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January 10, 2011

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Re: Registration of Swap Dealers and Major Swap Participants, RIN 3038-AC95;¹

Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant” and “Eligible Contract Participant,” RIN 3235-AK65.²

Secretary Murphy, Secretary Stawick:

The Institute of International Bankers (the “Institute”) appreciates the opportunity to provide comments to the Securities and Exchange Commission (the “SEC”) and the Commodity Futures Trading Commission (the “CFTC” and, together with the SEC, the “Commissions”) with respect to the Proposed Rules. The Institute and its members support the efforts of the Commissions and their counterparts in other jurisdictions to enhance the resiliency of the financial system, reduce systemic risk and increase transparency in the OTC derivatives markets. Given the truly global nature of the OTC derivatives markets, the Institute believes that, to accomplish these objectives, the Commissions must establish, in the near-term, an appropriate framework for U.S. regulation of the cross-border swap activities of foreign banks.³

¹ 75 Fed. Reg. 71379 (Nov. 23, 2010) (the “CFTC Registration Proposal”).

² 75 Fed. Reg. 80174 (Dec. 21, 2010) (the “Joint Definitions Proposal” and, together with the CFTC Registration Proposal, the “Proposed Rules”).

³ For convenience, unless otherwise specified, references in this letter to “swaps” are intended to refer to both swaps and security-based swaps.

The Institute’s mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.



INSTITUTE OF INTERNATIONAL BANKERS

While such a framework must of course be consistent with the Commissions' statutory mandates under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and appropriately protective of U.S. markets and customers, the Institute emphasizes that it must also take into account the various ways in which cross-border swap activities are conducted, inherent limitations on the Commissions' ability to effectively oversee extraterritorial activities, and the legitimate interests of regulators outside the U.S. in discharging their responsibilities as the primary supervisors of foreign banks.

In light of these considerations, the Institute respectfully proposes to the Commissions below a framework for global supervision of cross-border swap activity by foreign banks. The proposed framework is designed to (i) allocate to the Commissions the regulation of swap activity conducted with U.S. counterparties, (ii) allocate to home (or non-U.S. host) country authorities the regulation of swap activity conducted with counterparties located outside the U.S., and (iii) establish an appropriate allocation of regulatory responsibilities for registration, transaction-specific and non-transaction-specific supervision. In recognition of the structural diversity of the swap markets, this letter provides an overview of how this framework would be applied to a variety of common transaction paradigms.

The Institute believes that this proposed framework is best-suited to accomplishing Dodd-Frank's objectives while minimizing the potential for overlapping and inconsistent requirements. As a result, this framework would reinforce continued cross-border regulatory cooperation, promote efficient use of supervisory resources, prevent fragmentation of the derivatives markets along regional lines, and avoid the concomitant adverse consequences for systemic risk, transparency and economic efficiency. We believe that the proposed framework is consistent with the purposes of Dodd-Frank and within the scope of the Commissions' interpretive and definitional authority thereunder.

SUMMARY

Sections 731 and 764 of Dodd-Frank require swap and security-based swap dealers (collectively, "Swap Dealers") and major swap and security-based swap participants (collectively, "MSPs") to register with the CFTC and the SEC. Sections 721 and 761 of Dodd-Frank generally define a Swap Dealer as any person who (i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account, or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps. Sections 721 and 761 generally define MSPs, in turn, to include persons whose swap positions exceed thresholds established for the "effective monitoring, management, and oversight of entities that are systemically significant or can significantly impact the financial system of the United States" or whose "outstanding swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets" (emphases added).



INSTITUTE OF INTERNATIONAL BANKERS

Section 712(d) directs the Commissions, in consultation with the Board of Governors of the Federal Reserve System (the “Board”), to further define Swap Dealer and MSP. Section 712(d) also provides the Commissions with broad, flexible authority to adopt such other rules regarding the Swap Dealer and MSP definitions as the Commissions determine are necessary and appropriate, in the public interest, and for the protection of investors.

Sections 722 and 772 of Dodd-Frank, in turn, establish the territorial scope of each Commission’s jurisdiction with respect to swap activities. For the CFTC, Section 722 provides that the provisions of the Commodity Exchange Act (“CEA”) relating to swaps that were enacted by Title VII of Dodd-Frank “shall not apply to activities outside the United States unless those activities . . . have a direct and significant connection with activities in, or effect on, commerce of the United States [or] contravene [CFTC anti-evasion rules].” For the SEC, Section 772 provides that “[n]o provision” of the Securities Exchange Act of 1934 (the “Exchange Act”) added by Title VII of Dodd-Frank “shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of [SEC anti-evasion rules].” These provisions are consistent with existing interpretations and statutory provisions setting forth each of the Commissions’ jurisdictions.⁴

Congress also recognized the Board’s expertise in supervising the cross-border banking operations of foreign banks when it designated the Board, in Section 721’s “prudential regulator” definition and the capital and margin provisions of Sections 731 and 764, as the prudential regulator of Swap Dealers and MSPs that are state-licensed branches and agencies of foreign banks, foreign banks that do not operate insured branches, and foreign banks that are, or are treated as, bank holding companies under the International Banking Act of 1978.⁵

As a general matter, the international framework for the supervision of cross-border banking activities is premised on an allocation of supervisory responsibilities across home and host country supervisors. The Board’s own framework for supervising the cross-border banking operations of a foreign bank is based on an understanding that the foreign bank is

⁴ See, e.g., Statement of Policy Regarding Exercise of [CFTC] Jurisdiction Over Reparation Claims that Involve Extraterritorial Activities by Respondents, 49 Fed. Reg. 14721 (Apr. 13, 1984) (whether a person is required to be registered under the CEA may be determined by reference to whether (i) the person is based in the U.S., (ii) the person engages in the prescribed activities with customers in the U.S. or (iii) the prescribed activities take place or originate in the U.S.); In the Matter of Sumitomo Corporation, Comm. Fut. L. Rep. ¶27, 327 (May 11, 1998) (CFTC enforcement action for manipulative copper trading outside the U.S. that directly affected U.S. prices); Exchange Act Section 30(b) (providing that the Exchange Act “shall not apply to any person insofar as he transacts a business in securities without the jurisdiction of the United States”).

