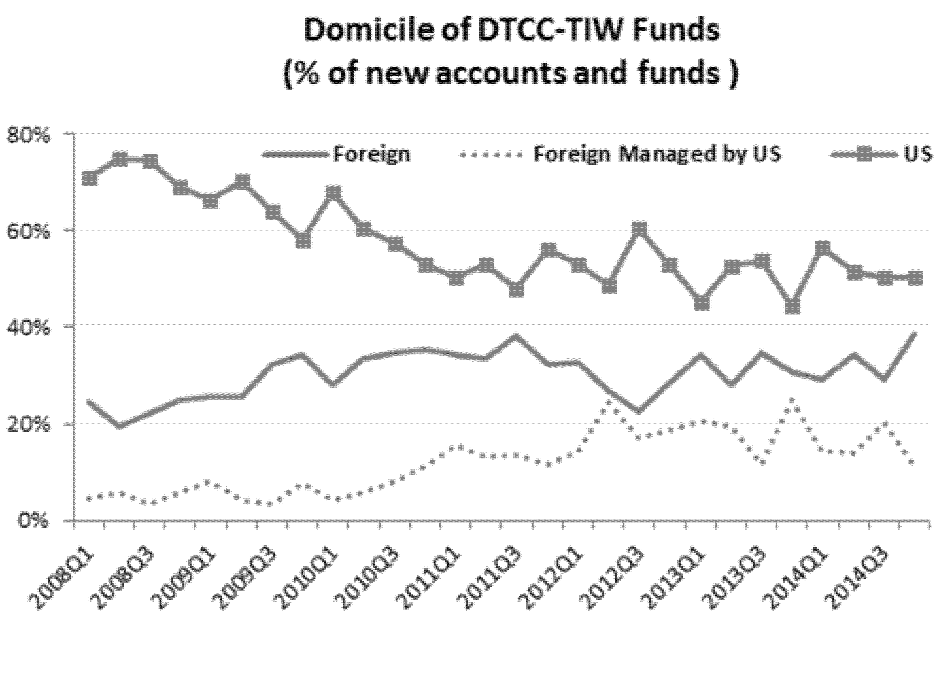
[48] Unregistered investment advisers include all investment advisers not registered under the Investment Advisers Act and may include investment advisers registered with a state or a foreign authority.

TABLE 2—THE NUMBER AND PERCENTAGE OF ACCOUNT HOLDERS—BY TYPE—WHO PARTICIPATE IN THE SECURITY-BASED SWAP MARKET THROUGH A REGISTERED INVESTMENT ADVISER, AN UNREGISTERED INVESTMENT ADVISER, OR DIRECTLY AS A TRANSACTING AGENT, FROM NOVEMBER 2006 THROUGH DECEMBER 2014 [49]

Account holders by type	Number	Represented by a registered investment adviser		Represented by an unregistered investment adviser		Participant is transacting agent [50]	
Private Funds	3,168	1,569	50%	1,565	49%	34	1%
DFA Special Entities	1,141	1,088	95%	33	3%	20	2%
Registered Investment Companies	800	768	96%	30	4%	2	0%
Banks (non-ISDA-recognized dealers)	327	17	5%	6	2%	304	93%
Insurance Companies	232	150	65%	21	9%	61	26%
ISDA-Recognized Dealers	75	0	0%	0	0%	75	100%
Foreign Sovereigns	72	53	74%	3	4%	16	22%
Non-Financial Corporations	61	43	70%	3	5%	15	25%
Finance Companies	13	6	46%	0	0%	7	54%
Other/Unclassified	5,011	3,327	66%	1,452	29%	232	5%
All	10,900	7,021	64%	3,113	29%	766	7%

Among the accounts, there are 1,141 Dodd-Frank Act-defined special entities and 800 investment companies registered under the Investment Company Act of 1940.[51] Private funds comprise the largest type of account holders that we were able to classify, and, although not verified through a recognized database, most of the funds we were not able to classify appear to be private funds.[52]

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 that are associated with a firm that also has a domicile outside the United States (referred to below as "Foreign"), and (3) new accounts with a domicile outside the United States that are associated with a firm that has a domicile in the United States (collectively referred to below as "Foreign Managed by US").[53] Unique new accounts are aggregated, and percentages are computed, on a quarterly basis, from January 2008 through December 2014.



[49] Adjustments to these statistics from the proposal reflect updated counterparty and transaction classification resulting from additional analysis of the TIW data.

[50] This column reflects the number of participants who are also trading for their own accounts.

[51] *See* 15 U.S.C. 80a1–80a64. There remain approximately 5,000 DTCC ''accounts'' unclassified by type. Although unclassified, each was manually reviewed to verify that it was not likely to be a special entity within the meaning of the Dodd-Frank Act and instead was likely to be an entity such as a corporation, an insurance company, or a bank.

[52] For the purposes of this discussion, ''private fund'' encompasses various unregistered pooled investment vehicles, including hedge funds, private equity funds, and venture capital funds.

[53] *See* note 39, *supra* (explaining how domiciles for firms were identified for purposes of this analysis).

b. Participant Domiciles

As depicted in Figure 1 above, the domiciles of new accounts participating in the market have shifted over time. It is unclear whether these shifts represent changes in the types of participants active in this market, changes in reporting, or changes in transaction volumes in particular underliers. For example, the increased percentage of new entrants that are foreign accounts may reflect an increase in participation by foreign account holders in the security-based swap market, and the increased percentage of the subset of new entrants that are foreign accounts managed by U.S. persons 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.[54] On the other hand, apparent changes in the percentage of new accounts with foreign domiciles may 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.[55]

c. Market Centers

A market participant's domicile, however, does not necessarily correspond to where it engages in security-based swap activity. In particular, financial groups engaged in security-based swap dealing activity operate in multiple market centers and carry out such activity with counterparties around the world.[56] Several commenters noted that 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.[57] Thus, although a significant amount of the dealing activity in security-based swaps on U.S. reference entities involves non-U.S. dealers, we understand 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.[58] 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.[59]

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 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, Tokyo, Hong Kong, Chicago, Sydney, Toronto, Frankfurt, Singapore and the Cayman Islands.[60]

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. And market activity may 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 for Firms Engaged in Security-Based Swap Dealing Activity

A financial group 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 financial group may weigh differently.

A financial group 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.[61] Alternatively, a financial group 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 that risk.[62] Some financial groups may book transactions originating in a particular region to an affiliate established in a jurisdiction located in that region.[63]

Regardless of where a financial group 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 financial group 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,[64] for example, when a counterparty's home financial markets

[54] *See* Charles Levinson, ''U.S. banks moved billions in trades beyond the CFTC's reach,'' Reuters (August 21, 2015), available at: *http://www.reuters.com/article/2015/08/21/usa-banks-swaps-idUSL3N10S57R20150821*.

[55] As noted above, 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).

[56] *See* U.S. Activity Proposing Release, 80 FR 27449–52.

[57] *See* IIB Letter at 2; SIFMA/FSR Letter at 6; ISDA Letter at 5. One commenter indicated that a significant number of interdealer transactions between two non-U.S. dealers involve trades arranged, negotiated, or executed within the United States, although this commenter did not specifically identify what underliers these trades involved. *See* MFA/AIMA Letter at 7, note 34.

[58] *See* IIB Letter at 2; SIFMA/FSR Letter at 6;

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).

[56] *See* U.S. Activity Proposing Release, 80 FR 27449–52.

[57] *See* IIB Letter at 2; SIFMA/FSR Letter at 6; ISDA Letter at 5. One commenter indicated that a significant number of interdealer transactions between two non-U.S. dealers involve trades arranged, negotiated, or executed within the United States, although this commenter did not specifically identify what underliers these trades involved. *See* MFA/AIMA Letter at 7, note 34.

[58] *See* IIB Letter at 2; SIFMA/FSR Letter at 6; ISDA Letter at 5.

[59] *See* IIB Letter at 2; SIFMA/FSR Letter at 6; ISDA Letter at 5.

[60] 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.

[61] *See* U.S. Activity Proposing Release, 80 FR 27463; Cross-Border Proposing Release, 78 FR 30977–78.

[62] *See, e.g.,* HSBC Letter at 2; SIFMA/FSR Letter at 6–7.

[63] There is some indication that this booking structure is becoming increasingly common in the market. *See, e.g.,* ''Regional swaps booking replacing global hubs,'' Risk.net (September 4,

are closed.[65] A financial group 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 take advantage of 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.[66] Some financial groups 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.[67]

The financial group 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 financial group may determine that another affiliate in the financial group 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 dealing activity on its behalf in that jurisdiction.[68] 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 financial group affiliate that books these transactions may in some circumstances determine to engage the services of an unaffiliated agent through which it can engage in dealing activity. For example, a financial group 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.[69] A financial group may also use unaffiliated agents that operate at its direction. Such an arrangement may be particularly valuable in enabling a financial group to service clients or access liquidity in jurisdictions in which it has no security-based swap operations of its own.

We understand that financial group affiliates (whether affiliated with U.S.-based financial groups or not) that are established in foreign jurisdictions may use any of 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. We understand 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 financial group 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.[70] 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.

e. Current Estimates of Number of Security-Based Wwap Dealers

As discussed above, security-based swap activity is concentrated in a relatively small number of dealers, which already represent a small percentage of all market participants active in the security-based swap market.[71] Based on analysis of 2014 data, our earlier estimates of the number of entities likely to register as security-based swap dealers remain largely unchanged.[72] Of the approximately 50 entities that we estimate may potentially register as security-based swap dealers, we believe it is reasonable to expect 22 to be non-U.S. persons.[73] Under the rules as they currently exist, we identified approximately 170 entities engaged in single-name CDS activity, with all counterparties, of $2 billion or more. Of those entities, 155 would be expected to incur assessment costs to determine whether they meet the ''security-based swap dealer'' definition. Approximately 57 of these entities are non-U.S. persons.[74]

Many of these dealers are already subject to other regulatory frameworks under U.S. law based on their role as intermediaries or on the volume of their positions in other products, such as swaps. Available data supports our prior estimates, based on our experience and understanding of the swap and security-based swap market, that of the 55 firms that might register as security-based swap dealers or major security-based swap participants, approximately 35 would also be registered with the CFTC as swap dealers or major swap participants.[75] Based on our analysis of TIW data and filings with the Commission, we estimate that 16 market participants expected to register as security-based swap dealers have already registered with the Commission as broker-dealers and are thus subject to Exchange Act and Financial Industry Regulatory Authority (''FINRA'') requirements applicable to such entities. Finally, as we discuss below, some dealers may be subject to similar

[64] 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.

[65] *See* SIFMA/FSR Letter at 3; HSBC Letter at 2.

[66] *See* HSBC Letter at 2.

[67] *See* note 59, *supra.*

[68] *See* HSBC Letter at 2.

[69] We understand 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 important role in facilitating transactions in less-liquid security-based swaps.

[70] *See* IIB Letter at 18–19.

[71] *See* II.A.2.a,, *supra.*

[72] *See* U.S. Activity Proposing Release, 80 FR 27452.

[73] These estimates are 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 we are 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 we do not observe security-based swap transactions other than in single-name CDS. *See* U.S. Activity Proposing Release, 80 FR 27452. *See also* Intermediary Definitions Adopting Release, 77 FR 30725 n.1457.

[74] Adjustments to these statistics from the proposal reflect further analysis of the TIW data. *Cf.* U.S. Activity Proposing Release, 80 FR 27452 (providing an estimate of 56 entities that are non-U.S. persons).

[75] Based on our analysis of 2014 TIW data and the list of swap dealers provisionally registered with the CFTC, and applying the methodology used in the Intermediary Definitions Adopting Release, we estimate that substantially all registered security-based swap dealers would also be registered as swap dealers with the CFTC. *See* U.S. Activity Proposing Release, 80 FR 27458; SBS Entity Registration Adopting Release, 80 FR 49000. *See also* CFTC list of provisionally registered swap dealers, available at: *http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.*

requirements in one or more foreign jurisdictions.[76]

3. Security-Based Swap Market: Levels of Security-Based Swap Trading Activity

As already noted, firms that act as dealers play a central role in the security-based swap market. Based on an analysis of 2014 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 $8.5 trillion, over 60 percent of which was intermediated by top 5 dealer accounts.[77]

These dealers transact with hundreds or thousands of counterparties. Approximately 35 percent 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 2014.[78] Approximately 9 percent of these accounts transacted with 500–1,000 unique counterparty accounts; another 35 percent transacted with 100–500 unique accounts, and only 22 percent of these accounts intermediated swaps with fewer than 100 unique counterparties in 2014. The median dealer account transacted with 453 unique accounts (with an average of approximately 759 unique accounts). Non-dealer counterparties transact almost exclusively with these dealers. The median non-dealer counterparty transacted with 3 dealer accounts (with an average of approximately 4 dealer accounts) in 2014.

Figure 2 below describes the percentage of global, notional transaction volume in North American corporate single-name CDS reported to the TIW between January 2008 and December 2014, 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 and that interdealer transactions continue to represent a significant majority of trading activity, even as notional volume has declined over the past six years,[79] from more than $6 trillion in 2008 to less than $3 trillion in 2014.[80]

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.[81] While we are unable to quantify the current level of trading costs for single-name CDS, those dealers appear to enjoy market power as a result of their small number and the large proportion of order flow they privately observe.

[75] Based on our analysis of 2014 TIW data and the list of swap dealers provisionally registered with the CFTC, and applying the methodology used in the Intermediary Definitions Adopting Release, we estimate that substantially all registered security-based swap dealers would also be registered as swap dealers with the CFTC. *See* U.S. Activity Proposing Release, 80 FR 27458; SBS Entity Registration Adopting Release, 80 FR 49000. *See also* CFTC list of provisionally registered swap dealers, available at: *http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer.*

[76] *See, e.g.,* ISDA Letter at 5, 6.

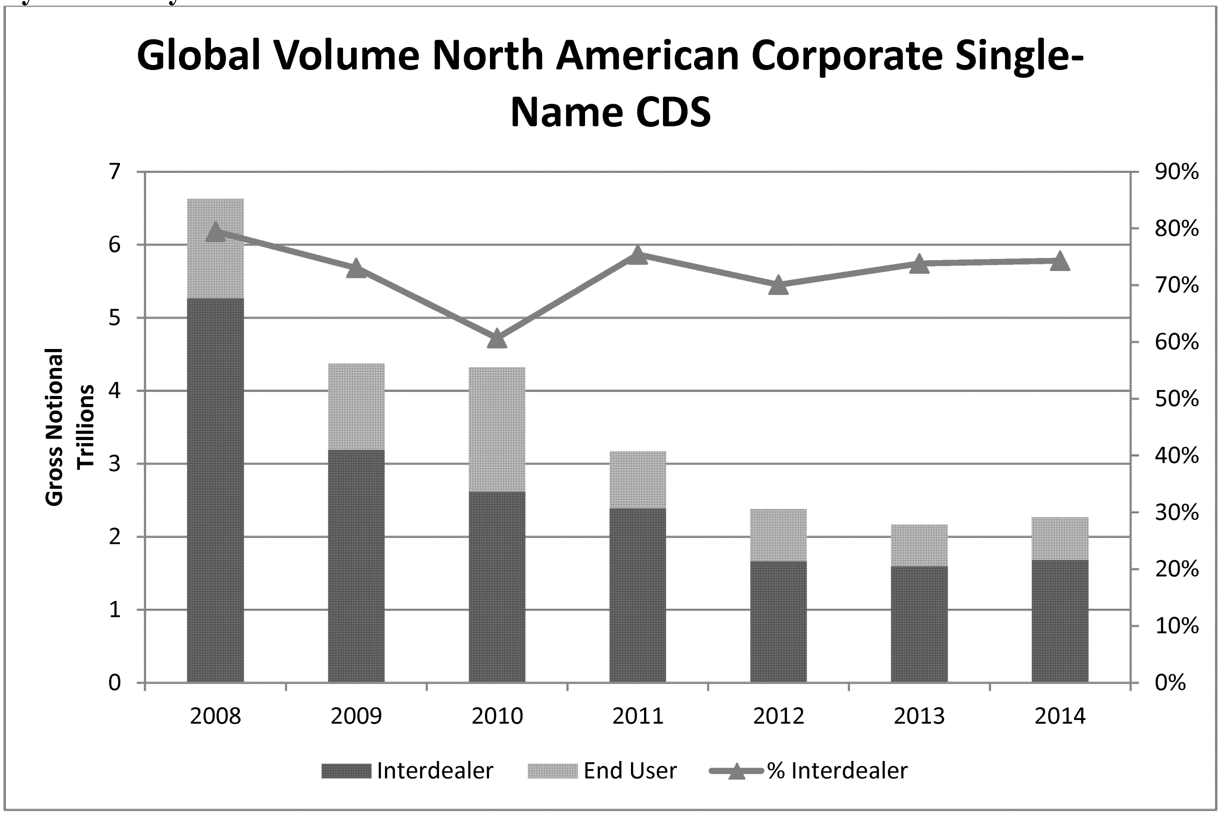
[78] Many dealer entities and financial groups transact through numerous accounts. Given that individual accounts may transact with hundreds of counterparties, we may infer that entities and financial groups, which may have multiple accounts, transact with at least as many counterparties as the largest of their accounts in terms of number of counterparties.

[79] 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.

[80] This estimate is lower than the gross notional amount of $8.5 trillion noted above as it includes only the subset of single-name CDS referencing North American corporate documentation. *See* note 77 and accompanying text, *supra.*

[81] One commenter criticized the analysis in the U.S. Activity Proposing Release as ''appear[ing] to suffer from certain defects'' because the data implied that security-based swap dealing was not a ''customer-driven business.'' *See* Letter from Citadel, dated July 13, 2015 (''Citadel Letter''), at 9. We note that our current estimate of the relative size of the interdealer business, based on our updated analysis, is somewhat lower than the 80 percent figure cited by the commenter. Nonetheless, we continue to estimate that interdealer transactions comprise the majority of price-forming transactions. Accordingly, it remains our view that dealers play a central role in the security-based swap market.

Figure 2: Global notional trading volume in North American corporate single-name CDS by calendar year and the fraction of volume that is interdealer. [82]



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 we 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, we estimate that only 12 percent of the global transaction volume by notional volume between 2008 and 2014 was between two U.S.-domiciled counterparties, compared to 48 percent entered into between one U.S.-domiciled counterparty and a foreign-domiciled counterparty and 40 percent entered into between two foreign-domiciled counterparties.[83]

If we consider the number of cross-border transactions instead 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 32 percent, and to 51 percent 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 40 percent to 17 percent. 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 83 percent) of all reported transactions in North American corporate single-name CDS.

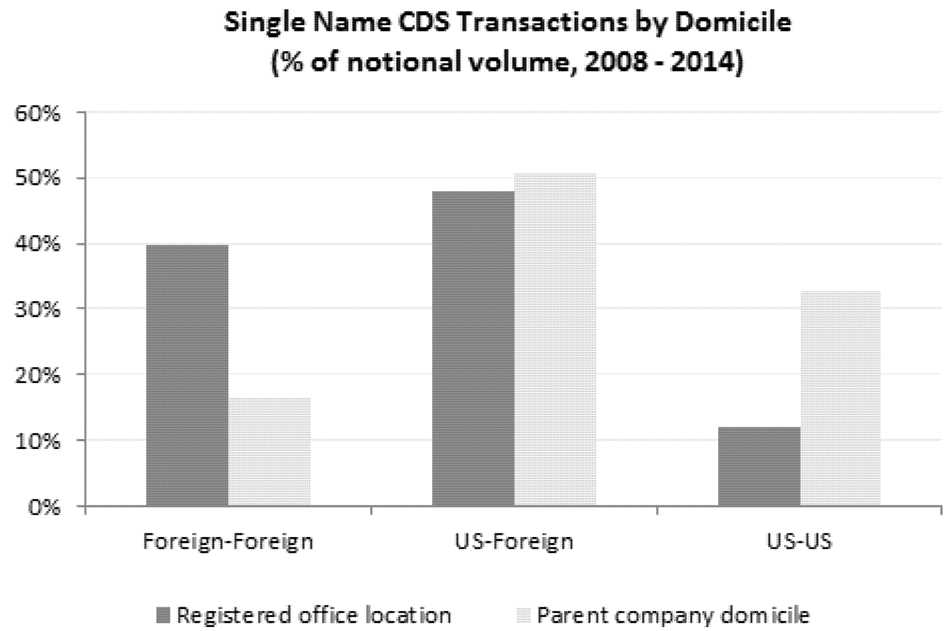
Financial groups based in the United States are also involved in a majority of interdealer transactions in North American corporate single-name CDS: Of transactions on North American corporate single-name CDS between two ISDA-recognized dealers and their branches or affiliates, 65 percent of transaction notional volume involved at least one account of an entity with a U.S. parent.

In addition, we note that a significant majority of North American corporate single-name CDS transactions occur in the interdealer market or between dealers and non-U.S.-person non-dealers, with the remaining (and much smaller) portion of the market consisting of transactions between dealers and U.S.-person non-dealers. Specifically, 79.5 percent of North American corporate single-name CDS transactions involved either two ISDA-recognized dealers or an ISDA-recognized dealer and a non-U.S.-person non-dealer. Approximately 20 percent of such transactions involved an ISDA-recognized dealer and a U.S.-person non-dealer.

[82] Adjustments to these statistics from the proposal reflect additional analysis of TIW data. *Cf.* U.S. Activity Proposing Release 80 FR 27453 (showing slightly different values for 2012 through 2014). For the purposes of this analysis, we assume that same-day cleared transactions reflect inter-dealer activity.

[83] For purposes of this discussion, we have assumed that the registered office location reflects the place of domicile for the fund or account, but we note that this domicile does not necessarily correspond to the location of an entity's sales or trading desk. *See* U.S. Activity Proposing Release, 80 FR 27541 n.44. *See also* note 39, *supra.*

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 2014.



4. Global Regulatory Efforts

In 2009, the G20 Leaders—whose membership includes the United States, 18 other countries, and the European Union (''EU'')—addressed global improvements in the OTC derivatives markets. 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.[84]

Many security-based swap dealers likely will be subject to foreign regulation of their security-based swap activities that are similar to regulations that may apply to them pursuant to Title VII, 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.[85]

Foreign legislative and regulatory efforts have focused on five general areas: Moving OTC derivatives onto organized trading platforms, requiring central clearing of OTC derivatives, requiring post-trade reporting of transaction data for regulatory purposes and public dissemination of anonymized versions of such data, establishing or enhancing capital requirements for non-centrally cleared OTC derivatives transactions, and establishing or enhancing margin and other risk mitigation requirements for non-centrally cleared OTC derivatives transactions. The rules being adopted in this release will affect a person's obligations with respect to the latter three of these requirements, as a person's status as a security-based swap dealer will affect its post-trade reporting obligations under Regulation SBSR,[86] and, as proposed, would subject it to capital, margin, and other risk mitigation requirements under the Title VII dealer framework, such as trade acknowledgement and verification requirements.[87]

Foreign jurisdictions have been actively implementing regulations in connection with each of these three categories of requirements. Regulatory transaction reporting requirements are in force in a number of jurisdictions including the EU, Hong Kong SAR, Japan, Australia, Brazil, Canada, China, India, Indonesia, South Korea, Mexico, Russia, Saudi Arabia, and Singapore; other jurisdictions are in the process of proposing legislation and rules to implement these requirements.[88] In addition, a number of major foreign jurisdictions have initiated the process of implementing margin and other risk mitigation requirements for non-centrally cleared OTC derivatives transactions.[89] Several jurisdictions

[84] *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.*

[85] Several commenters raised concerns about the potential for overlap or conflict of Title VII security-based swap dealer requirements and similar requirements under foreign law. *See* Citadel Letter at 8; Letter from ICI Global, dated July 13, 2015 (''ICI Global Letter''), at 8; SIFMA/FSR Letter at 9; IIB Letter at 4, 6; ISDA Letter at 5, 10.

[86] *See* Regulation SBSR, Rule 901(a)(2)(ii).

[87] *See* 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. 68071 (October 18, 2012), 77 FR 70213 (November 23, 2012) (''Capital, Margin, and Segregation Proposing Release''); Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 63727 (January 14, 2011), 76 FR 3859 (January 21, 2011). The Commission anticipates that it may address the impact, if any, of a person's status as a registered security-based swap dealer on the first two of those requirements (application of the clearing requirement and trade execution requirement) in a subsequent release or releases.

[88] Information regarding ongoing regulatory developments described in this section was primarily obtained from progress reports on implementation of OTC derivatives market reforms published by the Financial Stability Board. These are available at: *http://www.financialstabilityboard.org/list/fsb_publications/index.htm.*

[89] In November 2015, the Financial Stability Board reported that 12 member jurisdictions participating in its tenth progress report on OTC derivatives market reforms had in force a legislative framework or other authority to require exchange of

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.[90]

5. Cross-Market Participation

As noted above, persons registered as security-based swap dealers and major security-based swap participants are likely also to engage in swap activity, which is subject to regulation by the CFTC.[91] This overlap reflects the relationship between single-name CDS contracts, which are security-based swaps, and index CDS contracts, which may be swaps or security-based swaps. A single-name CDS contract covers default events for a single reference entity or reference security. Index CDS contracts and related products make payouts that are contingent on the default of index components and allow participants in these instruments to gain exposure to the credit risk of the basket of reference entities that comprise the index, which is a function of the credit risk of the index components. A default event for a reference entity that is an index component will result in payoffs on both single-name CDS written on the reference entity and index CDS written on indices that contain the reference entity. Because of this relationship between the payoffs of single-name CDS and index CDS products, prices of these products depend upon one another,[92] creating hedging opportunities across these markets.

