

GIBSON DUNN



Securities Enforcement Update

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## The SEC and Security-Based Swap Substituted Compliance: Preparing for Potential Scrutiny

*Substituted compliance offers a pathway for cross-border firms to navigate regulatory demands more efficiently – but regulatory oversight remains.*

Rooted in the derivatives markets, substituted compliance offers a pathway for cross-border regulated entities to navigate regulatory demands more efficiently. It permits a foreign firm regulated by the U.S. Securities and Exchange Commission (SEC) or the Commodity Futures Trading Commission (CFTC) to satisfy certain U.S. regulatory requirements via compliance with comparable requirements in its home jurisdiction. Security-based swap (SBS) regulations have matured and substituted compliance is likely to become increasingly important to participants in the growing digital asset markets, which are very often cross-border.

It is critical for foreign firms relying on substituted compliance orders to remain vigilant in complying with these orders. For instance, the SEC's Examinations Division has expressly noted its focus on compliance with SBS rules generally and, specifically, whether relevant entities are complying with the SEC's substituted compliance orders.<sup>[1]</sup> A recent first-in-kind enforcement action further signals that this topic occupies an area of interest to the SEC's Enforcement Division.<sup>[2]</sup> And regulators, among other things, want to ensure that foreign firms active in U.S. markets do not have a competitive advantage when it comes to regulatory costs or burdens. No matter the administration, oversight of substituted compliance will remain a priority.

## **I. Substituted Compliance in the SBS Market**

The SEC must affirmatively issue an order granting registered security-based swap dealers (SBSDs) and major security-based swap participants (SBSPs and, together with SBSDs, SBS Entities) the option to elect to apply substituted compliance for the Securities Exchange Act of 1934's provisions and applicable rules. If an SBS Entity operates under such an order, it may satisfy specified requirements by complying with comparable foreign requirements. Many of the substituted compliance orders that the SEC has granted have also included conditions to ensure that the foreign rules truly stand in for U.S. rules. In practice, many global firms leverage substituted compliance to operate internationally. Today, 39 SBS Entities have indicated that they rely on substituted compliance orders.[\[3\]](#)

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## **II. The Current Climate**

The subject of substituted compliance has been in the news recently. In May 2025, the CFTC's Market Participants Division (MPD) and Division of Enforcement issued new procedures for CFTC-registered non-U.S. swap dealers, non-U.S. major swap participants, and the foreign branches of U.S. swap dealers using substituted compliance.[\[4\]](#) The procedures provide that the foreign regulator, not the CFTC, will interpret and apply the home country's rules and CFTC staff will generally defer to the foreign regulator's findings. Any CFTC inquiry into a substituted compliance matter will initially be handled by the MPD, and only if the issue is material might it be referred for enforcement action. In essence, the CFTC will not second-guess foreign regulators on minor issues and will reserve enforcement for serious lapses.

The SEC has explicitly noted that substituted compliance does not eliminate a firm's obligations under U.S. securities laws[\[5\]](#) and that a failure to comply with foreign regulations under which a firm is substituting compliance is a violation of U.S. law.[\[6\]](#) As such, the SEC retains full authority to inspect, examine, and enforce requirements against SBS Entities relying on substituted compliance.[\[7\]](#) When not operating in line with a substituted compliance order, registrants must comply directly with all relevant U.S. rules. Moreover, firms operating under substituted compliance regimes must understand that a single failure to comply can result in violations of significantly more requirements than it may first appear.[\[8\]](#)

## **III. Key Compliance Considerations for Firms Relying on Substituted Compliance**

Firms relying on substituted compliance orders must live up to agreed standards, and U.S. regulators, no matter how pro-market and against overregulation and overenforcement they may be, are unlikely to forego enforcement action in the face of significant compliance lapses. Firms should proactively double-check their compliance with all applicable requirements today and take action to identify and correct weaknesses or outstanding deficiencies, whether identified by a foreign regulator, an internal review, or otherwise, as they could morph into issues in the U.S.