⁵ Section 721 similarly designates the Office of the Comptroller of the Currency (the “OCC”) as the prudential regulator of Swap Dealers and MSPs that are federally-licensed branches and agencies of foreign banks. Notably, in exercising supervisory authority over federal branches and agencies in matters relating to capital, the OCC looks to the capital of the foreign bank itself. See 12 C.F.R. § 28.14(a).



INSTITUTE OF INTERNATIONAL BANKERS

subject to primary supervision by its home country authority, with the Board, as a host country supervisor, exercising appropriate oversight of the bank's U.S. operations.⁶

As part of this framework, the Board assesses a foreign bank's capital adequacy in approving applications by the bank to establish a U.S. branch or agency or to make a bank or nonbank acquisition in the United States.⁷ Such assessments require a determination regarding whether the foreign bank's capital is equivalent to the capital that would be required of a similarly situated U.S. banking organization.⁸ Similarly, the Board assesses a foreign bank's capital in connection with a declaration by the bank to become a financial holding company ("FHC"), which requires that the foreign bank be "well-capitalized." For these purposes, the Board's assessment is based on whether the foreign bank's capital is comparable to the capital required in the case of a similarly situated U.S. banking organization seeking FHC status, "giving due regard to the principle of national treatment and equality of competitive opportunity."⁹ In the case of a foreign bank whose home country supervisor has adopted capital standards that are consistent with the Capital Accord of the Basel Committee on Banking Supervision, these various determinations are made on the basis of the bank's capital ratios calculated in accordance with applicable home country standards.¹⁰

As a result, as the Board is vested with, and will retain, authority to set and enforce capital and margin standards for foreign banks and state-licensed U.S. branches and agencies that register as Swap Dealers, it would be consistent with the Board's long-standing approach to cross-border banking supervision for it to give appropriate deference to home country supervisors with respect to capital and margin oversight in those cases where the Board has determined, or in the future determines, that the relevant supervisory regime is consistent

⁶ See Federal Reserve Board, "Policy Statement on the Supervision and Regulation of Foreign Banking Organizations" (Feb 23, 1979), Federal Reserve Regulatory Service 4-835; Federal Reserve Board Supervisory Letter SR 08-09 re Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 16, 2008).

⁷ See 12 U.S.C. §§1842(c), 1843(j) and 3105(d)(3)(B) and (j)(2).

⁸ In the case of branches and agencies, the capital adequacy determination is made by reference to the capital of the foreign bank since a branch or agency does not have any capital itself. See, e.g., 12 C.F.R. § 225.2(r)(3)(ii).

⁹ See 12 U.S.C. §1843(l)(3).

¹⁰ See, e.g., 12 C.F.R. §§ 225.2(r)(3)(i)(A) (bank and nonbank acquisitions) and 225.90(b)(1) (FHC declarations). In considering whether a foreign bank that seeks to become an FHC is well-capitalized in accordance with comparable capital adequacy standards, the Board also considers the foreign bank's composition of capital, Tier 1 leverage ratio, accounting standards, long-term debt ratings, reliance on government support to meet capital requirements, anti-money laundering procedures, and whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country authorities. See 12 C.F.R. § 225.92(e)(1).



INSTITUTE OF INTERNATIONAL BANKERS

with the standards required under Dodd-Frank.¹¹ This approach is also consistent with the international harmonization provisions contained in Section 752 of Dodd-Frank.

Further, the Swap Dealer/MSP provisions of Dodd-Frank must be interpreted in light of generally applicable principles of statutory construction. In particular, as reaffirmed by the Supreme Court in its recent Morrison v. National Australia Bank decision, it is a “long-standing principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.”¹² The presence of the territorial limitations in Sections 722 and 772 should not be regarded as indicating a contrary congressional intent to apply Title VII of Dodd-Frank extraterritorially, except in the limited circumstances expressly addressed by Sections 722 and 772.¹³ This is especially the case given that, under principles of statutory construction, Congress is deemed to have been on notice of the Morrison decision when it enacted Dodd-Frank and Congress chose to enact language in Section 772 that is modeled on the language in Section 30(b) of the Exchange Act interpreted by the Court in Morrison.

Moreover, as the CFTC has noted, even where the Commissions may have jurisdiction, considerations of international comity should play an important role in determining the appropriate scope for the Commissions’ oversight of extraterritorial activities under federal statutes.¹⁴ In the particular context of Title VII of Dodd-Frank, the Commissions must take into

¹¹ Sections 731 and 764 of Dodd-Frank require the Board’s capital requirements for Swap Dealers and MSPs to ensure the safety and soundness of the Swap Dealer or MSP and be appropriate for the risk associated with the non-cleared swaps held by the Swap Dealer or MSP. In the Institute’s view, home country capital requirements deemed comparable by the Board in accordance with its longstanding approach to cross-border banking supervision would clearly satisfy these standards, especially as deference to those requirements would facilitate consolidated supervision by home country authorities. For similar reasons, the Institute also views this approach as warranted for non-U.S. entities for which the Commissions are responsible for setting capital and margin requirements, such as foreign broker-dealers and investment firms that are also subject to comparable requirements supervised by home country authorities. Such an approach would help to ensure that the Commissions and the prudential regulators establish and maintain comparable capital and margin requirements, as required by Sections 731 and 764 of Dodd-Frank.

¹² 130 S. Ct. 2869 (2010) at 2877. Notably, in applying Morrison in the context of security-based swaps to hold that the federal securities laws do not permit recovery of losses from swap agreements that reference securities traded on a foreign exchange, the U.S. District Court for the Southern District of New York recently emphasized “Morrison’s strong pronouncement that U.S. courts ought not to interfere with foreign securities regulation without a clear Congressional mandate.” Elliot Associates, L.P. v. Porsche Automobil Holding SE, No. 10 Civ. 532 (HB) (S.D.N.Y. Dec. 30, 2010) at 13. The Institute urges the Commissions to apply the same principle to Title VII, *i.e.*, to avoid applying the normative regulatory provisions of Title VII in a manner that would unduly interfere with the regulation of foreign banks by their home country authorities.

¹³ See id. at 2882-83 (applying the same analysis to the analogous language in Section 30(b) of the Exchange Act).

¹⁴ CFTC Registration Proposal at 71382 (citing Hartford Fire Insurance Co. v. California, 509 U.S. 764 (1993)).