These hedging opportunities mean that participants that are active in one market are likely to be active in the other. Commission staff analysis of approximately 4,500 TIW accounts that participated in the market for single-name CDS in 2014 revealed that approximately 3,000 of those accounts, or 67 percent, also participated in the market for index CDS. Of the accounts that participated in both markets, data regarding transactions in 2014 suggest that, conditional on an account transacting in notional volume of index CDS in the top third of accounts, the probability of the same account landing in the top third of accounts in terms of single-name CDS notional volume is approximately 64 percent; by contrast, the probability of the same account landing in the bottom third of accounts in terms of single-name CDS notional volume is only 10 percent.[93]

Similarly, since the payoffs of security-based swaps are dependent upon the value of underlying securities, activity in the security-based swap market can be correlated with activity in underlying securities markets. Security-based swaps may be used in order to hedge or speculate on price movements of reference securities or the credit risk of reference securities. For instance, prices of both CDS and corporate bonds are sensitive to the credit risk of underlying reference securities. As a result, trading across markets may sometimes result in information and risk spillovers between these markets, with informational efficiency, pricing, and liquidity in the security-based swap market affecting informational efficiency, pricing, and liquidity in markets for related assets, such as equities and corporate bonds.[94]

B. Economic Considerations

These final rules, together with our previously adopted rules defining ''security-based swap dealer'' and applying that definition in the cross-border context, define the scope of entities that are subject to the Title VII dealer requirements. Although these final rules do not define specific substantive requirements, the scope of the definition will play a central role in determining the overall costs and benefits of particular regulatory requirements, and of the Title VII regulatory framework as a whole.[95] In evaluating the expected benefits and costs of our final rules in this context, we have identified several economic considerations relevant to our analysis that have informed our final rule, in light of the establishment in Title VII of the Dodd-Frank Act of a statutory framework to reduce risk, increase transparency, and promote market integrity within the financial system.[96]

First, as we have previously noted, the security-based swap market is a global market.[97] A significant proportion of single-name CDS transactions on U.S. reference entities is between counterparties that are based in different jurisdictions, and these counterparties may use personnel located in other jurisdictions to perform various functions in connection with these transactions.[98] Moreover, dealers that carry out a global business, as noted above, have significant flexibility in choosing how to structure their business.[99] In determining the scope of the rules specifying which transactions non-U.S. persons must include in their dealer *de minimis* calculations, we are aware both that non-U.S. persons engage in security-based swap dealing activity with other non-U.S. persons in the

margin for non-centrally cleared transactions and had published implementing standards or requirements for consultation or proposal. A further 11 member jurisdictions had a legislative framework or other authority in force or published for consultation or proposal. *See* Financial Stability Board, OTC Derivatives Market Reforms Tenth Progress Report on Implementation (November 2015), available at *http://www.financialstabilityboard.org/wp-content/uploads/OTC-Derivatives-10th-Progress-Report.pdf.*

90 In November 2015, the Financial Stability Board reported that 18 member jurisdictions participating in its tenth progress report on OTC derivatives market reforms had in force standards or requirements covering more than 90 percent of transactions that require enhanced capital charges for non-centrally cleared transactions. A further three member jurisdictions had a legislative framework or other authority in force and had adopted implementing standards or requirements that were not yet in force. An additional three member jurisdictions had a legislative framework or other authority in force or published for consultation or proposal. *See* Financial Stability Board, OTC Derivatives Market Reforms Tenth Progress Report on Implementation (November 2015), available at *http://www.financialstabilityboard.org/wp-content/uploads/OTC-Derivatives-10th-Progress-Report.pdf.*

91 *See* note 75 and accompanying text, *supra. See also* U.S. Activity Proposing Release, 80 FR 27458; SBS Entity Registration Adopting Release, 80 FR 49000.

92 ''Correlation'' typically refers to linear relationships between variables; ''dependence'' captures a broader set of relationships that may be more appropriate for certain swaps and security-based swaps. *See, e.g.,* George Casella and Roger L. Berger, ''Statistical Inference'' (2002), at 171.

93 The Commission recently revised its methodology for estimating cross-market participation of TIW accounts. This has resulted in an increase in the reported number of accounts that participated in both markets relative to previous Commission releases.

94 *See* SBS Entity Registration Adopting Release, 80 FR 49003. Empirical evidence on the direction and significance of the CDS-bond market spillover is mixed. *See also* Massimo Massa & Lei Zhang, CDS and the Liquidity Provision in the Bond Market (INSEAD Working Paper No. 2012/114/FIN, 2012), available at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2164675* (considering whether the presence of CDS improves pricing and liquidity of investment grade bonds in 2001–2009); Sanjiv Ranjan Das, Madhu Kalimipalli & Subhankar Nayak, Did CDS Trading Improve the Market for Corporate Bonds?, 111 J. Fin. Econ. 495 (2014) (considering the effects of CDS trading on the efficiency, pricing error and liquidity of corporate bond markets); Martin Oehmke & Adam Zawadowski, The Anatomy of the CDS Market (Working Paper, 2014), available at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2023108* (suggesting a standardization and liquidity role of CDS markets and documenting cross-market arbitrage links between the CDS market and the bond market); and Ekkehart Boehmer, Sudheer Chava, & Heather Tookes, Related Securities and Equity Market Quality: The Cases of CDS, forthcoming, J. Fin. & Quant. Analysis (2015) (providing evidence that firms with traded CDS contracts on their debt experience significantly lower liquidity and price efficiency in equity markets when these firms are closer to default and in times of high market volatility).

95 *See* Cross-Border Adopting Release, 79 FR 47327 (stating that the registration and regulation of entities as security-based swap dealers and major security-based swap participants would lead to programmatic costs and benefits).

96 *See* Intermediary Definitions Adopting Release, 77 FR 30596.

97 *See* Cross-Border Adopting Release, 79 FR 47282.

98 *See* Section II.A.3, *supra.*

99 *See* Section II.A.2d, *supra.*

United States and that U.S. financial groups may choose to restructure their business to ensure that transactions with non-U.S. persons that involve dealing activity in the United States are booked in non-U.S.-person affiliates.[100] Thus, the scope of our final framework could have a significant effect on the number of persons that ultimately register as security-based swap dealers and the proportion of security-based swap dealing activity carried out in the United States that will ultimately be carried out by such dealers.

Second, the final scope of our rules, and market participants' reactions to our rules (including rules already adopted as part of the Intermediary Definitions Adopting Release, and the Cross-Border Adopting Release) may affect competition between U.S.-person and non-U.S.-person dealers when they engage in security-based swap transactions with non-U.S. persons. In particular, without these rules, competitive disparities might arise between U.S.-person dealers, which would be subject to these rules, and non-U.S.-person dealers, which may not be, even if the non-U.S.-person dealers engage in dealing activity at levels exceeding the relevant *de minimis* thresholds using personnel located in the United States. This disparity in treatment likely would produce disparities in the costs that different types of dealers might bear, with significant effects on the structure and integrity of the security-based swap market.

Under currently existing rules, for example, even if a U.S.-person dealer and a non-U.S.-person dealer both engaged in dealing activity in the United States in connection with transactions involving non-U.S.-person counterparties, the non-U.S.-person dealer would be more likely to be able to engage in this activity without registering as a security-based swap dealer,[101] which would permit it, unlike the U.S.-person dealer, to avoid the costs associated with Title VII dealer requirements, including compliance with registration, books and records, and capital and margin requirements. To the extent that the non-U.S.-person dealer does not incur these costs, it would be likely to be able to offer more competitive pricing to its non-U.S.-person counterparties.

Similarly, a non-U.S. person seeking to trade in a security-based swap on a U.S. reference entity may prefer to enter into the transaction with a non-U.S.-person dealer rather than a U.S.-person 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 incur lower costs in transacting with a non-U.S. person dealer. For example, a non-U.S.-person counterparty may find transacting with the non-U.S.-person dealer that is not required to register as a security-based swap dealer to be more attractive because a transaction with that dealer may not involve a requirement to post collateral consistent with Title VII margin requirements, particularly if it can do so without surrendering the benefits associated with facing personnel located in the United States.

In addition, under currently existing rules, financial groups that use non-U.S. persons to carry out their dealing business with non-U.S.-person counterparties may be able to use profits from that dealing business to subsidize their dealing business with U.S.-person counterparties carried out through a registered security-based swap dealer. This cross-subsidization would allow them to gain further competitive advantage over financial groups whose dealers are U.S. persons, even with respect to transactions with U.S.-person counterparties.

These competitive disparities likely would create an incentive for financial groups (whether based in the United States or abroad) to book security-based swap transactions with non-U.S.-person counterparties in a non-U.S.-person affiliate while continuing to use affiliates or agents that are located in the United States to engage in dealing activity with those counterparties. As discussed further below, market participants may respond in different ways to these incentives, but any such response likely would lead to significant changes in market structure, exacerbating market fragmentation. The final amendments reflect our consideration of the likely competitive effects of the scope of Title VII dealer requirements on participants in the security-based swap market.

Third, as just noted, the scope of our rules may provide incentives for market fragmentation and negatively affect liquidity and pricing in the U.S. market. Subjecting certain transactions but not others to regulatory requirements, including the security-based swap dealer *de minimis* counting requirements, may lead certain dealers to seek to limit dealing activity with certain counterparties, to cease dealing with certain counterparties altogether, or to restructure their dealing business to minimize the volume that it carries out in a firm that is required to register as a security-based swap dealer.[102] One commenter noted that requiring certain transactions but not others to be subject to Title VII requirements may lead dealers to quote less competitive prices to counterparties for transactions that are subject to these requirements,[103] and it appears that some U.S.-based financial groups, in response to similar regulatory reforms, have already restructured their swap business to book their transactions in non-U.S.-person affiliates.[104] Such responses by market participants are likely to fragment security-based swap liquidity into two pools, one for U.S. persons and the other for non-U.S. persons, even if non-U.S.-person dealers continue to engage in security-based swap dealing activity with non-U.S. persons (including other dealers) in the United States. This fragmentation could adversely affect the security-based swap market's ability to efficiently allocate risk among its participants,[105] as discussed further below.[106]

Depending on the final scope of Title VII application, the nature of the fragmentation could have a particularly deleterious effect on pricing and liquidity for U.S. persons seeking to enter into security-based swap transactions. To the extent that dealers seek to carry out transactions with other dealers in affiliates that are not subject

[100] *See* Cross-Border Adopting Release, 79 FR 47285 (noting that ''market participants may shift their behavior'' in response to our cross-border application of Title VII requirements).

[101] We note that, under Exchange Act rule 3a71–3, a non-U.S.-person affiliate of a U.S. person is not required to include such transactions in its dealer *de minimis* threshold calculations if that non-U.S. person's counterparties do not have recourse to a U.S. person under the terms of the security-based swap and the non-U.S. person is not a conduit affiliate. *See* Exchange Act rule 3171–3(b)(1)(ii) and (iii) (applying the *de minimis* exception to cross-border dealing activity of conduit affiliates and non-U.S. persons).

[102] *See* IIB Letter at 2–3; ISDA Letter at 5; SIFMA/FSR Letter at 6. *See* Section V.B, *infra,* for further discussion of potential effects of the final rules on non-U.S. persons' incentives to use personnel located in U.S. branches or offices to arrange, negotiate, or execute security-based swap transactions. *See also* HSBC Letter at 2 (discussing the possibility of moving security-based swap trading relationships with non-U.S. customers from a U.S.-based affiliate to a registered security-based swap dealer affiliate while noting the impracticability of this response).

[103] *See* IIB Letter at 15 (explaining that a dealer may widen its bid-ask spread for security-based swaps that are subject to public dissemination requirements to account for the risk that, due to the requirements the dealer may not be able to hedge the security-based swap before it is publicly disclosed).

[104] *See* Charles Levinson, ''U.S. banks moved billions in trades beyond CFTC's reach,'' Reuters (August 21, 2015), available at: *http://www.reuters.com/article/2015/08/21/usa-banks-swaps-idUSL3N10S57R20150821*.

[105] *See* note 27, *supra* (citing IIB Letter at 2).

[106] *See* Section V.B.2, *infra.*

to Title VII security-based swap dealer requirements, the large interdealer market, which accounts for a large majority of all security-based swap transactions,[107] could shift to non-U.S. dealers that are not required to register as security-based swap dealers under currently existing rules. Such a shift likely would exacerbate the effects of market fragmentation on U.S. market participants, as security-based swap activity would be split into two very different pools: One very large pool of transactions unregulated by Title VII (interdealer trades, carried out primarily by unregistered non-U.S. persons, and transactions between unregistered non-U.S.-person dealers and non-U.S.-person non-dealers) and one much smaller pool limited to transactions between registered dealers (whether U.S. persons or non-U.S. persons) and U.S.-person counterparties.[108] The final amendments reflect our consideration of the relationship between the scope of Title VII dealer requirements and market fragmentation, including related effects on market liquidity and pricing, particularly for U.S. market participants.

Fourth, in addition to creating an incentive for market fragmentation, applying Title VII dealer requirements only to certain transactions carried out in the United States could affect the integrity of the U.S. security-based swap market as well as our ability to monitor the activity of participants in that market. To the extent that subjecting transactions involving dealing activity carried out by personnel located in the United States increases the likelihood that a non-U.S. person must register as a dealer, Title VII dealer recordkeeping requirements may enhance our ability to evaluate dealers' records for evidence of market manipulation or other abusive practices within the United States. For example, such records, when combined with information from other sources available to the Commission,[109] could help reveal situations where a registered security-based swap dealer is engaging in abusive or manipulative conduct with respect to a series of transactions in which it lays off risk from a transaction with a U.S.-person counterparty to a non-U.S.-person via an affiliated non-U.S.-person dealer, using personnel located in a U.S. branch or office. Absent these final amendments, the affiliated non-U.S.-person dealer might not need to register, which would inhibit our ability to evaluate the affiliated non-U.S.-person dealer's records for the offsetting transaction with the non-U.S.-person counterparty, or related transactions, effected by the same personnel located in a U.S. branch or office that effected the transaction with the U.S.-person counterparty. The final amendments thus reflect our consideration of the impact that the scope of Title VII dealer requirements under our final rules may have on our ability to detect abusive and manipulative practices in the security-based swap market.

Finally, the global security-based swap market is highly interconnected and highly concentrated.[110] As we have previously described, most market participants have only a few counterparties, but dealers can have hundreds of counterparties, consisting of both non-dealing market participants (including registered investment companies and private funds) and other dealers.[111] Furthermore, as we have described above, a majority of security-based swap trades are dealer-to-dealer, rather than dealer-to-non-dealer or non-dealer-to-non-dealer, and a large fraction of single-name CDS volume is between counterparties domiciled in different jurisdictions.[112] This interconnectedness facilitates the use of security-based swaps as a tool for sharing financial and commercial risks. The global scale of the security-based swap market allows counterparties to access liquidity across jurisdictional boundaries, providing U.S. market participants with opportunities to share these risks with counterparties around the world.[113]

However, as we have also noted, these opportunities for international risk sharing also represent channels for risk transmission.[114] In other words, the interconnectedness of security-based swap market participants provides paths for both liquidity and risk to flow throughout the system, meaning that it can be difficult to isolate risks to a particular entity or geographic segment. Because dealers facilitate the great majority of security-based swap transactions, with bilateral relationships that extend to potentially thousands of counterparties, liquidity problems or other forms of financial distress that begin in one entity or one corner of the globe can potentially spread throughout the network, with dealers as a central conduit.[115]

As we have previously recognized, a non-U.S.-person dealer affiliated with a U.S. financial group may pose ''reputational risk'' to its U.S. parent, irrespective of the existence of any explicit guarantee from a U.S. person.[116] This risk may affect the U.S. financial system in a number of ways. Specifically, if market participants generally expect a U.S. financial group to provide support to a foreign affiliate engaged in security-based swap dealing activity for reasons other than fulfilling obligations arising from an express guarantee from the U.S. financial group, financial contagion may spread to U.S. financial markets through the U.S. financial group, regardless of whether the U.S. parent financial group decides to support its foreign affiliate. If the U.S. financial group supports its foreign affiliate by bringing the foreign affiliate's liabilities onto its balance sheet, the resulting capital deficiencies on the parent's balance sheet may reduce its creditworthiness and increase the U.S. financial group's risk of default. Alternatively, if the financial group acts contrary to the expectations of market participants by deciding not to support the foreign affiliate, this could be

[107] *See* Section III.A.3, *supra,* for an analysis of the proportion of the security-based swap market that constitutes interdealer transactions. For the purposes of this analysis we classify any security-based swap transaction between two ISDA-recognized dealers as interdealer activity.

[108] Reducing the ability of market participants to find counterparties may increase bid-ask spreads. *See, e.g.,* Darrell Duffie, Nicolae Garleanu and Lasse Heje Pedersen, ''Over-the-Counter Markets'' Econometrica, Vol. 73, No. 6 (2005).

[109] Such information may include records of transactions reported to a swap data repository pursuant to rule 901(a)(2)(ii), which subjects all transactions that include a registered security-based swap dealer on a transaction side to regulatory reporting requirements.

[110] *See* Section II.A.2.a., *supra. See also* Cross-Border Adopting Release, 79 FR 47283.

[111] *See* Cross-Border Adopting Release, 79 FR 47283. Based on an analysis of 2014 transaction data by staff in the Division of Economic and Risk Analysis, the median account associated with market participants recognized by ISDA as dealers had 453 counterparties. The median of all other accounts (*i.e.,* those more likely to belong to non-dealers) was 3 counterparties. *See* Section 0, *supra.*

[112] *See* Section II.A.3, *supra. See also* Cross-Border Adopting Release, 79 FR 47283.

[113] *See* Cross-Border Adopting Release, 79 FR 47283.

[114] *See id.* As discussed in more detail below, several commenters argued that the Commission should not finalize the proposed rules because they encompassed transactions that pose no risk to the United States. *See* notes 159–160 and accompanying text, *infra* (citing IIB Letter at 3, 5; ISDA Letter at 4, 5–6, SIFMA/FSR Letter at 5; and HSBC Letter at 3).

[115] We have previously stated that spillover and contagion risks are important characteristics of the security-based swap market that are important considerations in our rulemaking. *See* Cross-Border Adopting Release, 79 FR 47284. In particular, given the structure of the security-based swap market and the concentration of security-based swap dealing activities among a relatively small number of firms, ''the failure of a single large firm active in the security-based swap market can have consequences beyond the firm itself,'' including that risk may eventually ''spill over into other jurisdictions and even other markets in which security-based swap dealers participate.'' *See id.*

[116] *See* U.S. Activity Proposing Release, 80 FR 27482.

viewed as a negative signal by investors about the U.S. financial group's risk of default. Consequently, even though the U.S. financial group is not exposed to any counterparty credit risk arising from its foreign affiliate's security-based swap transactions, it may still be exposed to reputational risk from its foreign affiliates engaged in security-based swap activity. The final amendments reflect our consideration of the likely effects of the scope of Title VII dealer requirements on the degree of reputational risk posed to U.S. persons by their foreign affiliates.[117]

Another potential channel of the propagation of risk is through liquidity shocks from the failure of one market participant to other participants in the same market.[118] In a highly concentrated market, the failure of a key liquidity provider poses a particularly high risk of propagating this kind of shock 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. As already discussed, the security-based swap market is highly concentrated, with a relatively small number of dealers responsible for most of the activity in the market. Moreover, security-based swap activity carried out in U.S. market centers largely involves security-based swaps on U.S. reference entities,[119] and the overwhelming majority of non-dealer counterparties to these transactions are U.S. persons; similarly, a significant proportion of the dealers active in this market are either U.S. persons or foreign affiliates of U.S. financial groups.[120] In light of these market characteristics, we have considered the potential propagation of such risks through the failure of one or more non-U.S. persons engaged in dealing activity in the United States.[121]

III. Overview of Prior Proposals

The Exchange Act excepts from designation as a ''security-based swap dealer'' an entity that engages in a ''*de minimis''* quantity of security-based swap dealing activity with or on behalf of customers.[122] Under the final rules adopted in the Intermediary Definitions Adopting Release, a person may take advantage of that exception if, in connection with CDS that constitute security-based swaps, the person's dealing activity over the preceding 12 months does not exceed a gross notional amount of $3 billion, subject to a phase-in level of $8 billion.[123] The phase-in level will remain in place until—following a study regarding the definitions of ''security-based swap dealer'' and ''major security-based swap participant''—we either terminate the phase-in period or establish an alternative threshold following rulemaking.[124]

As noted above, we have twice proposed rules to address the application of the security-based swap dealer *de minimis* exception to transactions between two non-U.S. persons on the basis of activity in the United States.[125] In the Cross-Border Proposing Release, we stated that a non-U.S. person engaged in dealing activity through a U.S. branch, office, or affiliate or by a non-U.S. person that otherwise engages in security-based swap dealing activity in the United States, particularly at levels exceeding the relevant *de minimis* thresholds, may raise concerns that Title VII addresses, even if a significant proportion—or all—of its transactions involve non-U.S.-person counterparties.[126] Accordingly, we initially proposed to require any non-U.S. person to include in its *de minimis* calculation any security-based swap transaction connected with its dealing activities that is a ''transaction conducted within the United States.''[127] We proposed to define ''transaction conducted within the United States'' as any ''security-based swap transaction that is solicited, negotiated, executed, or booked within the United States, by or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty to the transaction.''[128] Thus, under this initially proposed definition, a non-U.S. person engaged in dealing activity would have been required to include in its *de minimis* calculation any dealing transaction entered into with another non-U.S. person that was conducted in the United States by either the non-U.S. person engaged in dealing activity or its counterparty or an agent of either the dealer or the counterparty.[129] Given the number of concerns raised by commenters in connection with this element of the Cross-Border Proposing Release, we subsequently determined that final resolution of this issue would benefit from further consideration and public comment.[130] Accordingly, we did not address this issue in our Cross-Border Adopting Release.

In light of comments received on the initial proposal, subsequent regulatory and other developments in the security-based swap market, and further consideration of policy concerns arising from these transactions, we proposed a modified approach in April 2015 that would amend Exchange Act rule 3a71–3 to address the regulatory concerns associated with dealing activity in the United States while mitigating many of the concerns expressed by commenters on the initial proposal. The modified approach did

[117] See Section IV.B.2, *infra* (noting, among other things, that, as the market develops, foreign affiliates that might otherwise avoid Title VII dealer requirements, including margin, may be required to register as security-based swap dealers because they arrange, negotiate, or execute transactions in connection with their dealing activity using personnel located in the United States).

[118] *See* Cross-Border Adopting Release, 79 FR 47284 (noting that ''the failure of a single large firm active in the security-based swap market can have consequences beyond the firm itself'' and that ''[o]ne firm's default may reduce the willingness of dealers to trade with, or extend credit to, both non-dealers and other dealers'').

[119] *See* note 57 and accompanying text, *supra.*

[120] *See* Section II.A.3, *supra.*

[121] For more on liquidity shocks and contagion, see Rodrigo Valdés, ''Emerging Market Contagion: Evidence and Theory'' (1996). *See also* Guillermo Calvo and Enrique Mendoza, ''Contagion, Globalization, and the Volatility of Capital Flows,'' *Capital Flows and the Emerging Economies* (2000).

[122] *See* Exchange Act section 3(a)(71)(D).

[123] *See* Exchange Act rule 3a71–2(a)(1)(i). Lower thresholds are set forth in connection with dealing activity involving other types of security-based swaps. *See* Exchange Act rule 3a71–2(a)(1)(ii).

[124] *See* Intermediary Definitions Adopting Release, 77 FR 30640–41. Exchange Act rule 3a71–2 establishes a phase-in period during which the *de minimis* threshold for CDS will be $8 billion and during which Commission staff will study the security-based swap market as it evolves under the new regulatory framework, resulting in a report that will consider the operation of the ''security-based swap dealer'' and ''major security-based swap participant'' definitions. In that release we explained that, at the end of the phase-in period, we will take into account the report, as well as public comment on the report, in determining whether to terminate the phase-in period or propose any changes to the rule implementing the *de minimis* exception, including any increases or decreases to the $3 billion threshold. *See id.* at 30640.

[125] *See* Cross-Border Proposing Release, 78 FR 30999; U.S. Activity Proposing Release, 80 FR 27444.

[126] *See* Cross-Border Proposing Release, 78 FR 31000–01.

[127] *See* initially proposed Exchange Act rule 3a71–3(b)(1)(ii).

[128] *See* initially proposed Exchange Act rule 3a71–3(a)(5). *See also* Cross-Border Proposing Release, 78 FR 30999–31000.

[129] The initially proposed definition of ''transaction conducted within the United States'' did not include submitting a transaction for clearing in the United States, reporting a transaction to a security-based swap data repository in the United States, or performing collateral management activities (such as exchanging margin) within the United States. *See* Cross-Border Proposing Release, 78 FR 31000.

[130] *See, e.g.,* Cross-Border Adopting Release, 79 FR 47280.

not include the initially proposed defined term ''transaction conducted in the United States'' and would not require a non-U.S. person engaging in dealing activity to consider the location of its non-U.S.-person counterparty or that counterparty's agent in determining whether the transaction needs to be included in its own *de minimis* calculation. Instead, we proposed to require a non-U.S. person to include in its *de minimis* calculation any transaction connected with its security-based swap dealing activity that it enters into with a non-U.S.-person counterparty only when the transaction is arranged, negotiated, or executed by personnel of the non-U.S. person located in a U.S. branch or office, or by personnel of such person's agent located in a U.S. branch or office.[131]

Various statutory and policy concerns underpinned our proposed revisions to the initial approach. We noted in the U.S. Activity Proposing Release that requiring non-U.S. persons to include such transactions in their *de minimis* threshold calculations would help to ensure that all persons that engage in significant relevant dealing activity, including activity engaged in by personnel located in a U.S. branch or office, are required to register as security-based swap dealers and to comply with relevant Title VII requirements applicable to security-based swap dealers.[132] We also explained that subjecting security-based swap activity involving activity in the United States to Title VII, even when a transaction is between two non-U.S. persons, is consistent with Section 30(c) of the Exchange Act and is appropriate under a territorial approach.[133] We also noted that the modified approach would prevent market participants from engaging in significant dealing activity in the United States while avoiding Title VII by booking such transactions in non-U.S. person dealers who are not conduit affiliates and whose obligations under such transactions are not guaranteed by a U.S. person.[134]

[131] *See* proposed Exchange Act rule 3a71–3(b)(1)(iii)(C).

[132] *See* U.S. Activity Proposing Release, 80 FR 27467.

[133] *See id.* at 27464.

