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SEC Adopts Rules on Non-US Firms That "Arrange, Negotiate, or Execute" Security-Based Swaps in the US

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On Wednesday, the Securities and Exchange Commission (SEC) adopted rules that will affect firms operating in the global security-based swap market. Specifically, the SEC is requiring non-US firms that arrange, negotiate, or execute security-based swaps using personnel located in the United States to include those security-based swaps in their calculations of whether they reach the threshold requiring security-based swap dealer registration.[1] Accordingly, a non-US dealer that conducts security-based swap activity through personnel located in the United States will be required to register with the SEC if its annual US-touching trading activity, including the security-based swaps entered into using US-located personnel, exceeds the applicable *de minimis* threshold. Compliance with the final rules will be required 12 months following publication in the Federal Register.

The final rules apply to security-based swaps "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." With respect to personnel "located in a U.S. branch or office," the rules apply to personnel assigned to, on an ongoing or temporary basis, or regularly working in a US branch or office. They do not apply to a non-US person assigned to a foreign office if that person is only "incidentally present" in the United States (e.g., to attend an educational or industry conference). In a footnote, the SEC notes that it interprets the term "personnel" consistent with the definition of "associated person of a security-based swap dealer" in Securities Exchange Act § 3(a)(70). In the SEC's view, this definition is not dependent on whether a natural person is technically an "employee"; rather, the SEC expects to consider whether an entity is able to control or supervise the actions of an individual when determining whether that individual is "personnel" of a US branch or office, or an agent of that entity.

According to the adopting release, "arranging," "negotiating," and "executing" refer to market-facing activity of sales and trading personnel in connection with a particular security-based swap. "Arranging" and "negotiating" include interactions with counterparties and their agents in connection with a particular transaction. "Executing" means "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." Arranging, negotiating, and executing would also cover US-located

personnel or agents who direct personnel not located in the United States to arrange, negotiate, or execute a particular transaction. Similarly, the rules would cover US-located personnel or agents who specify the trading strategy carried out through algorithmic trading or automated electronic execution of security-based swaps, even if the related server is located outside the United States.

Arranging, negotiating, and executing do not extend to the booking of trades or other internal functions such as the processing of trades, preparation of underlying documentation, ministerial or clerical tasks, or other back-office activities. Accordingly, the involvement of personnel located in a US branch or office does not fall within the scope of the final rules where such personnel do not engage in or direct market-facing activities. The final rules do not require a non-US 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 must be included in its own *de minimis* calculation.

The final rules are limited to the calculation by non-US firms of their security-based swap dealing activity for purposes of security-based swap dealer registration. They do not address other requirements proposed by the SEC relating, among other things, to whether such dealing activity would be subject to mandatory clearing or trade execution and whether the external business conduct standards or SEC Regulation SBSR (security-based swap data reporting and dissemination) would apply. The SEC expects to address these requirements in subsequent releases.

The Commodity Futures Trading Commission (CFTC) has provided no-action relief with respect to certain transaction-level requirements for non-US swap dealers that use US-located personnel or agents to arrange, negotiate, or execute swap transactions with non-US counterparties. The CFTC is considering public comment on a 2013 staff advisory that took the position that "persons regularly arranging, negotiating, or executing swaps for or on behalf of" a swap dealer are performing "core, front-office activities" for that swap dealer, and therefore, any non-US swap dealer using US-located personnel to arrange, negotiate, or execute a swap with a non-US person generally would be required to comply with the CFTC's transaction-level requirements for swap dealers.[2]

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[1] 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; Security-Based Swap Dealer *De Minimis* Exception, Exchange Act Release No. 77104 (Feb. 10, 2016). Under Exchange Act rule 3a71-2, the current *de minimis* threshold for security-based swap dealer registration is $8 billion in gross notional dealing activity over the preceding 12 months for credit default swaps and $400 million for all other security-based swaps. These limits are subject to reduction by the SEC to $3 billion for credit default swaps and $150 million for all other security-based swaps. The threshold for security-based swaps with certain special entity counterparties is $25 million. See Exchange Act Rule 3a71-2.

[2] *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" (Nov. 14, 2013); Request for Comment on Application of Commission Regulations to Swaps Between Non-US

Swap Dealers and Non-US Counterparties Involving Personnel or Agents of the Non-US Swap Dealers Located in the United States, 79 Fed. Reg. 1347 (Jan. 8, 2014); Extension of No-Action Relief: Transaction-Level Requirements for Non-US Swap Dealers, CFTC Letter No. 15-48 (Aug. 13, 2015).

Authors

Paul M. Architzel

RETIRED SENIOR COUNSEL

+1 202 663 6000

Jeannette K. Boot

PARTNER

jeannette.boot@wilmerhale.com

+1 212 295 6507

Elizabeth L. Mitchell

PARTNER

elizabeth.mitchell@wilmerhale.com

+1 202 663 6426

Dino Wu

PARTNER

dino.wu@wilmerhale.com

+1 212 295 6436

Daniel J. Martin

COUNSEL

daniel.martin@wilmerhale.com

+1 202 663 6038