INSTITUTE OF INTERNATIONAL BANKERS

account the nature and structuring of the interactions between swap counterparties located within and outside the U.S., the extent to which other regulatory regimes substantially parallel U.S. law, and the extent to which non-U.S. regulators are better positioned to effectively supervise the activities conducted, and the institutions domiciled, in their jurisdictions.¹⁵

These legal considerations underscore the very real practical considerations that the Commissions must address. Globally, there are a number of paradigms under which swap activity is conducted. To achieve the benefits of reduced risk and increased liquidity and efficiency associated with netting and margining on a portfolio basis, foreign banks (like their U.S. domestic counterparts) typically seek to transact with swap counterparties globally, to the extent feasible, through a single, highly creditworthy entity. In many cases, however, the personnel who have relationships with U.S. customers or who manage the market risk of the foreign bank's swap portfolio are located regionally, outside the jurisdiction in which the foreign bank is domiciled. In some cases, entities other than the foreign bank (such as a U.S. branch, agency, or affiliate) transact with local customers in order to satisfy unique customer documentation, insolvency, tax, regulatory, or other considerations.

Additionally, the swap and other activities of most foreign banks are already subject to comprehensive prudential supervision and regulation by home country authorities, who, of necessity, serve as the primary supervisors of those activities. Authorities in those jurisdictions likewise also often permit U.S. banks to deal in derivatives with institutional customers in those jurisdictions without becoming subject to host country licensing or registration requirements.¹⁶ The European Commission (“EC”) has proposed for comment and is in the process of considering revisions to the Markets in Financial Instruments Directive (among others) that would allow it to negotiate mutual recognition frameworks with non-EU countries that would result in “exemptive relief for investment firms and market operators based in jurisdictions with equivalent regulatory regimes applicable to markets in financial instruments.”¹⁷ The Institute strongly urges the Commissions to work cooperatively with authorities in the EU and other jurisdictions, consistent with the principles articulated by the G-

¹⁵ See 1 Restatement (Third) of Foreign Relations Law of the United States §§ 402-403 (1987), cited in CFTC Registration Proposal at 71382.

¹⁶ See, e.g., FSA PERG 2.9.15-17 (overseas person exclusion).

¹⁷ Public Consultation: Review of the Markets in Financial Instruments Directive (MiFID) (Dec. 8, 2010) at Section 8.3 (Dec. 8, 2010), available at http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf. The EC also noted that it considers it necessary to establish an EU-wide regime for access by non-EU market participants to EU financial markets “in order to create a real level playing field for all financial services actors in the EU territory.” Id.



INSTITUTE OF INTERNATIONAL BANKERS

20,¹⁸ in implementing frameworks for cross-border access, based on home country supervision that is determined to be equivalent to that of the host jurisdiction(s).¹⁹

Accordingly, the Commissions should establish a framework for cross-border swap activities that preserves and leverages the strengths of existing market practices and home country supervision and regulation. Such a framework would have the salutary benefits of facilitating cross-border liquidity and access of counterparties to both domestic and offshore markets. The Commission should likewise avoid a framework that is duplicative, inefficient (for supervisors and market participants) and would result in unrealistic extraterritorial supervisory responsibilities for the Commissions and potential fragmentation of the derivatives markets. In this regard, we note that any inefficiencies associated with an inappropriate U.S. framework are likely to be compounded to the extent that any such framework engenders reciprocal approaches abroad.

Specifically, the Institute respectfully recommends that the Commissions use the interpretive and definitional authority granted to them under Title VII of Dodd-Frank to provide certain clarifications discussed in **Part I** below regarding the nature of the connections to the U.S. that would require a non-U.S. person to register as a Swap Dealer or MSP. The Institute further recommends that the Commissions use that authority to establish a framework for Swap Dealer and MSP registration and regulation that addresses the following transaction paradigms:

- (a) **Transactions Directly with a Foreign Bank.** As discussed in **Part II.A** below, a foreign bank that transacts in swaps in a dealing capacity directly (or through U.S. introducing brokers and/or broker-dealers) from abroad with U.S. customers without intermediation by a U.S.-registered Swap Dealer should be subject to registration with the Commissions as a Swap Dealer, should be required to comply with Dodd-Frank's business conduct standards in connection with such activity, should be required to comply with home country capital and margin standards as deemed comparable by the Board in accordance with its longstanding approach to cross-border banking supervision (as described above), and should otherwise be subject to home country standards and supervision;

¹⁸ Consistent with declarations by the G-20, both the proposed European Market Infrastructure Reform ("EMIR") and the amendment to Japan's Financial Instruments and Exchange Act enacted in May 2010 provide for mandatory clearing and enhanced public and regulatory transparency requirements for OTC derivatives. See Derivatives Reform: Comparison of Title VII of the Dodd-Frank Act to International Legislation, presentation prepared by the CFTC Staff for the Global Markets Advisory Committee (Oct. 5, 2010), available at http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/gmac_100510-cftc2.pdf. A further proposed compromise version of EMIR was published by the Presidency of the Council of Ministers on December 7, 2010, and is available at <http://register.consilium.europa.eu/pdf/en/10/st17/st17615.en10.pdf>.

¹⁹ To the extent that the Commissions believe that further legislative authorization would facilitate the implementation of such frameworks, the Institute strongly urges the Commissions to pursue such authorization.