[134] *See id.* at 27465. As we have stated elsewhere, the transactions of a guaranteed non-U.S. person exist, at least in part, within the United States, and the economic reality of these transactions is substantially identical to transactions entered into directly by a U.S. person (including through a foreign branch). *See* Regulation SBSR Adopting Release, 80 FR 14651. *See also* Cross-Border Adopting Release, 79 FR 47289–90.

IV. Final Rules

A. Overview

Having carefully considered comments received in response to our proposal as well as the objectives of Title VII dealer regulation and recent regulatory and market developments (including market participants' responses to the implementation of regulatory reforms of the OTC derivatives markets),[135] we are amending Exchange Act rules 3a71–3 and 3a71–5 in a manner generally consistent with the amendments proposed in our U.S. Activity Proposing Release.[136] As discussed in the proposal, Exchange Act rule 3a71–3, as amended, focuses on certain activity carried out, at least in part, by personnel located in the United States in connection with a non-U.S. person's dealing activity, but it does not require a non-U.S. person engaging in dealing activity to consider the location of its non-U.S.-person counterparty or that counterparty's agent in determining whether the transaction needs to be included in its own *de minimis* calculation. Specifically, the amendment to final rule 3a71–3(b) requires a non-U.S. person to include in its *de minimis* calculation any transaction connected with its security-based swap dealing activity that it enters into with a non-U.S.-person counterparty only when the transaction is arranged, negotiated, or executed by that person's personnel who are located in a U.S. branch or office, or by its agent's personnel who are located in a U.S. branch or office.[137] Final Exchange Act rule 3a71–5(c) makes the exception for cleared anonymous transactions unavailable for trades that non-U.S. persons are required to count under proposed Exchange Act rule 3a71–3(b)(1)(iii)(C).[138] The following sections discuss these rules, as well as guidance regarding the application of Exchange Act rule 3a71–3(b)(1)(iii)(C) to specific categories of transactions raised by commenters.

[135] *See* note 164, *infra* (noting our understanding that some U.S.-based financial groups have restructured their swap business to book their transactions in non-U.S. person affiliates).

[136] *See* Exchange Act rule 3a71–3(b)(1)(iii)(C); Exchange Act rule 3a71–5(c).

[137] *See* Exchange Act rule 3a71–3(b)(1)(iii)(C). The final rule does not incorporate a broker-dealer exception as requested by some commenters, but it does except transactions connected with the dealing activity of those international organizations excluded from the definition of U.S. person in Exchange Act rule 3a71–3(a)(4)(iii). *See* Section IV.C.4, *infra*.

[138] *See* Exchange Act rule 3a71–5(c).

B. Statutory Scope and Policy Concerns Arising from Security-Based Swap Dealing Activity in the United States

1. Territorial Application of ''Security-Based Swap Dealer'' Definition

Some commenters have suggested that the modified approach to the *de minimis* exception set forth in our U.S. Activity Proposing Release would impose U.S. regulation on transactions and market participants lacking a sufficient ''nexus'' to the United States or to the U.S. financial system and, consequently, would produce few or no benefits.[139] Several commenters argued that the primary focus of the security-based swap dealer registration regime is on protecting U.S. market participants, and the market as a whole, against risk and that these transactions lack a sufficient ''nexus'' to the United States and to the U.S. financial system because they do not give rise to risk in the United States.[140] One commenter further argued that the proposed rule was inconsistent with the concept of a *de minimis* threshold, stating that, under the Commission's rules, the

[139] *See* ISDA Letter at 4–5 (arguing that the proposed rule would capture firms that ''have no material connection with the United States''); SIFMA/FSR Letter at 5 (arguing that ''[a] non-U.S. entity should not be required to count a security-based swap toward its security-based swap dealer *de minimis* threshold solely on the basis of the conduct of its or its agent's U.S.-located personnel,'' as ''such transactions between non-U.S. persons, where none of the risks of the transactions reside in the United States, do not have a sufficient nexus to the United States to be included in a determination of whether a non-U.S. entity should need to register with the Commission''). We discuss the benefits of the final rule below. *See* Sections IV.B.2 and V.B, *infra*.

[140] *See* SIFMA/FSR Letter at 5; IIB Letter at 5–6 (arguing that the ''Commission's policy interests in regulating the [security-based swap] and its counterparties are much more limited than if one of the parties was a U.S. person, guaranteed affiliate or conduit affiliate,'' as only the sales and trading activity at the inception of the transaction is occurring in the United States and the risks of such transactions ''do not flow back to the U.S. financial system''); HSBC Letter at 3 (arguing that subjecting foreign subsidiaries to entity-level dealer requirements would not provide additional benefits ''since no risk-based nexus would exist between those subsidiaries and the U.S. financial system,'' particularly given that the Commission could use existing recordkeeping requirements to access the books and records relating to transactions involving U.S. activity); ISDA Letter at 5–6 (arguing that the Commission's principal concern in regulating these entities is risk mitigation and that such transactions do not transmit risk into the U.S. financial system). Other commenters, in the context of discussing the Commission's proposed approach to the clearing and trade execution requirements, argued that these types of transactions do pose counterparty credit risk to the U.S. financial system. *See* MFA Letter at 6 (disagreeing with our preliminary view that counterparty credit risk and operational risk of such transactions reside primarily outside the United States); Citadel Letter at 6–7 (discussing the significant risks to the U.S. financial system posed by ''offshore'' transactions).

threshold is ''based on the aggregate notional size of security-based swaps, not the extent of U.S. involvement,'' suggesting, in the commenter's view, that ''the threshold is concerned with risk posed to the entity, not the extent of involvement by the entity.''[141] Accordingly, these commenters argued that imposing security-based swap dealer regulation on non-U.S. persons on the basis of transactions with other non-U.S. persons—even if arranged, negotiated, or executed by personnel located in the United States—is inappropriate.[142]

To the extent that these comments are directed at whether transactions arising from this activity or persons engaged in this activity fall within the scope of Title VII,[143] we reiterate our view that it is consistent with a territorial approach to the application of the Exchange Act to require non-U.S. persons that use personnel located in the United States to arrange, negotiate, or execute a security-based swap to include those transactions in their *de minimis* calculations. In the Cross-Border Adopting Release, we rejected the suggestion that ''the location of risk alone should . . . determine the scope of an appropriate territorial application of every Title VII requirement,'' including the application of the ''security-based swap dealer'' definition.[144] In doing so, we stated that ''neither the statutory definition of 'security-based swap dealer,' our subsequent further definition of the term pursuant to section 712(d) of the Dodd-Frank Act, nor the regulatory requirements applicable to security-based swap dealers focus solely on risk to the U.S. financial system.'' [145] And we have noted that the definition of ''security-based swap dealer'' focuses on a person's activity, not solely on the amount of risk created by that activity.[146] Accordingly, we do not believe that security-based swap dealing activity must create counterparty credit risk in the United States for there to be a ''nexus'' sufficient to warrant security-based swap dealer registration.[147]

As we have previously noted, Exchange Act section 3(a)(71)(A) identifies specific activities that bring a person within the definition of ''security-based swap dealer'': (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.[148] We have further interpreted this definition to apply to persons engaged in indicia of dealing activity, including, among other things, providing liquidity to market professionals, providing advice in connection with security-based swaps, having regular clientele and actively soliciting clients, and using interdealer brokers.[149] Neither the statutory definition of ''security-based swap dealer'' nor our further definition of that term turns primarily on the presence of risk or on the purchase or sale of any security, including a security-based swap.[150] Accordingly, we disagree with the view that the ''*de minimis* threshold is based on the aggregate notional size of security-based swaps'' and that this suggests that ''the *de minimis* threshold is concerned with the risk posed to the entity, not the extent of involvement by the entity.'' [151] The *de minimis* exception relates to the volume of dealing activity and not to specifically risk-related factors, such as the notional volume of positions held by the dealer.[152]

Accordingly, the fact that the counterparty credit risk from a transaction between two non-U.S. persons, which are not conduit affiliates and where neither counterparty has a right of recourse against a U.S. person under the security-based swap, exists largely outside the United States is not determinative under our territorial analysis as to whether a sufficient ''nexus'' exists to require a non-U.S. person to count the transaction toward its *de minimis* threshold. The appropriate analysis, in our view, also considers whether a non-U.S. person in such a transaction is engaged, in the United States, in any of the activities set forth in the statutory definition or in our further definition of ''security-based swap dealer.'' [153] If it is so engaged, it is appropriate under a territorial approach to require the non-U.S. person to include such transactions in its security-based swap dealer *de minimis* threshold calculations and, if those security-based swaps (together with any other security-based swaps it is required to include in its threshold calculations) exceed the *de minimis* threshold, to register as a security-based swap dealer.[154]

As we stated in the U.S. Activity Proposing Release, this analysis applies regardless of whether the non-U.S. person engages in dealing activity (as described in the statutory definition and in our further definition of ''security-

[141] *See* SIFMA/FSR Letter at 6.

[142] *See, e.g., id.* at 5.

[143] *Cf.* ISDA Letter at 6, note 11.

[144] Cross-Border Adopting Release, 79 FR 47287–88.

[145] *Id.* at 47288. We have also stated that security-based swap dealer regulation may be warranted either to promote market stability and transparency in light of the role that these dealers occupy in the security-based swap market or to address concerns raised by the nature of the interactions between such dealers and their counterparties. *See* Intermediary Definitions Adopting Release, 77 FR 30617.

[146] *See* Cross-Border Proposing Release, 78 FR 30988 (noting our view that the statutory provisions suggest that our focus should be not ''solely on the risk these entities pose to the financial markets'' but also on whether regulation is warranted due to the nature of their interactions with counterparties or in order to promote market stability and transparency, given the role these persons play in the security-based swap market). *See* Intermediary Definitions Adopting Release, 77 FR 30612. Indeed, we expressly contrasted this focus of the ''security-based swap dealer'' definition with the focus of the ''major security-based swap participant'' definition, which is focused on ''the market impacts and risks associated with a person's . . . security-based swap positions.'' *Id.* at 30661.

[147] *See* note 140, *supra.*

[148] *See* Exchange Act section 3(a)(71)(A), 15 U.S.C. 78c(a)(71)(A).

[149] *See* Intermediary Definitions Adopting Release, 77 FR 30617–18. As we stated in the Cross-Border Adopting Release, when the statutory text does not describe the relevant activity with specificity or provides for further Commission interpretation of statutory terms or requirements, our territorial analysis may require us to identify through interpretation of the statutory text the specific activity that is relevant under the statute or to incorporate prior interpretations of the relevant statutory text. *See* Cross-Border Adopting Release, 79 FR 47287.

[150] *See* Exchange Act section 3(a)(71)(A), 15 U.S.C. 78c(a)(71)(A); Intermediary Definitions Adopting Release, 77 FR 30617–18.

[151] *See* note 141, *supra* (citing SIFMA/FSR Letter). *Cf.* Intermediary Definitions Adopting Release, 77 FR 30620 (noting the focus of the ''security-based swap dealer'' definition on dealing *activity*).

[152] *See* Exchange Act section 3(a)(71)(D), 15 U.S.C. 78c(a)(71)(D) (providing that the Commission ''shall exempt from designation as a security-based swap dealer an entity that engages in a *de minimis* quantity of security-based swap dealing''); Exchange Act rule 3a71–2 (establishing transaction-based notional thresholds for the security-based swap dealer *de minimis* exception).

[153] *See, e.g.,* Intermediary Definitions Adopting Release, 77 FR 30612 (noting the focus of the ''security-based swap dealer'' definition on dealing *activity*).

[154] *See* Cross-Border Adopting Release, 79 FR 47286–92 (describing the Commission's territorial approach). In light of the foregoing analysis, we believe that the statutory prohibition on application of Title VII requirements to persons that ''transact[] a business in security-based swaps without the jurisdiction of the United States'' has no bearing on the final rule. *See* Exchange Act section 30(c). Under this rule, a non-U.S. person must include a transaction with another non-U.S. person in its dealer *de minimis* threshold calculations only when, in connection with its dealing activity, it arranges, negotiates, or executes a security-based swap using its personnel (or personnel of its agent) located in the United States. *See* Exchange Act rule 3a71–3(b)(1)(iii)(C). The final rule, accordingly, would not impose requirements on non-U.S. persons that are ''transacting a business in security-based swaps without the jurisdiction of the United States'' for purposes of section 30(c).

based swap dealer'') in the United States using its own personnel or using the personnel of an agent acting on its behalf.[155] As described above, persons engaged in security-based swap dealing activity routinely do so both directly and through their agents, including as part of an integrated dealing business. Indeed, our further definition of ''security-based swap dealer'' specifically identifies the use of interdealer brokers as one of several indicia of security-based swap dealing activity, and engaging an interdealer broker as agent or sending a trade to such a broker generally would be dealing activity.[156] To the extent that this activity is directed to a broker in the United States, the non-U.S. person is engaged in dealing activity in the United States.[157] Accordingly, a non-U.S. person that reaches into the United States by engaging an agent (including an interdealer broker) to perform dealing activity on its behalf is itself engaged, at least in part, in dealing activity in the United States. It is therefore consistent with our territorial approach to require the non-U.S. person to include transactions arising out of those activities in its own *de minimis* threshold calculations.[158]

2. Policy Concerns Associated With Security-Based Swap Dealing Activity in the United States

Requiring transactions that, in connection with a non-U.S. person's dealing activity, are arranged, negotiated, or executed by personnel located in the United States to be counted toward the non-U.S. person's security-based swap dealer *de minimis* threshold is also consistent with the policy objectives of Title VII dealer regulation. Some commenters interpreted the primary, or even the sole, goal of Title VII dealer regulation as risk mitigation, generally arguing that no policy rationale warranted requiring non-U.S. persons to count transactions with other non-U.S. persons based on their activity in the United States.[159] One commenter specifically urged us not to adopt the proposed rule, arguing that application of U.S. requirements to these transactions should ''be tailored to address only the specific policy considerations raised by use of U.S. personnel,'' such as certain concerns related to counterparty protection.[160]

We believe that these characterizations of the policy objectives of Title VII are incomplete. Although it is true that mitigating counterparty and operational risks—which we have acknowledged lie primarily outside the United States in these transactions [161]—is an important objective of the Title VII dealer requirements, these 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.[162]

We believe that not requiring non-U.S. persons to count these trades toward their *de minimis* thresholds would significantly impair the effectiveness of the Title VII dealer framework in advancing these objectives. As noted above, financial groups engaged in security-based swap dealing activity may structure their business in many different ways.[163] Many non-U.S. persons engaged in dealing activity in the United States do so through an affiliated or unaffiliated agent in the United States and, under currently existing rules, are not required, absent a guarantee, to include transactions arising from such activity in their dealer *de minimis* calculations if the counterparty is also a non-U.S. person. Some financial groups also use U.S. persons to book such transactions, but even U.S.-based financial groups may opt to book their security-based swap transactions in non-U.S. persons in response to regulation or to competitive disparities between U.S. persons and non-U.S. persons.

Given these dynamics, failure to require non-U.S. persons to count the transactions encompassed by the final rule toward the dealer *de minimis* thresholds, even though doing so is entirely consistent with our territorial approach, would permit financial groups that have a security-based swap dealing business to avoid registering non-U.S. persons that engage in security-based swap dealing activity in the United States. 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.

Subjecting the transactions of certain dealers engaged in dealing activity in the United States, but not others, to the Title VII dealer requirements would undermine each of the policy objectives

[155] *See* U.S. Activity Proposing Release, 80 FR 27465.

[156] *See* Exchange Act rule 3a71–1(a) (defining ''security-based swap dealer''); Intermediary Definitions Adopting Release, 77 FR 30617–18 (providing guidance to ''further clarify the scope of the security-based swap dealer definition'').

[157] More generally, we believe that the routine use by dealers of the structures described in this discussion suggests that a person may engage in dealing activity through an agent in a manner very similar to engaging in such activity through its own branch or office. *Cf.* Exchange Act section 3(a)(71)(A) (defining ''security-based swap dealer''); Intermediary Definitions Adopting Release, 77 FR 30617–18 (further defining ''security-based swap dealer'').

[158] Our treatment of activity performed by an agent on behalf of a non-U.S. person in connection with its dealing activity does not apply Title VII to persons that are ''transact[ing] a business in security-based swaps without the jurisdiction of the United States,'' within the meaning of section 30(c) of the Exchange Act. *See* note 154, *supra*. An approach that treated a non-U.S. person dealer that used an agent, whether affiliated or unaffiliated, in the United States to carry out some or all of its dealing business with non-U.S. persons as transacting a business in security-based swaps without jurisdiction of the United States, would, in our view, reflect an understanding of what it means to conduct a security-based swap business within the jurisdiction of the United States that is divorced from the definition of ''security-based swap dealer,'' from Title VII's statutory objectives, and from the various structures that non-U.S. persons use to engage in security-based swap dealing activity. But in any event we also believe that this final rule is necessary or appropriate as a prophylactic measure to help prevent the evasion of the provision of the Exchange Act that were added to the Dodd-Frank Act, and thus would help prevent the relevant purposes of the Dodd-Frank Act from being undermined. *See* Cross-Border Adopting Release, 79 FR 47291–92 (interpreting anti-evasion provisions of Exchange Act section 30(c)). Without this rule, non-U.S. persons could simply carry on a dealing business within the United States with other non-U.S. persons through agents and remain outside of the application of the dealer requirements of Title VII, as described more fully in the following sections.

[159] *See* SIFMA/FSR Letter at 5 (''[S]uch transactions between non-U.S. persons . . . do not have a sufficient nexus to the United States to be included in a determination of whether a non-U.S. entity should need to register with the Commission.''); IIB Letter at 5 (arguing that the Commission's policy interests in such transactions are more limited than in transactions involving a U.S. person and that ''[i]t is not necessary for one of the parties to register with the Commission as an SBSD for the Commission to address these more limited policy objectives.''); ISDA Letter at 5 (''In the absence of risks to the U.S. financial system and U.S. counterparties, the Commission has not identified *any benefit* associated with regulating SBS transactions between non-U.S. persons.'') (emphasis added). Several commenters argued that the location of personnel involved in a transaction on behalf of a non-U.S.-person dealer is not particularly relevant to the policy considerations addressed by security-based swap dealer registration and accordingly should not ''form the sole basis for requiring'' firms to register as security-based swap dealers and to comply with the Title VII rules. *See, e.g.,* ISDA Letter at 4.

[160] *See* IIB Letter at 3.

[161] *See* U.S. Activity Proposing Release, 80 FR 27481.

[162] *See* note 145, *supra*. These policy objectives reflect the goals of Title VII of the Dodd-Frank Act, which established a statutory framework to reduce risk, increase transparency, and promote market integrity within the financial system. *See* Intermediary Definitions Adopting Release, 77 FR 30596.

[163] *See* Sections II.A.2.d and II.B, *supra*.

described above. Under currently existing rules, a significant proportion of activity in the security-based swap market that is carried out within the United States—particularly as financial groups respond to the competitive pressures discussed in more detail below—likely would involve counterparties that are not subject to our regulations or oversight. Dealers accounting for significant volumes of security-based swap dealing activity in the United States—and together potentially accounting for a significant majority of all security-based swap activity in the United States—would not be subject to Title VII recordkeeping and reporting requirements, which would significantly impede our ability to monitor the market for manipulative and abusive conduct on the part of dealers or other market participants. Similarly, these dealers would not be subject to the Title VII business conduct requirements with respect to any of their transactions, which could significantly impair market integrity or raise other concerns, as counterparties seeking to enter into transactions with dealers through those dealers' personnel located in the United States would not receive the full range of disclosures and other protections provided by Title VII. And these firms would not be subject to Title VII capital, margin, or segregation requirements. These requirements are intended to play a key role in mitigating the potential for financial contagion to spread to participants in the U.S. security-based swap market and to the U.S. financial system more generally by mitigating the risk of firm failure.

Subjecting only a limited subset of transactions involving activity in the United States to Title VII dealer requirements would also likely produce competitive disparities and exacerbate market fragmentation, which would not only further undermine the policy objectives just described but also create potentially significant market distortions. Competitive disparities would arise as financial groups that use non-U.S.-person dealers to carry out their dealing business in the United States find themselves able to 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). These dealers likely would incur fewer costs related to their dealing activity in the United States than U.S.-person dealers transacting with the same counterparties, and non-U.S. person counterparties likely would also find that they 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. U.S.-person dealers would be at a further disadvantage as financial groups that carry out a significant proportion of their security-based swap dealing activity in the United States through non-registered dealers cross-subsidize the dealing activity of their affiliated registered security-based swap dealers that engage in dealing activity with U.S.-person counterparties, permitting financial groups that have shifted a significant proportion of their dealing activity to non-U.S.-person dealers to offer even U.S.-person counterparties better pricing than financial groups that have not made this shift are able to provide.

These competitive pressures would provide a strong incentive for financial groups to book transactions with non-U.S. person counterparties (including with other dealers) in non-U.S.-person affiliates of those financial groups.[164] Eventually, both U.S. and foreign financial groups may restructure their business in a way that would permit them to do the vast majority of their security-based swap dealing activity—including a significant majority of that activity that they continue to carry out using personnel located in the United States—outside the Title VII framework.

This potential response to competitive disparities demonstrates the ''nexus'' between the regulatory concerns addressed by the Title VII security-based swap dealer regulatory framework and our final rule. As already noted, the security-based swap market is a highly concentrated market in which dealers play a central role.[165] Absent the amendment to rule 3a71–3(b), restructuring could lead to a market where the largest dealers representing a significant majority of security-based swap activity in the United States would not be required to register as security-based swap dealers or comply with Title VII dealer requirements because they would limit their transactions to other non-U.S.-person dealers (some affiliated with U.S.-based financial groups) and non-U.S. persons that are not dealers. In other words, the commenters' suggested approach potentially would permit hundreds of billions of dollars in annual notional transaction activity (including most or all of the interdealer business in security-based swaps with U.S. underliers), representing two-thirds or more of all security-based swap transactions that currently involve U.S. counterparties or U.S. activity, to be carried out, at least in part, within the United States without being subject to Title VII dealer regulation, much as if Title VII had never been enacted.[166] Thus, while we acknowledge the potential for this rule to increase the number of security-based swap dealers from the number that would be required to register under currently existing rules,[167] we believe that it will mitigate these competitive disparities and help ensure the ability of the Title VII dealer requirements to advance the regulatory objectives described above.

We further expect that the rule will be essential to reducing the likelihood of significant market fragmentation that would impair the liquidity available to, and increase costs for, U.S. market participants. As we have noted above, if a majority of security-based swap dealing activity in the United States, including most or all interdealer activity in the United States, is carried out by non-U.S. persons that are not subject to Title VII dealer regulation, the market is likely to fragment into two pools. The larger pool likely would consist of transactions that are carried out by unregistered non-U.S.-person dealers with non-U.S.-person counterparties, including the largest dealers in the security-based swap market, while the smaller pool likely would be limited to U.S.-person counterparties and registered dealers that do business exclusively with those U.S.-person counterparties (and that may or may not themselves be U.S. persons). In other words, absent these rules, U.S. market participants likely would find

[164] *See* Section II.B, *supra* (discussing relationship between the scope of Title VII regulations and likely competitive disparities between different types of dealers). *See also* Charles Levinson, ''U.S. banks moved billions in trades beyond CFTC's reach,'' Reuters (August 21, 2015), available at: *http://www.reuters.com/article/2015/08/21/usa-banks-swaps-idUSL3N10S57R20150821.*

[165] *See* Section II.B, *supra.*

[166] *See* Section II.A.3, *supra.* For this reason, we do not agree with the commenters that suggested that we should not require a firm to register as a security-based swap dealer solely on the basis that it has transactions with non-U.S. persons arising out of dealing activity in the United States that exceed the dealer *de minimis* threshold. *See* ISDA Letter at 4; SIFMA/FSR Letter at 5; IIB Letter at 4–5. The overwhelming majority of transactions captured by this rule are likely to be transactions carried out by non-U.S. persons whose dealing activity likely exceeds the *de minimis* threshold by at least an order of magnitude.

[167] The available data and analysis suggest that all entities that will exceed the *de minimis* threshold for credit default swaps under Exchange Act rule 3a71–3(b), as amended by this release, will already exceed the threshold by virtue of the transactions they are required to count under Exchange Act rule 3a71–3(b) as adopted in June 2014. However, as we describe more fully below, we acknowledge the potential for a change in the number of registrants based on a number of factors. *See* Section V.B, *infra.*

themselves confined to a shallower liquidity pool with worse pricing than would be available to non-U.S. persons, even though those non-U.S. persons likely would themselves be using personnel, or facing dealers using personnel, located in the United States to arrange, negotiate, or execute similar transactions.

Finally, as we have noted, a significant proportion of the dealing activity that is likely to be captured by this rule is actually carried out by foreign affiliates of U.S. financial groups.[168] Given the significant volumes arising from the U.S. dealing activity of such foreign affiliates and the potential reputational effect that an affiliate's failure can have on other affiliates in the same corporate group, this activity may pose a risk of contagion to the U.S. financial markets, as we have already discussed above.[169] We previously acknowledged these concerns in explaining why we were not proposing to impose the clearing requirement on these transactions in the U.S. Activity Proposing Release, noting our view that other regulatory provisions, including Title VII margin requirements, were better suited to address the risk of spillovers and contagion arising from these affiliate relationships.[170] But it is important to note that, as the market develops, many of those foreign affiliates may be required to register as security-based swap dealers and to comply with the Title VII margin requirements only because they arrange, negotiate, or execute transactions in connection with their dealing activity using personnel located in the United States.[171] The final rule ensures that these affiliates, to the extent that they are engaged in such activity at levels above the relevant dealer *de minimis* threshold, are in fact required to register and comply with these requirements, which should mitigate the risks described above.[172]

Subjecting non-U.S. persons that engage in security-based swap dealing activity in the United States [173] 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.[174] The amendments being adopted today should also, in a manner consistent with our territorial approach, reduce gaps in the application of these types of requirements to global firms that are engaged in security-based swap dealing activity.[175]

We note that one commenter suggested that our amendments should exclude dealing activity by a non-U.S. person that ''is part of or supports a business that is primarily based outside the United States.'' [176] However, we do not believe that the fact that dealing activity is part of or supports a business primarily based outside the United States is relevant to the concerns described above regarding regulatory effectiveness, competitive disparities, market fragmentation, or contagion. Non-U.S.-person dealers, whose business may be characterized as ''primarily based outside the United States,'' account for a significant volume of transactions in North American single-name CDS and may be expected to raise these concerns, even when ''the bilateral, executory credit risk'' in the transaction is borne by two non-U.S. persons.[177]

3. Existing Regulatory Frameworks and Security-Based Swap Dealer Regulation

Several commenters suggested that we need not rely on Title VII dealer regulation at all to address regulatory concerns arising from dealing activity carried out by non-U.S. persons using personnel located in the United States.[178] According to these commenters, the existing U.S. and foreign requirements (including broker-dealer regulation, and anti-fraud and anti-manipulation provisions) provide us with the tools needed to address what, in their view, are the primary regulatory concerns raised by this dealing activity, and using these tools would ''essentially sever[ ] the nexus between the dealer counterparty and the U.S. market,'' [179] eliminating the need to include the transaction in a firm's dealer *de minimis* threshold calculations.[180]

Because they view the concerns potentially raised by this activity as relating primarily to counterparty protection concerns and because registered broker-dealers are already

[168] *See* Section II.A.3, *supra.*

[169] *See* Section II.B, *supra.*

[170] *See* U.S. Activity Proposing Release, 80 FR 27482. *See also* note 115, *supra* (noting the importance of these issues in our consideration of rules for the security-based swap market).

