CFTC PROPOSED GUIDANCE ON CROSS-BORDER SWAP REGULATION

A Comment Letter by the Futures and Options Association

13 AUGUST 2012

THE CFTC'S PROPOSED GUIDANCE ON CROSS-BORDER SWAP REGULATION

1. INTRODUCTION

1.1 The Futures and Options Association (the "FOA") is the principal European industry association for over 170 firms and organisations engaged in the carrying on of business in futures, options and other derivatives. Its international membership includes banks, financial institutions, brokers, commodity trade houses, energy and power market participants, exchanges, clearing houses, IT providers, lawyers, accountants and consultants (see Appendix 1).

1.2 The FOA appreciates the opportunity to comment on the proposed interpretive guidance (the "Proposed Guidance")[1] released on June 29, 2012 by the Commodity Futures Trading Commission ("Commission" or "CFTC") addressing the extent to which the registration and compliance provisions for swap dealers and major swap participants ("MSPs") in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") apply to persons and entities located outside the United States. The comments contained herein are also relevant to the Commission's concurrently-released proposed exemptive order relating to compliance with certain swaps provisions in Title VII of the Dodd-Frank Act (the "Proposed Order").[2]

1.3 Insofar as the proposed guidance addresses the regulation of cross-border swaps, the FOA anticipates that the International Swaps Dealers Association (ISDA) will respond in detail to the questions raised in the CFTC release. For this reason, the FOA has restricted its response to comments of a general nature.

1.4 The FOA recognises and appreciates that, through the Proposed Guidance, the CFTC staff has sought to address long-standing concerns about the impact on non-US counterparties and their customers of applying the CFTC's Dodd-Frank rulemakings extraterritorially to swaps market participants which are licensed and regulated in jurisdictions that have comparable frameworks of regulation to the US. In particular, the FOA is encouraged by the CFTC's embrace of "substituted compliance".

We understand that the Proposed Guidance will reflect US public policy to protect the US financial system and US customers, but the CFTC will also appreciate that the international financial markets – especially the swaps (and listed derivatives) markets – are global and interdependent. We believe that the drive to achieve convergence between US and EU regulation of swaps, combined with the role of the European Supervisory Authorities in harmonising EU member state rules more closely, will facilitate greater regulatory co-ordination, co-operation and recognition, particularly between the EU and the US. As the EU-US Coalition on Financial Regulation (of which FOA is a member) recently noted, cross-border regulatory issues should be addressed "through regulatory cooperation rather than unilateral action"[3] (see Appendix 2 for a summary of the Report).

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[1] *See* Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41214 (12 July 2012).

[2] *See* Exemptive Order Regarding Compliance With Certain Swap Regulations, 77 Fed. Reg. 41110 (12 July 2012).

[3] "Inter-Jurisdictional Regulatory Recognition: Facilitating Recovery and Streamlining Regulation", report from the EU-US Coalition on Financial Regulation (June 2012), p. 12 (the "Coalition Report"). In addition to the

1.5 In this context, while the Proposed Guidance may represent a reasoned approach to protecting the US financial markets, the G-20 has consistently advocated an integrated, coordinated approach to financial regulatory reform.[4] From a global perspective, certain aspects of the Proposed Guidance could be seen as leading to a number of undesirable cross-border consequences, not just for swaps dealers, but also their customers, in terms of increased regulatory complexity, cost and legal risk, and, most importantly, the likely confusion for customers over applicable standards of investor protection. This would be exacerbated significantly if other key jurisdictions decided to apply their rules extraterritorially to cross-border swaps.

The FOA has sought to identify several such consequences, including the limited coverage of the Commission's proposed "substituted compliance" regime, particularly in relation to transaction-level requirements; potentially duplicative and inconsistent regulatory requirements; and the potentially inconsistent and unpredictable application of Dodd-Frank compliance requirements to non-US swaps market participants.

As an aside, we would urge the CFTC to consider simplifying its approach in order to simplify the function of compliance and enhance customer understanding of what is a fairly complex set of provisions.

1.6 The FOA notes that Section 2(i) of the US Commodity Exchange Act (the "CEA") (as amended by section 722(d) of the Dodd-Frank Act) provides that the provisions of the CEA shall not apply to activities outside the United States unless they:

(i) have a direct and significant connection with activities in, or effect on, commerce of the United States; or

(ii) contravenes such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of the Act.