INSTITUTE OF INTERNATIONAL BANKERS

- (b) **Transactions Intermediated by a Registered U.S. Branch, Agency, or Affiliate.** As discussed in **Part II.B** below, a foreign bank subject to home country capital requirements deemed comparable by the Board in accordance with its longstanding approach to cross-border banking supervision that transacts in swaps indirectly with U.S. customers through the intermediation of a U.S.-registered Swap Dealer acting as agent of the foreign bank should not itself be required to register as a Swap Dealer in the U.S. where the U.S.-registered Swap Dealer acting as agent takes responsibility for complying with Dodd-Frank's business conduct and other transaction-specific requirements as though it were the swap counterparty;
- (c) **Transactions with a U.S. Branch, Agency, or Affiliate Acting as Principal in a Dealer Capacity.** As discussed in **Part II.C** below, a U.S. branch, agency, or affiliate of a foreign bank that, acting as a principal in a dealer capacity, transacts in swaps with counterparties located within and outside the U.S. should be required to register as a Swap Dealer in the U.S. and to comply with Dodd-Frank's business conduct and other regulatory standards (including capital and margin requirements as applied by the Board or the OCC, as applicable, in the case of a U.S. branch or agency)²⁰ in connection with all of its swap activity conducted from the U.S., but the foreign bank itself should not need to register and be subject to regulation as a Swap Dealer; and
- (d) **Inter-Branch or Inter-affiliate Transactions.** As discussed in **Part II.D** below, swap transactions between a registered U.S. branch, agency, or affiliate and an unregistered foreign bank (or between a registered foreign bank and its unregistered U.S. branch, agency, or affiliate) conducted for the purpose of allocating market risk arising from swap dealing activities should not require the participating unregistered entity to register as a Swap Dealer or MSP, and such transactions should also not be subject to Dodd-Frank's mandatory clearing, execution, margin, or counterparty business conduct requirements.

Regardless of which of these transaction paradigms applies, this proposed regulatory framework would ensure that (i) the Board would be able to make a determination as to the comparability of the foreign bank's capital in accordance with its longstanding approach to cross-border banking supervision and, in appropriate circumstances, defer to home country capital requirements and prudential supervision and (ii) responsibility for compliance with Dodd-

²⁰ As discussed above in the text accompanying note 8, the capital of a U.S. branch or agency is assessed by reference to the capital of the foreign bank.



Frank's mandatory clearing, execution, counterparty business conduct, margin, segregation, and recordkeeping requirements would lie with a Commission registrant.²¹

DISCUSSION

I. Overall Scope of Swap Dealer and MSP Registration

In order to address the application of Swap Dealer or MSP registration and other requirements to particular transaction paradigms, the Commissions must first determine the nature of the connections to the U.S. that could require a non-U.S. person to register as a Swap Dealer or MSP.

In this regard, the Institute agrees with the CFTC that a person should not be required to register as a Swap Dealer if its only connection to the U.S. is the use of a U.S.-registered swap execution facility, derivatives clearing organization, or designated contract market in connection with its swap dealing activities, or its reporting of swaps to a U.S.-registered swap data repository.²² The Institute urges the SEC to adopt a similar interpretation with respect to security-based swaps, consistent with its approach to foreign securities broker-dealers under the Exchange Act. The Institute similarly does not regard the reference to a U.S. underlier or reference entity in a swap conducted outside the U.S. by counterparties located outside the U.S. as a sufficient connection to the U.S. to subject either counterparty to U.S. Swap Dealer registration requirements, and we urge the Commissions to adopt such an interpretation.²³

²¹ In recommending this proposed framework, the Institute has sought to focus on certain core interpretive, definitional and other issues that arise in relation to cross-border swap activities. There are naturally other issues relating to the Swap Dealer and MSP definitions and other aspects of Dodd-Frank (including Section 716) that are relevant to internationally headquartered banks but are beyond the scope of this comment letter. For instance, the Institute urges the Commissions to apply the *de minimis* exception to the Swap Dealer definitions to foreign banks in a manner consistent with Sections 722 and 772 of Dodd-Frank, such as by excluding swaps with counterparties located outside the U.S. from the calculation of any relevant threshold based on size of positions or number of counterparties. The Institute also would like to call the CFTC's attention to the exclusion from the Swap Dealer definition for an insured depository institution that offers to enter into a swap with a customer in connection with originating a loan with that customer. Consistent with the longstanding U.S. principle of national treatment and equality of competitive opportunity with respect to foreign banks' U.S. operations, the CFTC should exercise its authority under Section 712(d) of Dodd-Frank to make that exclusion available to uninsured branches and agencies of foreign banks on the same terms that it is available to U.S. banks that are insured depository institutions.

²² CFTC Registration Proposal at 71382.

²³ The Institute acknowledges that the reference to a U.S. underlier or use of a U.S. execution venue could be relevant to the Commissions' exercise of so-called "effects" jurisdiction under appropriate circumstances. ("Effects" jurisdiction generally refers to a U.S. regulator's authority to regulate or prosecute conduct outside the U.S. that has a certain "effect" within the U.S. that is subject to regulation or prohibition.) The extent of the Commissions' effects jurisdiction is beyond the scope of this comment letter. We merely note that determinations

(footnote continued on next page . . .)



INSTITUTE OF INTERNATIONAL BANKERS

Similarly, neither the manner in which a swap is executed nor the underlier or reference obligation for the transaction should have any bearing on MSP registration, since neither factor is relevant to whether a non-U.S. person's swap activities give rise to the exceptional risks to the U.S. financial system that are the basis for MSP registration. Rather, the analysis of whether a non-U.S. person should register as an MSP should turn upon the scope and nature of its swap positions with unaffiliated U.S. counterparties (including U.S. clearinghouses, to the extent positions in cleared swaps are relevant to the determination of whether an entity is an MSP), and the related credit exposures to which they give rise.

Solicitation of or negotiation with counterparties located outside the U.S. by U.S.-based personnel employed by a separate U.S. branch, agency, or affiliate acting as agent for a non-U.S. person should also not subject a non-U.S. person to Swap Dealer registration. Dodd-Frank contemplates separate registration regimes, where appropriate, for persons who act in such an introducing capacity – introducing broker registration for swaps, and broker-dealer registration for security-based swaps. Similarly, swap portfolio management activities by a U.S. agent or U.S. advisor of a non-U.S. person are best addressed by requiring the agent or advisor, where appropriate, to register as either a commodity trading advisor (for swaps) or investment adviser (for security-based swaps), and should not subject the non-U.S. person to MSP registration unless the non-U.S. person's swaps are with unaffiliated U.S. counterparties (including U.S. clearinghouses, as noted above).²⁴

It bears noting, in this regard, that different branches and agencies of a foreign bank should not be treated as the same legal "person" for purposes of Swap Dealer designation. As noted above, Dodd-Frank's "prudential regulator" definition distinguishes between a state or federally-licensed branch or agency of a foreign bank, on the one hand, and a foreign bank that does not operate an insured branch, on the other. These distinctions suggest that Congress intended to take an approach to Swap Dealer designation that is consistent with the traditional approach of federal banking regulation, which likewise distinguishes between the U.S. branch or agency of a foreign bank and the foreign bank's branches and agencies outside the U.S.²⁵

(. . . footnote continued from previous page)

with respect to the non-regulation or non-registration of certain activities or persons outside the U.S. do not imply limitations on the scope of the relevant Commission's effects jurisdiction.