[171] *See* U.S. Activity Proposing Release, 80 FR 27482. This is particularly likely if most or all of the interdealer activity is carried out by non-U.S. persons using personnel located in the United States.

[172] For these reasons, we do not agree with those commenters that suggested that our proposed approach was inconsistent with our determination not to propose to subject transactions to the mandatory clearing requirement solely on the basis of U.S. activity. *See* SIFMA/FSR Letter at 5–6; IIB Letter at 13–14. *See also* Citadel Letter at 6–7 (arguing that the Commission's assertion that the risks of transactions involving U.S. activity reside primarily offshore is inconsistent with other Commission rulemakings, namely the Volcker Rule, and the statutory interpretation adopted by the CFTC).

[173] *See* Section IV.B.1, *supra* (describing territorial application of the dealer definition); Cross-Border Adopting Release, 79 FR 47287–88 (same).

[174] *See* Section II.B, *supra* (discussing the potential that a liquidity shock resulting from the failure of a non-U.S.-person dealer engaged in dealing activity in the United States might propagate risks to, and adversely affect the stability of, U.S. persons also active in those market centers and to the U.S. financial system more broadly). *See also* Capital, Margin, and Segregation Proposing Release, 77 FR 70222 (noting that the ''failure of a stand-alone SBSD could have a broader adverse impact on a larger number of market participants, including customers and counterparties'' and that the proposed capital requirements ''are meant to account for this potential broader impact on market participants''); *id.* at 70304 (describing the primary benefit of the proposed capital and margin requirements as reducing the probability of the failure of a security-based swap dealer, noting that such a default ''could have adverse spillover or contagion effects that could create instability for the financial markets more generally'').

[175] Certain other Title VII dealer requirements may similarly help to mitigate these types of risks. For example, the risk management provision requires a security-based swap dealer to have systems in place to manage its exposure to risks arising from its security-based swap dealing activity. *See* Exchange Act section 15F(j)(2). *See also* Capital, Margin, and Segregation Proposing Release, 77 FR 70213. In that release, the Commission proposed to (1) amend Rule 15c3–1 by adding a new paragraph (a)(10)(ii); (2) add new Rule 18a–1(g) and; (3) add new Rule 18a–2(c) which, taken together, generally would require each nonbank security-based swap dealer and major security-based swap participant to comply with existing Rule 15c3–4 (except for certain specified provisions of that rule), as if it were an OTC derivatives dealer. Rule 15c3–4 currently requires each person subject to the rule to ''establish, document, and maintain a system of internal risk management controls to assist it in managing the risks associated with its business activities, including market, credit, leverage, liquidity, legal, and operational risks.'' 17 CFR 240.15c3–4.

[176] ISDA Letter at 3.

[177] *See* Section II.B, *supra. Cf.* IIB Letter at 8 (stating that the Commission's rationale for taking an approach different from broker-dealer regulation to regulate persons engaged in security-based swap activity does not hold where, among other things, ''the bilateral, executory credit risk inherent in [security-based swaps]'' is not borne by a U.S. counterparty).

[178] *See, e.g.,* IIB Letter at 5, 8; ISDA Letter at 8; SIFMA/FSR Letter at 6; HSBC Letter at 2–3.

[179] SIFMA/FSR Letter at 7–8.

[180] *See, e.g.,* IIB Letter at 4, 5, 6, 8; ISDA Letter at 8–9 (arguing that the Commission could reasonably limit the impact of the proposal on market participants by ''leveraging the existing components of the SEC's regulatory program,'' specifically identifying the Commission's existing regime that applies to broker-dealers and pointing out that cleared transactions are subject to regulations in other jurisdictions). One commenter argued that ''[t]o the extent the Commission is concerned about conduct of non-registered dealers, it has more targeted tools at its disposal, including existing antifraud and anti-manipulation provisions and broker-dealer regulatory obligations applicable to registered agents.'' SIFMA/FSR Letter at 6.

subject to customer protection requirements, these commenters argued that adding security-based swap dealer requirements would simply duplicate protections already available under existing law or impose requirements that address concerns (such as counterparty credit risk) that arise only outside the United States.[181] Because the Exchange Act defines security-based swaps as securities,[182] they asserted that an agent acting on behalf of a non-U.S. person that is engaged in security-based swap dealing activity generally would be required to register as a broker [183] and could be required to comply with relevant Exchange Act and FINRA requirements with respect to the security-based swap transactions that it intermediates.[184] Some commenters argued that sales practice and recordkeeping rules applicable to registered U.S. security-based swap dealers and broker-dealers that intermediate these transactions would adequately address the key policy interests that underlie the requirement to count U.S. activity towards the *de minimis* thresholds.[185] Another commenter suggested that this approach would be consistent with our historical approach to cross-border issues in cash markets, which provides an exemption from registration for foreign broker-dealers that use a registered broker-dealer to intermediate transactions on their behalf.[186] One commenter argued that such an approach would help ensure consistency in rules applicable to cash and derivatives markets, ''reduce the incentives for regulatory arbitrage,'' and help mitigate compliance costs that would arise from ''applying different registration standards to activity in economically comparable instruments.'' [187]

We recognize that some parallels exist between the Title VII dealer framework and the broker-dealer regime; we also recognize that there is at least a possibility of duplication between some of the requirements that would apply to the non-U.S.-person dealer's security-based swap transactions if it is required to register as a security-based swap dealer, the requirements that likely would apply to the registered broker-dealer whose personnel arrange, negotiate, or execute the relevant security-based swap transactions, and some requirements that may apply to the foreign security-based swap dealer under foreign law. However, as we discussed at some length in the U.S. Activity Proposing Release in response to similar comments, we do not believe it appropriate to except non-U.S.-person dealers from this requirement merely because some transactions of some non-U.S.-person dealers could be subject to broker-dealer or other requirements that could duplicate some of the security-based swap dealer requirements.[188]

As we noted in that release, this type of approach has two significant weaknesses. First, the definition of ''broker'' includes a number of exceptions for banks, including U.S. branches of foreign banks, that are engaged in certain activities, and these exceptions may be used by non-U.S.-person dealers to engage in market-facing activity in the United States in connection with their dealing activity in security-based swaps.[189] Second, broker-dealer regulation of the agent operating in the United States on behalf of the non-U.S.-person dealer would not address all of the concerns raised by non-U.S. persons engaged in this activity, as described above.[190]

Regulation of the agent, whether as a broker-dealer or as a security-based swap dealer, also does

[181] *See, e.g.,* IIB Letter at 6, 17. Commenters argued that permitting the personnel of non-U.S.-person dealers, or their agents, located in the United States to rely on existing regulatory requirements would be more efficient as these personnel could comply with a uniform set of requirements with respect to all of their business, whether in securities or in security-based swap transactions, on their own account or in their capacity as an intermediary for a non-U.S. person. *See* ISDA Letter at 9 (citing anti-fraud provisions of Securities Act section 17(a) and the fraud prohibitions in Rule 10b–5); IIB Letter at 6, 8, 17 (stating that broker-dealer and FINRA rules, including sales practice, books and records, and examination and inspection requirements, will apply to broker-dealers arranging, negotiating, and executing security-based swaps on behalf of non-U.S.-person dealers and arguing that applying only broker-dealer rules would avoid unnecessary duplication).

[182] *See also* U.S. Activity Proposing Release, 80 FR 27470 n.198 (noting that Title VII of the Dodd-Frank Act amended the Exchange Act definition of ''security'' to encompass security-based swaps); Exchange Act section 3(a)(10), 15 U.S.C. 78c(a)(10) (defining ''security'') as revised by section 761(a)(2) of the Dodd-Frank Act.

[183] *See* Exchange Act section 3(a)(4) (defining ''broker'').

[184] *See, e.g.,* note 181, *supra* (citing IIB Letter).

We have granted temporary exemptive relief from compliance with certain provisions of the Exchange Act in connection with the Dodd-Frank Act's amendment of the definition of ''security'' in order generally to maintain the *status quo* during the implementation process for the Dodd-Frank Act. *See* Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Pending Revisions of the Definition of ''Security'' to Encompass Security-Based Swaps, Exchange Act Release No. 64795 (July 1, 2011), 76 FR 39927 (July 7, 2011) (''Exchange Act Exemptive Order''). Among other things, this relief granted temporary exemptions specific to security-based swap activities by registered brokers and dealers. *See id.* at 39–44. In February 2014, we extended the expiration dates (1) for exemptions that are generally not directly related to specific security-based swap rulemakings until the earlier of such time that we issue an order or rule determining whether any continuing exemptive relief is appropriate for security-based swap activities with respect to any of the Exchange Act provisions or until three years following the effective date of that order; and (2) for exemptions that are directly related to specific security-based swap rulemakings, until the compliance date for the relevant security-based swap rulemaking. *See* Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with the Revision of the Definition of ''Security'' to Encompass Security-Based Swaps, and Request for Comment, Exchange Act Release No. 71485 (February 5, 2014), 79 FR 7731 (February 10, 2014).

FINRA also adopted a rule, FINRA Rule 0180 (Application of Rules to Security-Based Swaps), which temporarily limits the application of certain FINRA rules with respect to security-based swaps. On January 4, 2016, FINRA filed a proposed rule change, which was effective upon receipt by the Commission, extending the expiration date of FINRA Rule 0180 to February 11, 2017. See Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Extend the Expiration Date of FINRA Rule 0180 (Application of Rules to Security-Based Swaps), Exchange Act Release No.76850 (January 7, 2016).

[185] *See* HSBC Letter at 2–3 (stating that relevant U.S. personnel would already be subject to U.S. security-based swap dealer or broker-dealer regulation, ''including extensive sales practice and recordkeeping rules'' and suggesting that the Commission could require certain non-U.S. person subsidiaries to provide access to books and records in a manner similar to Rule 15a-6(a)(3) applicable to foreign broker-dealers); ISDA Letter at 3 (requesting that, if the Commission adopts the proposed U.S. activity test, it minimize the impact by relying on certain already existing requirements on registered broker-dealers, such as recordkeeping); IIB Letter at 7. *See also* ISDA Letter at 6 (stating that the proposal would regulate these transactions ''solely on the basis of some *de minimis* level of U.S. nexus during the initial stage of the transaction''); *id.* at 9 (describing how existing rules would address regulatory concerns).

[186] *See* ISDA Letter at 6, 8 (arguing that ''the Commission already possesses a range of regulatory tools (such as books and records requirements and direct regulation of U.S.-based intermediaries) that it can use to satisfy its important regulatory interests in protecting against issues such as fraud and manipulation'').

[187] IIB Letter at 7. This commenter stated that such an approach ''also would be consistent with Congress' decision to define [security-based swaps] as a type of security.'' *See id.* To the extent that a firm uses a U.S. person to intermediate a security-based swap transaction, that U.S. person may be required to register as a broker and comply with relevant broker requirements, but nothing in the statute suggests that the regulation of the broker under the Exchange Act affects the Title VII obligations of the non-U.S.-person dealer that uses the U.S. broker—perhaps as part of an integrated dealing business—to engage in dealing activity within the United States under the comprehensive Title VII regulatory framework for security-based swap dealers.

[188] *See* U.S. Activity Proposing Release, 80 FR 27470–71.

[189] *Compare* Exchange Act section 3(a)(71) (defining ''security-based swap dealer'' with no exceptions for banks or banking activities) *with* Exchange Act section 3(a)(4)(B) (creating exception from broker definition for banks engaged in certain activities) *and* Exchange Act section 3(a)(5)(C) (creating exception from dealer definition for banks engaged in certain activities).

[190] *See* U.S. Activity Proposing Release, 80 FR 27466–67; Section IV.B.2, *supra* (describing regulatory concerns raised by security-based swap dealing activity, including risk, market integrity and transparency, and counterparty protection).

Accordingly, while we recognized that the statutory framework provides for the regulation of brokers that intermediate security-based swap transactions,[191] we preliminarily took the position that this provision neither warrants nor compels the adoption of an exception from the Title VII regime governing security-based swap dealers.[192]

In response to our preliminary determination, several commenters suggested that, to the extent that the existing framework (including the broker-dealer regulatory regime) does not fully address our concerns, we could adopt an exception to the counting requirement subject to certain conditions that would help ensure that the non-U.S. person engaged in dealing activity is subject to requirements, whether under domestic or foreign law, that are similar to those imposed on security-based swap dealers by Title VII dealer requirements.[193] For example, one commenter suggested that the non-U.S.-person dealer not be required to count any transaction entered into in a dealing capacity if the U.S. personnel are (a) personnel of a registered broker-dealer; or (b) personnel of a U.S. bank or U.S. branch of a foreign bank that, in connection with the arranging, negotiating, or executing activity, (i) complies with external business conduct requirements, (ii) maintains related books and records, and (iii) provides the Commission with access to such books and records and testimony of the relevant U.S. personnel.[194]

Another commenter suggested that we except transactions from the requirement that they be counted toward a non-U.S.-person dealer's *de minimis* threshold if the non-U.S.-person dealer is ''(i) [ ] an affiliate of the U.S.-located registered broker-dealer, (ii) [ ] registered as a dealer in a local jurisdiction recognized by the Commission as comparable, and/or (iii) [ ] located in a Basel-compliant jurisdiction and subject to such capital requirements under its local regime.'' [195] In the commenters' view, this type of alternative approach would leverage certain additional elements of domestic and foreign law, avoiding the costs of registering foreign affiliates and complying with potentially duplicative requirements, while achieving similar regulatory objectives.[196]

In offering these alternative approaches, commenters attempted to encompass all structures that non-U.S.-person dealers use to engage in dealing activity in the United States with non-U.S. counterparties and address the full range of regulatory concerns raised by that activity. But instead of a uniform set of comprehensive requirements using the framework that Congress established in Title VII, they urged us to develop an alternative approach that would cobble together existing foreign and domestic regulations in an attempt to replicate—and, as we discuss below, effectively replace—the statutory framework established by Congress by using a combination of pre-Dodd Frank Act regulatory authority, anti-fraud and anti-manipulation authority, anti-evasion authority, and certain foreign requirements. After careful consideration of these alternatives, we believe that such an approach would undermine the policy objectives advanced by Title VII that we describe above.[197]

As an initial matter, we believe that the approach suggested by commenters is inconsistent with the comprehensive, uniform statutory framework established by Congress for the regulation of security-based swap dealers in Title VII. The statutory definition of ''security-based swap dealer'' and the consequent regulatory requirements that apply to such persons apply to any person that engages in relevant activity above the dealer *de minimis* thresholds. The comprehensive scope of this definition and of the related requirements differs from the broker-dealer framework under the Exchange Act. Most significantly, as already discussed, the broker-dealer framework does not apply to banks engaged in certain activities, which may include a significant proportion of security-based swap dealing activity. Title VII, on the other hand, provides that both banks and non-banks—whether engaged in dealing activity with other dealers or with non-dealers—are subject to the same comprehensive regulatory framework, suggesting that the Title VII security-based swap dealer framework is designed to establish a uniform regulatory regime for all persons engaged in security-based swap dealing activity at levels above the *de minimis* threshold, regardless of the business structure that they use to carry out their business.

Commenters argued that precedent for an approach that provides an exception for trades intermediated by a registered broker-dealer exists in the exemption available for foreign broker-dealers under Exchange Act rule 15a–6.[198] However, this comparison is inapposite. First, the rule 15a–6(a)(3) exemption that commenters would have us follow [199] permits a foreign broker-dealer to effect transactions in the United States without being required to register only if the intermediating broker under rule 15a–6 is itself a registered broker-dealer. In other words, rule 15a–6(a)(3) exempts the foreign dealer only if its U.S. intermediary is subject to the same regulatory regime that otherwise would apply to the foreign broker-dealer absent the exemption. The commenters, on the other hand, urged us to permit a non-U.S.-person dealer engaged in security-based swap dealing activity in the United States to substitute broker regulation (subject to certain conditions, including compliance with certain foreign requirements) of the U.S. intermediary for comprehensive Title VII security-based swap dealer regulation of the non-U.S. person engaged in security-based swap dealing activity.

Second, an exception of this type likely would effectively supplant Title VII dealer regulation for a majority of dealing activity carried out in the United States, replacing it with a less effective alternative cobbled together from other domestic and foreign requirements. As described above, much

nothing to address concerns about the potential spillover risk or contagion from the activity of non-U.S.-person dealers—including affiliates of U.S.-based financial groups—that are engaged in potentially significant volumes of security-based swap activity in the United States. *See* Section IV.B.2, *supra.*

[191] *See* U.S. Activity Proposing Release, 80 FR 27470 n.198 (noting that Title VII of the Dodd-Frank Act amended the Exchange Act definition of ''security'' to encompass security-based swaps); Exchange Act section 3(a)(10), 15 U.S.C. 78c(a)(10) (defining ''security''), revised by section 761(a)(2) of the Dodd-Frank Act.

[192] *See* U.S. Activity Proposing Release, 80 FR 27470–471.

[193] *See* IIB Letter at 8–10; SIFMA/FSR Letter at 8; ISDA Letter at 9–10.

[194] *See* IIB Letter at 8–10. The commenter suggested that the Commission could use its anti-evasion authority to require access to books and records of the non-U.S.-person dealer and consent to service of process and that it could ensure adequate capital regulation of the non-U.S.-person dealer by requiring the non-U.S.-person dealer to count these transactions toward the *de minimis* exception if it is not supervised by a home country prudential supervisor that is a member of the Basel Committee or located in a G20 jurisdiction. *See id.* at 9. *See also* ISDA Letter at 8 (stating that such an approach would be consistent with Exchange Act rule 15a-6, which provides an exemption from broker-dealer registration on the condition that, among other things, the foreign broker or dealer maintains books and records and makes them available to the Commission upon request).

[195] *See* SIFMA/FSR Letter at 8. *See also* IIB Letter at 9 (suggesting that any exception could be conditioned on the non-U.S. person being supervised by a home country prudential supervisor that is either a member of the Basel Committee or located in a G–20 jurisdiction).

[196] *See* IIB Letter at 8–10; SIFMA/FSR Letter at 7–8.

[197] *See* Section IV.B.2, *supra.*

[198] *See* IIB Letter at 7–8; ISDA Letter at 8–9; HSBC Letter at 3, note 3.

[199] *See* IIB Letter at 7–8; ISDA Letter at 8–9; HSBC Letter at 3, note 3.

of the dealing activity carried out in the United States is currently booked in non-U.S. persons, and the absence of a U.S. activity trigger for *de minimis* threshold calculations would create a strong incentive to move booking for all transactions with non-U.S. persons—including, eventually, potentially all dealer-to-dealer transactions—to booking entities that are themselves non-U.S. persons.[200] Doing so would permit all of this activity—potentially a significant majority of security-based swap activity in the United States—to be regulated under an alternative to Title VII. Thus, whereas the exemption under Exchange Act rule 15a–6 permits a foreign broker-dealer to effect transactions in the United States without being required to register if the intermediating broker is subject to the same requirements that would apply to the foreign broker-dealer absent the exemption, the commenters' alternative would potentially enable most security-based swap dealing activity in the United States to be regulated under an entirely different regime from the comprehensive dealer regulatory framework established by Congress.

One commenter argued that permitting personnel located in the United States to comply with the requirements that apply to registered broker-dealers would increase efficiency because such personnel would be subject to a single set of regulatory compliance obligations with respect to both their underlying securities transactions and derivatives transactions.[201] Another commenter argued that our ''generally favorable view of substituted compliance'' suggests that we should be willing to refrain from adopting these amendments on the basis that existing Exchange Act and FINRA requirements ''already secure the regulatory aims sought to be provided by the SBS dealer regime.'' [202] However, banks engaged in certain activities, including U.S. branches of foreign banks, are, as noted above, excepted from the definition of ''broker'' and would not benefit from the efficiencies described by commenters, whether they are required to register as security-based swap dealers (because the exemption is not available to them) or required to comply with broker-dealer requirements as a condition of an exception, as suggested by one commenter.[203] In addition, while permitting reliance on broker-dealer requirements for certain non-U.S.-person dealers may provide intra-firm efficiencies, it is also likely to create unnecessary competitive disparities between non-U.S.-person dealers that are eligible for the exception, on one hand, and U.S. dealers and other non-U.S.-person dealers that are not eligible.[204] And to the extent that the commenters' concerns relate to the difficulties in persuading non-U.S.-person counterparties to make representations and accept disclosures pursuant to business conduct requirements as proposed,[205] reliance on broker-dealer regulation is unlikely to eliminate these concerns, as it is likely that similar requirements may apply under the Exchange Act or under FINRA rules, following the termination of relevant exemptions.[206] For these reasons, we do not agree with commenters that existing requirements in fact secure the same regulatory aims as those secured by the Title VII dealer regulatory framework.[207]

Finally, many of the concerns expressed by commenters could be mitigated by the availability of substituted compliance, which, as proposed, may permit non-U.S.-person dealers to comply with comparable foreign requirements as an alternative means of complying with certain Title VII requirements.[208] A person relying on substituted compliance would remain subject to the applicable Exchange Act requirements, but could comply with those requirements in an alternative fashion.[209]

In practice, however, we recognize that there will be limits to the availability of substituted compliance. For example, it is possible that substituted compliance may be permitted with regard to some requirements and not others with respect to a particular jurisdiction. For certain jurisdictions, moreover, substituted compliance may not be available with respect to any requirements depending on our assessment of the comparability of the relevant foreign requirements, as well as the availability of supervisory and enforcement arrangements among the Commission and relevant foreign financial regulatory authorities. Although comparability assessments will focus on regulatory outcomes rather than rule-by-rule comparisons, the assessments will require inquiry regarding whether foreign regulatory requirements adequately reflect the interests and protections associated with the particular Title VII requirement. In some circumstances, such a conclusion may be difficult to achieve.

In the event that we are unable to determine that an entity may satisfy certain Title VII requirements via substituted compliance, we recognize that such persons may, as a result, be subject to requirements that are duplicative of particular Title VII requirements. While we recognize the

[200] As already discussed, the security-based swap market is a global market, and firms engaged in security-based swap dealing activity can restructure their dealing business to ensure that security-based swap transactions are not booked in U.S. persons. *See* Section II.B, *supra.*

[201] *See* IIB Letter at 7.

[202] *See* ISDA Letter at 9–10.

[203] *See* IIB Letter at 8–9.

[204] Indeed, we note that any exception from the uniform application of the requirement that non-U.S.-person dealers that engage in security-based swap dealing activity in the United States include the resulting transactions in their dealer *de minimis* threshold calculations is likely to create similar competitive disparities and exacerbate market fragmentation in the manner described in the previous section. *See* Section IV.B.2, *supra.* For this reason, and the reasons given in note 190, *supra,* we do not agree that compliance by the agent with either broker-dealer or security-based swap dealer requirements would warrant an exception from counting transactions under the U.S. Activity Test. *Cf.* note 185, *supra* (citing HSBC Letter at 3).

[205] *See* IIB Letter at 11; SIFMA/FSR Letter at 9. For example, one commenter explained that a non-U.S. counterparty ''would be surprised by any need to provide representations, agree to covenants or fill out questionnaires designed to comply with U.S. requirements'' that would only apply if U.S. personnel is used in a subsequent transaction, particularly if such requirements differ from any local requirements that are already applicable. IIB Letter at 11.

[206] *See* note 184, *supra.*

[207] *See* notes 201–203, *supra.*

[208] *See* proposed Exchange Act Rule 3a71–5; Cross-Border Proposing Release, 78 FR 31088. *See also* IIB Letter at 19 (noting that significant modifications to existing compliance and risk management systems in response to adoption of the U.S. Activity Test ''may prove unnecessary'' if foreign security-based swap dealers ''are ultimately able to rely on substituted compliance'').

Although we did not directly address substituted compliance with respect to security-based swap dealer requirements in the U.S. Activity Proposing Release, we noted in that release that we had previously proposed such an approach and continued to believe that substituted compliance for such requirements would be the appropriate means of addressing potential overlap or duplication in their application, rather than forgoing regulation entirely. *See* U.S. Activity Proposing Release, 80 FR 27471 and 27473 n.223. *Cf.* ISDA Letter at 10 (expressing concern that the U.S. Activity Proposing Release had proposed substituted compliance only with respect to Regulation SBSR).

