

MEMO# 30351

October 26, 2016

CFTC Proposes New Definition of "US Person" for Purposes of Applying the Swap Provisions to Cross-Border Transactions; Member Call to Discuss Scheduled for Nov 14

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 66-16
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 74-16
ICI GLOBAL TRADING & MARKETS COMMITTEE No. 55-16
INTERNATIONAL COMMITTEE No. 59-16
REGISTERED FUND CPO ADVISORY COMMITTEE
SECURITIES OPERATIONS ADVISORY COMMITTEE RE: CFTC PROPOSES NEW DEFINITION OF "US PERSON" FOR PURPOSES OF APPLYING THE SWAP PROVISIONS TO CROSS-BORDER TRANSACTIONS; MEMBER CALL TO DISCUSS SCHEDULED FOR NOV 14

The Commodity Futures Trading Commission recently proposed new rules and interpretations ("Proposed Rule") that address the application of certain swap provisions of the Commodity Exchange Act to cross-border transactions.[\[1\]](#) The Proposed Rule defines key terms for cross-border transactions and addresses the cross-border application of the registration thresholds and business conduct standards ("external business conduct standards") for swap dealers ("SDs") and major swap participants ("MSPs"). The Proposed Rule also outlines whether and to what extent these thresholds and standards would apply to swap transactions that are arranged, negotiated, or executed using personnel located in the United States ("ANE transactions").

The CFTC's key terms, if adopted, will apply not only to the registration thresholds and external business conduct standards but to the cross-border application of other swap requirements. The CFTC expects to address the specific cross-border application to other substantive requirements, including their application to ANE transactions and the availability of substituted compliance, in subsequent rulemakings.

Comments on the Proposed Rule are due on December 19, 2016. A member call is scheduled for 11:00 am (Eastern Time) on November 14 to discuss whether to

comment on the Proposed Rule. A calendar invite with the details for the call will be sent out separately. If there are comments you would like the Institute to make, please contact Jennifer Choi at jennifer.choi@ici.org or Kenneth Fang at kenneth.fang@ici.org no later than November 18, 2016.

I. Definitions

The proposed definitions of “US person” and “Foreign Consolidated Subsidiary” are based on the definition of these terms in the CFTC’s final rules on the cross-border application of the margin requirements for uncleared swaps.^[2]

A. “US Person”

The Proposed Rule defines “US person” to include those individuals or entities whose activities have a significant nexus to the US market by virtue of their organization or domicile in the United States.^[3] The proposed definition for “US person” generally is consistent with the interpretation set forth in the Guidance except in two critical ways.^[4] First, unlike the Guidance, the proposed definition of “US Person” does not exclude from the term non-US funds that are publicly offered only to non-US persons and not offered to US persons (e.g., UCITS). The Proposed Rule reiterates the Cross-Border Margin Rule that whether a pool, fund or collective investment vehicle is publicly offered only to non-US persons and not offered to US persons would not be relevant in determining whether it falls within the scope of the proposed US person definition.^[5] Under the Proposed Rule, non-US funds that are offered publicly to non-US persons would be required to analyze their own facts to determine whether they have a principal place of business in the US and are a “US person” under the definition. The CFTC invites comments on whether and in what respects the CFTC should further harmonize this definition to either the interpretation of “US person” in the Guidance or the “US person” definition adopted by the SEC in Rule 3a71-3(a)(4) under the Securities Exchange Act of 1934.^[6]

Second, unlike the definition in the Guidance, the new proposed definition does not include the US majority-ownership subsection that was included in the Guidance (i.e., 50 percent US-person ownership of a fund or other collective investment vehicle).^[7] In choosing not to include the subsection in the definition, the CFTC noted the significant challenges that identifying and tracking a fund’s beneficial ownership would pose.

B. “Foreign Consolidated Subsidiary”

Consistent with the Cross-Border Margin Rule, the Proposed Rule defines the term “Foreign Consolidated Subsidiary” (“FCS”) as a non-US person that is consolidated for accounting purposes with an ultimate parent entity that is a US person.^[8] The Proposed Rule would define the term “ultimate parent entity” to mean the parent entity in a consolidated group in which none of the other entities in the consolidated group has a controlling interest, in accordance with US generally accepted accounting principles.

II. ANE Transactions

The CFTC uses the terms “arrange” and “negotiate” to refer to market-facing activity normally associated with sales and trading, as opposed to internal, back-office activities performed by personnel not involved in the actual sale or trading of the relevant swap. Accordingly, the terms would not encompass activities such as swap processing, preparation of the underlying swap documentation (including negotiation of a master agreement and related documentation), or the mere provision of research information to sales and trading personnel located outside the United States. In line with CFTC precedent,

“executed” would refer to the market-facing act of becoming legally and irrevocably bound to the terms of the swap transaction under applicable law.[\[9\]](#)

III. Cross-Border Application of Registration Thresholds

The Proposed Rule sets forth provisions to address how the *de minimis* registration threshold should apply to the cross-border swap dealing transactions of US and non-US persons. Whether a potential SD includes a particular swap in its *de minimis* calculation would depend on how the potential SD is classified (*i.e.*, US person, non-US person whose obligations under the swap are guaranteed by a US Person (“US Guaranteed Entity”), FCS, or a non-US person that is neither a FCS nor a US Guaranteed Entity).[\[10\]](#)

The Proposed Rule also seeks to address the cross-border application of the MSP thresholds to the swap positions of US and non-US persons.[\[11\]](#) Under the Proposed Rules, a potential registrant that is not a SD would count swap positions toward the MSP threshold calculations to the same extent as potential SDs count swap dealing transactions toward the SD *de minimis* calculation, except there would be no aggregation of affiliate positions.[\[12\]](#)

