

**MEMO# 31449**

October 22, 2018

# **CFTC Chair Giancarlo Releases White Paper on Cross-Border Swaps Regulation Reform**

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October 22, 2018 TO: Derivatives Markets Advisory Committee

ICI Global Trading & Markets Committee RE: CFTC Chair Giancarlo Releases White Paper on Cross-Border Swaps Regulation Reform

US Commodity Futures Trading Commission Chairman J. Christopher Giancarlo recently released a white paper that analyzes and recommends changes to the CFTC's current approach on cross-border swaps regulation.<sup>[1]</sup> The white paper sets forth principles meant to guide a new cross-border approach and a series of recommendations in line with those principles.<sup>[2]</sup> Chair Giancarlo intends to direct CFTC staff to propose new rules based on the principles and recommendations. The new rules would replace CFTC cross-border guidance issued in 2013 and rules proposed in 2016, and address certain positions taken in CFTC staff advisories and no-action letters.

## **Current Approach**

Chair Giancarlo believes the CFTC's current cross-border approach, which imposes CFTC transaction rules on swaps traded by US persons, has created a rift in cross-border swaps cooperation with non-US jurisdictions. He believes the current approach is flawed because it:

1. Is expressed in "guidance" instead of formal regulation;
2. Is too expansive, complex, and operationally impractical, increasing transaction costs and reducing economic growth;
3. Is premised on the incorrect assumption that almost all swaps US persons enter, regardless of where and how transacted, have a direct and significant connection with US commerce, requiring application of CFTC rules;
4. Relies on a substituted compliance regime that encourages an arbitrary, rule-by-rule comparison of CFTC and non-US rules under which a transaction or entity may be subject to a patchwork of CFTC and non-US regulation;
5. Shows insufficient deference to non-US regulators that have adopted comparable swaps reforms and is inconsistent with the CFTC's traditional approach of comity with competent non-US regulators in futures regulation;
6. Fails to distinguish between swaps reforms designed to mitigate systemic risk and

those that address market and trading practices suitable for adaptation to local trading conditions; and

7. Has driven global market participants away from transacting with entities subject to CFTC swaps rules and caused fragmentation of global markets into separate liquidity pools that are less resilient to market shocks and pose a greater systemic risk.

## Principles

The white paper proposes an alternative framework for applying the CFTC's swaps rules to cross-border activities that is built upon and guided by a series of principles.<sup>[3]</sup> These are:

1. **The CFTC should distinguish between swaps reforms designed to mitigate systemic risk and those designed to address market and trading practices suitable for adaptation to local market conditions.**

The white paper provides that the CFTC's focus should be on swaps reforms designed to mitigate systemic risk, such as swaps clearing, margin for uncleared swaps, dealer capital, and recordkeeping and regulatory reporting. Swaps reforms that are designed to address market and trading practices, such as public trade reporting and price transparency, trading platform design, trade execution methodologies and mechanics, and personnel qualifications, are not as directly related to cross-border risk transfer and should be of secondary importance.

2. **The CFTC should pursue multilateralism, not unilateralism, with respect to swaps reforms designed to mitigate systemic risk.**

For reforms designed to mitigate systemic risk, the CFTC should seek a stricter degree of comparability between CFTC requirements and those in jurisdictions that have adopted the G20 swaps reforms. Thus, with respect to systemic risk reforms, the CFTC's jurisdiction should continue to apply cross-border to US firms on an "entity" basis, with the availability of substituted compliance for non-US jurisdictions that are strictly comparable. The CFTC, moreover, should lead international efforts to achieve stronger coordination between regulatory jurisdictions.

3. **The CFTC should end the current division of global swaps markets into separate US person and non-US person marketplaces. Markets in regulatory jurisdictions that have adopted the G20 swaps reforms should each function as a unified marketplace under one set of comparable trading rules and under one competent regulator.**

The white paper explains that since the start of the CFTC's swap execution facility ("SEF") regime in 2013 and mandatory SEF trading in 2014, swaps trading in major financial centers around the world has separated into distinct trading and liquidity pools, with US market participants in one pool and non-US participants in another. The white paper deems this fragmentation to be detrimental to global swaps reform efforts and a potential source of systemic risk.

4. **The CFTC should be a rule maker, not a rule taker, in overseeing US markets.**

The white paper states that the CFTC should expect non-US regulators to defer to it on oversight of US derivatives trading markets and should defer to non-US regulators for activities conducted primarily in their jurisdictions, if comparable. The agency also

should seek to reconcile its rules with those adopted by its non-US regulatory counterparts, as appropriate.

5. **The CFTC should act with deference to non-US regulators in jurisdictions that have adopted comparable G20 swaps reforms, seeking stricter comparability for substituted compliance for requirements meant to address systemic risk and more flexible comparability for requirements intended to address market and trading practices.**

With respect to requirements that address market and trading practices, the CFTC's substituted compliance analysis should require flexible comparability and focus on whether a non-US regulator's regulatory framework provides sufficient outcomes to justify a positive comparability assessment. For requirements intended to address systemic risk, however, the CFTC should expect stricter comparability. This would allow market participants to rely on one set of rules without fear that another jurisdiction would selectively impose an additional layer of obligations.