Against that background, the FOA welcomes:

(a) the CFTC's recognition of the view of the US Supreme Court that *"an act of Congress ought never to be construed to violate the law of nations"* and their jurisdiction should *"avoid unreasonable interference with the sovereign authority of other nations"*;

(b) the fact that the concept of *"direct and significant connection"* is largely linked to business undertaken for US customers; and

(c) the use of the word *"evasion"* insofar as it should not trigger the extraterritorial application of US rules or regulations if the *"evasion"* is generated by legitimate business *"relocation".*

1.7 More generally, the FOA believes that:

FOA, the other members of the Coalition are: the American Bankers Association Securities Association, the Association of Financial Markets in Europe / Global Financial Markets Association, the Bankers' Association for Finance and Trade, the British Bankers' Association, the Futures Industry Association, the International Capital Markets Association, the Investment Industry Association of Canada, the International Swaps and Derivatives Association, the Securities Industry and Financial Markets Association, and the Swiss Bankers Association.

[4] *See*, *e.g.*, Coalition Report, pp. 9-10 (providing excerpts of communiqués from the G-20 Leaders' Summits).

(a) the release, in its final form, should comprise a set of rules rather than guidance and, because of the severe cost implications for non-US firms and their customers of a limited approach to substituted compliance, be subject to cost-benefit analysis;

(b) the differentiated terms of ”regulatory recognition”, “equivalence”, “comparability” and “substituted compliance” represented different facets of the same policy, i.e. “regulatory recognition” based on “equivalent” regimes with “comparable” policy objectives, processes and outcomes, which are given practical effect through “substituted compliance”, by which compliance with the rules of the home state of a non-US firm substitutes for compliance with host state rules;

(c) providing that the home state will draw no differentiation between the domicile or nationality of customers or counterparties, and subject to satisfying the regulatory compatibility test, particularly as it relates to customer protection matters, compliance with host state rules should generally apply regardless of the location of the customer or counterparty;

(d) it is critical that, in this climate of regulatory change and continuing uncertainty in terms of the final supporting rules, particularly in the EU, market participants should be given practical timescales in which to come into compliance, which takes into account the huge burden being placed on firms' resources in coming into compliance with the global regulatory change agenda, the need to sustain business continuity and the need for continuous review to monitor the impact of unintended consequences; and

(e) from the perspective of non-US firms and institutions undertaking business in different classes of swaps, the importance of a co-ordinated approach with the SEC is critically important, and that includes a common approach to ”substituted compliance” covering key prudential and business conduct requirements.

2. THE PROPOSED “SUBSTITUTED COMPLIANCE” REGIME WILL NOT DELIVER MEANINGFUL REGULATORY RECOGNITION

2.1 Regulatory recognition – i.e., where one national regulator relies on another national regulator's supervision and oversight of persons and entities in its jurisdiction – is a particularly suitable tool where the basic policies, principles and outcomes of regulation are highly correlated across national jurisdictions. As noted above, the G-20 set out in 2009 a series of common principles for the regulation of the international swaps markets, and the FOA believes that these shared regulatory objectives, combined with the more detailed 38 IOSCO Principles of Securities Regulation (originally published 1998, updated 2010), provide a basic foundation for establishing a meaningful regulatory recognition regime.

2.2 The approach to regulatory recognition that the CFTC has articulated in the Proposed Guidance – known as “substituted compliance” – is a positive, but, in the view of the FOA, an incomplete step towards establishing a workable regulatory recognition regime for the international swaps markets. Under the proposed “substituted compliance” regime, non-US registered swap dealers and MSPs would be able to comply with applicable regulatory requirements (which the CFTC identifies

as "Entity-Level Requirements"[5] and "Transaction-Level Requirements"[6]) through compliance with applicable home country regulation, where the CFTC has determined, upon application, that the regulatory regime in that home jurisdiction is comparable with the CEA and CFTC Regulations. For these purposes, the CFTC will assess comparability through an "outcomes-based" process of determining whether the home jurisdiction's regulatory requirements are designed to meet the same regulatory objectives as the Dodd-Frank Act.[7]

2.3 The FOA is concerned that the Proposed Guidance contains several gaps and missed opportunities which together threaten to undermine the utility of the CFTC's "substituted compliance" regime.

