European Financial
Markets Lawyers Group

- THE CHAIRMAN -

Frankfurt am Main, 24 March 2011

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Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
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Dear Mr. Stawick, Ms. Murphy and Ms. Johnson:

Application of Title VII of the Doddd-Frank Act to foreign Banks' Global Swaps Businesses

The European Financial Markets Lawyers Group (www.efmlg.org) is a body established in 1998 composed of senior lawyers of the major banking institutions of the European Union, active in the wholesale and investment markets, whose aim is to discuss legal matters, both regulatory and contractual, of common interest and with the aim to contribute to the furtherance of integration of financial markets in Europe.

Within its membership are the six European banks that, together with the Royal Bank of Canada, wrote to you a letter dated 11 January 2011 commenting on 12 proposed rules implementing Title VII of the Dodd-Frank Act, drafted by your organisations.

The EFMLG examined the issues raised by such part of the Dodd-Frank Act at its meeting of the 22 March 2011. I would like to inform you that all the European banks members of the EFMLG would and actually do endorse the reasoning and petitions contained in the above-mentioned letter. In view of the current discussions of the European Markets Infrastructure

Regulation (EMIR), it is imperative -in order to achieve legal certainty- to have a clear delimitation of the scope of application, and full substantive consistency, of the Frank-Dodd implementation rules and the projected EMIR rules in Europe. The EFMLG would like to kindly ask the Board of Governors and the two Commissions to actively undertake conversations with the European Commission aimed at a jointly agreed normative result.

Yours sincerely,

Antonio Sáinz de Vicuña

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Encl.

January 11, 2011

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Re: Application of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act to Foreign Banks' Global Swaps Businesses

Dear Mr. Stawick, Ms. Murphy and Ms. Johnson:

The undersigned seven foreign-headquartered banking organizations ("foreign banks") are among some of the largest financial institutions involved in lending, capital markets and swap[1] dealing activities in the United States.[2] We operate global swaps businesses and book swaps primarily in our well-capitalized, highly rated foreign-based banking institutions. Each of us faces a threshold business decision in deciding how to restructure our global swaps businesses to comply with the developing regulatory regimes in the United States and our home country jurisdictions. Because the ***first step*** in organizing a firm's swaps business to compete effectively and in full compliance with all applicable rules and regulations is to identify the legal entity through which we will operate, the need for regulatory guidance on the scope of Title VII ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protection Act's (the "Dodd-Frank Act") application to foreign banks is immediate and pressing.

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[1] Unless the context otherwise requires, references herein to "swaps" and "swap dealers" will include security-based swaps and security-based swap dealers, respectively.

[2] Eight of the 14 largest international derivatives dealers (known as the G14) are foreign banks. *See* ISDA Research Notes, Concentration of OTC Derivatives among Major Dealers, Issue 4 (2010), *available at* www.isda.org/researchnotes/pdf/ConcentrationRN_4-10.pdf. According to the ISDA Market Survey for Mid-Year 2010, the G14 collectively account for 82 percent of the global total notional amount outstanding of derivatives reported by survey respondents. *Id.* Six of the eight foreign bank G14 derivatives dealers are signatories to this letter.

We respectfully urge the Commodity Futures Trading Commission (the "CFTC"), the Securities and Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions") and the Board of Governors of the Federal Reserve System (the "Federal Reserve") to adopt implementing regulations under the Dodd-Frank Act that enable and encourage foreign banks engaged in swap dealing activities to book their swaps businesses in a single well-capitalized, highly rated foreign-based banking institution. Absent such a regulatory model, foreign bank swap dealer registration may be incompatible with home country requirements, objectionable to home country supervisors, prohibitively expensive, impossible to achieve in the necessary timeframe and impractical from an operational perspective. These considerations will be equally relevant to U.S. financial institutions operating globally as the EU implements the European Market Infrastructure Regulation ("EMIR"). Accordingly, it is critical to develop a framework that can support global business models.

To conduct global swaps businesses raises considerations of conflicting U.S. and foreign rules, the potential for clashing regulatory jurisdictions, questions of legal certainty and the need to develop systems compatible with the requirements in each jurisdiction. We believe there are several potential operating models that could effectively address these issues and that should be available to international banks in organizing their swaps businesses.[3] Regardless of the operating model selected, we believe that the Commissions and the Federal Reserve can, and should, adopt common principles and craft rules that implement Title VII in a way that relies on home country supervision where the regulations operate at the entity level and applies Title VII to U.S. swap transactions, but not to foreign swap transactions, in the case of regulations that operate at the transaction level. The framework discussed herein is consistent with the letter and spirit of Title VII, promotes stability, legal certainty, prudent management and effective regulatory oversight, and facilitates international comity and mutual cooperation among international financial regulators.

Advantages of a Central Booking Entity

Many foreign banks operate and manage their global swaps businesses out of a single entity, which is usually a comprehensively regulated foreign banking institution. Typically, this entity is the central booking vehicle, acting as principal to counterparties in the U.S. and other jurisdictions. When dealing with U.S. counterparties and, in some cases, with non-U.S. counterparties, foreign banks often use U.S. broker-dealers or other affiliates as their agents to solicit and/or assist in arranging or effecting swap transactions.