6. **The CFTC should encourage non-US jurisdictions that have not adopted swaps reform for significant trading activity to adopt comparable swaps reforms.**

The CFTC should encourage broader adoption of comparable G20 swaps reform worldwide through, among other things, application of US rules to US-related entities in non-US jurisdictions without comparable G20 swaps reforms.

## **Recommendations**

Based on these principles, Chair Giancarlo recommends the following, aimed at balancing systemic risk mitigation with healthy swaps market activity in support of broad-based economic growth.

### **1. Registration of Non-US Central Counterparties ("CCPs")**

The white paper recommends that the CFTC regulate swaps CCPs based on whether the CCP is located within the United States, a jurisdiction with comparable standards, or a jurisdiction that does not have comparable standards. Specifically, the white paper recommends that the CFTC should: (1) continue to require a CCP located in the United States that seeks to clear swaps under the jurisdiction of the CFTC to register with the CFTC as a derivatives clearing organization ("DCO") and be subject to the agency's oversight; (2) expand its authority to exempt from DCO registration non-US CCPs if a CCP is subject to comparable regulation in its home country and does not pose substantial risk to the US financial system;[\[4\]](#) and (3) consider providing relief from DCO registration to non-US CCPs in non-comparable jurisdictions until those jurisdictions develop comparable standards.[\[5\]](#)

### **2. Registration of Non-US Trading Venues**

The white paper also recommends that the CFTC regulate trading venues based on whether they are located within the United States, a jurisdiction with comparable standards, or a jurisdiction that does not have comparable standards. Specifically, the white paper recommends that the CFTC should: (1) continue requiring swaps trading venues that meet the definition of a SEF located in the United States to register as a SEF or designated contract market ("DCM") with the CFTC and be subject to the

agency's oversight; (2) expand its authority to exempt from SEF registration non-US swaps trading venues in jurisdictions with comparable standards;[\[6\]](#) and (3) require non-US trading venues in jurisdictions that do not have comparable standards to register as SEFs or DCMs if they provide US persons access, subject to an appropriate materiality threshold.

### 3. **Registration of Non-US Swap Dealers**

Similar to its recommendations with respect to non-US CCPs and non-US trading venues, the white paper recommends that the CFTC regulate non-US swap dealers based on whether the swaps activity occurs in the United States, a jurisdiction with comparable standards, or a jurisdiction that does not have comparable standards.

According to the white paper, the CFTC should: (1) continue to require US persons to count all of their swap dealing transactions toward the *de minimis* threshold;[\[7\]](#) (2) require non-US persons in jurisdictions with comparable standards to (i) count all of their swap dealing activity toward their *de minimis* threshold if such non-US person's swaps are guaranteed by a US person ("Guaranteed Entities"), and (ii) if such non-US person's operating results, financial position, and statement of cash flows is consolidated with an ultimate parent entity that is a US person ("Foreign Consolidated Subsidiaries" or "FCS"), only count swap dealing activity with US persons and certain Guaranteed Entities;[\[8\]](#) and (3) require non-US persons in regulatory jurisdictions that do not have comparable standards to (i) count all of their swap dealing activity toward their *de minimis* threshold if such non-US person is a Guaranteed Entity, and (ii) if such non-US person is not a Guaranteed Entity, to count swap dealing activity with US persons and certain Guaranteed Entities.[\[9\]](#)

### 4. **Clearing and Trade Execution Requirements**

The white paper explains that certain standardized swaps are required to be submitted to CCPs for clearing and execution on a DCM, a registered SEF, or a SEF that is exempt from registration, unless no DCM or SEF makes the swap available for trade or an exception applies. In this regard, the white paper recommends that:

(1) US Persons: US Persons (including foreign branches) should continue to be subject to the CFTC's swaps clearing and trade execution requirements for all applicable swaps, unless an exception or exemption applies;

(2) Comparable Jurisdictions: Non-US persons in jurisdictions with comparable standards should be eligible to rely on substituted compliance that the CFTC grants with respect to its swaps clearing and trade execution requirements;[\[10\]](#) and

(3) Non-Comparable Jurisdictions:

(i) Non-US persons in jurisdictions that do not have comparable standards should be subject to the CFTC's swaps clearing requirement for all swaps subject to CFTC Regulation 50.4:[\[11\]](#)

- Of foreign branches, subject to a materiality threshold that the CFTC should set;
- Between Guaranteed Entities and:
  - US persons (including foreign branches),
  - Guaranteed Entities, and

- Non-US persons, subject to a materiality threshold, unless the swaps are subject to margin requirements for uncleared swaps; and
  - With (1) US persons (including foreign branches); and (2) Guaranteed Entities, unless the swaps are subject to margin requirements for uncleared swaps.
- (ii) Non-US persons in jurisdictions that do not have comparable standards should be subject to the CFTC’s trade execution requirement on a case-by-case basis because the trade execution requirement does not directly address systemic risk, and it may not be appropriate to extend the trade execution requirement to the same extent as the clearing requirement outside the United States.

