Security-based Swap Dealers

Registration Regime for Overseas Swaps Counterparties Coming into Focus, But Not There Yet

Involvement of Personnel in U.S. Will Count Toward 'De Minimis' Volume Test

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The SEC adopted a final rule Feb. 10 that will make it harder for security-based swap dealers to avoid U.S. registration using a *de minimis* exemption that incorporates a trading volume test. The SEC has been fine-tuning regulations, in concert with its foreign counterparts, that will identify derivative transactions that could trigger U.S. registration requirements based on their involvement of people in the United States.

Under the final rule, swap dealers outside the U.S. will have to keep track of the value of any deals in which they use a person on the ground in the U.S. to either arrange, negotiate or execute a transaction in connection with the entity's dealing activity, because the SEC will tally those transactions toward the maximum volume allowed for a firm to qualify for the Commission's *de minimis* exception to registration requirements. And the transaction counts whether the U.S.-based person is employed by the dealer or by the dealer's agent.

But that day is at least a year off, given that the SEC said in a Feb. 10 rulemaking that firms will not have to begin calculating these transactional volumes until a raft of other swaps rules are on the books for at least six months. The earliest possible compliance date, according to the various contingencies described in a number of related cross-border security-based swap rulemakings, is Feb. 21, 2017 (see "Compliance Date," below).

The Feb. 10 final rule, along with the rules finalized in the SEC's 2014 cross-border adopting release (see "SEC Moves Toward Security-based Swap Transparency," Jan. 27, 2015), would finalize the SEC's rulemaking efforts aimed at identifying the transactions that will be subject to the *de minimis* volume test to determine whether a foreign dealer must register with the SEC, the Feb. 10 SEC press release said. Identification is just part of a multi-part regulatory regime — which is not yet complete — intended to subject both U.S. and foreign swaps dealers to transparency, stability and oversight provisions that were part of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, when they engage in security-based swap dealing activity in the United States, said SEC Chair Mary Jo White in a commission press release Feb. 10.

"About half of the trading activity in North American corporate single-name [credit default swaps] occurs between U.S. counterparties and those based abroad, while approximately 40 percent occurs between non-U.S. counterparties," Commissioner Kara Stein said in a prepared statement Feb. 10, as the commission met to vote on the final rule. In her statement she described the risks of economic spillover effects like the dominos that fell during the 2008 global credit meltdown that resulted in the failure of several large financial institutions and triggered the Great Recession. Stein used AIG, the insurance giant with positions in swaps deals all over the map, as an example of what the Commission and its counterparties in other rich countries intend to address with the security-based swaps rulemakings. The Commodity Futures Trading Commission is

engaging in similar efforts (see ¶960 for more on CFTC regulation), but the SEC has jurisdiction over security-based swaps.

“Foreign affiliates of a U.S. financial group may expose the U.S. financial group to ‘reputational risk,’” Stein said, describing the economic contagions the SEC has set out to address. “A U.S. parent financial group is subject to consequences of the dealing activity of its foreign affiliate, regardless of any explicit guarantees. A U.S. financial group can face this exposure by absorbing its foreign affiliate’s liabilities. However, it can also face this exposure if market participants question the group’s creditworthiness in the event that it decides to not support its foreign affiliate,” she said.

Compliance Date

While the effective date of the final rule is 60 days from its Feb. 19 publication in the*Federal Register*, the compliance date is still undetermined. It will be the later of Feb. 21, 2017, or the “SBS Entity Counting Date,” which is defined as “two months prior to the ‘Registration Completion Date’.” That date turns on completion of rules establishing recordkeeping and reporting requirements, business conduct requirements under the Exchange Act Sections 15F(h) and 15F(k) and other rules that have not yet been finalized.

Stein said there were still a number of important rules that needed to be finalized “prior to turning on the new dealer registration regime, including the application of business conduct standards, the application of capital and margin, as well as other dealer requirements.” The requirements come from Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (see ¶130 of the *Guide* for more on the Dodd-Frank Act).