IV. External Business Conduct Standards

US SDs (except their foreign branches) would be required to comply with applicable external business conduct standards governing the conduct of SDs/MSPs in transacting with swap counterparties. The standards are designed to enhance counterparty protections by expanding the obligations of SD/MSPs with respect to their counterparties. The CFTC’s external business conduct standards would apply to cross-border transactions as follows:[\[13\]](#)

- US SDs and MSPs would comply with applicable external business conduct standards, without substituted compliance, except with respect to transactions conducted through a foreign branch of the US SD/MSP.
- Non-US SD/MSPs and foreign branches of US SD/MSPs would comply with applicable external business conduct standards, without substituted compliance, if the counterparty is a US person (other than a foreign branch of a US SD/MSP).
- Non-US SD/MSPs and foreign branches of US SD/MSPs would not be subject to external business conduct standards for their swaps with non-US persons and foreign branches of a US SD/MSP, subject to one narrow exception: foreign branches of US SDs and non-US SDs that use personnel located in the United States to arrange, negotiate, or execute such transactions would be required to comply with certain external business conduct standards prohibiting fraud, manipulation or other abusive conduct, without substituted compliance.

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endnotes

[\[1\]](#) See *Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants*, 81 Fed. Reg.

71949 (October 18, 2016) ("Proposing Release"), available at:
<https://www.gpo.gov/fdsys/pkg/FR-2016-10-18/pdf/2016-24905.pdf>.

[2] See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross Border Application of the Margin Requirements*, 81 Fed. Reg. 34855 (May 31, 2016) ("Cross-Border Margin Rule"), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-05-31/pdf/2016-12612.pdf>. For a summary of the Cross-Border Margin Rule, see ICI Memorandum No. 29957 (Jun. 6, 2016), available at <https://www.iciglobal.org/iciglobal/pubs/memos/memo29957>.

[3] The Proposed Rule defines a "US person" to mean:

- i. Any natural person who is a resident of the United States;
- ii. Any estate of a decedent who was a resident of the United States at the time of death;
- iii. Any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of entity similar to any of the foregoing (other than an entity described in paragraph (iv) or (v)) ("legal entity"), in each case that is organized or incorporated under the laws of the United States or that has its principal place of business in the United States, including any branch of the legal entity;
- iv. Any pension plan for the employees, officers or principals of a legal entity described in paragraph (iii), unless the pension plan is primarily for foreign employees of such entity;
- v. Any trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust;
- vi. Any legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is owned by one or more persons described in paragraphs (i) through (v) who bear(s) unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity; and
- vii. Any individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in paragraphs (i) through (vi).

See proposed 17 CFR §1.3(aaaaa)(5).

[4] See *Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations*, 78 Fed. Reg. 45292, 45308-17 (July 26, 2013) ("Guidance") (setting forth an interpretation of "US person"), available at: <https://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf>. For a summary of the Guidance, see ICI Memorandum No. 27385 (July 18, 2013), available at https://www.ici.org/my_ici/memorandum/memo27385.

[5] See Proposing Release at note 28.

[6] Exchange Act Rule 3a71-3(a)(4) defines "US person" to mean:

- Any natural person resident in the United States;
- Any partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;

- Any account (whether discretionary or non-discretionary) of a US person; or
- Any estate of a decedent who was a resident of the United States at the time of death.

See 17 CFR §240.3a71-3(a)(4). The SEC defines “principal place of business” to mean “the location from which the officers, partners, or managers of the legal person primarily direct, control, and coordinate the activities of the legal person.” It also provides that, with respect to an *externally managed* investment vehicle, this location “is the office from which the manager of the vehicle primarily directs, controls, and coordinates the investment activities of the vehicle.” See *id.*

[7] The CFTC’s definition of the term “US person” as set forth in the Guidance included a subsection (iv) which covered “any commodity pool, pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership is held, directly or indirectly by a US person(s).” See Guidance at 45302.

[8] See Proposed Rule at 71950.

[9] See Proposed Rule at 71952-53.

[10] Under the Proposed Rule, a US person would be required to count all swap dealing transactions, irrespective of the counterparty. A non-US person that is a FCS or a US Guaranteed Entity would be required to do the same. Other non-US persons would count swap dealing transactions with US persons and with non-US persons that are FCSs or US Guaranteed Entities, unless the swap is executed anonymously on a swap execution facility, designated contract market, or foreign board of trade and cleared through a registered or exempt derivatives clearing organization. All potential SDs, whether US or non-US persons, would aggregate their swap dealing transactions with those of persons controlling, controlled by, or under common control with the potential SD to the extent that those affiliates are themselves required to include those swaps in their own *de minimis* thresholds, unless the affiliated person is a registered SD.

[11] The Proposing Release provides helpful tables showing how the CFTC proposes to apply the SD and MSP registration thresholds to cross-border transactions. See Proposing Release at 71971-72.

[12] Also, swap positions of a US or non-US person entity should not be attributable to a parent, other affiliate, or guarantor for purposes of the MSP analysis if there is no recourse. If recourse is present, a US person guarantor would attribute to itself any guaranteed entity’s swap position, whether a US person or non-US person, for which the counterparty to the swap has recourse against that US person guarantor. A non-US person would attribute to itself any entity’s swap position for which the counterparty to the swap has recourse against the non-US person, unless the guarantor, the guaranteed entity, and its counterparty are non-US Persons that are neither a FCS nor a US Guaranteed Entity.

[13] The Proposing Release provides a helpful table showing how the CFTC proposes to apply the external business conduct standards to cross-border transactions. See Proposing Release at 71972.

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.