[209] *See* Cross-Border Proposing Release, 78 FR 31085. Under the proposal, the Commission would not permit dealer requirements to be satisfied by substituted compliance unless (i) the Commission determined that the foreign regime's requirements were comparable to the otherwise applicable requirements, after taking into account such factors as the Commission determines are appropriate, including the scope and objectives of the relevant foreign regulatory requirements the effectiveness of the supervisory compliance program administered, and the enforcement authority exercised by the foreign financial regulatory authority in support of its oversight; and (ii) the Commission has entered into a supervisory and enforcement memorandum of understanding or other arrangement with the relevant foreign financial regulatory authority or authorities. *See* proposed Exchange Act Rule 3a71–5(a)(2)(i) and (ii); Cross-Border Proposing Release, 78 FR 31086–88.

significance of such a result, in our view compliance with the Title VII requirements is necessary to advance the policy objectives of Title VII. This would be undermined by permitting non-U.S.-person dealers to comply with their Title VII obligations by satisfying foreign requirements, unless the alternative route provided by substituted compliance has been made available.

C. Application of the Dealer De Minimis Exception to Non-U.S. Persons Using Personnel Located in a U.S. Branch or Office to Arrange, Negotiate, or Execute Security-Based Swap Transactions

We are amending Exchange Act rule 3a71–3(b)(1)(iii) in a manner generally consistent with our proposal. The final rule requires a non-U.S. person engaged in security-based swap dealing activity to include in its *de minimis* calculations any transactions connected with its security-based swap dealing activity that it arranges, negotiates, or executes using its personnel located in a U.S. branch or office, or using personnel of its agent located in a U.S. branch or office.[210] This approach reflects our view that it is reasonable to conclude that a non-U.S. person that, in connection with its dealing activity, engages in market-facing activity using personnel located in the United States, is performing activities that fall within the statutory definition of ''security-based swap dealer'' or our further definition of that term, as described above, at least in part in the United States.[211]

This amendment reflects our further consideration of the issues raised by non-U.S. persons engaged in this activity. We continue to believe that requiring non-U.S. persons to include such transactions in their *de minimis* threshold calculations will help to ensure that all persons that engage in a significant level of relevant dealing activity, including activity carried out through personnel located in a U.S. branch or office, are required to register as security-based swap dealers and to comply with relevant Title VII requirements applicable to security-based swap dealers when the volume of that activity exceeds the dealer *de minimis* threshold.[212]

Most commenters that expressed a view on the U.S. Activity Test set forth in the U.S. Activity Proposing Release supported the changes made from our initially proposed approach.[213] Under that initial approach, market participants would have been required to determine, in connection with several different Title VII rules, whether a transaction was a ''transaction conducted within the United States,'' and this determination would have required an analysis of the location of relevant activity performed by either counterparty or its agent in connection with that transaction.[214] These commenters supported the narrower approach set forth in our U.S. Activity Proposing Release, which focused only on the location of relevant activity of a counterparty acting in a dealing capacity in the transaction of such counterparty's agent[215] and limited relevant activity to ''market-facing'' activity of that counterparty or the counterparty's agent.[216] One commenter stated that the modified approach created ''a definable standard that will bring clarity to the application of security-based swap requirements to security-based swap dealers, and is appropriate and consistent with the expectations of the parties as to when U.S. security-based swap requirements will apply.''[217]

We have considered commenters' concerns about the potential costs associated with the final rule, including the systems and monitoring costs, as well as the likelihood of market fragmentation arising from the full or partial exit of some dealing firms from the U.S. market.[218] As discussed above, however, we believe that imposing the counting requirements on non-U.S.-person dealers engaged in such transactions will advance important regulatory objectives.[219] However, the

[210] *See* Exchange Act rule 3a71–3(b)(1)(iii)(C). Consistent with our proposal, a person would be required to include in its *de minimis* calculations only security-based swaps that, in connection with its dealing activity, are *arranged, negotiated,* or *executed* by personnel located in the United States. A non-U.S. person is not required to include in this calculation transactions connected with that person's dealing activity solely on the basis that they were submitted for clearing in the United States, reported to a security-based swap data repository in the United States, or because activities related to collateral management of the transaction, such as the exchange of margin, occurred within the United States. *See* U.S. Activity Proposing Release, 80 FR 27467 n.166; 27468 n.180; Cross-Border Proposing Release, 78 FR 31000. In our view, none of these activities, by themselves, indicate that a non-U.S. person is likely to raise the types of concerns addressed by Title VII security-based swap dealer regulation.

[211] Non-U.S. persons engaged in security-based swap dealing activity may include persons whose counterparties have legal recourse against a U.S. person arising out of the security-based swap transactions of the non-U.S. person or persons that are conduit affiliates. Our Cross-Border Adopting Release finalized rules providing that a non-U.S. person must include in its dealer *de minimis* calculation transactions arising out of its dealing activity with counterparties that are U.S. persons, or such transactions with non-U.S. person counterparties if the non-U.S. person affiliate of the non-U.S. person is a conduit affiliate or if its counterparty has a right of recourse against a U.S.-person affiliate of the non-U.S. person under the security-based swap, even if the non-U.S. person is not engaging in dealing activity using personnel located in the United States to arrange, negotiate, or execute the transaction. *See* Exchange Act rules 3a71–3(a)(1), (b)(1)(ii), and (b)(1)(iii)(B).

[212] Several commenters urged the Commission to work with the CFTC to harmonize the Commissions' approaches to cross-border and other issues, arguing that no administrative or economic rationale exists for different approaches. *See* Chris Barnard Letter at 2 (noting that the U.S. Activity Proposing Release differs in its application of mandatory clearing and trade execution from the CFTC and that, ideally, the SEC and CFTC should work together to create one set of rules); ICI Global Letter at 3–4 (emphasizing the need for coordination among regulators to determine the treatment of cross-border transactions); MFA Letter at 2–4 (urging that the Commission work with the CFTC and the prudential regulators to adopt a single approach, particularly with respect to the definition of ''U.S. person''); SIFMA Sequencing Letter at 5 (requesting that the Commission coordinate with the CFTC on cross-border rules generally and on any rules governing U.S. activity in particular). One commenter expressed concern about differences among cross-border approaches proposed by U.S. regulators particularly in light of the close relationship between the single-name CDS market and the index CDS market, given that many market participants are active in both markets. *See* MFA Letter at 3. We recognize the commenters' concerns and continue to consult and coordinate with the CFTC and other regulators to minimize differences in our Title VII rules, including with respect to the issues addressed in this release.

Another commenter specifically urged that the Commission's proposed interpretation of ''arrange, negotiate, and execute'' be applied consistently to the use of these terms in other contexts, including the CFTC Staff Advisory and the Volcker Rule. *See* SIFMA/FSR Letter at 2–4. The Commission adopted the Volcker Rule together with the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the CFTC under a provision of the Dodd-Frank Act separate from the provisions under which the rules addressed in this release are being adopted. *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, Release No. BHCA–1 (December 10, 2013), 79 FR 5535 (January 31, 2014) (''Volcker Rule'').

[213] *See* ICI Letter at 1–2, 5; SIFMA/FSR Letter at 3; IIB Letter at 2.

[214] *See* Cross-Border Proposing Release, 78 FR 30999.

[215] *See* ICI Global Letter at 1–2, 5 (stating that the modified proposal would enable non-U.S. dealers to enter into transactions with non-U.S. persons that may use a U.S. fund manager without requiring the non-U.S. dealer to include the transaction in its *de minimis* calculations).

[216] *See* IIB Letter at 17; SIFMA/FSR Letter at 3 (stating that ''market-facing focus is appropriate and consistent with the expectations of the parties as to when U.S. regulations will apply'').

[217] SIFMA/FSR Letter at 2–3 (stating also that the commenters ''strongly believe that the Commission has taken the correct approach in focusing on market-facing activity of sales and trading personnel in defining the 'arrange, negotiate, or execute' nexus that subjects security-based swap activity to the Commission's regulations based on location of conduct'').

[218] *See* Sections V.A and V.B, *infra* (discussing comment letters addressing costs, competition, and market fragmentation).

[219] *See* Section IV.B.2, *supra.* We recognize, as two commenters argued, that it is possible that the final rule will result in additional registrants and

Continued

final rule is intended to avoid unnecessary costs and complexity that may make it difficult for market participants to comply with such requirements. As we stated in connection with the proposed rule, this approach reflects our recognition of commenters' concerns that our initially proposed approach to ''transactions conducted within the United States'' potentially could have imposed significant costs on, and presented compliance challenges to, market participants.[220] The final rule should reduce the likelihood that personnel who are incidentally within the United States will trigger the counting requirement, and it will eliminate any need on the part of the non-U.S.-person dealer either to monitor the location of relevant personnel acting on behalf of its counterparty or to obtain relevant representations regarding the location of the counterparty's or the counterparty's agent's personnel from their counterparty on a transaction-by-transaction basis.

In the following subsections, we describe key elements of the amendment to Exchange Act rule 3a71–3(b)(1)(iii) and address comments received in response to the U.S. Activity Proposing Release that are of particular relevance with respect to each element.

1. ''Arranging, Negotiating, or Executing'' a Security-Based Swap Transaction

Exchange Act rule 3a71–3(b)(1)(iii)(C) applies only to transactions connected with a non-U.S. person's security-based swap dealing activity that its personnel (or the personnel of an agent) located in the United States *arrange, negotiate, or execute.* The final rule, accordingly, would reach a narrower range of activity than did the initially proposed rules that would have required a non-U.S.-person dealer to count any ''transaction conducted within the United States'' [221] that it entered into in connection with its dealing activity.

Consistent with our preliminary views set forth in the U.S. Activity Proposing Release, ''arrange'' and ''negotiate'' in the final rule indicate market-facing activity of sales or trading personnel in connection with a particular transaction, including interactions with counterparties or their agents.[222] ''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.[223]

As noted in the proposal, this limitation to market-facing activity should enable market participants to identify the location of relevant activity in a relatively efficient manner. The final rule requires a market participant to focus on whether its sales or trading personnel (or such personnel of its agent) located in the United States engage in this market-facing activity in connection with a particular transaction, *not* on where these or other personnel perform internal functions (such as the processing of trades or other back-office activities) in connection with that transaction. Accordingly, the involvement of personnel located in a U.S. branch or office in a transaction, where such personnel do not engage in market-facing activities with respect to a specific transaction (such as a person who designs the security-based swap but does not communicate with the counterparty regarding the contract in connection with a specific transaction and does not execute trades in the contract), and does not direct these activities (as described below), does not fall within the scope of the final rule.[224] Similarly, the final rule also does not include the preparation of underlying documentation for the transaction, including negotiation of a master agreement and related documentation, or performing ministerial or clerical tasks in connection with the transaction as opposed to negotiating with the counterparty the specific economic terms of a particular security-based swap transaction.[225]

The final rule also does not require persons engaged in dealing activity to consider the location of personnel booking the transaction. As we have noted elsewhere, the booking entity is the counterparty to a transaction and bears the ongoing risk of performance on the transaction,[226] and the entity in which the transaction is booked is the entity that may be required to include a transaction in its *de minimis* threshold calculations.[227] However, the ministerial task of entering transactions on a non-U.S. person's books once the transaction has been executed by market-facing personnel does not appear to involve the type of market-facing activity that reflects an involvement in the U.S. financial market that would indicate that the non-U.S. person may be likely to raise the types of regulatory concerns addressed by the Title VII dealer requirements, particularly if both counterparties to the transaction are non-U.S. persons and all relevant market-facing activity occurs outside the United States.[228] On the other hand, 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, for the reasons described in detail above,[229] particularly when its

that this increase in the number of security-based swap dealers will impose additional responsibilities on the Commission and its staff. *See* IIB Letter at 7, 10; HSBC Letter at 2. As discussed above, the final rule is intended to subject to registration requirements only those firms whose activity in the United States suggests that they raise the types of concerns addressed by Title VII dealer regulation, and we believe that the concern regarding Commission resources is not relevant, given that the final rule appears reasonably tailored to achieve our policy interests.

[220] *See* U.S. Activity Proposing Release, 80 FR 27468.

[221] As noted above, the initially proposed rule would have required non-U.S. persons to include in their *de minimis* calculation any ''transaction conducted within the United States'' related to their dealing activity. *See* Cross-Border Proposing Release, 78 FR 30999–31000. Under that proposal, this term would have included any transaction solicited, negotiated, executed, or booked, by either party or either party's agent, within the United States. *See id.* at 30999.

[222] *See* U.S. Activity Proposing Release, 80 FR 27467–68.

Consistent with the approach taken to the final definition of ''transaction conducted through a foreign branch'' adopted in the Cross-Border Adopting Release, the amendment includes ''arrange'' instead of ''solicit'' in recognition of the fact that a dealer, by virtue of being commonly known in the trade as a dealer, may respond to requests by counterparties to enter into dealing transactions, in addition to actively seeking out such counterparties. *See id.* at 27467 n.173 (citing Cross-Border Adopting Release, 79 FR 47322 n.381; 15 U.S.C. 78c(a)(71)(A)(iv)).

[223] *See* U.S. Activity Proposing Release, 80 FR 27468.

[224] On the other hand, 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.

[225] Similarly, the final rule does not encompass a transaction solely on the basis that a U.S.-based attorney is involved in negotiations regarding the terms of the transaction.

[226] *See* Cross-Border Proposing Release, 78 FR 30976. *See also* Intermediary Definitions Adopting Release, 77 FR 30617 n.264. For further discussion of this issue, see note 244, *infra.*

[227] For example, if the transaction is booked in a U.S. person, that U.S. person is a counterparty to the security-based swap and is required to include the security-based swap in its own *de minimis* calculation if the transaction is in connection with its dealing activity, irrespective of whether the U.S. person used its own personnel or an agent's personnel to carry out that dealing activity. *See* Exchange Act rule 3a71–3(b)(1)(i).

[228] *See* Section IV.B.2, *supra* (describing concerns addressed by the final rule, including uniform application of Title VII dealer requirements, market integrity and fragmentation, and potential channels of financial contagion arising from dealing activity in the United States). *See also* U.S. Activity Proposing Release, 80 FR 27467 n.173 (stating our preliminary view that it is market-facing activity, rather than the booking of the transaction, that raises the types of concerns underlying our proposal of the U.S. Activity Test).

[229] *See* note 162 and accompanying text, *supra.*

relevant dealing transactions exceed a *de minimis* threshold.

Finally, we note that, consistent with our proposal, ''arranging,'' ''negotiating,'' and ''executing'' also include directing other personnel to arrange, negotiate, or execute a particular security-based swap. 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, and we would view personnel located in a U.S. branch or office who direct personnel not located in the United States to arrange, negotiate, or execute a security-based swap transaction as themselves arranging, negotiating, or executing the transaction. Similarly, personnel directing the arranging, negotiation, or execution of security-based swaps include personnel located in a U.S. branch or office that 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.[230] Some commenters requested that certain requirements not apply to transactions that involve U.S. activity if parties have no reasonable basis to expect that Title VII regulations will apply, for example, because the trade has been executed on an anonymous electronic platform or in algorithmic/program driven trading, in which a counterparty may have personnel in the U.S. but there is no human contact within the U.S. related to the transaction.[231] However, we do not believe that it is appropriate to create a blanket exclusion for these transactions from the *de minimis* counting requirement, as neither algorithmic trading nor automated electronic execution of security-based swaps eliminates the concerns addressed by Title VII dealer regulation, which exist irrespective of the expectations of the counterparty to a particular transaction.[232]

2. ''Located in a U.S. Branch or Office''

Exchange Act rule 3a71–3(b)(1)(iii)(C) applies only to transactions connected with a non-U.S. person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel *located in a U.S. branch or office.*[233] Thus, on the one hand, we generally would view the rule to require a non-U.S.-person dealer to include in its *de minimis* calculations any transactions arranged, negotiated, or executed in the United States by, for example, personnel assigned to, on an ongoing or temporary basis, or regularly working in a U.S. branch or office. On the other hand, we would not view the rule to require a non-U.S.-person dealer to include in its *de minimis* calculations transactions arranged, negotiated, or executed by personnel assigned to a foreign office if such personnel are only incidentally in the United States. For example, the amendment does not require a non-U.S. person to include transactions that such personnel arrange, negotiate, or execute while traveling in the United States to attend an educational or industry conference.

As we noted in our U.S. Activity Proposing Release, this element of the final rule also should mitigate the burdens associated with determining whether a particular transaction needs to be included in a non-U.S. person's *de minimis* calculation.[234] We acknowledge that the final rule potentially would lead a market participant to perform a trade-by-trade analysis to determine the location of relevant personnel performing market-facing activity in connection with the transaction. However, because the final rule encompasses a person's dealing activity only when its personnel or personnel of its agent located in a U.S. branch or office have arranged, negotiated, or executed the transaction, a non-U.S. person performing this analysis should be able to identify for purposes of ongoing compliance the specific sales and trading personnel whose involvement in market-facing activity would require a transaction to be included in its *de minimis* calculation.[235] Alternatively, such non-U.S. person may establish policies and procedures that would facilitate compliance with this final amendment by requiring transactions connected with its dealing activity to be arranged, negotiated, and executed by personnel located outside the United States.

Consistent with our proposed approach, the final 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 in response to inquiries from a non-U.S.-person counterparty outside business hours in the counterparty's jurisdiction. One commenter urged us not to include such transactions in the U.S. Activity Test, arguing that dealing activity carried out in the United States in response to inquiries is generally occurring pursuant to ''product, credit and market risk parameters'' set by management personnel outside the United States and that the activity is not ''regular business'' because the location of the activity is ''solely incidental to the hour of the day when the non-U.S. counterparty desires to trade.''[236]

We do not agree that these circumstances, including the fact that the dealer's counterparty made the initial contact leading to the transaction, are relevant in determining whether a transaction should be included in a non-U.S. person's *de minimis* threshold calculations. The focus of our U.S. Activity Test is on the location of the personnel used to arrange, negotiate, or execute the security-based swap transaction, as we continue to believe that a non-U.S. person that uses sales or trading personnel located in a U.S. branch or office to engage in market-facing activity in connection with its dealing activity, at least to the extent that its relevant dealing activity exceeds the *de minimis* threshold, is likely to

[230] We would not view personnel responsible solely for coding the algorithm as specifying the trading strategy or techniques carried out through such trading or execution.

[231] *See* ISDA Letter at 7–8; SIFMA/FSR Letter at 7 (stating that transactions should not be counted towards the *de minimis* calculations if executed anonymously on an exchange and cleared, or through algorithmic or program-driven trading); IIB Letter at 17–18 (same, noting that doing so could deter non-U.S. counterparties from trading on those platforms).

[232] *Cf.* ISDA Letter at 5 (acknowledging that ''the Commission's concern that electronic trading does not eliminate the possibility of abusive or manipulative conduct'' and requesting further clarification of the application of the proposed rule to electronic trading).

[233] As noted in Section IV.C.1, however, if personnel located in a U.S. branch or office are arranging, negotiating, or executing a particular security-based swap by directing personnel not located in a U.S. branch or office to arrange, negotiate, or execute a security-based swap transaction, we would view that transaction as having been arranged, negotiated, or executed by the personnel located in the United States.

[234] *See* U.S. Activity Proposing Release, 80 FR 27469.

[235] Based on our staff's discussions with market participants, we continue to believe that persons engaged in dealing activity may already identify personnel involved in market-facing activity with respect to specific transactions in connection with regulatory compliance policies and procedures and to facilitate compensation. *See id.* at 27469 n.191.

In addition, we believe that some market participants engaged in both swap dealing and security-based swap dealing activity may perform a similar analysis consistent with the CFTC Staff Advisory, which sets forth the CFTC staff's view that Title VII requirements apply to transactions arranged, negotiated, or executed in the United States by, or on behalf of, swap dealers. *See* note 20, *supra.*

[236] *See* IIB Letter at 18–19 (arguing that the dealing activity of the U.S. personnel in the trade is solely based on the hour of the day and thus incidental and that maintaining the proposed approach would be difficult as it would require non-U.S. persons to hire staff to work after-hours in the non-U.S. offices). *See also* HSBC Letter at 2 (explaining that U.S. sales and trading personnel may arrange, negotiate, or execute security-based swaps solely due to time-zone differences).

raise concerns addressed by Title VII dealer regulation.[237] As noted above, to the extent that personnel assigned to a foreign office are themselves only incidentally present in the United States, we would not view the final rule as encompassing any transactions that they arrange, negotiate, or execute. But we do not believe that either the nature of the initial contact made by the foreign counterparty or the fact that parameters for the market-facing activity in the United States are established by management personnel outside the United States mitigates the concerns arising from a non-U.S. person that, in connection with its dealing activity, uses personnel located in the United States to arrange, negotiate, or execute a security-based swap.[238] Accordingly, we would view the final rule as encompassing transactions under such circumstances to the extent that the personnel arranging, negotiating, or executing the transaction on behalf of the non-U.S. person dealer are located in a U.S. branch or office as described above.[239]

3. ''Personnel of Such Non-U.S. Person'' or ''Personnel of an Agent''

Exchange Act rule 3a71–3(b)(1)(iii)(C) would apply to transactions connected with a non-U.S. person's security-based swap dealing activity that are arranged, negotiated, or executed by personnel located in a U.S. branch or office, *whether the non-U.S. person arranges, negotiates, or executes the transaction directly using its own personnel* located in a U.S. branch or office, *or does so using personnel of an agent of such non-U.S. person,* located in a U.S. branch or office.

As noted above, a non-U.S. person engaged in security-based swap dealing activity with other non-U.S. persons, if it wishes to avail itself of the expertise of sales, trading, and other personnel located in a U.S. branch or office, may carry out that activity using its own personnel located in a U.S. branch or office, or using the personnel of its agent, located in a U.S. branch or office.[240] We continue to believe that the location of personnel carrying out market-facing activity appears particularly relevant for identifying non-U.S. persons that may raise the types of concerns described above,[241] whether that dealing activity is carried out by the non-U.S. person's personnel located in a U.S. branch or office or on its behalf by the personnel of its agent, located in a U.S. branch or office.[242] Accordingly, the final rule requires a non-U.S. person to include in its *de minimis* calculations any transactions in connection with its security-based swap dealing activity that are arranged, negotiated, or executed by personnel of such person located in a U.S. branch or office, or by personnel of its agent located in a U.S. branch or office.[243] For the reasons discussed in Section IV.B.3, above, the final rule does not include any exception from the *de minimis* counting requirement for security-based swap transactions that a non-U.S. person, in connection with its dealing activity, arranges, negotiates, or executes using personnel located in the United States.[244]

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[237] *See* Sections IV.B.2 and II.B, *supra.*

[238] *Cf.* note 222, *supra* (noting that the amendment includes ''arrange'' instead of ''solicit'' in recognition of the fact that a dealer, by virtue of being commonly known in the trade as a dealer, may respond to requests by counterparties to enter into dealing transactions, in addition to actively seeking out such counterparties).

[239] We also recognize that Exchange Act section 3(a)(71)(C) excepts from the security-based swap dealer definition a person that enters into security-based swaps for its own account, but not as a part of regular business. However, we have previously interpreted ''regular business'' to focus on activities of a person that are usual and normal in the person's course of business and identifiable as a security-based swap dealing business. *See* Intermediary Definitions Adopting Release, 77 FR 30610 (interpreting ''regular business'' for purposes of the ''swap dealer'' definition). We do not agree with the commenter that, because the non-U.S. person's use of the personnel located in a U.S. branch or office is to accommodate the non-U.S. person counterparty outside its local market hours, the use of the trading or sales personnel located in a U.S. branch or office is incidental and thus not ''regular business'' of the non-U.S. person. Under our interpretation of ''regular business,'' it is important to consider whether the non-U.S. person's usual and normal course of business is identifiable as a security-based swap dealing business, not the frequency of or reasons for using personnel located in a U.S. branch or office.

[240] For purposes of Exchange Act rule 3a71–3(b)(1)(iii)(C), we interpret the term ''personnel'' in a manner consistent with the definition of ''associated person of a security-based swap dealer'' contained in section 3(a)(70) of the Exchange Act, 15 U.S.C. 78c(a)(70), regardless of whether such non-U.S. person or such non-U.S. person's agent is itself a security-based swap dealer. This definition is, in turn, substantially similar to the definition of ''associated person of a broker or dealer'' in section 3(a)(18) of the Exchange Act, 15 U.S.C. 78c(a)(18). The definition in section 3(a)(18) is intended to encompass a broad range of relationships that can be used by firms to engage in and effect securities transactions, and is not dependent solely on whether a natural person is technically an ''employee'' of the entity in question. *See* Alexander C. Dill, *Broker-Dealer Regulation Under the Securities Exchange Act of 1934: The Case of Independent Contracting,* 1994 Colum. Bus. L. Rev. 189, 211–213 (1994) (noting that the Securities Act Amendments of 1964, which amended section 3(a)(18) of the Exchange Act, ''rationalized and refined the concept of 'control' by firms over their sales force by introducing the concept of an 'associated person' of a broker-dealer.''). Accordingly, we expect to consider whether a particular entity is able to control or supervise the actions of an individual when determining whether the individual is considered to be ''personnel'' of a U.S. branch, office, or agent of a security-based swap dealer. This is particularly relevant in the context of a financial group that engages in a security-based swap dealing business, where personnel of one affiliate may operate under the direction of, or in some cases, report to personnel of another affiliate within the group. *See also* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, BHCA–1 (December 10, 2013), 59 FR 5535, 5591 (January 31, 2014) (explaining, in the context of adopting certain provisions of what is commonly referred to as the Volcker Rule, that the relevant ''trading desk'' of a banking entity ''may manage a financial exposure that includes positions in different affiliated legal entities'' and similarly ''may include employees working on behalf of multiple affiliated legal entities or booking trades in multiple affiliated entities'') (internal citations omitted).

[241] *See* Section IV.B, *supra.* One commenter urged the Commission to return to its initially proposed approach, which would have looked to the location of relevant activity of both counterparties. Letter from Better Markets, dated July 13, 2015 (''Better Markets Letter''), at 3, 6. The commenter urged the Commission to ''strengthen its proposal by requiring that if either non-U.S. counterparty uses U.S.-based personnel, then the transaction must be included within U.S./Foreign Personnel Activity,'' explaining that the involvement of personnel in the United States would be consistent with the Supreme Court's decision in *Morrison* v. *National Australia Bank, Ltd.,* 130 S. Ct. 2869, 2884 (2010) (''*Morrison*''), and that a counterparty engaged in dealing activity can reasonably be required to consider the location of its counterparty's activity, as well as its own). *Id.* at 3. Given the structure of the security-based swap market and the concentration of security-based swap dealing among a small group of firms, we believe the final rule is appropriately tailored to capture the dealing activity that is likely to raise the types of concerns addressed by the Title VII dealer regime. *See* Section IV.B.2.