²⁴ The Institute notes that whether registration as an introducing broker, broker-dealer, commodity trading advisor, or investment adviser is required under the relevant provisions will, in a given case, of course depend on the facts and circumstances of the activities conducted by U.S. personnel.

²⁵ See Section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101(b)) (distinguishing between an "agency," a "branch," and a "foreign bank").



INSTITUTE OF INTERNATIONAL BANKERS

To the extent that a U.S. branch or agency of a foreign bank or the foreign bank itself chooses to register as a Swap Dealer, Dodd-Frank provides the Commissions with authority to designate and regulate only those branches or agencies that transact with U.S. customers. Specifically, Dodd-Frank’s Swap Dealer definitions provide that a “person may be designated as a [swap/security-based swap dealer] for a single type or single class or category of . . . activities and considered not to be a [swap/security-based swap dealer] for other types, classes, or categories of . . . activities” (emphases added).²⁶ Accordingly, in circumstances where it is appropriate to require registration, the Commissions should designate as a Swap Dealer only the particular U.S. or non-U.S. branch or agency of the foreign bank involved in the execution of swaps with U.S. customers.

Moreover, the Institute strongly believes that swaps with a non-U.S. affiliate of a U.S. person should not give rise to Swap Dealer or MSP registration requirements for that non-U.S. affiliate’s counterparties located outside the U.S. Although, as noted by the CFTC, market participants are able to transfer swap-related risks within affiliated groups,²⁷ the Commissions should encourage effective group-wide risk management, not discourage it through unnecessary registration requirements. Moreover, just as the Commissions would expect to regulate the swap activities of a U.S. affiliate of a non-U.S. person, the swap activities of a non-U.S. affiliate of a U.S. person with counterparties located outside the U.S. are more properly the subject of regulation by authorities in the relevant non-U.S. jurisdiction. A contrary result would be inconsistent with Sections 722 and 772 of Dodd-Frank, which do not contain any language suggesting that the territorial limits on the Commissions’ jurisdictions with respect to swap activities are subject to an exception in the case of a non-U.S. affiliate of a U.S. person. Furthermore, no financial regulatory statute adopts such an approach to extraterritoriality, since it would effectively prevent U.S. market participants (including corporate end-users) from accessing non-U.S. markets through their non-U.S. affiliates.

The Commissions should also clarify that a non-U.S. person would not be subject to Swap Dealer or MSP registration requirements simply by virtue of contacting a U.S.-domiciled professional fiduciary that acts for a counterparty located outside the U.S., since that counterparty would not expect U.S. Swap Dealer or MSP requirements to apply to swap transactions with a non-U.S. person merely because its account is managed by a U.S.-resident fiduciary. This clarification would be consistent with the SEC’s existing approach in the context of foreign broker-dealer registration.²⁸

²⁶ See Sections 1a(49)(B) of the CEA and 3(a)(71)(B) of the Exchange Act, each as amended by Dodd-Frank.

²⁷ CFTC Registration Proposal at 71382.

²⁸ See Cleary, Gottlieb, Steen & Hamilton (avail. Nov. 22, 1995, revised Jan. 30, 1996).



Finally, the Commissions should clarify that a non-U.S. person will not be deemed to be acting as a Swap Dealer within the U.S. solely on the basis of swaps it enters into with U.S.-registered Swap Dealers (including U.S. branches and agencies that are registered) from outside the U.S. This clarification is necessary to preserve access to non-U.S. markets by U.S.-registered Swap Dealers. The existence of a U.S.-registered Swap Dealer on one side of such transactions ensures that the requirements of Title VII are appropriately satisfied. Moreover, this clarification is also consistent with the territorial scope limitations contained in Sections 722 and 772 of Dodd-Frank, since the relevant activity of the non-U.S. person would take place outside the U.S.

II. Application to Common Transaction Paradigms

With the foregoing clarifications in mind, the Institute describes below how its proposed framework for Swap Dealer and MSP registration and regulation would apply to the four most common paradigms under which an unregistered U.S. person may have a foreign bank (or its U.S. branch, agency, or affiliate) as its swap counterparty: (a) transactions directly with a foreign bank acting from abroad without intermediation by a registered Swap Dealer, (b) transactions with a foreign bank as principal intermediated as agent by a U.S. branch, agency, or affiliate that is registered as a Swap Dealer, (c) transactions with a U.S. branch, agency, or affiliate acting as principal in a dealer capacity, and (d) transactions in which the market risk from swap dealing activities is allocated by a registered U.S. branch, agency, or affiliate to the unregistered foreign bank or by a registered foreign bank to its unregistered U.S. branch, agency, or affiliate.

The proposed framework is designed to apply to these paradigms in a complementary fashion to address the structural diversity of the swap markets in a manner that ensures compliance with Dodd-Frank. Accordingly, in the case of each paradigm, (i) the Board would be able to make a determination as to the comparability of the foreign bank's capital in accordance with its longstanding approach to cross-border banking supervision and, in appropriate circumstances, defer to home country capital requirements and prudential supervision and (ii) responsibility for compliance with Dodd-Frank's mandatory clearing and execution, customer business conduct, margin, segregation, and recordkeeping requirements would lie with a Commission registrant. Furthermore, the Commissions have the legal authority to adopt this framework through interpretation of the extraterritorial application of Dodd-Frank in light of Sections 722 and 772 and, in some cases, through exercise of their definitional authority pursuant to Section 712(d).

The Institute emphasizes that it is not suggesting that the Commissions adopt the proposed framework only for one of the below paradigms. Providing only one option for Swap Dealer and MSP registration and regulation fails to recognize the diversity of business models under which foreign banks operate and would require many foreign banks (and indeed some U.S. banks) to restructure their businesses significantly, which would entail material costs and reduced flexibility for both banks and corporate end-users and other counterparties. The Institute respectfully recommends that the Commissions recognize this diversity and, instead,



accommodate multiple dealing structures under appropriate an appropriate regulatory framework so as to facilitate compliance with Dodd-Frank without causing undue disruption to the global derivatives markets.