2.4 *Mechanics of Obtaining "Substituted Compliance"*

2.4.1 The CFTC anticipates that it will make determinations of substituted compliance upon application. In other words, it is up to the non-US person(s) individually or collectively (or the appropriate licensing authority) wishing to benefit from substituted compliance to submit an application to the CFTC. The FOA considers the timing requirements of submitting a request for substituted compliance should take into significantly better account the depth, scope and complexity of global regulatory change, particularly in the EU and the US and the continuing uncertainty and developments surrounding the supporting rules and technical standards governing swaps business, particularly in the EU. The Proposed Guidance indicates that a substituted compliance request must be made as part of an applicant's swap dealer or MSP registration submission. Registration for swap dealers and MSPs is required 60 days after publication of the CFTC's final product definitions (the "Product Definitions") in the Federal Register.[8] The Product Definitions were approved by the CFTC and the SEC in early July and are expected to be published in the Federal Register in the next week or so, meaning that swap dealer and MSP registration may be required by the middle of October 2012. There is simply not enough time or regulatory certainty before then for non-US persons to determine the cross-border application of the Dodd-Frank Act to their swaps activities and to prepare the necessary information to be included in a substituted compliance request, particularly because (a) the CFTC's cross-border guidance is still in proposed form and will likely not be finalised prior to early September; and (b) as already indicated, the EU's own technical standards in support of EMIR will not be finalised until, at the earliest, the end of September.

2.4.2 A related concern is how groups of non-US persons in a given jurisdiction are expected to prepare and submit a unified request for substituted compliance. It is not clear in the Proposed Guidance whether the CFTC expects the most significant swaps market participants in a given jurisdiction to cooperate in preparing a common request, nor does the Proposed Guidance address the

[5] The Commission proposes to define "Entity-Level Requirements" to include: (i) capital adequacy; (ii) chief compliance officer; (iii) risk management; (iv) swap data recordkeeping; (v) swap data reporting; and (vi) physical commodity swaps reporting. *See* Proposed Guidance, p. 41224.

[6] The Commission proposes to define "Transaction-Level Requirements" to include: (i) clearing and swap processing; (ii) margining and segregation for uncleared swaps; (iii) trade execution; (iv) swap trading relationship documentation; (v) portfolio reconciliation and compression; (vi) real-time public reporting; (vii) trade confirmation; (viii) daily trading records; and (ix) external business conduct standards. *See* Proposed Guidance, p. 41225.

[7] Proposed Guidance, p. 41232.

[8] The Product Definitions were approved by the Securities and Exchange Commission (the "SEC") on 9 July 2012 and the CFTC followed suit on 11 July 2012.

Commission's process for handling multiple requests from a single jurisdiction. It would not seem tenable for the Commission to determine to permit substituted compliance in response to one application from a given jurisdiction but not make an identical determination for all other applications from the same jurisdiction. If that is the case, then the Proposed Guidance may actually create an incentive for swaps market participants in many jurisdictions to wait until some other applicant or group of applicants from the same jurisdiction has done the hard work of submitting a request for substituted compliance and then effectively "free ride" on their efforts. At the same time, there is a high risk of unnecessary duplication in individual submissions and the risk of potential different interpretations that will have to be analysed by the CFTC in discussions with the relevant national supervisors.

The FOA believes that one possible approach would be for the required regulatory gap analysis in support of an application to be undertaken on a central basis – e.g., through an industry association – which would reduce the cost and complexity of individual applications.