We believe operating and managing a global swaps business out of a single booking entity presents many advantages from the perspective of foreign banks, customers and supervisors. Foremost is a reduction in systemic risk resulting from

[3] As will be described later in this letter, various potential operating models should be available to financial institutions, including a direct access model under which a foreign-based bank could register as a swap dealer and transact directly with U.S. persons, as well as an intermediation model under which an unregistered foreign-based bank could transact with U.S. persons through the intermediation of a registered swap dealer acting in an agency capacity.

centralized and efficient management of market risks, credit, documentation, operations and systems. From a customer perspective, the proposed structure enables counterparties to transact bilateral, non-cleared swaps with a well-capitalized, highly rated entity and to maximize the benefits of counterparty netting. By limiting the number of swaps entities, consolidated supervision is also enhanced.

Conversely, there are many disadvantages in using separate, country-by-country special purpose companies to book swap transactions. Using such companies presents greater risk to counterparties because they may lose the benefits of counterparty netting and would be entering into swaps with a less creditworthy entity. The establishment of new special purpose swaps companies also would entail complex risk management, tax planning and other considerations, further complicating management and supervision on a group-wide basis. Such an approach also would involve a massive re-documentation of business relationships, as well as more costly, but by no means more effective, risk management, reporting, operations, monitoring and technology systems. An extensive re-documentation exercise would be very time-consuming and in all likelihood would not be complete by the third quarter of 2011, when most of the provisions in Title VII will come into effect. Since dealing without signed documentation is generally avoided as a risk management matter, this could result in loss of liquidity and other burdens for U.S. customers during the re-documentation process. Finally, in a global swaps market characterized by jurisdiction-specific special purpose entities, systemic risk would be increased and there would be fewer incentives for cooperation among foreign and U.S. regulators.

Proposed Regulatory Approach

Application of Entity-level and Transaction-level Rules

Our proposed regulatory framework for applying Title VII to global swap dealers distinguishes between rules that apply to swap dealers at the entity level and those rules that regulate particular swap transactions. For purposes of illustration, the following discussion uses the direct access model (under which a foreign-based bank or branch thereof would register as a swap dealer and transact directly with U.S. persons) as the basis for examples of each type of rule and the proposed approach to them. Other potential operating models, including the intermediation model, are described in later in this letter.

1. Entity-level Rules: Rely on Home Country Supervision

Title VII rules that apply to a swap dealer at the entity level include capital, margin, conflicts of interest and risk management systems and, to a limited extent, recordkeeping. In deciding how to apply these rules to foreign banks, the Commissions and the Federal Reserve should recognize in their rulemaking that most foreign banks with global swaps businesses – particularly those headquartered in EU member states, Switzerland, Japan and Canada – have in place extensive governance, risk management and control mechanisms, and are subject to comprehensive home country regulation. The need for recognition of existing and developing home country regulatory regimes is particularly acute given the parallel regulatory reform initiatives in various jurisdictions. Absent such recognition, the risk of inconsistent and unduly burdensome regulation with

considerable disruption to the swaps business is high. To the maximum extent possible, the Commissions and the Federal Reserve should look to and rely on home country governance and risk management requirements, both as they currently exist and will soon be put into place, and avoid applying rules that mandate specific organizational structures for global banks headquartered outside the U.S.

In addition, most global banks have regulated non-swaps businesses that dwarf their swaps activities. We therefore request that entity-level rules be applied in a way that does not interfere with or extend to non-swaps businesses of such banks merely by virtue of being a principal booking entity for U.S. swaps.

Entity-level Rule: Capital

Under Sections 731 and 764 of Title VII, the Federal Reserve is, in general, required, in consultation with the Commissions, to prescribe capital requirements for swap dealers that are foreign banks. Due to the potential for conflict between home country and U.S. capital regulation, the Federal Reserve should rely on home country capital regulation for foreign banks that are subject to comprehensive regulation in their home countries by a home country supervisor that has adopted risk-based capital standards consistent with the Capital Accord of the Basel Committee on Banking Supervision (the "Basel Accord"). Reliance on home country supervision is consistent with established Federal Reserve precedent,[4] and is particularly appropriate in light of the greater uniformity in global capital requirements and prudential standards that will result from the adoption of Basel III.

Entity-level Rule: Margin for Non-cleared Swaps

As with capital, Sections 731 and 764 of the Dodd-Frank Act require the Federal Reserve, in consultation with the Commissions, to prescribe minimum initial and variation margin requirements for non-cleared swaps transacted by swap dealers that are foreign banks. One of the purposes of minimum margin requirements is to offset the risk to the swap dealer and the financial system arising from non-cleared swaps. In this respect, margin is closely related to capital and their proximate relationship is reflected in the Dodd-Frank Act. In the case of a foreign bank swap dealer, it would generally be appropriate for the Federal Reserve to defer to the foreign bank swap dealer's home country supervisor with regard to safety and soundness issues, including margin. The home country regulator has the greatest interest in and is in the best position to protect a foreign bank swap dealer under its primary supervision by setting appropriate margin requirements.