A. Transactions Directly with a Foreign Bank

There may be circumstances in which a foreign bank chooses to transact in swaps with U.S. customers (as opposed to U.S.-registered Swap Dealers) directly from abroad without U.S. intermediation. For instance, the foreign bank may make its personnel in non-U.S. markets available to execute swap transactions directly with U.S. customers, since those personnel may have more expertise in the relevant market. The foreign bank may also make its non-U.S. personnel available to execute swap transactions with U.S. customers outside U.S. trading hours. Less commonly, some foreign banks may not have qualified personnel at a U.S. branch, agency, or affiliate. In each case, if the foreign bank engages in swap “dealing” activity (*i.e.*, holds itself out as a dealer, makes a market, regularly enters into swaps as a business, or engages in activity causing it to be commonly known as a dealer or market maker) directly into the U.S. from abroad, then it would be subject to Swap Dealer registration in the U.S.²⁹

It is imperative that the Commissions adopt an approach for foreign banks that choose to register as Swap Dealers which recognizes that, for reasons of international comity and the necessity of a realistic regulatory approach, U.S. regulators should only oversee those aspects of the foreign bank’s swap business that directly affect U.S. counterparties and markets. This would facilitate establishment with the EU and other G-20 jurisdictions of a framework for cross-border access by third country firms subject to home country supervision that is determined to be equivalent to that of the host jurisdiction(s).³⁰

The Institute notes that a foreign bank that registers with one or both of the Commissions as a Swap Dealer will have the Board as its prudential regulator.³¹ Accordingly, the Board will be in a position, in accordance with its longstanding approach to cross-border banking supervision, to assess the adequacy of the foreign bank’s capital in cases where the Board determines that the foreign bank Swap Dealer’s home country supervisory regime is consistent with the standards required under Dodd-Frank. In the case of other requirements that apply across a Swap Dealer’s overall business – such as risk management systems, supervisory

²⁹ If personnel of a U.S. branch, agency, or affiliate of the foreign bank Swap Dealer also solicited or negotiated with U.S. customers on behalf of the foreign bank Swap Dealer, then that branch, agency or affiliate would be subject to introducing broker and/or broker-dealer registration, as and to the extent applicable. The branch, agency or affiliate should not separately be subject to Swap Dealer registration unless it acts other than in an agency capacity, such as in the paradigms described in Parts II.B and II.C below.

³⁰ See notes 17-19, *supra*, and accompanying text.

³¹ Section 1a(39) of the CEA, as amended by Dodd-Frank (defining “prudential regulator”).



policies and procedures, and information barriers – the Institute suggests that the Commissions similarly defer to home country regulation and supervision, where comparable. This is particularly important given that risk management, capital adequacy and related supervisory processes must be implemented on a consolidated basis and structured in light of each other in order to be effective.

On the other hand, Dodd-Frank requirements that apply to a particular transaction, such as mandatory clearing, execution, counterparty business conduct, margin, and segregation requirements, should apply to the foreign bank Swap Dealer with respect to those swaps that involve an unaffiliated U.S. counterparty.³² The Swap Dealer should be permitted to outsource the performance, but not the responsibility for due performance, of those requirements to a U.S. branch, agency, or affiliate.

Consistent with Sections 722 and 772 of Dodd-Frank, those transaction-specific requirements should not, however, apply to swaps by a foreign bank Swap Dealer conducted from outside the U.S. with counterparties located outside the U.S., since those transactions will be subject to non-U.S. regulatory requirements, and such counterparties will not be looking to U.S. regulatory protections in the context of such transactions. This approach is consistent with positions taken by the Commissions under the CEA and the Investment Advisers Act of 1940 (the “Advisers Act”).³³ This should also be the case if U.S.-based personnel employed by a U.S. branch, agency, or affiliate of the foreign bank Swap Dealer are involved, as agents of the foreign bank, in soliciting or negotiating with the counterparty.³⁴ The result should be the same if U.S. personnel of a U.S. branch, agency, or affiliate of that counterparty are involved in soliciting or negotiating with the foreign bank.

In the case of recordkeeping and related examination requirements, the Commissions should permit records for transactions with U.S. customers to be kept either in the U.S. or, if the Swap Dealer agrees to provide records to the Commissions upon request, outside

³² Although Dodd-Frank’s margin requirements would apply, those requirements for non-cleared swaps will, for a foreign bank Swap Dealer, be applied by the Board. It would be consistent with the Board’s long-standing approach to cross-border banking supervision for it to adopt an approach to margin that is based on deference to home country standards that it deems to be comparable. This approach would, in the Institute’s view, also be consistent with the standards for margin requirements mandated by Sections 731 and 764 of Dodd-Frank for the reasons discussed in note 11, supra.

³³ See CFTC Regulations § 4.7(a)(2)(xi) (providing a non-U.S. registered commodity trading advisor with exemptions from certain CEA requirements with respect to its non-U.S. clients) and Uniao de Bancos Brasileiros S.A. (avail. July 28, 1992) (concluding that the registered foreign advisory subsidiary of a foreign bank need not comply with U.S. requirements with respect to its non-U.S. clients).

³⁴ Those personnel would, however, need to comply with U.S. requirements applicable to introducing brokers or securities broker-dealers to the extent that the U.S. branch, agency, or affiliate is so registered and those personnel are acting as employees or associated persons of the registered branch, agency, or affiliate.



the U.S.³⁵ This approach would allow the Commissions to readily examine records for U.S.-related transactions. Records for other transactions should be permitted to be kept in accordance with comparable home country requirements, and the Commissions should examine such records through information sharing agreements, memoranda of understanding, and other similar arrangements with home country regulators. These arrangements should be designed to address concerns that Commission examination of such records might otherwise pose under non-U.S. privacy laws.³⁶

The Commissions should also establish a registration and regulatory framework for swap data repositories that limits the extent to which U.S. and non-U.S. market participants might be required to comply with duplicative or inconsistent swap reporting regimes in multiple jurisdictions or to report the same transactions to both U.S. and non-U.S. data repositories.