[242] We continue to believe that it is appropriate for the final rule to take into account where personnel of the non-U.S. person's agent are arranging, negotiating, or executing the transaction on behalf of the non-U.S. person, regardless of whether the agent is affiliated with the non-U.S. person, as security-based swap dealing activity carried out through an unaffiliated agent is likely to raise the same concerns as such activity carried out through an affiliated agent.

[243] A non-U.S. person that uses a broker as its agent to arrange, negotiate, or execute security-based swap transactions in connection with that non-U.S. person's dealing activity would be required to include those transactions in its own *de minimis* calculations. We recognize that this approach may make certain brokers less able to compete for the business of non-U.S.-person dealers that would otherwise not be arranging, negotiating, or executing transactions using personnel located in a U.S. branch or office, but given the regulatory concerns such transactions may raise, we think it is appropriate to require such transactions to be included in the non-U.S. person's *de minimis* threshold calculations. *See* Sections IV.B.2, IV.B.3, and II.B, *supra.*

[244] Consistent with our views expressed in prior releases, if a financial group used one entity to perform the sales and trading functions of its dealing business and another to book the resulting transactions, we would ''view the booking entity, and not the intermediary that acts as an agent on behalf of the booking entity to originate the transaction, as the dealing entity.'' Cross-Border Proposing Release, 78 FR 30976. *See also* Intermediary Definitions Adopting Release, 77 FR 30617 n.264 (''A sales force, however, is not a prerequisite to a person being a security-based swap dealer. For example, a person that engages in

4. Exception for Transactions Involving Certain International Organizations

In response to the Cross-Border Proposing Release, certain commenters raised concerns about the potential application of various Title VII provisions to multilateral development banks (''MDBs''), including the International Bank for Reconstruction and Development (or the World Bank) and the International Finance Corporation.[245] These commenters argued that MDBs have absolute immunity under federal law and should be excluded from regulation under Title VII entirely; in addition, they argued that MDBs should be excluded from the definition of U.S. person.[246] In the Cross-Border Adopting Release, which addressed the cross-border application of the ''security-based swap dealer'' and ''major security-based swap participant'' definitions, we took the position that such issues were outside the scope of the release, as the source of any such immunities lies outside the Dodd-Frank Act and the federal securities laws.[247] However, we concluded that their status as international organizations warranted excluding them from the definition of ''U.S. person.'' [248]

One commenter on the U.S. Activity Proposing Release objected to the view set forth in the Cross-Border Adopting Release that the scope of these entities' immunities was outside the scope of our prior release, arguing that we had left unaddressed the effect of that immunity on relevant statutory provisions and that we should have entirely excluded MDBs from any obligation to register as a security-based swap dealer or major security-based swap participant, as the CFTC had done in the jointly adopted Intermediaries Definition Adopting Release.[249]

As an initial matter, we reiterate our view that issues related to the immunities of MDBs or other international organizations are outside the scope of our Title VII rulemaking, given that the source of any such immunities lies outside the scope of the Dodd-Frank Act and the federal securities laws. We recognize that to the extent that an MDB or other international organization believes that its security-based swap activities fall within the scope of the immunities available to it under U.S. law, the organization may decide not to register as either a security-based swap dealer or a major security-based swap participant, even if the volume of its transactions in these instruments exceed the *de minimis* threshold.[250] However, we are not, in adopting rules under Title VII, expressing any views as to the immunities such entities may possess generally under international or U.S. law.

In any event, on further consideration, and consistent with the considerations underlying the exclusion of certain international organizations from the definition of U.S. person, the final rule excepts the same international organizations, as defined in Exchange Act rule 3a71–3(a)(4)(iii), from the requirement to count a security-based swap transaction with another non-U.S. person toward their *de minimis* thresholds when they use personnel located in the United States to arrange, negotiate, or execute the transaction.[251] Independent of any immunities that may be applicable to these international organizations, including MDBs, we do not believe that their dealing activity with other non-U.S. persons should be included in any *de minimis* calculations that such organizations may make.[252]

D. Availability of the Exception for Cleared Anonymous Transactions

Under Exchange Act rule 3a71–5, a non-U.S. person, other than a conduit affiliate, is not required to include in its *de minimis* calculation transactions that are entered into anonymously on an execution facility or national securities exchange and are cleared through a clearing agency.[253] This rule mitigates the likelihood that market participants will find themselves in a position where they are required to determine the treatment of the transaction under the *de minimis* exception in circumstances where the information necessary to that determination (*e.g.,* the U.S.-person status of the counterparty) is unavailable to them.[254] In addition, this exception should reduce the likelihood that execution facilities outside the United States will exclude U.S. market participants to prevent a non-U.S. market participant from potentially being required to register as a security-based swap dealer based on information unavailable to the non-U.S. market participant at the time of the transaction.[255]

As we noted in the U.S. Activity Proposing Release, neither risk arises under the revised approach to transactions that are arranged, negotiated, or executed by personnel located in the United States that was proposed in that release.[256] Accordingly, we proposed to amend rule 3a71–5 by adding new paragraph (c) to make this exception unavailable to transactions that non-U.S. persons would be required to count under proposed Exchange Act rule 3a71–3(b)(1)(iii)(C). Several commenters have urged us to exclude from this modified approach transactions that are traded on an electronic exchange or platform, whether registered or not, or that are cleared through a clearing agency located outside the United States, as such transactions do not create risk in the United States and such a rule would interfere with access to such platforms.[257]

However, as we have noted already, to the extent that personnel located in the

dealing activity can fall within the dealer definition even if it uses an affiliated entity to market and/or negotiate those security-based swaps connected with its dealing activity (*e.g.,* the person is a booking entity).'').

To the extent that the activities performed by the entity performing the sales and trading functions involve arranging, negotiating, or executing security-based swaps as agent for the booking entity in connection with the booking entity's dealing activity, this amendment treats the booking entity's transmission of an order and instructions to the agent as part of the dealing activity of the booking entity itself. As already noted, a person engaged in these activities on behalf of the booking entity may itself be subject to regulation as a broker under the Exchange Act. *See* note 187, and accompanying discussion, *supra.*

[245] *See* Cross-Border Adopting Release, 79 FR 47305–06, nn. 224, 225 (citing commenters expressing concern about application of Title VII to certain MDBs).

[246] *See id.* at 47305–06.

[247] *See id.* at 47349.

[248] *See id.* at 47312–313; Exchange Act rule 3a71–3(a)(4)(iii) (excluding certain international organizations from the definition of U.S. person).

[249] *See* Letter from Sullivan and Cromwell, dated July 13, 2015 (''Sullivan and Cromwell Letter''), at 1–2.

[250] The commenter noted that MDBs currently do not engage in security-based swap transactions in volumes that would require them to register either as security-based swap dealers or as major security-based swap participants. *See* Sullivan and Cromwell Letter at 2, note 5.

[251] *See* Exchange Act rule 3a71–3(b)(1)(iii)(C).

[252] *Cf.* Cross-Border Adopting Release, 79 FR 47313 (determining that the MDBs' status as international organizations warranted excluding them from the definition of ''U.S. person'').

[253] *See* Exchange Act rule 3a71–5.

[254] *See* Cross-Border Adopting Release, 79 FR 47325 n.412.

[255] *See id.* at 47325.

[256] *See* U.S. Activity Proposing Release, 80 FR 27472–73.

[257] *See* ISDA Letter at 3, 8 (stating that transactions cleared outside the United States should not be subject to Title VII, as they ''are subject to regulatory oversight in the clearing jurisdiction and are subject to reporting and recordkeeping requirements in that jurisdiction''); IIB Letter at 17–18 (explaining that non-U.S. counterparties trading on a platform may not know that their non-U.S. dealer counterparty is using U.S. personnel and therefore would not expect or want such trades to be subject to sales practice and reporting requirements, so they may be deterred from trading on the platforms or the platform may prohibit access by U.S. personnel). *See also* SIFMA/FSR Letter at 7 (stating that transactions should not be counted towards the *de minimis* calculations if executed anonymously on an exchange and cleared).

United States are arranging, negotiating, or executing a security-based swap transaction, the fact that a transaction is traded on a platform or exchange does not eliminate the regulatory concerns that would warrant applying Title VII dealer regulation to the extent the non-U.S. person's dealing activity exceeds the *de minimis* thresholds: Dealing activity carried out by personnel located in the United States on behalf of a non-U.S. person, whether in over-the-counter markets or on a platform, may raise the risk of financial contagion and may present counterparty protection, market integrity, and transparency concerns.[258] Moreover, although we recognize that clearing a security-based swap transaction can be expected to reduce operational and counterparty credit risks, we do not believe it entirely addresses these other regulatory concerns.

Indeed, we note that a significant proportion of the interdealer market consists of cleared transactions, which suggests that the exception urged by commenters may lead to a similar result as is likely under a broker-dealer exception to the counting requirement described above, namely a shift of a significant portion of the interdealer market to foreign clearing agencies, taking that part of the market entirely outside the Title VII dealer framework even though the dealing activity continues to occur in the United States.[259] In addition, we note that nothing in Title VII suggests that clearing a transaction should except a dealer from the requirement to include it in the dealer's *de minimis* calculations.

Because excepting such transactions could leave significant volumes of dealing activity carried out by non-U.S. persons in the United States outside the scope of Title VII dealer regulation and undermine the effectiveness of that regulatory framework to address the risks created by such activity, we are adopting Exchange Act rule 3a71–5(c) as proposed, with technical edits to clarify that the rule's exclusion applies to the exceptions in both Exchange Act rules 3a71–5(a) and (b). Accordingly, under the final rule, to the extent that a non-U.S. person is required to count a transaction under Exchange Act rule 3a71–3(b)(1)(iii)(C), it must count the trade toward its *de minimis* threshold, even if the trade is executed anonymously on a platform and cleared.[260]

[258] *See* Section IV.B.2, *supra.*

[259] *See* Section IV.B.2, *supra.*

[260] The final rule should also help avoid competitive disparities that could arise if a non-U.S. person could avail itself of this exception even when arranging, negotiating, or executing a transaction in connection with its dealing activity using personnel located in a U.S. branch or office.

V. Economic Analysis

We are sensitive to the economic consequences and effects, including costs and benefits, of our rules. In the following economic analysis, we identify and consider the assessment costs and programmatic costs and benefits of the rules we are now adopting, as well as the likely effects of the rules on efficiency, competition, and capital formation. We also discuss the potential economic effects of certain alternatives to the approach taken by the final rules. Our analysis addresses several issues that are particularly relevant to the security-based swap market—including the market's global nature, the concentration of dealing activity, and the ease with which dealers can relocate their operations to different jurisdictions—and has informed the policy choices we have described throughout this release.

A. Assessment Costs

Several commenters argued that the proposed rule would impose significant costs on market participants, including costs related to identifying transactions that needed to be counted toward the *de minimis* thresholds.[261] We recognize that under the final rules non-U.S. persons will incur costs to assess whether their activities must be counted against the dealer *de minimis* thresholds and subjected to Title VII dealer requirements.[262] The analysis of assessment costs in the U.S. Activity Proposing Release accounted for these costs, and we continue to believe that the final rule represents a reasonable approach that mitigates the burden to market participants while applying the Title VII dealer framework to non-U.S. persons that are likely to raise the types of concerns that framework seeks to address.[263]

As in the U.S. Activity Proposing Release, we first estimate the likely increase in the number of entities that are likely to incur costs associated with the *de minimis* analyses because the final rule requires additional transactions to be included in these calculations.[264] We then consider the effect on assessment costs associated with building, operating, and maintaining systems to identify security-based swap activity that non-U.S. persons would be required to count toward their *de minimis* thresholds under Exchange Act rules 3a71–3(b)(1)(iii)(C) and 3a71–5(c).

1. Costs Associated With Increase in Number of Firms Performing Analysis

We have previously assumed that any non-U.S. person that annually enters into more than $2 billion, in notional value, of security-based swap transactions that would count toward its *de minimis* threshold would be likely to incur assessment costs under Exchange Act rule 3a71–3(b).[265] Under Exchange Act rules 3a71–3(b)(1)(iii)(C) and 3a71–5(c), these non-U.S. persons would likely also incur assessment costs in connection with their transactions with other non-U.S. persons if they use personnel located in a U.S. branch or office to arrange, negotiate, or execute the transactions.

As we have previously noted, the TIW transaction data do not permit us to determine whether particular transactions were arranged, negotiated, or executed by personnel located in the United States.[266] However, as discussed above, it appears that many dealers prefer to use personnel located in the United States to arrange, negotiate, or execute transactions in security-based swaps on U.S. reference entities.[267] Accordingly, we believe that we can estimate the increase in the number of firms that would incur assessment costs in connection with determining the location of relevant activity involving single-name CDS, by assuming that all

[261] One commenter stated that these costs ''would include the establishment and maintenance of compliance systems, controls, policies and procedures that track and control the interactions of U.S. personnel with non-U.S. counterparties across a wide range of communication media, including telephone, chat, instant messaging and electronic trading platforms.'' *See* IIB Letter at 3. Another commenter stated that the global nature of the security-based swap market means that participants will arrange, negotiate, and execute security-based swap transactions in multiple jurisdictions, meaning that ''elements of a single [security-based swap] transaction may take place in different parts of the world, which may often make it difficult, or even impossible to determine what, if any, activity has taken place in the United States.'' *See* ISDA Letter at 5. *See also* HSBC Letter at 2 (stating that establishing a robust control framework for tracking these transactions would present challenges).

[262] We refer to these costs as ''assessment costs.'' *See* Intermediary Definitions Adopting Release, 77 FR 30722.

[263] The amendments the Commission is adopting do not make substantive or material modifications to any collection of information requirements as defined by the Paperwork Reduction Act of 1995, as amended.

[264] *Cf.* HSBC Letter at 2 (noting that even firms that are not required to register as security-based swap dealers as a result of the final rule could face significant costs and challenges associated with performing the *de minimis* analysis).

[265] *See* U.S. Activity Proposing Release 80 FR 27490; Cross-Border Adopting Release, 79 FR 47331.

[266] *See* Section II.A.1, *supra.*

[267] *See, e.g.,* Section II.A.2.c, *supra.*

transactions by non-U.S. person [268] dealers with other non-U.S. persons on U.S. reference entities are arranged, negotiated, or executed by personnel located in the United States.

Under these assumptions, we can estimate that a total of approximately 10 additional non-U.S. persons,[269] beyond those already incorporated into baseline estimates, that are likely to exceed the $2 billion threshold we have previously employed under Exchange Act rule 3a71–3(b), as amended, and to incur assessment costs associated with the *de minimis* exception based on 2014 TIW transactions data. We acknowledge, however, that this estimate reflects some uncertainty: On one hand, it may be overinclusive, as it is unlikely that all such transactions 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.[270]

In light of this uncertainty and to account for potential growth in the security-based swap market, we believe that it is reasonable to increase this estimate by a factor of two. As a result, our estimate for the purposes of analysis is that the rules being adopted today will increase the number of non-U.S. persons likely to incur any assessment costs in connection with the *de minimis* exception by 20. In addition to the assessment costs directly connected with determining where personnel who arrange, negotiate, or execute a security-based swap transaction are located, as described more fully below, these 20 persons would also be required to perform the analyses, and incur the assessment costs, associated with the dealer *de minimis* rules adopted in the Cross-Border Adopting Release.[271]

2. Costs Associated With Determining the Location of Relevant Personnel Who Arrange, Negotiate, or Execute a Transaction

In addition, these 20 non-U.S. persons, as well as the 114 persons that are likely to incur assessment costs in connection with the rules adopted in the Cross-Border Adopting Release,[272] will incur costs to identify transactions that they are required to include in their *de minimis* thresholds under Exchange Act rules 3a71–3(b)(1)(iii)(C) and 3a71–5(c). We note that our final rule should mitigate the concerns of some commenters regarding the costs associated with the use of the defined term ''transactions conducted within the United States'' as originally proposed in the Cross-Border Proposing Release.[273] In particular, by focusing on the location of relevant personnel of only the dealer (or of its agent), this approach should eliminate the need for non-U.S. persons that engage in dealing activity to assess whether their counterparties (or the counterparties' agents) engage in relevant activity in the United States.[274] Accordingly, the assessment costs arising from the final rule should be lower than under an approach that required a dealer to consider both the location of its own personnel (or the personnel of its agents) and of the personnel of its counterparties (or their agents).

The costs these persons incur under the final rule will, to a significant extent, be influenced by the business structures employed by non-U.S. persons to engage in this dealing activity, and it is reasonable to expect that non-U.S. persons will generally choose a business structure that reflects, among other things, a careful consideration of their regulatory costs for both compliance and assessment. In this section, we discuss the approaches that these market participants may use to determine which transactions must be counted towards dealer *de minimis* thresholds under our approach and, to the extent possible, estimate the per-entity assessment costs they would incur.

First, non-U.S. persons may perform assessments on a per-transaction basis. We continue to believe that the approach reflected in our final rule should be less costly to implement than the approach that we initially proposed in the Cross-Border Proposing Release, which looked to whether a transaction was conducted, by either counterparty, within the United States. At the same time, we recognize that performing these assessments could involve significant costs for persons engaged in dealing activity in the United States. These costs likely would include one-time costs associated with developing computer systems to capture information about the location of personnel involved with each transaction in addition to ongoing costs of analyzing these data and modifying classification of transaction activity as personnel or offices change locations over time.[275]

Based on analogous situations dealing with the development and modification of information technology (IT) systems that track the location of firm inputs, we estimate the start-up costs associated with developing and modifying these systems to track the location of persons with dealing activity will be $410,000 for the average non-U.S. entity. To the extent that non-U.S. persons already employ such systems, the costs of modifying such IT systems may be lower than our estimate. In addition to the development or modification of IT systems, we believe that entities would incur the cost of $6,500 per location per year on an ongoing basis for training, compliance, and verification costs.[276] We believe a reasonable estimate of these costs in aggregate is $8,710,000.[277]

Second, non-U.S. firms might instead restrict personnel located in a U.S. branch or office from arranging, negotiating, or executing security-based

[268] We note that TIW's definitions of U.S. and non-U.S. entities do not necessarily correspond to the definition of U.S. person under Exchange Act rule 3a71–3(a)(4). *See* note 39, *supra.*

[269] Adjustments to these statistics from the proposal reflect further analysis of the TIW data. *Cf.* U.S. Activity Proposing Release 80 FR 27491 (providing an estimate of 15 additional entities that would be non-U.S. persons).

[270] Although the total gross notional for equity swaps is significantly smaller than credit default swaps, some number of market participants may incur assessment costs as a result of their equity swap activity.

[271] *See* Cross-Border Adopting Release, 79 FR 47331–33.

[272] Although firms that would already be registered under existing Exchange Act rule 3a71–3 may not establish systems to count these transactions for purposes of the *de minimis* exception because they would already be registered, for purposes of the following analysis, we assume that they would also incur these costs. In the Cross-Border Adopting Release, we identified 71 persons that would incur systems and analysis costs, but based on 2014 data, as noted above, we have identified only 57 firms that are likely to incur these costs pursuant to current rules. *See* Section II.A.2.e, *supra.* We continue to believe it is reasonable to increase this estimate by a factor of two, to account for any potential growth in the security-based swap market and to account for the fact that we are limited to observing transaction records for activity between non-U.S. persons that reference U.S. underliers. *See* U.S. Activity Proposing Release, 80 FR 27491.

[273] *See* U.S. Activity Proposing Release, 80 FR 27467, *supra* (discussing cost concerns about initially proposed approach).

[274] *See* ICI Global Letter at 5.

[275] *See* note 261, *supra.*

[276] Calculated as Internal Cost, 90 hours × $50 per hour = $4,500 plus Consulting Costs, 10 hours × $200 per hour = $2000, for a total cost of $6,500.

[277] Calculated as 134 entities × 10 market centers as identified in TIW × $6,500 per location, for a total cost of $8,710,000. This estimate assumes that each of the 134 persons that we believe are likely to incur costs to identify transactions that they are required to include in their *de minimis* thresholds under Exchange Act rules 3a71–3(b)(1)(iii)(C) and 3a71–5(c) perform assessments on a per-transaction basis and further assumes that each person has personnel located in each market center identified in the TIW. *See supra* Section II.A.2.c.

swaps in connection with the non-U.S. firm's dealing activity with non-U.S.-person counterparties.[278] Such restrictions on communication and staffing for the purposes of avoiding certain Title VII requirements would reduce the costs of assessing the location of personnel involved in arranging, negotiating, or executing each trade, and may entirely remove the need for a system that assesses the location of personnel on a trade-by-trade basis. However, this reduction in assessment costs may be offset by the additional costs and inefficiencies of duplicating personnel in foreign and U.S. locations.[279] Accordingly, we believe that non-U.S. persons that primarily trade with non-U.S. persons on non-U.S. reference entities may be most likely to undertake this approach. However, because our access to TIW transactions data is limited to transactions in which at least one counterparty is U.S.-domiciled or the reference entity or security is a U.S. entity or security, we cannot at this time estimate the size of this set of participants.

While we do not currently have data necessary to precisely estimate these costs in total,[280] we can estimate the costs of establishing 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 dealing activity. Based on staff experience, we estimate that establishing policies would take a non-U.S. person approximately 100 hours and would cost approximately $28,300 for each entity that chooses this approach.[281] Further, we believe that the total costs incurred by entities that choose to restrict communication between personnel would be determined by the number of entities that choose such an approach as well as the number of additional personnel that these entities must hire as a result of restricted communication.

Third, a dealer may choose to count all transactions with other non-U.S. persons towards its *de minimis* threshold, regardless of whether counting them is required, to avoid the cost of assessing the locations of personnel involved with each transaction. This strategy may be preferred by a non-U.S. person engaged in dealing activity that expects few transactions involving other non-U.S. persons to be arranged, negotiated, and executed by personnel located outside the United States, such as a non-U.S. person that primarily transacts in security-based swaps on U.S. reference entities or securities, and generally relies on personnel located in the United States to perform market-facing activities. For these non-U.S. persons, the expected benefits of identifying a few transactions that do not involve dealing activity by personnel from a location in the United States, which would not be required to be counted toward the person's *de minimis* threshold, might be lower than the costs of implementing a system to track the locations of personnel on a trade-by-trade basis.

We believe that the same principles apply to non-U.S. persons that rely on agents to arrange, negotiate, or execute security-based swaps on their behalf. We anticipate that non-U.S. persons may employ any of the strategies above to comply with the final rules through the choice of their agents. For example, a non-U.S. person may choose agents that do not use U.S.-based personnel to avoid the assessment and programmatic costs of this rule. We also anticipate that a non-U.S. person might rely on representations from its agents about whether transactions conducted on its behalf involved relevant dealing activity by personnel from a location in the United States. This may occur on a transaction-by-transaction basis, or, if the agent uses personnel located in the United States in all or none of its transactions, it may choose to make a representation about the entirety of the agent's business.

We believe that all the methods described above are likely to involve an initial one-time review of security-based swap business lines to help each entity determine which of the business structures outlined above is optimal. This review likely will encompass both employees of potential registrants as well as employees of agents used by potential registrants and identify whether these personnel are involved in arranging, negotiating, or executing security-based swaps. The information gathered as a result of this review would allow a foreign security-based swap dealer to assess the revenues it expects to flow from transaction activity performed by personnel located in a U.S. branch or office. This information would also help these market participants form preliminary estimates about the costs associated with various alternative structures, including the trade-by-trade analysis outlined above. This initial review may be followed with reassessment at regular intervals or subsequent to major changes in the market participant's security-based swap business, such as acquisition or divestiture of business units. We estimate that the per-entity initial costs of a review of business lines would be approximately $104,000.[282] Further, we believe that periodic reassessment of business lines would cost, on average, $52,000 per year, per entity.[283]

[278] *See* SIFMA/FSR Letter at 2, 6; IIB Letter at 2–3; ISDA Letter at 5.

[279] *See* IIB Letter at 2–3.

[280] The aggregate cost of this rule will ultimately depend on how the affected non-U.S. persons adjust their security-based swap activity because of this rule. For example, if a non-U.S. person chooses to relocate its operations abroad, it will not incur any direct assessment costs as a result of this rule, but it will incur the costs to relocate its operations. 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 in turn will depend on the relative volumes of dealing activity that a firm carries out on different underliers and with counterparties in different jurisdictions. As a result of these dependencies, we cannot reliably quantify the costs of these alternative approaches to compliance. However, we believe that firms would rely on these approaches only if they expect them to result in higher net profits than assessments on a per-transaction basis.

[281] Calculated as Compliance Manager, 100 hours × $283 per hour = $28,300. We use salary figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

The costs of policies and procedures are based on burden estimates in the recent Nationally Recognized Statistical Rating Organizations; Final Rule, Exchange Act Release No. 72936 (August 27, 2014), 79 FR 55078 (September 15, 2015) (''NRSRO Adopting Release''). Specifically, we assume that the policies and procedures required to restrict communication between personnel located in a U.S. branch or office and personnel not located in a U.S. branch or office are similar to policies and procedures required to eliminate conflicts of interest under Rule 17g–5(c)(8). *See* NRSRO Adopting Release, 79 FR 55239, 55249.

[282] Calculated as (Senior Accountant, 500 hours × $198 per hour) + (Outside Counsel, 5 hours × $400 per hour) + (Compliance Attorney, 2 hours × $334 per hour) + (Compliance Manager, 8 hours × $283 per hour) = $103,932.