Other Entity-level Swap Dealer Duties

Procedures to monitor a firm's swaps activities, such as risk management procedures, conflict of interest systems, trade monitoring mechanisms and recordkeeping regarding corporate, financial and compliance matters typically operate at the entity

[4] *See* 12 C.F.R. § 225.90.

level.[5] In deciding how to apply their rules requiring these procedures to foreign banking entities, the Commissions should take account of the fact that many foreign banks already have in place extensive control mechanisms, which are subject to existing home country rules and supervision as well as imminent derivatives-specific regulation. In particular, the Commissions should avoid applying requirements that mandate specific organizational structures, such as proposed CFTC requirements concerning the reporting line and functions of a chief compliance officer and the organization of the risk management function, to foreign bank swap dealers.

2. **Transaction-level Rules: Distinguish Between U.S. and Foreign Swap Transactions**

With respect to transaction-level rules, we suggest an approach for applying Title VII's swap dealer requirements and implementing rules that distinguishes between (i) foreign swap transactions and (ii) U.S. swap transactions.

Foreign Swap Transactions: Generally, Home Country Rules Apply

Foreign swap transactions are those not involving a U.S. counterparty, *i.e.*, between two foreign counterparties. Such transactions are more appropriately the province of the supervisory authorities in the relevant non-U.S. jurisdiction.

Accordingly, we propose that home country requirements apply for business conduct rules, swap reporting, swap recordkeeping and collateral segregation for foreign swap transactions. Such an approach avoids conflicting legal standards of both U.S. and home country regulators. It also avoids jurisdictional conflicts harmful to international comity and reduces the risk of challenges to the exercise of U.S. regulatory authority under Title VII.

A swap transaction between a foreign bank or one of its foreign branches that is registered as a swap dealer and a non-U.S. counterparty may involve, for reasons of administrative convenience (*e.g.*, same time zone) or substantive expertise, a U.S.-based sales or trading employee of the registered swap dealer. With respect to such transactions, we propose that the swap dealer and its U.S. employees would be subject to Title VII's transaction-related business conduct requirements in relation to their swap dealings with the non-U.S. counterparty, but not other transaction-specific requirements. By contrast, if a non-swap dealer U.S. affiliate is involved in arranging a swap transaction with a non-U.S. counterparty on behalf of a foreign bank registered swap dealer, the affiliate and its U.S. employees would not be subject to Title VII business conduct requirements; however, to the extent that the U.S. affiliate is a registered broker-dealer, futures commission merchant or other regulated entity, the requirements that otherwise apply to such entities and their personnel would apply to these activities.

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[5] In its proposed rule on duties for swap dealers and major swap participants, the CFTC also proposed entity-level rules regarding diligent supervision, business continuity and disaster recovery, disclosure and the ability of regulators to obtain general information, and antitrust considerations. *See* Proposed Rule - Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71,397 (Nov. 23, 2010).

U.S. Swap Transactions: Generally, U.S. Rules Apply

U.S. swap transactions are those where a foreign bank swap dealer (whether acting directly, or indirectly through its regulated affiliates in the U.S. acting as agent) enters into swap transactions with U.S. counterparties.[6] For U.S. swap transactions, the Commissions and (to the extent applicable) the Federal Reserve should apply U.S. requirements for business conduct rules, swap reporting requirements, transaction recordkeeping and collateral segregation requirements, with limited modifications.[7] Foreign bank swap dealers should be encouraged to delegate certain compliance functions to their U.S. affiliates, but such delegation would not relieve the foreign bank of its ultimate compliance obligations with respect to U.S. swap transactions.

3. **Applying the Proposed Transaction-level Rule Framework to Specific Rules**

As the Commissions have recognized in the rule proposals that they have released to date, the application of particular Title VII requirements in an international context should vary depending on the nature of the requirement.[8] We believe that the Commissions and the Federal Reserve need to apply the framework outlined above on a rule-by-rule basis to balance the policy goals with the global scope of the business and the characteristics of the obligations in question.

Transaction-related Recordkeeping: U.S. Rules Apply to U.S. Swap Transactions

With respect to Title VII-driven trading records for specific transactions, U.S. requirements should only apply to U.S. swap transactions. Foreign bank swap dealers should be encouraged to delegate Title VII recordkeeping duties for these transactions to their U.S. affiliates or offices, whose physical presence in the U.S. makes inspections less burdensome for the Commissions. With respect to swap transactions and activities that are already required to be recorded under home country rules and subject to inspection by home country supervisors, the Commissions should not impose duplicative U.S. recordkeeping requirements. Rather, the Commissions should cooperate with their counterpart regulatory agencies to establish effective information sharing arrangements and transaction recordkeeping conventions. The Commissions should not extend recordkeeping requirements to foreign swap transactions.

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[6] We propose that the term "U.S. counterparty" be defined in the same way as the term "U.S. person" in Rule 902(k) of the SEC's Regulation S under the Securities Act of 1933, 17 C.F.R. § 230.902(k). This established definition is familiar to countless financial market professionals. Following the "U.S. person" definition in Regulation S, rather than creating an entirely new definition, would avoid confusion and also provide consistency of application and legal certainty for a financial institution that offers a security and a swap to the same customer, which is common.

[7] In addition, the foreign bank swap dealer would be required to use a futures commission merchant to accept any money, securities, or property from, for, or on behalf of a U.S. swaps customer with respect to cleared swaps.

[8] *See, e.g.*, Proposed Rule - Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71,379, 71,382 (Nov. 23, 2010) ("E. Extraterritorial Application of Swap Dealer and Major Swap Participant Registration Requirements"); Proposed Rule - Regulation SBSR - Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75,208, 75,239-40 (Dec. 2, 2010) ("VIII. Jurisdictional Matters").