B. Transactions Intermediated by a U.S. Branch, Agency, or Affiliate

Perhaps more commonly, a foreign bank may transact in swaps as a dealer with U.S. customers through a separate U.S. branch, agency, or affiliate that intermediates the transactions as agent for the foreign bank. This is often because, to facilitate strong relationships with U.S. customers, the personnel who solicit and negotiate with U.S. customers and commit a foreign bank to swaps are located in the U.S. Local personnel may also have greater expertise in local markets.

In this paradigm, the Swap Dealer registration analysis should turn on the status of the intermediating U.S. branch, agency, or affiliate. In cases where the U.S. branch, agency, or affiliate acting as agent is registered merely as an introducing broker and/or securities broker-dealer – and there is no U.S.-resident registered Swap Dealer responsible for the transactions – then the foreign bank should be regarded as engaging in swap dealing activity directly into the U.S. from abroad, and should be subject to registration and regulation as discussed in Part II.A above.

In contrast, the U.S. branch, agency, or affiliate acting as agent for the foreign bank may be registered as a Swap Dealer and hold itself out to U.S. customers as such. In such a case, if the U.S. branch, agency, or affiliate complies with Dodd-Frank’s transaction-specific mandatory clearing, execution, counterparty business conduct, margin, segregation, and

³⁵ This approach is consistent with the CFTC’s proposal for recordkeeping by Swap Dealers. See 75 Fed. Reg. 76666, 76669 (Dec. 9, 2010). See also Rule 17a-7 under the Exchange Act (establishing a similar regime for non-U.S. broker-dealers) and Rule 204-2(j)(3) under the Advisers Act (establishing a similar regime for non-U.S. advisers).

³⁶ See, e.g., Article 29 of the EU’s Data Protection Directive, Directive 95/46/EC (imposing restrictions on transfer of personal data to non-EU countries).



INSTITUTE OF INTERNATIONAL BANKERS

recordkeeping requirements as though it were the swap counterparty,³⁷ then the Commissions should not regard the foreign bank – which would merely be an offshore “booking” center for the swap transactions – to be acting as a Swap Dealer in the U.S. Accordingly, the foreign bank should not be required, under these circumstances, to register with the Commissions as a Swap Dealer.³⁸

As a policy matter, this approach would address the objectives of Dodd-Frank. Because a U.S.-registered Swap Dealer would take part in the swap and be responsible for compliance with Dodd-Frank and CFTC/SEC rules, the transaction would be subject to oversight by the Commissions and the U.S. customer would be protected by Dodd-Frank’s business conduct requirements and anti-fraud and anti-manipulation provisions.

With respect to counterparty credit risk, there would be no risk as between the U.S. customer and the foreign bank for a cleared swap because the U.S. customer would face the CFTC-registered FCM or SEC-registered broker-dealer acting as clearing member of the derivatives clearing organization or securities clearing agency, not the foreign bank. The foreign bank would be required to post margin as and to the extent required by the rules of the relevant derivatives clearing organization or clearing agency. Also, for swaps cleared in the U.S., the U.S. customer’s margin would be protected by a CFTC-registered FCM or SEC-registered broker-dealer or security-based swap dealer, as appropriate.³⁹

In the case of a non-cleared swap, the U.S.-registered Swap Dealer would, as noted above, comply with Dodd-Frank’s margin and segregation requirements, which would mitigate some measure of credit risk between the U.S. customer and the foreign bank. Although the Institute recognizes that the U.S. customer would still have some residual uncollateralized credit exposure to the foreign bank, the Commissions should address that risk by requiring the U.S.-registered Swap Dealer, as a condition for intermediating non-cleared swaps with U.S. customers as agent for an unregistered foreign bank, to obtain a determination from the Board that

³⁷ Because the U.S. branch, agency, or affiliate would be acting solely in an agency capacity, it would not be required to hold capital against the swap positions. Also, where the intermediating Swap Dealer registrant is a U.S. branch or agency of the foreign bank, the Board should defer to comparable home country margin requirements for non-cleared swaps, as discussed in note 32, supra.

³⁸ The Institute notes that this approach would be consistent with the CFTC’s interpretive position that a foreign futures commission merchant (“FCM”) may, without registration as an FCM or exemption under CFTC Regulations Part 30, carry customer omnibus accounts for U.S. customers intermediated through a U.S.-registered FCM. See CFTC Interpretive Letter 87-7 (Nov. 17, 1987). It would also be consistent with the SEC’s territorial approach to broker-dealer registration. See SEC Release No. 34-27017 (Jul. 11, 1989).

³⁹ The Institute also recommends that the Commissions adopt an approach to cross-border swap clearing that is consistent with the CFTC’s approach for foreign FCMs in the futures markets. See, e.g., CFTC Interpretive Letter 87-7, supra note 38 (providing a framework for intermediation by a U.S.-registered FCM) and CFTC Regulations § 30.10 (providing a framework for exempting a foreign FCM subject to comparable home country regulation).



INSTITUTE OF INTERNATIONAL BANKERS

the foreign bank is subject to home country capital standards that are consistent with the standards required under Dodd-Frank.⁴⁰ Indeed, in a case where the U.S. registered entity intermediating the transaction is a U.S. branch or agency of the foreign bank, then, as a practical matter, the Board will have already made that determination because the Board assesses the capital of a U.S. branch or agency by reference to the capital of the foreign bank itself.⁴¹

This framework would ensure that a U.S. customer that transacts in swaps with an unregistered foreign bank would be in the same position with respect to its residual uncollateralized credit risk to the foreign bank it would have been in if the foreign bank were registered. This is because, under the framework suggested above, the foreign bank that is the swap counterparty to the U.S. customer would be subject to capital requirements and prudential supervision that the Board has determined to be appropriate, which is all that Dodd-Frank requires or seeks to achieve.⁴²

Additionally, applying the same analysis, where (a) a U.S.-registered Swap Dealer intermediates transactions with U.S. customers as agent for the foreign bank and complies with Dodd-Frank's transaction-level requirements as though it were the swap counterparty and (b) the foreign bank is subject to home country capital requirements determined by the Board to be consistent with Dodd-Frank, the swap positions of the foreign bank with those U.S. customers and the related credit exposures to which they give rise would not, in the Institute's view, pose the exceptional risks to the U.S. financial system that are the basis for the MSP definitions. Accordingly, a foreign bank should not be subject to MSP registration in these circumstances.

