

MEMO# 28961

May 7, 2015

SEC Proposes Amendments to Address Application of SEC Rules to Cross-Border Security-Based Swap Activities

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 8-15
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 30-15
ICI GLOBAL MEMBERS No. 17-15
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 20-15
INVESTMENT ADVISER MEMBERS No. 12-15
SEC RULES MEMBERS No. 30-15 RE: SEC PROPOSES AMENDMENTS TO ADDRESS
APPLICATION OF SEC RULES TO CROSS-BORDER SECURITY-BASED SWAP ACTIVITIES

Recently, the Securities and Exchange Commission (“SEC” or “Commission”) proposed rule amendments to address the application of the de minimis exception to security-based swap transactions connected with a non-US person’s security-based swap dealing activities that are arranged, negotiated, or executed by personnel of such person located in a US branch or office or by personnel of such person’s agent located in a US branch or office. [\[1\]](#) The SEC also re-proposed a rule and proposed rule amendments to address the applicability of external business conduct requirements to the US business and foreign business of registered security-based swap dealers. Finally, the SEC proposed amendments to Regulation SBSR [\[2\]](#) to apply the regulatory reporting and public dissemination requirements to transactions that are arranged, negotiated, or executed by personnel of non-US persons or personnel of such non-US persons’ agents that are located in the United States and to transactions effected by or through a registered broker-dealer (including a registered security-based swap execution facility).

The Proposal is of significance to non-US regulated funds because the SEC would no longer look at the activity of a non-US person not engaged in dealing activity (e.g., a non-US regulated fund) to determine whether the SEC’s rules would apply to the transactions that such a non-US person would engage in with a non-US dealer. Instead, the external business conduct rules would only apply to a transaction of a registered foreign security-based swap dealer with another non-US person when the registered foreign security-based swap dealer is using personnel located in the United States to arrange, negotiate, or execute the security-based swap. In addition, the Proposal would not subject transactions

between two non-US persons to the clearing and trade execution requirements on the basis of dealing activity in the United States, including transactions that are arranged, negotiated, or executed by personnel located in a US branch or office.

This memorandum summarizes some of the most relevant aspects of the Proposal for registered funds. Comments on the Proposal are due 60 days after the Proposal is published in the Federal Register.

De Minimis Calculation for Security-Based Swap Dealers

The Securities Exchange Act of 1934 (“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. In the SEC’s original cross-border proposal, the SEC proposed to require a non-US person to include in its de minimis calculation any security-based swap transaction connected with its dealing activity that is a “transaction conducted within the United States” as defined in the proposed rule. [\[3\]](#) In response in part to comments regarding the scope of the definition of “transaction conducted within the United States,” the SEC has determined to focus on certain dealing activity for purposes of the de minimis calculation.

Under the Proposal, a non-US person engaged in security-based swap dealing activity would be required to include in its de minimis calculation any transactions connected with its security-based swap dealing activity that it arranges, negotiates, or executes using its personnel located in a US branch or office or using personnel of its agent located in a US branch or office. The Proposal would no longer require a non-US person engaging in dealing activity to consider the location of its non-US counterparty or that counterparty’s agent in determining whether the transaction needs to be included in its own de minimis calculation.

External Business Conduct Requirements

In the Cross-Border Proposing Release, the SEC proposed to except the foreign business of registered security-based swap dealers from the external business conduct requirements. [\[4\]](#) The SEC had proposed to define “foreign business” to mean any security-based swap transactions entered into, or offered to be entered into, by or on behalf of the foreign security-based swap dealer or the US security-based swap dealer that do not include its US business. For a foreign security-based swap dealer, the definition of “US business” would have been defined to include any transaction entered into or offered to be entered into by or on behalf of such foreign security-based swap dealer with a US person or any transaction “conducted within the United States.”