There are several critical compliance points to keep front-of-mind when relying on a substituted compliance order. Overall, firms should take proactive steps to ensure they meet all relevant requirements—both U.S. and foreign. Key considerations for relevant registered entities and compliance teams include:

- *Meet All Conditions of SEC Orders.* Ensure that all relevant personnel are clear on the scope and limits of the firm's substituted compliance order, including the specific conditions imposed in the order. Certain requirements vary depending on whether a firm is prudentially regulated.
- *Adhere Rigorously to Comparable Foreign Laws.* Treat the substituted foreign regulations as if they were U.S. law. The SEC has been clear that if a firm falls out of compliance with applicable foreign requirements or the specific conditions of its substituted compliance order, it is violating the parallel SEC requirement.<sup>[9]</sup>
- *Maintain Robust Communication with Regulators.* Firms engaged in substituted compliance may effectively answer to multiple regulators: the U.S. regulator(s) and their home regulator(s). Beyond ensuring required notices are made to the proper regulators, proactive, transparent communication can help prevent misunderstandings.
- *Prepare for Examinations and Documentation Requests.* Be prepared to demonstrate compliance with documentation. The SEC requires strict recordkeeping and a failure to abide may not be overlooked, even if compliance is demonstrated retrospectively.

#### IV. Conclusion

Firms operating under substituted compliance orders can strengthen their control environment and reduce the risk of falling out of step with either U.S. or foreign laws by remaining attentive and proactive. The SEC is not abandoning its interest in this area; rather, it remains vigilant to ensure substituted compliance does not become a loophole for laxity or a competitive advantage for foreign firms doing business in the U.S. The importance of these precautions is only growing, as the SEC appears poised to hold a harder line on enforcement in the substituted compliance arena.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding the issues discussed in this update, including any requests for information from the regulators.

<sup>[1]</sup> SEC Division of Examinations, 2024 Examination Priorities 11 (2025), *available at* <https://www.sec.gov/files/2025-exam-priorities.pdf>.

<sup>[2]</sup> MUFG Securities EMUA plc, Exchange Act Release No. 34-103646 (Aug. 6, 2025), *available at* <https://www.sec.gov/enforcement-litigation/administrative-proceedings/34-103646-s>.

<sup>[3]</sup> Substituted Compliance Notices, U.S. Securities and Exchange Commission (last visited Aug. 6, 2025), *available at* <https://www.sec.gov/about/divisions-offices/division-trading-markets/security-based-swap-markets/substituted-compliance-notice>.

[4] CFTC Press Release, CFTC Releases Procedures on Registered Non-U.S. Swap Entities Using Substituted Compliance (May 20, 2025), *available at* <https://www.cftc.gov/PressRoom/PressReleases/9076-25>.

[5] SEC Staff Guidance, Information Regarding Foreign Regulatory Requirements for Substituted Compliance Applications (Dec. 23, 2019), *available at* <https://www.sec.gov/files/staff-guidance-substituted-compliance-applications.pdf>.

[6] Order Granting Conditional Substituted Compliance in Connection With Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic, Exchange Act Release No. 34-92484, 86 Fed. Reg. 41612 (Aug. 2, 2021), *available at* <https://www.federalregister.gov/documents/2021/08/02/2021-16135/order-granting-conditional-substituted-compliance-in-connection-with-certain-requirements-applicable>.

[7] *Id.*

[8] A failure to comply with certain substituted compliance obligations can create a domino effect of violations. For example, a registered SBSB may only substitute compliance for recordkeeping requirements under Exchange Act Rule 18a-5(a)(9) if it also applies substitutes compliance for the capital requirements of Exchange Act Section 15F(e) and Exchange Act Rules 18a-1 and 18a-1a through 18a-1d. As such, a violation of the capital requirements would also create a violation of the recordkeeping requirements. The same goes for certain financial reporting requirements under Exchange Act Rule 18a-7 and those same capital requirements.

Additionally, a firm that fails to comply with its substituted compliance obligations must comply with the U.S. requirements for which it was substituting compliance. If the firm also fails to comply with those U.S. requirements, it may be found to have violated both its substituted compliance obligations and its obligations to comply with the U.S. requirements. For example, a registered SBSB satisfying that fails to meet its substituted compliance obligations with respect to annual reporting obligations and methods to reasonably address non-compliance issues under Exchange Act Section 15F(k) and Exchange Act Rule 15Fk-1 may also be found to have violated Exchange Act Section 15F(k) and Exchange Act Rule 15Fk-1.

[9] Order Granting Conditional Substituted Compliance in Connection With Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic, Exchange Act Release No. 34-92484, 86 Fed. Reg. 41612 (Aug. 2, 2021), *available at* <https://www.federalregister.gov/documents/2021/08/02/2021-16135/order-granting-conditional-substituted-compliance-in-connection-with-certain-requirements-applicable>.

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