[283] This estimate is based on previous experience with cost estimates for financial statements for a large financial institution. An entity's assessment costs may require it to determine the amount of profits that it expected to flow from transaction activity performed by personnel located in the United States and compare it to the flow of profits from transaction activity performed by personnel not located in a U.S. branch or office. To the extent that the preparation of financial statements also involves analysis of the flow of profits from an entity's different business lines, we believe that the cost of preparing financial statements provide a reasonable estimate of assessment costs. However, we acknowledge that costs associated with assessment and compliance for a given firm will depend on the firm's size and structure. Calculated as (Senior Accountant, 250 hours × $198 per hour) + (Compliance Attorney, 4 hours × $334 per hour) + (Compliance Manager, 4 hours × $283 per hour) = $51,968. We use salary figures from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by SEC staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

B. Programmatic Costs and Benefits

Programmatic costs and benefits arise from applying substantive regulation to those transactions and entities that fall within the scope of the Title VII regulatory regime.[284] Commenters raised a wide range of concerns about costs, both the direct costs of compliance with Title VII dealer requirements on the part of persons required to register and broader costs to the market as a whole. With respect to the former, commenters generally argued that the proposed rules would impose significant additional and unwarranted costs on firms that are required to register as security-based swap dealers, given that the proposed rules are not likely to generate significant benefits.[285] Several commenters specifically urged the Commission to perform ''additional cost-benefit analysis'' that reflects the ease with which market participants can move their business out of the United States.[286] Some commenters noted that the proposed approach may impose disproportionate costs on certain market participants that carry out their dealing business using separately incorporated subsidiaries or affiliates in other jurisdictions.[287]

Several commenters expressed concerns that our approach would create a strong incentive to move dealing business out of the United States, and that this exit would have negative effects on market structure, risk management, and market efficiency.[288] Some commenters also suggested that foreign counterparties of non-U.S. persons engaged in dealing activity may be reluctant to devote the resources necessary to comply with Title VII rules, and may instead opt to exit the U.S. security-based-swap market.[289]

In the following sections, we discuss the costs and benefits of requiring a non-U.S. person to include in its *de minimis* threshold calculations any transaction that it, in connection with its dealing activity, arranges, negotiates, or executes using personnel located in a U.S. branch or office.

1. Benefits and Costs of the Final Rules

Because the set of market participants that are subject to security-based swap dealer regulation under Title VII will determine the allocation and flow of programmatic costs and benefits arising from these Title VII requirements, the inclusion of additional transactions that must be counted under Exchange Act rule 3a71–3(b), as amended, will affect the ultimate costs and benefits of our transaction-level and entity-level rules. At this time, we are unable to precisely estimate the number of potential new dealers that would be required to register because we cannot observe in the data the location of entities' dealing activity. However, even if we assume that all North American single-name CDS security-based swap dealing activity takes place in the United States, currently available data suggest that no additional entities above the baseline would be required to register.[290]

At the same time, we believe it is important to acknowledge the potential for a change in the number of registrants as a result of, among other things, security-based swap dealing activity located in the United States that is not reflected in the data, including equity swaps transactions that are not in our available data, transactions on non-U.S. underliers that non-U.S.-person dealers carry out in the United States that are not accounted for under the assumptions underlying this analysis, and the aggregation of the transactions of affiliated entities that do not themselves exceed the *de minimis* thresholds but must count transactions that involve market-facing activity by personnel located in a U.S. branch or office.[291] The notional amounts of these additional types of transactions may cause some additional non-U.S. entities to exceed the *de minimis* threshold as a result of this rule.

However, it is unclear how market participants might react to the final rules. Some non-U.S. entities, including those that might be required to register as a result of this rule because of transactions that lie beyond the scope of our available data, may instead prefer to restructure or relocate to avoid

[284] *See* Intermediary Definitions Adopting Release, 77 FR 30722.

[285] According to commenters, costs include those associated with compliance with the various requirements that apply to registered security-based swap dealers under Title VII, and costs arising from relocation of personnel and operations to avoid application of Title VII requirements and any market fragmentation that results. *See, e.g.,* ISDA Letter at 6 (arguing that the proposed approach ''will result in the unnecessary application of onerous and costly U.S. regulatory requirements to non-U.S. entities''); HSBC Letter at 3 (arguing that costs of requiring firms to register on the basis of U.S. activity would exceed the benefits and cause both non-U.S. subsidiaries and the Commission to incur significant costs); IIB Letter at 3–4, 6–7 (arguing that the proposed rules would not only result in costs to the market such as market fragmentation, decentralized risk management, and home country compliance costs, but also significant costs to the Commission in overseeing the additional registered security-based swap dealers); SIFMA Sequencing Letter at 5 (arguing that the Commission's approach should accommodate the risk management and operational structures that market participants already have in place). *See also* ISDA Letter at 9 (suggesting that by not leveraging existing broker-dealer recordkeeping requirements to include access to the books and records relating to SBS transaction between non-U.S. persons in their dealing capacity, the proposal ''only adds complexity and cost without offering any corresponding benefit'').

[286] *See* IIB Letter at 4 (stating, among other things, that non-U.S. persons can opt not to do business with U.S. security-based swap dealers or with non-U.S. security-based swap dealers that use personnel in the United States, and non-U.S. security-based swap dealers may feel compelled to move personnel out of the United States, limiting the security-based swap dealers' ability to centralize risk management and increase costs and affect pricing to non-U.S. persons); ISDA Letter at 6 (urging the Commission to complete its cost-benefit analysis, including by providing a quantitative account of the benefits that would result from adoption of the proposal and comparing the costs of regulatory approaches that may be less burdensome).

[287] *See* SIFMA/FSR Letter at 6–7; HSBC Letter at 2 (stating also that firms may be required to register multiple foreign affiliates as security-based swap dealers to the extent that they rely on personnel of affiliates located in the United States to interact with the foreign customers of these foreign subsidiaries, in part because it may not be practicable for counterparties to shift their trading relationship to an affiliate of its dealer, given that security-based swap transactions may represent only a small portion of their overall trading relationship with the dealer).

[288] *See* IIB Letter at 2–3; ISDA Letter at 5; SIFMA/FSR Letter at 6. Commenters argued that exit from U.S. market centers would potentially interfere with efficient pricing and prudent risk management, as this depends on centralization of pricing, hedging, and other risk-management functions with trading personnel, preferably ''in the region of the underlying asset.'' One commenter also argued that centralizing these functions in the United States, where the traders are located ''also helps promote U.S. market liquidity by integrating trading interest from non-U.S. counterparties into the U.S. market.'' *See* IIB Letter at 2.

[289] *See, e.g.,* IIB Letter at 4 (stating that ''[n]on-U.S. counterparties have shown great reluctance to undertake significant documentation changes due to the costs and resources necessary to obtain familiarity with a complicated body of foreign law'').

[290] In Section V.A, *supra,* we have identified, as a result of this rule, approximately 10 non-U.S. entities that would exceed the $2 billion threshold we used in 2014 to identify entities that may incur assessment costs and thus would be likely to assess their transactions to determine whether they are required to register as a dealer. Of these 10 entities, we believe that none would exceed the $3 billion dealer *de minimis* threshold and thus be required to register as a security-based swap dealer. Given that we have multiplied our estimates by two to take into account portions of the security-based swap market we are unable to observe with our data, we estimate that 20 additional entities would incur assessment costs as a result of relevant activity exceeding the $2 billion threshold, and that zero additional entities will exceed the $3 billion dealer *de minimis* threshold.

[291] Under Exchange Act rules 3a71–2(a) and 3a71–4, a person engaged in dealing activity must aggregate the notional amount of its dealing activity that must be counted toward the *de minimis* threshold with that of any person controlling, controlled by, or under common control with such person, unless that person is registered with the Commission as a security-based swap dealer or deemed not to be a security-based swap dealer pursuant to Exchange Act rule 3a71–2(b). *Cf.* IIB Letter at 3 (stating that the proposed approach to the *de minimis* counting requirement could impose prohibitive costs on non-U.S.-person dealers that intend to operate under the *de minimis* threshold).

registration as a result of this rule.[292] Other non-U.S. entities may otherwise alter their behavior in response to these amendments, given the potential change in costs of conducting dealing activity using personnel or their agents located in a U.S. branch or office. Although we are able to provide some estimates of the direct programmatic costs of these amendments, the extent to which market participants' activities are sensitive to these costs is difficult to quantify.

Notwithstanding these uncertainties, we believe the rules being considered for adoption today represent an important step towards treating substantially all dealing activity occurring in the United States similarly for purposes of determining whether a market participant is subject to the Title VII security-based swap dealer regime. We expect the final rules to yield benefits by reducing differences in the treatment of similar activity by U.S. persons and non-U.S. persons in the United States and potential gaps in the Title VII regulatory regime for security-based swap entities.

Additionally, we expect consistent treatment of dealing activity carried out within the United States to affect competition and market fragmentation. As discussed elsewhere in this release,[293] we believe these amendments may mitigate the competitive disparities that would result from application of the Title VII dealer requirements under existing rules and that would permit non-U.S. persons to carry out significant volumes of dealing activity using personnel located in the United States without being required to register as a security-based swap dealer. The competitive disparities would create an incentive for, among other things, financial groups that carry out their security-based swap dealing business in a U.S.-person dealer to restructure a potentially significant proportion of this business to be carried out in a non-U.S.-person dealer.

Even if the non-U.S.-person dealers continued using personnel located in a U.S. branch or office to arrange, negotiate, or execute security-based swap transactions, this type of restructuring could fragment the market into two pools, as the non-U.S.-person dealers that engage in dealing activity with other non-U.S. persons (whether dealers or otherwise) would have a strong incentive not to engage in dealing activity with U.S.-person counterparties. To the extent that the interdealer business and other dealing business with non-U.S.-person counterparties is moved to non-U.S.-person dealers, a significant majority of security-based swap dealing activity carried out in the United States could be inaccessible to U.S. persons. These counterparties would instead be limited to a much smaller pool of liquidity consisting of U.S. persons and dealers (whether U.S. persons or non-U.S. persons) that are willing to face U.S.-person counterparties.

However, under these amendments, non-U.S. dealers that carry out a large volume of transaction activity using personnel located in a U.S. branch or office would not be able to avoid registration obligations under Title VII unless they relocate these personnel to locations outside the United States or restructure operations to use different personnel that are located outside the United States. Because these forms of restructuring, and the resulting market fragmentation, would impose costs on non-U.S. dealers associated with moving personnel outside the United States and/or foregoing the expertise of sales, trading, and other personnel located in a U.S. branch or office, these amendments should reduce the likelihood or extent of market fragmentation and associated distortions.[294]

Given that the ultimate number of non-U.S. entities that are required to register as a result of this rule will depend on several factors that are beyond the scope of our available data or are inherently difficult to quantify, we believe that it is appropriate for purposes of this analysis to assume that it is possible that more entities will register as SBS dealers.[295] We also note that we expect a significant benefit of this rule to be its role in preventing significant volumes of dealing activity from being carried out in the United States without being subject to Title VII dealer requirements.[296]

If these final rules regarding the *de minimis* exception result in an increased number of non-U.S. persons that eventually register as security-based swap dealers or if they prevent firms from carrying on dealing activity in the United States without complying with Title VII dealer requirements, requirements applicable to registered dealers under Title VII (including, among others, capital requirements, recordkeeping requirements, and designation of a chief compliance officer) would apply to a larger number of dealers than without these rules.[297] Additionally, an increase in the number of registered dealers would also mean that business conduct requirements and Regulation SBSR would apply to a larger number of transactions, as well as to a larger notional volume of transactions.[298]

In addition, these final rules may mitigate the risk that might flow into U.S. financial markets by requiring the inclusion in dealer *de minimis* calculations of transactions that, while less likely to directly expose U.S. persons to counterparty risk, may allow financial risk to spill over into U.S. markets. As noted above,[299] reputational risk and liquidity spillovers represent two channels by which risks in foreign security-based swap markets may manifest in U.S. financial markets without the involvement of U.S. persons as counterparties. By requiring that all non-U.S. persons that use personnel located in a U.S. branch or office to

[292] *See* note 286, *supra.*

[293] *See* Section IV.B.2, *supra;* Section V.B.2, *infra.*

[294] *See* note 108, *supra.*

[295] We do not believe that the exception for certain international organizations in the final rule will have any effect on the number of security-based swap dealers, as such entities do not appear to engage in dealing activity to any significant extent. *See* Sullivan and Cromwell Letter at 2, note 5. Similarly, given our current understanding of the market, we do not believe it likely that final Exchange Act rule 3a71–5(c) will increase the number of security-based swap dealers, as any non-U.S. persons engaged in significant dealing activity in cleared, anonymous transactions are likely to already be required to register on the basis of their other dealing activity.

[296] *See* Section IV.B.2, *supra.*

[297] *See* IIB Letter at 5–7, 10 (arguing that registration with the Commission would subject certain non-U.S. market participants to various requirements despite posing no risk to the U.S. financial system; arguing that not adopting the proposed approach would permit the Commission to avoid expending resources on overseeing non-U.S. persons that may be required to register solely on the basis of aggregation with other affiliates); ISDA Letter at 6 (arguing that the proposed approach ''will result in the unnecessary application of onerous and costly U.S. regulatory requirements to non-U.S. entities''); HSBC Letter at 2–3 (arguing that costs of requiring firms to register on the basis of U.S. activity would exceed the benefits and cause both non-U.S. subsidiaries and the Commission to incur significant costs).

[298] Under rule 901(a)(2)(ii), all transactions that include a registered security-based swap dealer on a transaction side are subject to regulatory reporting requirements.

We note that our conclusion that the adopted approach will result in these requirements being applied to a larger number of transactions and notional volume of transactions requires the assumption that the demand for liquidity from security-based swap dealers is not very sensitive to price. Put another way, so long as market participants' demand for risk sharing opportunities provided by security-based swap transactions is relatively inelastic, any reduction in transaction volume due to the costs of Title VII regulation is unlikely to fully offset the increase in the scope of security-based swap transactions subject to Title VII regulation under the final rules. If, on the other hand, demand for liquidity is elastic, then the effects of higher costs may dominate any increase in the scope of external business conduct and regulatory reporting requirements, resulting in these requirements being applied to a smaller number and lower notional value of transactions.

[299] *See* Section II.B, *supra.*

arrange, negotiate, or execute security-based swaps in connection with their dealing activity include such transactions in their *de minimis* threshold calculations, the final rules should mitigate risk from both channels. The final rules should increase the likelihood that the Title VII dealer framework, including capital and margin requirements, applies both to the foreign affiliates of U.S. persons and to other foreign dealers that engage in dealing activity in U.S. security-based swap markets. Increasing the likelihood that this activity, which may represent the overwhelming majority of security-based swap dealing activity in the United States, is carried out by firms subject to Title VII capital, margin, and other security-based swap dealer requirements should mitigate the likelihood of the types of firm failures that may be likely to give rise to such risks.

We recognize that compliance with these requirements will impose direct costs on persons that are required to register as a result of these amendments, and that some firms may be required to register multiple entities because of how they have chosen to structure their business.[300] Other firms may be required to register as security-based swap dealers even though they use personnel located in a U.S. branch or office in connection with dealing activity only for certain asset classes in which they carry on a dealing business.[301] We also understand that firms may incur other costs associated with maintaining separate sales and trading operations, in part because non-U.S.-person counterparties are reluctant to trade with dealers that are required to register under Title VII,[302] or in connection with otherwise accommodating the preferences of non-U.S.-person counterparties. In some cases, these adjustments may reduce the efficiency of a non-U.S.-person's operations and increase operational risks, depending on the response of a particular firm to the final rules.[303]

At the same time, we continue to believe that, notwithstanding these costs, the final rules will produce significant benefits to the U.S. financial markets and participants in those markets, in terms of promoting uniform application of Title VII dealer requirements, reducing competitive disparities, mitigating the likelihood or extent of market fragmentation, and mitigating the risk of spillovers and contagion, as we have discussed in detail above.[304] Given these benefits, particularly in light of the magnitude of the potential competitive disparities that a more consistent application of Title VII dealer regulation may be expected to mitigate, we believe that the approach reflected in the final rules is appropriate even in light of the potential costs described by commenters.

2. Effects of Rule Amendments on Efficiency, Competition, and Capital Formation

The final rules are likely to affect efficiency, competition and capital formation in the security-based swap market through their effect on the scope of participants subject to dealer requirements under Title VII. In particular, the amendments may increase the likelihood that certain non-U.S. dealers would exceed *de minimis* levels of dealing activity and be required to register with the Commission. At the same time, they may make it more difficult to continue engaging in dealing activity in U.S. market centers while avoiding Title VII dealer requirements.

Accordingly, the final rules and amendments will affect the security-based swap market in a number of ways. A number of the potential effects that we discuss below are related to price efficiency, liquidity, and risk sharing. These effects are difficult to quantify for a number of reasons. First, in many cases the effects are contingent upon strategic responses of market participants. For instance, several commenters have noted that non-U.S. persons may choose to relocate personnel, which may make it more difficult for U.S. counterparties to access liquidity in security-based swaps.[305] The magnitude of these effects on liquidity and on risk sharing depend upon a number of factors that we cannot estimate, including the likelihood of relocation, the availability of substitute liquidity suppliers, and the availability of substitute hedging assets. Therefore, much of the discussion below is qualitative in nature, although we try to describe, where possible, the direction of these effects.

Moreover, there are many cases in which a rule could have two opposing effects, making it difficult to estimate a net impact on efficiency, competition, or capital formation. For example, while non-U.S. person dealers may have an incentive to relocate their operations outside of the United States to avoid the potential costs of dealer registration and requirements as a result of these rules, we assume that dealers would prefer to relocate their operations only if the benefits to the dealer of avoiding Title VII dealer registration and requirements exceed the cost of relocation.[306] By defining the scope of transactions that must be counted toward a non-U.S. person's *de minimis* threshold, this final approach not only affects the set of entities that would be subject to dealer registration and regulatory requirements, but also affects the extent—and cost—of relocation necessary to avoid dealer registration. The magnitude of these two opposing effects will depend on factors such as the sensitivity of traders to information about order flow, the impact of public dissemination of transaction information on the execution costs of large orders, and the ease with which non-U.S. persons can find substitutes that avoid contact with personnel located in a U.S. branch or office.[307] Each of these factors is difficult to quantify individually, which makes the net impact on efficiency difficult to quantify.

Notwithstanding this uncertainty, the amendments related to the treatment of transactions arranged, negotiated, or executed by personnel located in a U.S. branch or office for the purposes of *de minimis* calculations likely broaden the scope of security-based swap transactions and entities to which the Title VII regulatory regime for security-

[300] *See* note 287, *supra.*

[301] *See* SIFMA/FSR Letter at 7. We note, however, that this is true of any dealer that exceeds the *de minimis* threshold with respect to only one asset class in which it carries on a dealing business: In the Intermediaries Definitions Adopting Release, the Commission and the CFTC stated that the final rules reflected the presumption that ''a person who meets one of the dealer definitions will be deemed to be a dealer with regard to all of its swaps or security-based swaps activities'' absent a limitation on this designation in response to application from the registrant. *See* Intermediaries Definition Adopting Release, 77 FR 30644–645.

[302] *See* note 289, *supra.*

[303] *See, e.g.,* IIB Letter at 2–3.

[304] *See, e.g.,* Sections II.B and IV.B.2, *supra.*

[305] *See* IIB Letter at 2–3; ISDA Letter at 5; SIFMA/FSR Letter at 6. *See also* HSBC Letter at 2. *See* Section II.B, *supra,* for a discussion of potential effects of the final rules on non-U.S. persons' incentives to use personnel located in U.S. branches or offices to arrange, negotiate, or execute security-based swap transactions in the context of our economic considerations in formulating these rules. *But see* Citadel Letter at 12 (arguing that other commenters are overstating the possibility that U.S. personnel will be relocated outside of the United States in reaction to the adopted rules).

[306] *See* Citadel Letter at 12; Section II.A.2.c, *supra. But see* IIB Letter at 2–3 (stating that non-U.S. security-based swap dealers may need to relocate front office personnel from the United States in response to a U.S. activity test); ISDA Letter at 5 (stating that to continue to transact in U.S. products dealers will have incentives to move market-facing employees outside the United States); SIFMA/FSR Letter at 6 (explaining that dealers may move experts in U.S.-listed products outside of the United States to avoid the SEC's registration and regulatory requirements).

[307] *See* notes 57–59 and accompanying text, *supra.*

based swap dealers applies. As a result, the amendments may amplify the effects on efficiency, competition, and capital formation of rules already adopted as well as of future substantive rulemakings that place responsibilities on registered security-based swap dealers to carry out entity- or transaction-level requirements applicable to security-based swap dealers under Title VII.[308]

Our amendments reflect consideration of the potentially inefficient restructuring and reduced access to the security-based swap markets by U.S. persons on the one hand [309] and, on the other, advancing the objectives of Title VII as discussed in detail above.[310] Requiring these transactions to be included in their *de minimis* calculations may cause these non-U.S. dealers to incur registration costs (or prevent them from avoiding these costs while continuing to engage in dealing activity in the United States) and costs arising from dealer requirements under the Title VII regulatory regime, such as certain business conduct requirements, as well as under other Title VII requirements, such as Regulation SBSR. These costs may represent barriers to entry for non-U.S. persons that contemplate engaging in dealing activity using their own personnel or personnel of their agents located in a U.S. branch or office or may provide incentives for non-U.S. persons that currently engage in relevant activity using personnel or personnel of their agents located in a U.S. branch or office to restructure their business and move operations abroad or use agents with personnel outside of the United States.[311] The barriers to entry and incentives to exit the market may reduce the number of security-based swap dealers willing to trade with U.S. person counterparties, which may impede the incorporation of new information into prices.

The application of this approach to agents acting on behalf of non-U.S. persons may have similar effects on efficiency, competition, and capital formation. For example, the regulatory costs stemming from dealer registration may provide direct incentives for non-U.S. persons to avoid using personnel of agents located in a U.S. branch or office (or agents with such personnel) to arrange, negotiate, or execute security-based swaps on their behalf. By reducing the ability of these agents to compete for business from non-U.S. persons, the final rules may reduce entry by potential agents because of this competitive disadvantage, or cause existing agents to relocate or restructure their business to minimize contact with the United States.[312] In addition, to the extent that using agents with personnel located in a U.S. branch or office might result in substantial regulatory costs to non-U.S.-person dealers, such non-U.S.-person dealers might prefer and primarily use agents located outside the United States, while U.S. dealers might continue to use agents located in the United States. This incentive to split dealer and agent relationships on the basis of the location of personnel, as with the potential relocation of personnel discussed above, might also adversely affect the efficiency of risk sharing by security-based swap market participants.

Reduced market entry or restructuring by non-U.S. persons and their agents, and efforts by non-U.S. persons to choose agents, solely for the purposes of avoiding Title VII regulation in response to our final rules, may be inefficient, may raise costs to market participants, and may reduce the level of participation by personnel of non-U.S. persons located in the United States, or personnel of their agents located in the United States.[313]

We also believe that the amendments will affect competition among security-based swap dealers. Several commenters noted this possibility. One commenter argued that the competitive issues arising from the Commission's proposal were very complex and did not depend solely on the scope of application of Title VII regulatory requirements.[314] For example, many, if not all, foreign security-based swap dealers are likely to be subject to regulatory requirements in their home jurisdiction and may, therefore, already be subject to a competitive disparity with respect to U.S. firms, entirely independent of whether they are also required to register as security-based swap dealers.[315] This commenter also argued that the proposal would generate competitive disparities between U.S. and non-U.S. personnel of foreign security-based swap dealers.[316] Another commenter supported the re-proposed approach over the original proposal, arguing that it would prevent foreign funds that have a U.S. asset manager from being put at a competitive disadvantage compared to foreign funds with a foreign asset manager and would therefore avoid driving business overseas (as the commenter believed that the original proposal would have done).[317]

As noted in Section II.B, in the absence of these amendments, a U.S. person engaged in dealing activity and facing a non-U.S.-person counterparty or its agent would face different regulatory treatment under Title VII from a non-U.S. person engaged in the same activity with the same counterparty or its agent, even if both are arranging, negotiating, or executing the security-based swap using personnel located in a U.S. branch or office. As a result, and as some commenters argue, current rules may introduce different costs for U.S. security-based swap dealers and foreign security-based swap dealers, as well as their respective agents, that seek to supply liquidity to non-U.S. persons as a result of Title VII regulation. Under the current rules, non-U.S. persons seeking or supplying liquidity may also be reluctant to transact with a U.S. person because of the additional expected costs of dealer regulation and of future substantive regulations under Title VII that rest on the U.S.-person status of counterparties.[318]

These differences could introduce competitive disparities between U.S. persons and non-U.S. persons or their respective agents even if both, in connection with their dealing activity, use personnel located in the United States.[319] As a result, to the extent that dealers may have the flexibility to restructure their operations in response

[308] *See* Cross-Border Adopting Release, 79 FR 47361.

[309] *See* note 102, *supra.*

[310] *See* Section IV.B.2, *supra.* In particular, these final rules potentially reduce the risk of financial contagion and fraudulent or manipulative conduct by applying security-based swap dealer regulation to the appropriate set of entities whose activities raise these concerns. *See id.*

[311] *See* Cross-Border Adopting Release, 79 FR 47362.

[312] We also note that, under the final rules, non-U.S. persons may be willing to pay higher prices for higher quality services provided by non-U.S.-person counterparties that use personnel or agents located in the United States because the ability of these counterparties to meet the standards set by Title VII may be a credible signal of high quality. *See* Cross-Border Adopting Release, 79 FR 47362 n.762.

[313] *See id.* at 47364.

[314] *See* IIB Letter at 4.

[315] *See id.*

[316] *See id.* One commenter argued that the Commission's proposed approach likely would impose a particularly significant burden on firms that carry out their business, and book their security-based swap transactions, through local affiliates. *See* HSBC Letter. This commenter argued that this would create a ''severe and disparate'' impact on such firms, even though they have organized their business using this structure ''for *bona fide* commercial reasons.'' *Id.* at 3.

[317] *See* ICI Global Letter at 2, 5. The commenter stated that ''the Commission's modified approach would no longer incentivize non-U.S. dealers to avoid engaging in swaps transactions with a non-U.S. regulated fund with a U.S. manager to stay under the [*de minimis*] threshold''. *Id.* at 2.