2.4.3 More helpfully, the Proposed Guidance also permits a non-US regulator to make a request on behalf of those persons subject to its regulation and oversight in its jurisdiction. The FOA believes that the Commission should prioritize direct regulator-to-regulator discussions when making substituted compliance determinations. There are several significant advantages to this approach. The Commission and non-US regulators meet regularly to discuss the pace and scope of the regulatory reform efforts in their jurisdictions. Therefore, the CFTC staff already have significant awareness of the regulatory approach taken in other key jurisdictions, particularly the EU. The CFTC staff also therefore has direct contacts with the relevant personnel of other national regulators, which makes it much easier to resolve matters of interpretation or other questions directly between the regulators rather than having to relay such information through market participants submitting a request for substituted compliance. Direct regulator-to-regulator contacts would also eliminate the likelihood of duplicative effort in preparing requests as well as the risks of free-riding noted above. Finally, it seems clear that the CFTC will be directly accountable for the scope and depth of "substituted compliance" permitted by it and, on that basis, should undertake its own direct due diligence as to whether or not any jurisdiction has a comparable framework of rules sufficient to permit substituted compliance, i.e. this is an analysis that is best undertaken directly by the CFTC, working with the relevant national supervisor, rather than by the firms.

2.4.4 In addition to making substituted compliance determinations based on discussions at the regulator-to-regulator level, the FOA urges the CFTC to consider a more gradual, phased approach to substituted compliance to permit non-US persons sufficient time to assess the impact of the Proposed Guidance on their swaps activities. The form of such phased approach may include amending the terms of the Proposed Order to permit non-US swap dealers and MSPs: (1) to submit registration applications at least 90 days after the Commission's cross-border guidance is finalized rather than 60 days following publication of the Product Definitions, and (2) to comply with their home regulatory regime in respect of their swaps activities until the CFTC has made its substituted compliance determination. This phased approach should also require that, where the Commission determines that substituted compliance is <u>not</u> available in respect of a particular jurisdiction, a non-US

swap dealer or MSP from that jurisdiction should have a reasonable transition period during which to bring itself into compliance with applicable Dodd-Frank requirements.

2.5 *Multi-Jurisdictional Substituted Compliance Determinations*

2.5.1 The Proposed Guidance assumes that substituted compliance determinations can be assessed using a straightforward bilateral construct: a non-US person is regulated in its home jurisdiction, and therefore a substituted compliance determination need only assess that home jurisdiction.[9] The Proposed Guidance does not therefore provide any indication of how the Commission intends to approach situations where more than one non-US jurisdiction's rules may be relevant. For example, a bank headquartered in one country (e.g., France) may have a swap dealing branch that operates in another country (e.g., the United Kingdom). Any substituted compliance determination by the Commission must account for the interplay of the regulatory regimes in the relevant non-US jurisdictions. To take the example of the London branch of a French bank, under EU law the London branch is authorized by the UK Financial Services Authority ("FSA") and is subject to FSA supervision in connection with its fitness, sales practices and recordkeeping requirements whereas the French regulator retains prudential oversight over the entire French bank, including the London branch.

2.5.2 These multi-jurisdictional scenarios are quite common and therefore the Proposed Guidance must address the following questions regarding non-US persons that engage in swap dealing activities through branches located in different non-US jurisdictions:

- Does the Commission expect the non-US branch, its principal non-US entity, or both, to submit a request for substituted compliance?

- Does the answer change depending on whether the non-US branch acts solely as agent and all swaps are booked (either directly or via back-to-back booking) into the principal non-US entity?

- If the Commission has already made a substituted compliance determination in respect of both: (1) the jurisdiction in which the non-US branch is located; and (2) the jurisdiction of the principal non-US entity, can the non-US branch rely on these determinations or must it submit its own request based on its own facts and circumstances?

2.5.3 In this regard, the FOA notes that the Commission has previously issued an order[10] instructing the National Futures Association (the "NFA") to confirm relief from futures commission merchant ("FCM") registration pursuant to CFTC Regulation 30.10 for certain "cross-border futures brokers" located in the European Union that benefited from the EU's passporting regime.[11] The Commission determined that relief would be appropriate where "in the aggregate" the regulation by home and host country regulators met applicable

[9] The FOA notes however that the Commission has recognised that "[m]any US and non-US domiciled or incorporated financial institutions conduct their swaps business across multiple jurisdictions". Proposed Guidance, p. 41216.

[10] Performance of Certain Functions by National Futures Association With Respect to Those Foreign Firms Acting in the Capacity of a Futures Commission Merchant, 70 Fed. Reg. 2621 (14 January 2005).