Business Conduct Rules: U.S. Rules Apply to Swap Transactions with U.S. Customers or Effected by U.S.-based Employees of a Registered Swap Dealer

Under the Dodd-Frank Act, business conduct requirements are intended to protect the customer. Accordingly, U.S. business conduct requirements should apply to swap transactions involving a U.S. customer, whether undertaken inside or outside of the U.S. In addition, as noted above, consistent with the historical approach of the SEC and the Financial Industry Regulatory Authority of regulating registered broker-dealers in which business conduct rules apply irrespective of the customer's location or nationality, Title VII business conduct rules would apply to swap transactions effected by U.S.-based employees of a registered swap dealer with a non-U.S. counterparty.[9] The Commissions should not otherwise extend business conduct rules to foreign swap transactions and activities.

Swap Data Reporting to Swap Data Repositories and Real-Time Data Disseminators: U.S. Rules Apply to U.S. Swap Transactions

U.S. swap data reporting requirements should not apply with respect to foreign swap transactions. Further, to the extent any transaction is required to be reported to a foreign entity performing functions similar to a U.S. swap data repository ("SDR"), it should not also be required to be reported to a U.S. SDR.

The Commissions should work with foreign regulators to permit SDRs in all major jurisdictions to register with the appropriate regulators in each jurisdiction. Cross-registration of SDRs is not only necessary given the global nature of the swaps market, it also reduces duplicative data reporting. Cross-registration would also facilitate the creation of uniform reporting rules and procedures that would enable easy comparison of transaction data from different jurisdictions. Cross-border information sharing and cross-registration, coupled with the new standard identification codes that will be required for reporting to SDRs, would provide regulators and market participants with a comprehensive picture, thus enabling more robust surveillance and supervision of the global swaps market.

For U.S. swap transactions that are only reportable to a U.S. SDR, foreign banks could delegate any reporting obligations to their U.S. affiliates, which would be closer to

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[9] We do not, however, believe that Title VII's business conduct requirements should in all cases apply equally in an international context. For example, in its business conduct rule proposal, the CFTC specifically sought comment on whether the third prong in the definition of "special entity" in Sections 731 and 763 of the Dodd-Frank Act – "employee benefit plans, as defined in Section 3 of the Employee Retirement Income Security Act of 1974 ['ERISA'] (29 U.S.C. 1002)" – should be limited to plans subject to regulation under ERISA so as to exclude employee benefit plans such as those maintained outside the U.S. primarily for the benefit of nonresident aliens. *See* Proposed Rule - Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 75 Fed. Reg. 80,638, 80,649 (Dec. 22, 2010). The CFTC also sought comments on whether the fifth prong in the definition – "*any* endowment" – should include or exclude foreign endowments. *Id.* Because of the practical burdens in complying with the "special entity" requirement with respect to foreign entities, and the fact that including foreign pension plans and endowments would result in the application of standards of care and duties that are likely inconsistent with non-U.S. standards, we do not believe that these entities should be treated as "special entities" absent a clear statement of Congressional intent that they be included.

the transaction and would have more direct access to the transaction data. Such delegation is expressly permitted under the Commissions' proposals.[10]

Clearing: U.S. Rules Apply to U.S. Swap Transactions

We do not believe that Title VII's clearing requirement should apply to foreign swap transactions. Requiring mandatory clearing for such transactions is not necessary to protect U.S. financial institutions, markets or customers, in particular where such transactions are required to be cleared pursuant to the applicable foreign mandatory clearing regulations and accordingly the risks associated with such transactions reside in the relevant foreign central clearing counterparty ("CCP"). In light of the G-20 commitments with respect to the clearing of derivatives transactions, this is likely to be the case in the vast majority of swaps, and certainly swaps with European entities. In addition to being unnecessary, applying Title VII's clearing requirement to foreign swap transactions would also result in number of adverse consequences. First, requiring foreign swap transactions to be cleared through a U.S.-regulated clearinghouse may conflict with any applicable foreign law that requires such transactions to be cleared at a home country (non-U.S.) clearinghouse.[11] Second, such an approach would also legally compel a disproportionate amount of global swaps clearing to be conducted through U.S.-regulated clearinghouses. Third, such a requirement would also concentrate risk that is non-U.S. (because the transactions are with non-U.S. persons) in the U.S.-regulated clearinghouses, which would cause them and the U.S. financial system to bear additional non-U.S. risks. Therefore, U.S. clearing requirements (and the related requirements for end user reporting) should apply only to swap transactions involving a U.S. counterparty. Further, if, as a matter of foreign law, any swap transaction is required to be cleared on a non-U.S. regulated clearinghouse, it should be exempt from the requirement to be cleared on a U.S.-regulated clearinghouse.[12]

Collateral Segregation: U.S. Rules Do Not Apply to Foreign Swap Transactions

Generally, Sections 724 and 763 of the Dodd-Frank Act provide that, with respect to a non-cleared swap, a swap dealer must, at the option of the counterparty, segregate initial margin for the counterparty's benefit at a third-party custodian. The Dodd-Frank Act further requires a swap dealer to report on a quarterly basis to a

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[10] *See, e.g.,* Proposed Rule - Swap Data Recordkeeping and Reporting, 75 Fed. Reg. 76,574, 76,604 (Dec. 8, 2010) (Proposed 17 C.F.R. § 45.6(d) would permit counterparties to contract with third-party service providers to facilitate reporting.)