[318] *See* note 289, *supra.*

[319] *See* section II.B, *supra. See also* IIB Letter at 2–3; ISDA Letter at 5; SIFMA/FSR Letter at 6.

to competitive disparities in regulation, a significant portion of the security-based swap market may exit from the Title VII regime, and a significant portion of the market may be susceptible to fragmentation as a result.[320] We believe that a significant portion of the costs of such a fragmentation would be borne by U.S.-person counterparties through higher spreads and by U.S. security-based swap dealers through the loss of non-U.S. person customers. The amendments may mitigate these competitive frictions because non-U.S. persons would be required to count transactions arranged, negotiated, or executed by personnel located in a U.S. branch or office towards their *de minimis* thresholds in a way that is identical to their U.S.-person competitors.[321]

At the same time, we acknowledge that this account of competitive impacts is complicated by the fact that many non-U.S. persons are likely to be subject to foreign regulatory frameworks that may, in certain respects, be similar to the Title VII dealer requirements.[322] To the extent that these requirements achieve comparable regulatory outcomes, we note that we have proposed rules for a substituted compliance mechanism, which should mitigate this source of competitive disparity to the extent that we make substituted compliance determinations and the other prerequisites to substituted compliance have been satisfied. At the same time, we recognize that there will be limits to the availability of substituted compliance, including the possibility that substituted compliance may be permitted with regard to some requirements and not others, or that, in certain circumstances, substituted compliance may not be permitted with respect to any requirements with regard to a particular jurisdiction, depending on our assessment of the comparability of the relevant foreign requirements and the availability of supervisory and enforcement arrangements among the Commission and relevant foreign financial regulatory authorities. As we have noted above, however, we do not believe it would be appropriate to permit foreign security-based swap dealers to satisfy their obligations under Title VII by complying with foreign requirements when the prerequisites to substituted compliance have not been satisfied.[323]

The amendment to rule 3a71–5 provides that its exception for cleared, anonymous transactions does not apply to non-U.S. persons that arrange, negotiate or execute transactions using personnel located in a U.S. branch or office or using agents with personnel located in a U.S. branch or office. Although non-U.S. persons engaged in dealing activity in the United States may also, as some commenters have suggested, find it more difficult to access foreign trading platforms,[324] this amendment may also reduce the competitive frictions that would exist if the final rules retained the exception for such non-U.S. person dealers. Such an exception would provide such non-U.S.-person dealers a potential competitive advantage relative to U.S. persons through lower regulatory compliance and assessment costs, as the non-U.S. persons would be able to avoid including these transactions in their *de minimis* calculations, while U.S. persons would be required to count all such transactions towards their *de minimis* thresholds.

However, we also note that, to the extent that non-U.S. persons otherwise would have relied upon this exception to engage in cleared, anonymous transactions using personnel located in a U.S. branch or office, our final approach may impair efficiency and capital formation by reducing liquidity in anonymous markets, increasing transaction costs, and reducing opportunities for risk-sharing among security-based swap market participants as non-U.S. persons reduce their security-based swap activity or switch to alternative methods to hedge risk.[325]

As some commenters have argued,[326] the final rule may result in inefficient restructuring to move the arrangement, negotiation, and execution of cleared, anonymous transactions abroad, in order to avoid activities that would require counting towards *de minimis* thresholds. This shift in the market could reduce the expected programmatic benefits described above.[327] It also may have adverse consequences for the availability of liquidity and the amount of transaction costs for U.S. persons seeking to hedge risk using security-based swaps. If non-U.S. persons relocate their dealing activity abroad in ways that make it more difficult for U.S. persons to find liquidity in the United States, those U.S. persons that might otherwise use security-based swaps to hedge financial and commercial risks may reduce their hedging activity and assume an inefficient amount of risk, or engage in precautionary savings by accumulating capital to mitigate the effects of market risks, which would inhibit capital formation. To the extent that non-U.S. persons use personnel located in a U.S. branch or office to engage in dealing activity only in particular categories of security-based swaps, such as those involving U.S. reference entities, we believe that the potential consequences of relocation on liquidity and risk sharing would be most concentrated in those categories.

Finally, we note that relocation of dealing activity by non-U.S. persons in response to today's amendments may produce the same type of market fragmentation we seek to avoid under existing rules. However, we expect fewer non-U.S. entities may exit U.S. markets under the amendments than in their absence. As noted above, in the absence of these amendments, non-U.S. entities that wished to avoid Title VII regulation would incur potentially lower costs, as they would not have to relocate their personnel and would only need to change the booking entity for their U.S.-facing business above the *de minimis* thresholds. This type of restructuring would likely lead to market fragmentation, as described above, given that non-U.S.-person dealers would have a strong incentive not to engage in dealing activity with U.S.-person counterparties, even if they continued to use personnel located in a U.S. branch or office to arrange, negotiate, or execute their transactions. On the other hand, the amendments being adopted today likely will increase the costs of the types of restructuring that would lead to market fragmentation. As noted above, in addition to the costs of relocating personnel who arrange, negotiate, or execute security-based swap transactions, non-U.S. persons who choose to relocate dealing activity as a result of the amendments would forgo

[320] As noted in Section II.A.3, *supra,* analysis of TIW data shows that 79.5 percent of North American corporate single-name CDS transactions in 2014 involved either two ISDA-recognized dealers or an ISDA-recognized dealer and a non-U.S.-person non-dealer. We believe that restructuring as a response to competitive disparities stemming from Title VII regulation is more likely to occur within this subset of the market because these dealers currently operate from locations throughout the world and enjoy a volume of business that is more likely to make such restructuring profitable.

[321] *See* Cross-Border Adopting Release, 79 FR 39152; Cross-Border Proposing Release, 78 FR 31127.

[322] *See* Section II.A.4, *supra.*

[323] *See* Section IV.B.3, *supra.*

[324] *See* note 231, *supra.*

[325] *See* Cross-Border Adopting Release, 79 FR 47363.

[326] *See* note 102, *supra* (citing comment letters asserting that the final rules may result in inefficient restructuring of business generally).

[327] *See* IIB Letter at 4 (arguing that avoidance of U.S. personnel by non-U.S. counterparties would likely reduce the transparency benefits of the proposed approach).

the benefits of access to local expertise in security-based swaps based on U.S. reference entities. As a result, we believe that the likelihood or extent of market fragmentation should be lower under the amendments being adopted today.

C. Alternatives Considered

In developing these amendments we considered a number of alternative approaches.[328] This section outlines these alternatives and discusses the potential economic effects of each.

1. Retention of the Definition of ''Transaction Conducted Within the United States''

In the Cross-Border Proposing Release, we originally proposed the definition ''transaction conducted within the United States'' and used it to identify (i) transactions that should be included in an entity's *de minimis* threshold calculations, and (ii) transactions that, subject to certain exceptions, would be subject to business conduct, clearing, trade execution, regulatory reporting, and public dissemination requirements under Title VII. The original objective of the initially proposed definition was identical to this rule: To capture relevant dealing activity within the United States in order to mitigate competitive frictions and prevent a non-U.S. person from shifting its security-based swap dealing activity to a non-U.S. person and continuing to carry out this dealing activity in the United States while avoiding application of the Title VII requirements. That initial approach would have looked to whether dealing activity involved a ''transaction conducted within the United States,'' which, as defined in that proposal, turned on the location of personnel on both sides of the transaction.

Most commenters supported the narrower approach set forth in our U.S. Activity Proposing Release, which focused only on the location of relevant activity of a counterparty acting in a dealing capacity in the transaction[329] and the limitation of relevant activity to ''market-facing'' activity of that counterparty.[330] One commenter stated that the modified approach created ''a definable standard that will bring clarity to the application of security-based swap requirements to security-based swap dealers, and is appropriate and consistent with the expectations of parties as to when U.S. security-based swap requirements will apply.''[331] Although one commenter argued that a non-U.S. person should be required to include a transaction with another non-U.S. person in its dealer *de minimis* threshold calculations if either counterparty is engaged in relevant activity in the United States,[332] we have determined to adopt the approach proposed in our U.S. Activity Proposing Release in part because we agree with other commenters that the initially proposed approach likely would have increased assessment costs significantly without materially enhancing the benefits of our Title VII dealer framework.[333] Under the rule as initially proposed, gathering the information regarding the location of the personnel of the counterparty (or its agent), communicating it to relevant counterparties, and keeping records of this information on a per-transaction basis could be costly. We believe that our approach, which focuses only on the location of the personnel of the dealer or its agent, achieves similar programmatic benefits while likely resulting in lower assessment costs.

2. Limited Exception From Title VII Requirements for Transactions Arranged, Negotiated, and Executed by Personnel Subject to Existing Domestic or Foreign Regulatory Requirements

In response to suggestions from several commenters,[334] we reconsidered providing an exception from the requirement to include a transaction in a person's *de minimis* threshold calculations if it is arranged, negotiated, or executed in the United States solely using personnel of a registered broker-dealer acting in their capacity as associated persons of that broker-dealer, of a registered security-based swap dealer, or of a U.S. branch of a non-U.S. person, pursuant to certain conditions.

Such an exception could reduce programmatic and assessment costs associated with engaging in customer-facing activity in connection with dealing activity in security-based swaps in the United States, which may mitigate incentives for inefficient relocation by financial groups that use a non-U.S. dealer to carry out their dealing activity in the United States. However, financial groups that use a U.S. dealer may respond to the incentives created by this exception by restructuring their security-based swap dealing business so that it is carried out by a non-U.S. person that relies on a registered broker-dealer, a registered security-based swap dealer, or a U.S. branch, that meets the conditions of the exception.

However, as described in more detail above,[335] such an exception could significantly reduce the expected benefits of our Title VII dealer framework: It could create potentially significant compliance gaps in the Title VII framework, impeding our effective enforcement of Title VII and other federal securities laws, by permitting non-U.S. persons to continue to carry out significant dealing activity—including dealing activity accounting for most or all of the interdealer market in security-based swaps on U.S. underliers—in the United States but outside the scope of Title VII dealer requirements.[336]

3. Non-Inclusion of Security-Based Swap Transactions Involving Dealing Activity in the United States in the *De Minimis* Threshold Calculations

Another alternative to the final rules would be not to require any transactions other than those required in Exchange Act rule 3a71–3 as adopted in June 2014 to be counted toward a person's dealer *de minimis* threshold.[337]

As with the alternative just discussed, this alternative could reduce programmatic and assessment costs associated with engaging in customer-facing activity in connection with dealing activity in security-based swaps in the United States, which may mitigate any incentives for inefficient

[328] *Cf.* ISDA Letter at 6 (urging the Commission to complete a cost-benefit analysis of the proposed approach that considers the benefits and costs that would apply to non-U.S. persons, taking into account alternative approaches that would achieve the goals preventing fraud and manipulation).

[329] *See* ICI Global Letter at 1–2, 5–6 (stating that the modified proposal would enable non-U.S. dealers to enter into transactions with non-U.S. persons that may use a U.S. fund manager without requiring the non-U.S. dealer to include the transaction in its *de minimis* calculations).

[330] *See* IIB Letter at 17; SIFMA/FSR Letter at 3.

[331] SIFMA/FSR Letter at 2–3 (stating also that the commenters ''strongly believe that the Commission has taken the correct approach in focusing on market-facing activity of sales and trading personnel in defining the 'arrange, negotiate, or execute' nexus that subjects security-based swap activity to the Commission's regulations based on location of conduct'').

[332] *See* Better Markets Letter at 3, 6 (urging that the Commission ''strengthen its proposal by requiring that if *either* non-U.S. counterparty uses U.S.-based personnel, then the transaction must be included within U.S./Foreign Personnel Activity,'' explaining that the involvement of personnel in the United States would be consistent with *Morrison* and that a counterparty engaged in dealing activity can reasonably be required to consider the location of its counterparty's activity, as well as its own (emphasis in original)).

[333] *See* U.S. Activity Proposing Release, 80 FR 27461 (discussing commenters' concerns related to costs of the initially proposed approach).

[334] *See* IIB Letter at 7; HSBC Letter at 3; SIFMA/FSR Letter at 7–8.

[335] *See* Section IV.B.3, *supra.*

[336] Quantifying the programmatic and assessment costs of this alternative is challenging given that we cannot observe the propensity of non-U.S. persons to use the limited exception.

[337] *See* SIFMA/FSR Letter at 5; IIB Letter at 5.

relocation by financial groups that use a non-U.S. dealer to carry out their dealing activity in the United States. However, as with the preceding alternative, financial groups that use a U.S. dealer may respond to the incentives created under the currently existing rules by restructuring their security-based swap dealing business so that it is carried out by a non-U.S. person, in which case none of its transactions with other non-U.S. persons would be counted toward the *de minimis* thresholds.

In our view, in the absence of some form of activity-based test, the current scope of Exchange Act rule 3a71–3 raises the full range of concerns arising from the ability of non-U.S. persons to continue to engage in security-based swap dealing activity in the United States without complying with Title VII dealer requirements, as described in detail above.[338] Moreover, to the extent that there are no limitations on a non-U.S. person's ability to exclude these transactions from its *de minimis* calculations, it is possible that a significant portion of that activity, including potentially all interdealer activity, eventually would occur entirely outside the scope of Title VII security-based swap dealer regulation, to the extent that financial groups restructure their dealing business in response to the incentives created by the resulting competitive disparities and market fragmentation. As we have already noted, this alternative would not only reduce the current volume of security-based swap transactions by non-U.S. persons included in such persons' dealer *de minimis* threshold calculations, but financial groups that currently use U.S. persons to carry out their dealing business in the United States may have an incentive to migrate that business to affiliated non-U.S. persons to stay competitive with their non-U.S. competitors.[339]

The absence of an activity-based test might also be costly because of its adverse competitive effects between U.S. and non-U.S. persons. Under current rules, the disparity in regulatory treatment means U.S. and non-U.S. persons would face disparate regulatory costs even if both engage in dealing activity using personnel located in a U.S. office. Given these cost differences, non-U.S. persons or their agents transacting with other non-U.S. persons or their agents in the United States would potentially be able to provide liquidity at lower cost than U.S. persons because of differing regulatory treatment in other jurisdictions. As a result, non-U.S. persons could prefer to transact with non-U.S. persons or their agents, and a substantial portion of liquidity from non-U.S. persons might become unavailable to U.S. persons.

4. Exception for Transactions Entered Into Anonymously on an Exchange and Cleared

Another alternative to these amendments would be to not require transactions that are entered into anonymously on an exchange and are cleared to be counted towards an entity's dealer *de minimis* threshold.[340] As we noted in the U.S. Activity Proposing Release, the purpose of the exception was to avoid putting market participants in a position where they are required to determine the treatment of the transaction under the *de minimis* exception in circumstances where the information necessary to that determination is unavailable to them.[341] We do not believe that anonymous trades raise these concerns in the context of the amendment to Exchange Act rule 3a71–3(b), given that it does not require non-U.S. persons to look to the location or status of their counterparty but only at that of its own personnel. We do, however, believe that allowing such an exception would have adverse consequences for competition between U.S. and non-U.S. dealers in the United States. If non-U.S. dealers could transact in the United States with non-U.S. counterparties but not be required to apply those transactions to their *de minimis* thresholds because their transactions were entered into anonymously on an exchange and cleared, non-U.S. dealers would be able to continue to operate in the U.S. without being subject to the dealer requirements of Title VII. The disparate costs generated by the unequal application of Title VII dealer requirements may further fragment liquidity into U.S. and non-U.S. pools, reducing the liquidity available to participants in the U.S. security-based swap market.

5. Exception for Transactions Cleared Through Foreign Clearing Agencies

One commenter suggested that we should not apply Title VII requirements to any transaction between two non-U.S. persons that is cleared outside the United States.[342] As we have noted elsewhere, however, clearing of security-based swaps reduces counterparty risk and operational risk, but the benefits of Title VII dealer regulations extend beyond the concerns addressed by clearing, to concerns about contagion, market fragmentation, and counterparty protection, among others. Because clearing these transactions does not address these concerns, whether a transaction is cleared does not appear to provide a useful basis for determining whether a transaction should be excepted from the *de minimis* counting requirement.[343] It is also important to note that such an exception would allow non-U.S. security-based swap dealers to operate using personnel or personnel of agents located in the United States, without being subject to Title VII dealer requirements by clearing their transactions through a foreign clearing agency. This disparity, as already discussed, could cause security-based swap liquidity to fragment into two pools, and reduce the amount of liquidity available to U.S. security-based swap market participants.[344]

6. Exception for Transactions Arranged, Negotiated, or Executed in the United States Merely To Accommodate Foreign Clients' Needs When Foreign Markets Are Closed

Another alternative would be to provide an exception for transactions arranged, negotiated, or executed in the United States merely to accommodate foreign clients' needs when foreign markets are closed. For example, one commenter argued that the U.S. Activity Test should not include security-based swaps in which U.S. personnel are involved only to accommodate a non-U.S. counterparty outside of operating hours in the counterparty's time zone.[345] Under these amendments, a

[338] *See* Section IV.B.2, *supra.*

[339] For additional discussion of the likely effects of this alternative, see the discussion in Sections IV.B.2 and IV.B.3, *supra.*

[340] *See* ISDA Letter at 7–8; SIFMA/FSR Letter at 7 (stating that transactions should not be counted towards the *de minimis* calculations if executed anonymously on an exchange and cleared). *See also* ISDA Letter at 5 (stating that the Commission correctly noted that electronic execution ''does not eliminate the possibility of abusive or manipulative conduct,'' but expressing concern that the proposed rules did not provide sufficient guidance regarding application of this test to electronic trading).

[341] *See* U.S. Activity Proposing Release, 80 FR 27472; Cross-Border Adopting Release 79 FR 47325.

[342] *See* ISDA Letter at 3, 8 (stating that transactions cleared outside the United States should not be subject to Title VII, as they ''are subject to regulatory oversight in the clearing jurisdiction and are subject to reporting and recordkeeping requirements in that jurisdiction'').

[343] *See* text accompanying note 259, *supra.*

[344] *See* Section II.B, *supra.*

[345] *See* IIB Letter at 18–19 (arguing that the dealing activity of the U.S. personnel in the trade is solely based on the hour of the day and thus incidental and that maintaining the proposed approach would be difficult as it would require non-U.S. persons to hire staff to work after-hours in the non-U.S. offices); HSBC Letter at 2.

non-U.S. person is required to include in its dealer *de minimis* threshold calculations transactions that it arranges, negotiates, or executes using personnel located in the United States even if it does so for the sole purpose of accommodating a foreign client's needs when foreign markets are closed.[346] Commenters have argued that requiring these transactions to be included in a dealer's *de minimis* threshold calculations may discourage non-U.S.-person dealers from providing these services to their non-U.S.-person clients, which may increase the transaction costs and the time necessary to execute their clients' transactions.[347] An exception for these types of transactions might improve the liquidity available to non-U.S. security-based swap market participants by allowing non-U.S. dealers to use personnel or personnel of their agents located in the United States to arrange, negotiate, or execute certain transactions when foreign markets are closed.

However, the implementation of such an exception might have several adverse consequences. For example, such an exception might create an incentive for non-U.S. person dealers to claim such an exception for trades that, at any other time of day, they would still have arranged, negotiated, or executed using personnel located in the United States. In addition, non-U.S. person dealers may have incentives to artificially delay or advance the timing of trades to claim such an exception. By abusing such an exception, non-U.S. dealers might create a significant disparity in the way that they account for transactions that they arrange, negotiate, or execute using personnel located in the United States under the dealer *de minimis* exception. As a result, non-U.S. dealers might not exceed a *de minimis* threshold and therefore may not be required to register with the Commission, even if these non-U.S. dealers continue with substantial amounts of dealing activity located within the United States. The subsequent difference in the application of dealer requirements between U.S. and non-U.S. dealers operating in the United States may have the adverse market fragmentation and competition effects discussed earlier.[348]

VI. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act (''RFA'')[349] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. The Commission certified in the U.S. Activity Proposing Release, pursuant to Section 605(b) of the RFA,[350] that the proposed amendments to Exchange Act rule 3a71–3 and 3a71–5 would not, if adopted, have a significant impact on a substantial number of ''small entities.''[351] The Commission received no comments on this certification.

For purposes of Commission rulemaking in connection with the RFA, 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;[352] 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,[353] 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.[354] Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) For entities in credit intermediation and related activities,[355] entities with $550 million or less in assets or; (ii) for non-depository credit intermediation and certain other activities,[356] entities engaged in non-depository credit intermediation and related activities, $38.5 million or less in annual receipts; (iii) for entities in financial investments and related activities,[357] entities with $38.5 million or less in annual receipts; (iv) for insurance carriers and entities in related activities,[358] entities with $38.5 million or less in annual receipts, or 1,500 employees for direct property and casualty insurance carriers; and (v) for funds, trusts, and other financial vehicles,[359] entities with $32.5 million or less in annual receipts.[360] Based on feedback from market participants and our information about the security-based swap markets, 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—which generally would be large financial institutions—would not be ''small entities'' for purposes of the RFA.[361]

For the foregoing reasons, the Commission certifies that the final amendments, as adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

VII. Effective Date and Implementation

These final rules will be effective April 19, 2016.

Three commenters requested that we provide market participants adequate time to comply with any final rule that would require them to monitor the location of personnel engaged in relevant activity with respect to security-based swap transactions. One commenter stated that we should provide a 12-month transition period and clarify that the *de minimis* counting would only apply prospectively to security-based swap transactions executed after the transition period.[362]

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[346] *See* Section IV.C.2, *supra.*

[347] *See* note 236, *supra.*

[348] *See* Section V.C.3, *supra.*

[349] 5 U.S.C. 601 *et seq.*

[350] 5 U.S.C. 605(b).

[351] 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 rulemaking, are set forth in Rule 0–10, 17 CFR 240.0–10. *See* Statement of Management on Internal Control, Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982).

[352] *See* 17 CFR 240.0–10(a).

[353] *See* 17 CFR 240.17a–5(d).

[354] *See* 17 CFR 240.0–10(c).

[355] Including commercial banks, savings institutions, credit unions, firms involved in other depository credit intermediation, credit card issuing, sales financing, consumer lending, real estate credit, and international trade financing. 13 CFR 121.201 at Subsector 522.

[356] Including firms involved in secondary market financing, all other non-depository credit intermediation, mortgage and nonmortgage loan brokers, financial transactions processing, reserve, and clearing house activities, and other activities related to credit intermediation. 13 CFR 121.201 at Subsector 522.

[357] Including firms involved in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, providing investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities. 13 CFR 121.201 at Subsector 523.

[358] Including direct life insurance carriers, direct health and medical insurance carriers, direct property and casualty insurance carriers, direct title insurance carriers, other direct insurance (except life, health and medical) carriers, reinsurance carriers, insurance agencies and brokerages, claims adjusting, third party administration of insurance and pension funds, and all other insurance related activities. 13 CFR 121.201 at Subsector 524.

[359] Including pension funds, health and welfare funds, other insurance funds, open-end investment funds, trusts, estates, and agency accounts, real estate investment trusts and other financial vehicles. 13 CFR 121.201 at Subsector 525.

[360] *See* 13 CFR 121.201.

[361] *See* U.S. Activity Proposing Release, 80 FR 27505–08; Cross-Border Adopting Release, 79 FR 47368.

[362] *See* HSBC Letter at 3–4.

Two commenters urged the Commission to defer the compliance date until it has made comparability determinations for a number of jurisdictions so that non-U.S. dealers can rely on substituted compliance.[363]

In the SBS Entity Registration Adopting Release, we established a compliance date for the final rules adopted in that release as the later of: Six months after the date of publication in the **Federal Register** of a final rule release adopting rules establishing capital, margin and segregation requirements for security-based swap dealers and major security-based swap participants (''SBS Entities''); the compliance date of final rules establishing recordkeeping and reporting requirements for SBS Entities; the compliance date of final rules establishing business conduct requirements under Exchange Act sections 15F(h) and 15F(k); or the compliance date for final rules establishing a process for a registered SBS Entity to make an application to the Commission to permit an associated person who is subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf (such date referred to as the ''Registration Compliance Date'').

In addition, we noted that, for purposes of complying with the registration and other requirements, persons engaged in dealing activity are not required to begin calculating whether their transactions meet or exceed the thresholds established in Exchange Act rule 3a71–2 until two months prior to the Registration Compliance Date (''SBS Entity Counting Date''). Accordingly, a person engaged in security-based swap dealing activity will not be required to include in its dealer *de minimis* threshold calculations any transactions entered into prior to the SBS Entity Counting Date. However, given the potential complexities of implementing the amendments being adopted today, we believe it is appropriate to establish a compliance date solely for Exchange Act rule 3a71–3(b)(1)(iii)(C) of the later of (a) February 21, 2017, or (b) the SBS Entity Counting Date.

[363] *See* IIB Letter at 19; SIFMA/FSR Letter at 15.

Statutory Basis and Text of Final Rules

Pursuant to the Exchange Act, 15 U.S.C. 78a *et seq.,* and particularly sections 3(a)(71), 3(b), 23(a)(1), and 30(c) thereof, and section 761(b) of the Dodd-Frank Act, the SEC is amending rules 3a71–3 and 3a71–5 under the Exchange Act.

List of Subjects in 17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

Text of Final Rules

For the reasons stated in the preamble, the SEC is amending Title 17, Chapter II of the Code of the Federal Regulations as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The authority citation for part 240 continues to read, and a sectional authority is added in numerical order 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, 78*l,* 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78*ll,* 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. 1376 (2010), unless otherwise noted.

* * * * *

Sections 240.3a71–3 and 240.3a71–5 are also issued under Pub. L. 111–203, sec. 761(b), 124 Stat. 1754 (2010), and 15 U.S.C. 78dd(c).

* * * * *

■ 2. § 240.3a71–3 is amended by adding paragraph (b)(1)(iii)(C) to read as follows:

§ 240.3a71–3 Cross-border security-based swap dealing activity.

* * * * *

(b) * * *

(1) * * *

(iii) * * *

(C) 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

* * * * *

■ 3. § 240.3a71–5 is amended by adding paragraph (c) to read as follows:

§ 240.3a71–5 Exception for cleared transactions executed on a swap execution facility.

* * * * *

(c) The exceptions in paragraphs (a) and (b) of this section shall not apply to any security-based swap transactions of a non-U.S. person or of an affiliated non-U.S. person connected with the 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.

By the Commission.

Dated: February 10, 2016.

Brent J. Fields,

Secretary.

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