[11] The EU's passporting regime geneally permits a firm organized and recognized in one EU member state to operate in all other EU member states without separate recognition.

standards While this order was issued in respect of futures business and FCM registration requirements, the Proposed Guidance indicates that the Commission's previous comparability determinations rendered under CFTC Regulation 30.10 will facilitate its substituted compliance determinations. Accordingly, the FOA would urge the Commission to consider adopting a similar, "aggregate" approach to multi-jurisdictional substituted compliance determinations.

3. THE PROPOSED GUIDANCE DOES NOT ELIMINATE THE RISKS OF DUPLICATIVE AND/OR INCONSISTENT REGULATIONS

3.1 The Commission clearly intended for the Proposed Guidance to provide greater, clarity on the cross-border application of the swaps provisions of the Dodd-Frank Act. However, the Commission will appreciate that it is not acting in a regulatory vacuum: other jurisdictions are in the process of implementing their own (potentially also extraterritorial) regulatory reforms applicable to their swaps markets and the FOA is concerned that the Proposed Guidance does not sufficiently eliminate the risks of duplicative and/or inconsistent regulations for swaps market participants. The CFTC will be well aware of the example of the late inclusion of the extraterritorial application of the EU's CCP clearing obligation requirement, which was inserted in EMIR at the last minute to mirror the US's own extraterritorial approach to the application of its domestic rules.

3.2 The FOA understands the benefit of flexibility that is inherent in the CFTC's approach, which would facilitate "substituted compliance" with certain specific non-US rules, even where the CFTC does not necessarily accept that the whole of a foreign regulatory regime is fully compatible with the US regime. On the other hand, there is a real risk that this approach of "partial" substituted compliance could increase, rather than decrease, the likelihood that a given swaps market participant will be subject to duplicative and/or inconsistent regulations. In addition, the FOA is concerned that the Proposed Guidance has focused too narrowly on swap dealers and MSPs and has not addressed other pressing cross-border topics.

3.3 *"Partial" Substituted Compliance Increases Operational and Compliance Risks*

3.3.1 In the Proposed Guidance, the Commission notes that a substituted compliance determination could be made in respect of some, but not all, aspects of another jurisdiction's regulations.[12] The FOA is concerned that a regime that permits partial substituted compliance determinations could introduce inconsistencies into the compliance burdens of non-US persons that could pose significant operational difficulties. The Proposed Guidance already establishes a form of variable geometry where swaps market participants must assess their Dodd-Frank compliance obligations based on the nature of their counterparty and the mechanics of how and where the swap is booked. To overlay on top of this already complex set of assessments a further obligation to identify within each such category the sub-set of requirements that are subject to substituted compliance and those that are not may overwhelm even the most robust compliance and information technology systems. When the Commission makes substituted compliance determinations, the FOA urges it to be sensitive to the possible compliance consequences for swaps market participants and, wherever possible, to

[12] *See* Proposed Guidance, pp. 41232-41233.

contain a presumption that where a significant portion of a jurisdiction's regulatory regime is determined to be comparable to the Dodd-Frank Act, the remainder of the jurisdiction's regulatory regime should also be deemed to be comparable.[13]

3.3.2 While we recognise that the Commission will look to keep duplicative or inconsistent requirements to a minimum, "partial" substituted compliance will nevertheless entrench a patchwork approach to cross-border regulation that will put excessive and, the FOA believes, potentially unnecessary, strain on the operational and compliance resources of swaps market participants. In addition, the CFTC's approach may also induce non-US regulators to adopt a similar mutual recognition regime that relies on evaluations of individual compliance requirements, which may not correlate with the CFTC's determinations. Swaps market participants and their customers could then be exposed to an ever-increasing complex web of compliance obligations and exceptions that will increase significantly both cost and legal risk, while reducing the regulatory clarity and transparency, of cross-border swaps business. This, in turn, will exacerbate the risk of inadvertent compliance breaches, generating, in turn, increased supervisory and enforcement costs for authorities which are already struggling to meet their domestic public policy obligations on fairly slender resources.

3.4 *The Scope of the Proposed Guidance Is Too Narrow*

3.4.1 The FOA notes that the Proposed Guidance does not address several key elements of the G-20 recommendations for regulation of the international swap markets, including clearing and trading obligations and transaction reporting requirements. The FOA would urge the Commission to take account of these issues and address them in the final guidance or in a separate interpretive release.