[11] By way of example, the clearing requirement set out in EMIR (proposed by the European Commission on September 15, 2010) would apply to EU-based financial and certain EU-based non-financial counterparties that enter into eligible OTC derivatives contracts with third country entities. EMIR Art. 3(1). Counterparties subject to EMIR's clearing requirement would not be allowed to use a foreign (non-EU) CCP to clear their trades, unless the relevant EU authority decided to recognize the foreign CCP based on specified criteria. EMIR Art. 23(1). Requiring foreign swaps to clear through a U.S.-regulated clearinghouse might also conflict with existing industry commitments, entered into in early 2009 by a number of G14 U.S. and non-U.S. banks in response to European regulatory concerns, to clear on European clearinghouses credit default swaps on European reference entities or indices.

[12] Similarly, where a U.S. counterparty elects to direct where a swap with a foreign bank swap dealer is to be cleared under Section 723 of the Dodd-Frank Act, the customer should be permitted to designate a foreign-regulated clearinghouse.

counterparty that does not choose to require segregation regarding the swap dealer's back office compliance with margin and collateral requirements. With respect to cleared swaps, Section 724 of the Dodd-Frank Act requires that customer margin in respect of CFTC-regulated swaps be held by a registered futures commission merchant. These rules are fundamentally aimed at protecting U.S. customers.[13] Accordingly, we do not believe they should apply to foreign swap transactions.

4. **Regulatory Examinations: Requires Cooperation Between U.S. and Home Country Supervisors**

The Commissions and the Federal Reserve, as the case may be, should have appropriate examination authority with respect to U.S. swap transactions and activities. U.S. regulators should not conduct examinations of foreign swap transactions and activities. Information relating to U.S. swap transactions and activities can largely be obtained from a U.S. affiliate of the foreign bank. Where information is required from the foreign bank swap dealer, U.S. regulators should seek to rely upon regulatory examinations by home country regulators, and information sharing arrangements, memoranda of understanding, and similar arrangements, to obtain such information to the maximum extent possible. This kind of cooperation is not only an efficient use of the Commissions' and the Federal Reserve's resources, it also allows U.S. regulators to better understand the regulatory regimes of other jurisdictions, which is essential for the effective supervision of a truly global swaps market.

Potential Operating Structures

The regulatory approach proposed in this letter would enable foreign banks to book their global swaps business in a single entity and would achieve key legislative and regulatory policies, including minimization of systemic risk, customer protection, international comity, and comprehensive global swaps regulation.

The specific operating structure and identification of the legal entity that would register with the Commissions as a swap dealer would depend on specific business requirements of the particular foreign bank. Below are examples of operating structures that a foreign bank could choose, which would achieve compliance with Title VII and allow customers, supervisors and foreign banks to fully benefit from a single-entity booking model, if the Commissions and the Federal Reserve were to adopt the regulatory approach outlined in this letter:

Registration of the Foreign-based Banking Institution (Direct Access Model)

A foreign bank may choose to **register a foreign-based banking institution or a foreign branch[14] with the Commissions as a swap dealer**. The bank, acting through

[13] If a swap is to be cleared on a foreign-regulated derivatives clearing organization, the requirement that customer margin be held by a registered futures commission merchant logically should not apply.

[14] Swap dealer registration should be available on a branch-by-branch basis. In particular, registration of a U.S. branch of a foreign bank as a swap dealer should not result in the entire foreign bank (...continued)

a non-U.S. branch, would be the primary booking entity for swaps with all counterparties, including those in the U.S. A foreign bank could also register one or more U.S. affiliates (or use existing registered affiliates) as futures commission merchants (or introducing brokers), broker-dealers or swap dealers, as necessary, depending upon their respective roles in soliciting transactions, acting as principal in respect of swap transactions, receiving customer margin, effecting transactions as an agent on exchanges and swap execution facilities ("SEFs") and in OTC markets, and clearing customer transactions. Such U.S. affiliates would assist the foreign bank registered swap dealer in discharging certain of its obligations as a registered swap dealer under contractual arrangements.[15] Under this approach, Title VII requirements would be applied to a registered swap dealer in the manner recommended above.

A variant on this would be to allow a foreign bank to register only a division thereof with the Commissions as a swap dealer, and to apply the requirements of Title VII only to the specific division, in the manner recommended above, and not to the entire firm.[16]

(continued...)

being treated as a swap dealer. Likewise, registration of the foreign bank or a foreign branch of the foreign bank should not result in the U.S. branches of the foreign bank being treated as a swap dealer.

We note that, in certain circumstances, the Federal Reserve has treated U.S. branches of foreign banks as if they were separate legal entities. *See e.g.*, 12 C.F.R. §§ 223.61; 225.90. *See also* Dodd-Frank Act § 721(a)(17) (contemplating that a "federally chartered branch . . . of a foreign bank" or a "State-chartered branch . . . of a foreign bank" could itself be a swap-dealer); New York State Banking Law § 606(4) (branch ring fencing statute). Similarly, in the securities law context, the SEC has taken the position that although U.S. branches of foreign banks are not separate legal entities in a strictly technical sense, for purposes of the exemption from registration provided by Section 3(a)(2) of the Securities Act of 1933, a U.S. branch of a foreign bank may be deemed to be a "bank." *See* SEC Release 33-6661 (Sept. 23, 1986). The SEC has also stated that it would consider a U.S. branch of a foreign bank to be "bank" for purposes of Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934, which exclude from the definitions of "broker" and "dealer" a "bank" engaging in certain bank activities. Registration Requirements for Foreign Broker-Dealers, 54 Fed. Reg. 30,013, 30,015 (Jul. 13, 1989).