## 5. “Arranged, Negotiated, or Executed” (“ANE”) Transactions

The white paper states that, if a swap is executed in the United States, then the counterparties should be required to follow US swap execution rules. In addition, it notes that any swap that is subject to the CFTC’s clearing and trade execution requirements must be traded on a SEF and centrally cleared, unless an exception or exemption applies. It then addresses two scenarios in which swap transactions by non-US counterparties are “arranged, negotiated, or executed” within the United States by personnel or agents of a non-US person located within the United States:[\[12\]](#) (1) when a third-party US intermediary (e.g., an introducing broker) located in the United States arranges or negotiates swaps among multiple non-US participants that are executed and booked outside the United States in a jurisdiction with comparable standards; and (2) when a US-based agent or employee of a non-US swap dealer arranges or negotiates a swap by the non-US swap dealer with a non-US person, where the trade is executed and booked outside the United States in a comparable jurisdiction

In the first scenario, the white paper recommends requiring the US intermediary that is engaged in arranging or negotiating swaps among multiple non-US participants to be a SEF and that the execution of the trade be subject to the rules of the SEF. In the second scenario, if a person is engaged in swaps trading activity in the United States, the white paper recommends generally applying US swaps trading rules to the person.[\[13\]](#)

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### endnotes

[\[1\]](#) See J. Christopher Giancarlo, Chairman, US Commodity Futures Trading Commission, *Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to*

*Comparable Non-U.S. Regulation* (Oct. 1, 2018), available at [https://www.cftc.gov/sites/default/files/2018-10/Whitepaper\\_CBSR100118.pdf](https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118.pdf).

[2] The white paper is intended to complement a white paper on swaps regulation reform released in April 2018. For a summary of the April 2018 white paper, please see ICI Memorandum No. 31188 (May 2, 2018), available at [https://www.ici.org/my\\_ici/memorandum/memo31188](https://www.ici.org/my_ici/memorandum/memo31188).

[3] The white paper explains that the principles, in turn, are built upon the two following foundations: (1) Section 2(i) of the Commodity Exchange Act limits the extraterritorial reach of the CFTC's swaps regulation to those activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States;" and (2) the nature of the global swaps markets is different from other financial markets primarily because swaps markets are institutional markets made up of professional traders.

[4] Under this approach, non-US CCPs would be permitted to provide clearing services to US customers indirectly through non-US clearing members, without the non-US CCP or its non-US clearing members having to register as a DCO or futures commission merchant, respectively.

[5] Such relief only would be available for non-US CCPs whose members are foreign branches ("foreign branches") of US banks that are registered as swap dealers, provided those foreign branches limit their clearing activities to proprietary and affiliate accounts or clearing customers that are non-US persons. Generally, the white paper recommends that as a starting point for staff consideration, non-US CCPs in non-comparable jurisdictions that seek to clear for US persons would be required to register as a DCO.

[6] This would permit such non-US trading venues to have US participants that are "eligible contract participants" without being required to register and US participants to satisfy their trade execution requirements on such platforms.

[7] Under CFTC regulations, a person is deemed to be a swap dealer, and therefore is required to register as one, if, during the preceding 12 months, the aggregate gross notional amount of the person's swap dealing activity exceeds the *de minimis* threshold.

[8] The white paper recommends that FCS exclude swaps with: (1) Guaranteed Entities that are registered as swap dealers (or are affiliated with a registered swap dealer); (2) Guaranteed Entities that are guaranteed by a non-financial guarantor; or (3) foreign branches. This differs from the 2016 proposed cross-border rules, which would have required an FCS to include all its swap dealing transactions toward its *de minimis* threshold (even those that take place completely outside the United States). The white paper also recommends that Guaranteed Entities and FCS that are in jurisdictions with comparable standards should be able to rely on substituted compliance with respect to applicable requirements.

[9] As with FCS in jurisdictions with comparable standards, the white paper recommends that FCS in jurisdictions with non-comparable standards exclude swaps with: (1) Guaranteed Entities that are registered as swap dealers (or are affiliated with a registered swap dealer); (2) Guaranteed Entities that are guaranteed by a non-financial guarantor; or (3) foreign branches that are registered as swap dealers.

[10] The white paper notes that the approach to substituted compliance should differ with

respect to the clearing and trading execution requirements. Because clearing is focused on systemic risk, it reasons that the CFTC should expect a stricter degree of comparability than with respect to comparability determinations for trade execution requirements.

[\[11\]](#) CFTC Regulation 50.4 establishes clearing requirements for certain classes of swaps.

[\[12\]](#) The white paper clarifies that “arranging” and “negotiating” refers to market-facing activity normally associated with sales and trading as opposed to internal, back-office activities, such as ministerial or clerical tasks, performed by personnel not involved in the actual sale or trading of the relevant swap.

[\[13\]](#) The white paper acknowledges that when the non-US dealer in an ANE transaction is subject to regulation in a comparable jurisdiction, there may be a basis to defer to the non-US jurisdiction. In those situations, the white paper notes that the CFTC staff will need to work through the various permutations to avoid fragmenting the swaps markets and imposing unwarranted costs.