3.4.2 The Proposed Guidance indicates that the Commission is prepared to make substituted compliance determinations relating to clearing requirements provided that the swap is subject to "comparable and comprehensive" mandatory clearing requirement in the non-US jurisdiction and where the swap is cleared through a derivatives clearing organization ("DCO") that is registered under the CEA or that is exempt from such registration.[14] The Commission does not, however, provide any additional guidance on how a non-US DCO may obtain an exemption from such registration requirements. In addition, the Proposed Guidance is silent on whether the Commission would expect the assessment of "comparable and comprehensive" clearing arrangements to include an assessment of customer protection requirements, including whether the Commission would require FCM registration for clearing members of such non-US DCO and/or US cleared swaps customer collateral to be held in accordance with the "legally segregated, operationally commingled" requirements of Part 22 of the CFTC Regulations. The approach of the EU, for example, is to permit segregation choice for customers, ranging from omnibus accounts through to fully individually segregated accounts.

3.4.3 The Proposed Guidance does not cover substituted compliance for mandatory trading requirements. As significant segments of the swaps market are expected to be subject to a mandatory trading requirement, it is vital for

[13] The Commission could nevertheless deny substituted compliance in extenuating circumstances.
[14] Proposed Guidance, pp. 41233-41234.

swaps market participants to know how the Commission proposes to assess whether another jurisdiction's trading requirements are "equivalent" to Dodd-Frank Act requirements. In particular, concerns remain whether the EU's existing multilateral trading facilities or the "organised trading facilities" that form part of the EU's MiFID/MiFIR proposals could demonstrate equivalence to swaps execution facilities. The FOA is also concerned whether the Commission would require as a predicate to a finding of substituted compliance for trading that the home regulatory regime require some assessment whether a swap has been made "available to trade", which is feature unique to the Dodd-Frank Act. The vibrancy of the transatlantic swaps markets could be undermined if a swap between US and EU counterparties that is subject to US and EU mandatory trading requirements cannot be executed through a single trading platform.

3.4.4 The FOA notes the restrictive approach adopted towards substituted compliance in the context of transaction-level requirements. They cover a wide range of regulatory requirements including trade processing, margining, segregation, execution, documentation, record-keeping, reporting and business conduct standards. The FOA is concerned that this restriction in the scope of substituted compliance may do little to achieve the objectives of simplifying and clarifying the regulation across cross-border swaps, or helping to control the inevitable increase in cost of cross-border business in swaps.

3.4.5 Finally, in connection with swap data reporting, the Commission proposes to permit non-US swap dealers and MSPs to request substituted compliance but only for those swaps entered into with other non-US persons and provided the Commission has "direct access" to such swap data records. In other words, any swap entered into by a non-US swap dealer or MSP with a US person remains subject to reporting to a swap data repository registered with the CFTC. While the FOA recognises the Commission's significant interest in having access to data regarding swaps subject to its jurisdiction, the FOA notes that the Commission has historically entered into memoranda of understanding with non-US regulators in order to obtain access to information, and the FOA considers that the Commission should continue this approach in respect of access to swap data records. Accordingly, there appears to be no reason why the Commission could not rely on reporting to a non-US swap data repository for swaps between a non-US swap dealer or MSP and a US person, provided the Commission has direct access to such data.

4. CROSS-BORDER REGULATION MUST BE APPLIED CONSISTENTLY AND PREDICTABLY

4.1 The transatlantic marketplace is the largest and most liquid financial centre in the world and serves as a valuable engine of economic growth for both the European Union and the United States. The continued success of the transatlantic marketplace depends on the presence of a consistent, predictable legal and regulatory framework within which market participants can transact business. The Dodd-Frank Act represents a fundamental reregulation of the swaps markets, which will affect numerous financial and non-financial entities in the United States and abroad. For swaps market participants, it is essential to know with a great degree of certainty the impact of the Commission's new regulations in order to make informed, reasoned decisions about how to best comply with the new Dodd-Frank regulatory regime. As

the Commission is well aware, non-US swaps market participants have been particular concerned with the cross-border effects of the Dodd-Frank Act and have eagerly awaited clear guidance as to the nature and extent of the Dodd-Frank Act's extraterritorial impact.