As a legal matter, the Commissions could adopt this approach as an interpretation of the limited extraterritorial application of the Swap Dealer and MSP registration requirements contained in Sections 731 and 764 and use their general rulemaking authority for Swap Dealers and MSPs to apply any additional conditions to the U.S.-registered Swap Dealer acting as agent for the unregistered foreign bank. Alternatively, the Commissions could use the broad authority granted to them by Section 712(d) to adopt rules regarding the Swap Dealer and MSP definitions that would conditionally exclude a foreign bank subject to home country capital standards deemed

⁴⁰ The Commissions could adopt this requirement pursuant to their respective general authorities under Section 4s(b)(4) of the CEA and Section 15F(b)(4) of the Exchange Act, each as amended by Dodd-Frank, to adopt rules regarding Swap Dealers and MSPs, including limitations on activity. Alternatively, they could adopt this requirement pursuant to their definition authority under Section 712(d) of Dodd-Frank as a condition to an exclusion from the Swap Dealer and MSP definitions for the foreign bank.

⁴¹ See note 8, *supra*.

⁴² The Institute notes that Title VII of Dodd-Frank anticipates that some degree of non-cleared swap activity will continue to take place, and so it is implicit that Dodd-Frank does not require the elimination of all credit risk of U.S. swap customers to Swap Dealers. Rather, Dodd-Frank addresses that risk by requiring that Swap Dealers be subject to capital requirements and prudential supervision.



comparable by the Board from those definitions if its only swaps with U.S. customers are executed through a U.S.-registered Swap Dealer acting as agent. Indeed, in the context of the MSP definitions, the Commissions have already suggested that Section 712(d) gives them the flexibility to adopt conditional or unconditional exclusions.⁴³

C. Transactions with a U.S. Branch, Agency, or Affiliate Acting as Principal in a Dealer Capacity

There are also circumstances under which a U.S. branch, agency, or affiliate of a foreign bank may choose to transact in swaps as a dealer with counterparties located within and outside the U.S. as principal and acting in a dealer capacity, such as when it has existing, documented relationships with those counterparties or when those customers prefer, for insolvency, tax or other reasons, to transact with a U.S. branch, agency, or affiliate. In those cases, the U.S. branch, agency, or affiliate would register with the Commission(s) as a Swap Dealer and comply with Dodd-Frank's business conduct and other regulatory standards in connection with all of its swap activity conducted from the U.S.⁴⁴ However, consistent with Sections 722 and 772 of Dodd-Frank, the foreign bank itself should not be subject to registration or regulation as a Swap Dealer or MSP simply by virtue of its relationship with the registered U.S. branch, agency, or affiliate.

D. Inter-affiliate or Inter-branch Transactions

In order to centralize risk management, a foreign bank's U.S. branch, agency, or affiliate that is registered as a Swap Dealer may use swap transactions to allocate some or all of the market risk arising from its swap dealing activities to the foreign bank through back-to-back transactions or other similar arrangements. Similarly, a foreign bank that is registered as a Swap Dealer may use swap transactions to allocate the market risk arising from its swap dealing activities to an unregistered U.S. branch, agency, or affiliate so that personnel employed by that U.S. branch, agency, or affiliate can manage that risk. By way of example, such arrangements can be used so that a foreign bank's U.S. dollar interest rate portfolio is managed centrally by expert personnel in the U.S. In each case, the participating unregistered entity should not be required to register as a Swap Dealer or MSP.

As noted by the Commissions in the Joint Definition Proposal, swaps between persons under common control simply represent an allocation of risk within a corporate group, and may not involve the interaction with unaffiliated persons that is a hallmark of the elements of

⁴³ Joint Definitions Proposal at 80202-03.

⁴⁴ In the case of a U.S. branch or agency that registers as a Swap Dealer, the Board or the OCC, as applicable, should look to the capital adequacy of the foreign bank in determining whether the branch satisfies Dodd-Frank's capital requirements.



the Swap Dealer definitions that refer to holding oneself out as a dealer or being commonly known as a dealer.⁴⁵ The Commissions also recognized that such swaps may not pose the exceptional risks to the U.S. financial system that are the basis for the MSP definitions.⁴⁶ This is particularly the case where, as here, there are bona fide commercial reasons for the registered U.S. branch, agency, or affiliate or registered foreign bank to structure transactions through back-to-back or similar inter-affiliate or inter-branch arrangements. Since those arrangements would, in each case, involve a registered entity, there should be no concern that they could be used to evade Swap Dealer or MSP requirements.⁴⁷ Accordingly, such transactions should not give rise to Swap Dealer or MSP registration requirements.⁴⁸

Additionally, the Institute urges the Commissions to consider which, if any, of Dodd-Frank's other swap-related requirements should be applicable to such inter-affiliate or inter-branch risk management transactions. Application of Dodd-Frank's mandatory clearing, execution, or margin requirements to such transactions would in some instances completely prevent, and in others seriously reduce the efficiency of, those transactions – thereby undermining Dodd-Frank's objective of mitigating systemic risk. Additionally, requirements intended to protect customers, such as Dodd-Frank's business conduct requirements, also plainly are not necessary in the case of inter-affiliate or inter-branch transactions.

* * *

⁴⁵ Joint Definitions Proposal at 80183.

⁴⁶ Id. at 80202.

⁴⁷ Transactions between persons under common control that are designed to evade Swap Dealer or MSP requirements should, if necessary, be addressed by appropriate Commission anti-evasion rules.

⁴⁸ In the Institute's view, the MSP definition should not be interpreted to encompass an affiliate of a named counterparty to a swap that provides a guarantee of the named counterparty's obligations. This is particularly the case where the affiliate providing the guarantee is a foreign bank or other non-U.S. entity, since risk held by a non-U.S. entity is more properly the subject of regulation by non-U.S. authorities.



INSTITUTE OF INTERNATIONAL BANKERS

The Institute appreciates the opportunity to submit these comments in connection with the Commissions' Proposed Rules. Please do not hesitate to contact the undersigned at (212) 421-1611 with any questions or if we can be of assistance to the Commissions.

Sincerely,

A handwritten signature in black ink that reads "Sarah A. Miller". The signature is fluid and cursive, with the first name being the most prominent.

Sarah A. Miller
Chief Executive Officer
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cc: Jennifer J. Johnson
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