In response to the Cross-Border Proposing Release, ICI and ICI Global had expressed concern that the definition of “US business” and “foreign business” may result in external business conduct requirements applying to transactions with non-US regulated funds whose security-based swap activity is managed by a US asset manager. [\[5\]](#) In response to comments such as those of ICI and ICI Global, the Proposal would modify the proposed definition of “US business” with respect to foreign security-based swap dealers to refer to any security-based swap transaction arranged, negotiated, or executed by personnel of the foreign security-based swap dealer located in a US branch or office or by personnel of its agent located in a US branch or office. In the Proposal, the SEC noted that the re-proposed approach should mitigate concerns regarding the potential effect of the initially proposed rule on US fund managers that manage offshore funds because only the location of the personnel of the registered foreign security-based swap dealer or the location of personnel

of its agent (and not that of persons acting on behalf of a non-US person fund in the transaction) would be relevant to whether the transaction is US business or foreign business of the registered foreign security-based swap dealer. [6]

Clearing and Trade Execution Requirements

The Proposal would not subject transactions between two non-US persons to the clearing and trade execution requirements on the basis of dealing activity in the United States, including transactions that are arranged, negotiated, or executed by personnel located in a US branch or office. The SEC believes that the risks that would be posed by these transactions would be better addressed through capital and margin requirements and that requiring such transactions to be cleared and executed on a platform would impose a significant burden on certain market participants.

Regulation SBSR

The Proposal would require any security-based swap transaction connected with a person's security-based swap dealing activity that is arranged, negotiated, or executed by personnel of such non-US person located in a US branch or office or by personnel of its agent located in a US branch or office to be reported to a registered swap data repository ("SDR") and publicly disseminated pursuant to Regulation SBSR. The proposed requirement would require the security-based swaps that a registered foreign security-based swap dealer arranges, negotiates, or executed using personnel located in a US branch or office to be publicly disseminated. In addition, the Proposal would require that a transaction of a non-US person that is not a registered security-based swap dealer to be subject to both regulatory reporting and public dissemination under Regulation SBSR if that non-US person would be required to include the transaction in its de minimis threshold calculation (transaction connected with the non-US person's security-based dealing activity that is arranged, negotiated, or executed using personnel located in a US branch or office).

In addition, the Proposal would require any security-based swap transaction that is executed on a platform having its principal place of business in the United States to be reported to a registered SDR and to be publicly disseminated pursuant to Regulation SBSR. The Proposal also sets forth which side would have the duty to report a security-based swap where neither side is a registered security-based swap dealer or a registered major security-based swap participant and neither side is a US person or only one side is a US person.

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endnotes

[1] Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected with a Non-US Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a US Branch or Office or in a US Branch or Office of an Agent, Release No. 34-74834 (Apr. 29, 2015), available at <http://www.sec.gov/rules/proposed/2015/34-74834.pdf> ("Proposal").

[2] Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 80 FR 14563 (Mar. 19, 2015), available at <http://www.gpo.gov/fdsys/pkg/FR-2015-03-19/pdf/2015-03124.pdf>. Regulation SBSR

assigns the duty to report covered transactions, which include all security-based swaps except: (1) clearing transactions; (2) security-based swaps that are executed on a platform and that will be submitted to clearing; (3) transactions where there is no US person, registered security-based swap dealer, or registered major security-based swap participant on either side; and (4) transactions where there is no registered security-based swap dealer or registered major security-based swap participant on either side and there is a US person only on one side. For a summary of Regulation SBSR, see ICI Memorandum No. 28913 (Apr. 20, 2015), available at http://www.ici.org/my_ici/memorandum/memo28913.

[3] 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, 78 FR 30967 (May 23, 2013), available at <http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf> (“Cross-Border Proposing Release”).

[4] The SEC has proposed Rules 15Fh-1 through 15Fh-6 under the Exchange Act to implement the business conduct requirements. See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 FR 42423 (July 18, 2011). In addition to external business conduct standards expressly addressed by Title VII, the proposed rules would, among other things, impose certain “know your counterparty” and suitability obligations on security-based swap dealers as well as restrict security-based swap dealers from engaging in certain “pay to play” activities and provide certain protections for “special entities.”

[5] See Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Elizabeth M. Murphy, Secretary, SEC, dated August 21, 2013, available at <http://www.ici.org/pdf/27482.pdf>. See ICI Memorandum No. 27482 (Aug. 22, 2013), available at <http://www.iciglobal.org/iciglobal/pubs/memos/memo27482>.

[6] To the extent that a non-US regulated fund is a US person (including because it has its principal place of business in the United States), a foreign security-based swap dealer would be required to comply with external business conduct requirements in any transaction with that fund because the counterparty is a US person.