[15] While the performance of such functions through the U.S. affiliate would be an acceptable means of achieving compliance with the foreign bank swap dealer's obligations under Title VII and the Commissions' rules, the foreign bank swap dealer would be ultimately responsible for the performance of such functions.

[16] *See* Proposed Rule - Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,182 (Dec. 21, 2010) ("[T]he CFTC anticipates that certain swap dealer requirements would apply to the swap dealing activities of the division, but not necessarily to the swap activities of other parts of the entity."). Such a division could potentially include persons and operations in more than one legal entity. *Cf.* Proposed Rule - Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71,391, 71,395 (Nov. 23, 2010) (Proposed 17 C.F.R. § 23.605(a)(2) defines "business trading unit" as "any department, division, group, or personnel of a swap dealer . . . or any of its affiliates, whether or not identified as such, that performs [certain enumerated business activities] on behalf of a swap dealer . . . .") *and* Proposed Rule - Reporting, Recordkeeping, and Daily Trading Records Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 76,666, 76,673 (Dec. 9, 2010) (Proposed 17 C.F.R. § 23.200(a) contains the same definition of "business trading unit.").

Registration of a U.S. Affiliate or Branch (Intermediation Model)

Alternatively, a foreign bank may choose to **register only its U.S. affiliate or branch with the Commissions as a swap dealer.**[17] Under such an approach, a foreign bank, acting through a non-U.S. branch, would still be the central booking location for swaps with all counterparties, including those in the U.S. but would not have direct interaction with U.S. customers and would not itself register as a swap dealer.[18] The U.S. affiliate or branch would act as agent in arranging all swap transactions with U.S. customers. In addition to registering as a swap dealer, the U.S. affiliate or branch may also register as a futures commission merchant (or introducing broker) and/or broker-dealer, as necessary in light of its functions.

There are multiple possible variants of the models described above that a foreign bank could select, depending on its particular business model and the nature of its activities, any of which could achieve compliance with Title VII under our proposed regulatory approach.

Legal Analysis

The rulemaking authority granted to the Commissions and the Federal Reserve in Title VII provides the necessary legal tools to implement the framework recommended in this letter in a manner consistent with policies underlying the Act, which include strengthening the regulatory regime for the swaps market in the United States, protection of U.S. investors and markets and respecting principles of international comity and international cooperation.

International Application of Title VII: Recognition of Existing and Developing Home Country Standards

We recommend in this letter that the Commissions and the Federal Reserve accept compliance with applicable home country standards as substitute compliance with certain provisions of Title VII and suggest that, in certain cases, the Commissions and the Federal Reserve should not exercise the full scope of their jurisdictional authority in connection with international application of Title VII. As the U.S. and Europe develop their structures for swaps regulation, it is critically important to work together to create systems that can coexist harmoniously and take into account the globally interconnected nature of the swaps business and to jointly preserve the systemic benefits of allowing

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[17] This model is similar to the mode of operation permitted by Rule 15a-6 under the Securities Exchange Act of 1934, pursuant to which foreign broker-dealers interface with U.S. customers under arrangements with affiliated or non-affiliated broker-dealers without themselves registering as broker-dealers in the U.S.

[18] If a U.S. affiliate or branch of a foreign bank registers as a U.S. swap dealer, the foreign bank or other branches or affiliates should not also have to register as swap dealers merely by virtue of engaging in swaps with or through the U.S. registered branch or affiliate. This approach would be consistent with existing principles of U.S. securities regulation. *See e.g.*, 17 C.F.R. § 240.15a-6(a)(4)(i).

banks to use their best capitalized and most highly rated entities as central booking vehicles.[19]

In promulgating the many rules that they are directed to issue under Title VII, and in defining terms,[20] the Commissions and the Federal Reserve should also give effect to the general jurisdictional limits specified in Sections 722 and 772 of the Dodd-Frank Act in a manner that is consistent with the principle of international comity evident in the statute and general legal principles governing statutory construction pertaining to extraterritorial and international matters.

In the Act, Congress recognized in numerous instances the principle of international comity – that is, the deference that sovereign nations afford to one another by limiting the reach of their laws. For instance, the Dodd-Frank Act directs regulators to consider the extent to which a foreign entity is comprehensively regulated in its home country before deciding whether to extend U.S. regulation to that entity[21] and requires U.S. regulators to consult with non-U.S. regulators before making certain decisions that could affect a foreign-regulated entity.[22] Specifically with respect to swaps, the Commissions and the Federal Reserve have a statutory mandate under Section 752(a) of the Dodd-Frank Act to "consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation . . . of swaps [and] swap entities. . . ."[23]

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[19] *See* Gary Gensler, Chairman, CFTC, Opening Statement at the Global Markets Advisory Committee Meeting (Oct. 5, 2010) ("As the [CFTC] works to implement [the Dodd-Frank Act], it is essential that we work across international borders to harmonize our regulatory approach.")