4.2 The FOA would urge the CFTC to develop the Proposed Guidance in ways which will deliver greater clarity to the international swaps marketplace. There are several elements of the Proposed Guidance where greater clarity from the Commission is essential, including: the scope of the definition of "US person"; the application of registration requirements to non-US swap dealers and their non-US swap dealing affiliates; and allocation of compliance requirements to US branches of non-US swap dealers.

4.3 *Definition of US person*

4.3.1 The Commission's proposed definition of "US person" is expansive and significantly broader than similar definitions found in the US federal securities and commodities laws, such as the SEC's definition of "US person" in Regulation S and the CFTC's own definition of "non-United States person" in CFTC Regulation 4.7. In particular, the Commission's proposed definition would include for the first time any commodity pool the operator of which would be required to register as a commodity pool operator ("CPO") under the CEA. Given the Commission's recent rescission of a widely-used exemption from CPO registration as well as the expansion of the term "commodity interests" to include swaps, a significant number of non-US commodity pools will require their operators to register as CPOs if they have US participants.[15] The Proposed Guidance would treat each such non-US commodity pool as a US person, which would substantially increase the number of such "US persons" to include a substantial number of market participants that would not otherwise reasonably be considered US persons. For example, a London-based real estate fund investing in Eurozone real estate assets and that uses currency swaps to hedge its exposure would be a "US person" even where its only connection to the United States is a highly-limited number of US investors. The proposed definition would also for the first time include discretionary and non-discretionary accounts where the beneficial owner is a US person, which considerably expands the notion of US personhood beyond what market participants have come to expect.

4.3.2 A related concern is the extent to which the definition of "US person" in the Proposed Guidance becomes the *de facto* definition of US person for all cross-border purposes under Title VII of the Dodd-Frank Act. Although the Commission clearly states that the proposed definition of "US person" is for the purposes of the Proposed Guidance only, there may be other cross-border contexts where the definition of US person may be relevant and the Commission may choose to rely on its first "Title VII" US person definition rather than introduce numerous US person definitions for Title VII purposes. For example, in a cross-border clearing context, there may eventually be a need to determine what constitutes a US customer of a clearing member and that determination may be linked to whether the customer is a "US person". As noted above, the breadth of the proposed definition of "US person" could have significant unintended consequences, especially for swaps market

[15] The Commission recently rescinded its Regulation 4.13(a)(4), which granted an exemption from CPO registration in respect of privately-offered commodity pools with sophisticated investors. *See* Commodity Pool Operators and Commodity Trading Advisors: Compliance Obligations, 77 Fed. Reg. 11252 (24 February 2012).

participants that would not ordinarily be considered US persons. Accordingly, the FOA proposes that the Commission expressly state that its proposed definition of "US person" is only applicable in respect of the registration and regulation of swap dealers and MSPs.

4.3.3 In light of the foregoing concerns, the FOA is concerned that the Proposed Guidance may create substantial market uncertainty on the most basic element of the Commission's approach, which is the definition of "US person". In order to provide as much certainty as possible to swaps market participants, the FOA recommends that the Commission adopt an approach that better matches with market experience and expectations and that limits the instances where a non-US market participant is deemed to be a "US person" on the basis only of a tenuous connection to the United States that falls significantly short of the overarching test of constituting a "direct and significant" US connection.

4.3.4 In light of the foregoing concerns, and in order to minimise the potentially significant market disruption when applying the Commission's final definition of "US person", the FOA suggests that, until the definition of "US person" is finalised, swaps market participants should be permitted to treat only the following as "US persons" for swap dealer and MSP registration purposes:

- any natural person who is a US resident; and
- any corporation, partnership, limited liability corporation, business or other trust, association, joint-stock company, fund, or any form of enterprise similar to any of the foregoing that is organized or incorporated under the laws of the United States (or of a State of the United States) or that has its principal place of business in the United States[16].

4.4 *Aggregation Among Non-US Affiliates and Swap Dealer Registration Requirements*

4.4.1 The Proposed Guidance requires that, when a non-US person determines whether it engages in more than a *de minimis* level of swap dealing activity, it must include, *inter alia*, all swap dealing transactions with US persons entered into by its non-US affiliates under common control as well as all swap dealing transactions of its non-US affiliates under common control where such affiliates' obligations are guaranteed by US persons.[17] Because each non-US person engaging in swap dealing activities with US persons must perform this aggregation, if the non-US person and its non-US swap dealing affiliates under common control engage in an aggregate amount of swap dealing that exceeds the *de minimis* threshold, then <u>each</u> member of the group of non-US swap dealing affiliates would be independently deemed to exceed the *de minimis* threshold and therefore <u>each</u> would be require to register as a swap dealer.