[20] Dodd-Frank Act § 712(d) ("[The Commissions], in consultation with the [Federal Reserve], shall further define the terms 'swap', 'security-based swap', 'swap dealer', [and] 'security-based swap dealer . . . .").

[21] *See, e.g.*, Dodd-Frank Act § 725(b) (CFTC may exempt a derivatives clearing organization from registration for the clearing of swaps if it is already subject to "comparable, comprehensive supervision and regulation by . . . the appropriate government authorities in the home country of the organization."); § 733 (CFTC may exempt a swap execution facility from registration on similar grounds); § 763(b) (SEC may exempt a clearing agency that clears security-based swaps from registration on similar grounds); § 738(a) (CFTC must make similar considerations in determining whether to permit a foreign board of trade to provide identified members or other participants located in the U.S. with direct access to its electronic trading and order matching system); § 113(b)(2)(H) (Financial Stability Oversight Council must undertake a similar consideration in determining whether a foreign nonbank financial company shall be supervised by the Federal Reserve and be subject to prudential standards); *see also* Dodd-Frank Act §§ 121(d); 165(b)(2); 174(b)(3).

[22] *See, e.g.*, Dodd-Frank Act § 113(f) (requiring the Financial Stability Oversight Council to consult with the appropriate home country supervisor of a foreign nonbank financial company before making certain determinations); § 113(i) ("In exercising its duties . . . with respect to foreign nonbank financial companies, foreign-based bank holding companies, and cross-border activities and markets, the [Financial Stability Oversight Council] shall consult with appropriate foreign regulatory authorities, to the extent appropriate."); *see also* § 175(c).

[23] Congress's concern for international considerations in Title VII is also evidenced in various other provisions, including Section 719(c), which requires the Commissions to study and report to specified Committees concerning evolving international swaps regulation, and Section 719(a)(4), which requires the Chairman of the CFTC to report to Congress on the impact of comparative regulation on the growth or decline of U.S. and international derivatives markets.

With specific reference to Title VII, the CFTC recently acknowledged in its rulemaking proposal concerning swaps entity registration the important role that "considerations of international comity play in determining the proper scope of extraterritorial application of federal statutes."[24] This statement is wholly consistent with the policies expressed by Congress and the legal principles applied by the Supreme Court.[25] We encourage the Commissions and the Federal Reserve to continue to consider principles of international comity in their rulemaking.

Application to Specific Requirements of Title VII: Broad Definitional Authority and Authority to Defer to Comparable Standards

As a threshold matter, we observe that the Commissions have broad authority to define the terms "swap dealer" and "security-based swap dealer."[26] The Commissions have the ability to define a swap dealer to include a business line of an entity (or group of entities), so as to limit the reach of Title VII to that business line.[27] The statute also recognizes that "[a] person may be designated as a swap dealer for a single type or single class or category of . . . *activities* and considered not to be a swap dealer [for others]"[28] The definitional flexibility under Title VII enables the Commissions and the Federal Reserve to address the specific organizational issues raised by foreign bank swap dealing activities.

More specifically, with regard to entity-level rules such as capital and margin, Sections 731 and 764 of the Dodd-Frank Act require the promulgation of "comparable" capital and margin requirements that take into account promoting the safety and soundness of the swap dealer, being appropriate for the risk, and, in the case of margin, preserving "the financial integrity of markets trading swaps" and "the stability of the

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[24] *See* Proposed Rule - Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71379, 71382 (Nov. 23, 2010).

[25] *See F. Hoffmann-La Roche Ltd* v. *Empagran S.A.*, 542 U.S. 155, 164-65 (2004) ("[The Supreme] Court ordinarily construes ambiguous statutes to avoid unreasonable interference with the sovereign authority of other nations . . . . [This approach] helps the potentially conflicting laws of different nations work together in harmony — a harmony particularly needed in today's highly interdependent commercial world."); *Morrison* v. *National Australia Bank Ltd.*, 130 S. Ct. 2869, 2877 (2010) ("'[U]nless there is the affirmative intention of the Congress clearly expressed' to give a statute extraterritorial effect, 'we must presume it is primarily concerned with domestic conditions.'")(citations omitted).

[26] *See* Dodd-Frank Act § 712(d) ("[The Commissions], in consultation with the [Federal Reserve], shall further define the terms 'swap', 'security-based swap', 'swap dealer', [and] 'security-based swap dealer . . . .").

[27] *See* Proposed Rule - Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80,174, 80,182 (Dec. 21, 2010). *See also id.* at n.50 ("[I]n order to efficiently impose the [swap] dealer requirements on only the person's [swap] dealing activities, it may be necessary for the person to have separate books and records and a separate compliance regime for its [swap] dealing activities.").

[28] Dodd-Frank Act § 721(a)(21)(emphasis added). § 761(a)(6) ("A person may be designated as a security-based swap dealer for a single type or single class or category of security-based swap or *activities* and considered not to be a security-based swap dealer for other[s]")(emphasis added). These provisions would permit the Commissions, for instance, to designate an entity as a swap dealer with respect to its swap "activities" involving U.S. customers, but not with respect to its foreign swap "activities."

United States financial system." We believe that reliance upon home country capital standards for those entities that are subject to comprehensive regulation by a home country supervisor that has adopted risk-based capital standards consistent with the Basel Accord would meet the comparability standard in Sections 731 and 764, promote the safety and soundness of the swap dealer by allocating responsibility for capital standards to the supervisor best situated to conduct effective supervision and be consistent with the way in which the Federal Reserve currently regulates foreign banks.[29] Similarly, the home country regulator has the greatest interest in and is in the best position to protect a foreign bank swap dealer under its primary supervision by setting appropriate margin requirements for non-cleared swaps.

Title VII's entity-level recordkeeping requirements for swap dealers and requirements for risk management, chief compliance officers and similar matters do not mandate uniformity among different classes, categories or types of swap dealers. It is consistent with the jurisdictional scope of Title VII, the policies underlying the Dodd-Frank Act, the definitional authority of the Commissions noted above and general principles of international comity for the requirements under Title VII to provide for deference to home country recordkeeping, risk management, chief compliance officer and similar requirements that are comparable in spirit and intent to those established by the Commissions.[30]

We urge the Commissions to facilitate international harmonization of position limit requirements.[31] Unless harmonization is achieved, counterparties may have severe disincentives to engage in swaps business in the U.S. and may instead trade outside the U.S. to avoid being subject to the position limits.[32] As far as trade reporting requirements are concerned, we encourage the Commissions to permit broad-based cross-registration of SDRs and exempt swap transactions that are reported to foreign SDRs under foreign reporting rules.

With respect to other transaction-level requirements, the regulatory framework described in this letter strikes a practical balance between the protection of U.S. investors and markets and the appropriate restraint on extraterritorial reach evidenced in Sections 722 and 772 in examining the policies underlying each rule and the potential for conflicts with home country regulatory requirements and other foreign regulatory considerations.

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[29] *Cf.* 12 C.F.R. § 225.90.

[30] In granting no-action relief to foreign boards of trade and issuing Rule 30.10 exemptions to foreign intermediaries, the CFTC has adopted a "comparability" analysis that looks broadly to whether a foreign regulatory authority "supports and enforces substantially equivalent regulatory objectives, such as prevention of market manipulation and customer protection. . . ." Proposed Rule - Registration of Foreign Boards of Trade, 75 Fed. Reg. 70,974, 70,977-78 (Nov. 19, 2010). Under this objectives-based approach, comparability does not turn on the contents of specific rules.

[31] We note that Congress was particularly concerned with the impact of CFTC-imposed position limits on U.S. markets and competitiveness, as evidenced in Section 719(a)(1), which requires the CFTC to study and report on this to Congress.

[32] Michael V. Dunn, Commissioner, CFTC, Impacts of the Financial Crisis on the Derivatives Markets, Remarks at the Bürgenstock Regulators' Meeting (Sept. 9, 2009) ("We must work internationally to harmonize speculative position limits, so that we do not allow for regulatory arbitrage. Unless harmonized, position limits will only serve to shift trading to other forums.").

This rule-by-rule approach is consistent with that recently suggested by the CFTC's General Counsel, who indicated that there is "no bright-line rule that says . . . the statute applies to its fullest [extraterritorial] extent in every single possible application"[33] and that there are "two questions for the various provisions in Dodd-Frank, does the extraterritorial provision *permit* application of U.S. law and *should* U.S. law apply in all those circumstances."[34]

Conclusion

Because the undersigned foreign banks believe in the benefits of operating a global swaps business out of a central, well-capitalized and effectively risk-managed entity, we request the Commissions and the Federal Reserve to articulate a workable framework that facilitates such a business model without raising concerns of incompatible or overlapping and burdensome regulation.[35] We believe our proposed regulatory approach appropriately reflects the goals of the Dodd-Frank Act, furthers the principles of international comity, provides legal certainty for foreign banks seeking to comply with the Commissions' and the Federal Reserve's rulemakings and promotes efficient means of conducting business in full compliance with applicable laws.

[33] CFTC Global Markets Advisory Committee, Meeting, Oct. 5, 2010, Tr. at 100 lns. 3-5 (Dan Berkovitz, CFTC Gen. Counsel).

[34] *Id.* at 99 lns. 10-14 (emphasis added).

[35] Société Générale has filed a separate comment letter on the issues presented here. *See* Letter from Laura Schisgall (Nov. 23, 2010). While the approach set forth in that letter differs somewhat from the framework described in this letter, Société Générale believes that this framework is also a workable approach to the difficult extra-territoriality issues facing foreign banks.

We appreciate the opportunity to share our views and recommendations and look forward to working with the Commissions and the Federal Reserve on these and other issues affecting foreign banks. We would also be available at any time to discuss any matters that may be useful to the Commissions and the Federal Reserve in crafting rules that apply to foreign banks. Please feel free to contact any of the undersigned banks or Lanny A. Schwartz (212-450-4174), Arthur S. Long (212-450-4742), Robert L.D. Colby (202-962-7121) or Courtenay U. Myers (212-450-4943) at Davis Polk & Wardwell LLP with any questions.

Sincerely,

BARCLAYS BANK PLC

BNP PARIBAS S.A.

DEUTSCHE BANK AG

ROYAL BANK OF CANADA

THE ROYAL BANK OF SCOTLAND GROUP PLC

SOCIETE GENERALE

UBS AG