4.4.2 The FOA believes that it would be disproportionate to require a non-US person engaging in a *de minimis* amount of US-facing swap dealing activities to register as a swap dealer simply because its other non-US affiliates under common control, in the aggregate exceed the *de minimis* threshold, especially

[16] A similar approach has been proposed by the Institute of International Bankers. See comment available on the Commission's website at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58348.

[17] Proposed Guidance, p. 41221.

where the group of non-US swap dealing affiliates do not coordinate their swap dealing activities. This is particularly the case where a non-US person only engages in very occasional or highly limited amounts of swap dealing with US persons but exceeds the *de minimis* threshold solely due to the swap dealing with US persons of its non-US affiliates under common control. The FOA recommends that the Commission consider permitting non-US persons to disaggregate the swap dealing activities of its non-US swap dealing affiliates under common control and to only impose an aggregation requirement where there is evidence that the group of non-US swap dealing affiliates sufficiently coordinate their swap dealing activities.

4.5 *Compliance by US Branch of Non-US Swap Dealer*

4.5.1 The Proposed Guidance provides that a non-US branch of a US person will be considered a US person because they are part of the same legal entity. Therefore, the non-US branch of a US swap dealer will be deemed to be registered as swap dealers through the registration of the principal office in the US, which will be responsible for compliance by its non-US branches with swap dealer regulations. The Proposed guidance does not, however, expressly address the treatment of the US branch of a non-US swap dealer.[18] Based on the definition of US person, the US branch should expect to be treated as a non-US person because it is the same legal entity as the non-US principal office. The FOA recommends that the Commission clarify that this is the case in its final guidance.

4.5.2 The Commission has also not clarified whether the US branch and its non-US principal office are permitted to allocate between themselves compliance with swap dealer regulations, which US persons and their non-US branches are permitted to do under the Proposed Guidance. The FOA urges the Commission to provide greater attention in its final guidance to the treatment of US branches of non-US persons as swap dealers and MSPs.

5. CONCLUSION

5.1 The FOA appreciates the opportunity to provide its comments on the Proposed Guidance and the Proposed Order. There are reasons to be optimistic about both, most importantly due to the Commission's embrace of regulatory recognition of other national comparable regulatory regimes, and so facilitate substituted compliance. However, the FOA is concerned that the Proposed Guidance does not address the full panoply of cross-border issues that must be resolved in order for the extraterritorial impact of the Dodd-Frank Act to be properly assessed. We therefore urge the Commission to consider carefully all comments received regarding the Proposed Guidance and Proposed Order and to craft an approach that will provide clear guidance so that swaps market participants can apply it in a consistent, predictable manner.

[18] *See* Proposed Guidance, n. 54 (indicating that further discussion of this topic may be found in "Subsection E", which is missing from the text).

APPENDIX 1

LIST OF FOA MEMBERS

FINANCIAL INSTITUTIONS

ABN AMRO Clearing Bank N.V.
ADMISI
Altura Markets S.A./S.V
AMT Futures Limited
Jefferies Bache Limited
Banco Santander
Bank of America Merrill Lynch
Banca IMI S.p.A.
Barclays Capital
Berkeley Futures
BGC International
BHF Aktiengesellschaft
BNP Paribas Commodity Futures
BNY Mellon Clearing International
Citadel Derivatives Group (Europe)
Citigroup
City Index
CMC Group Plc
Commerzbank AG
Crédit Agricole CIB
Credit Suisse Securities (Europe)
Deutsche Bank AG
ETX Capital
FOREX.COM UK
FXCM Securities
GFI Securities
GFT Global Markets UK Ltd
Goldman Sachs International
HSBC Bank Plc
ICAP Securities Limited
IG Group Holdings Plc
International FC Stone Group
JP Morgan Securities
Liquid Capital Markets
London Capital Group
Macquarie Bank
Mako Global Derivatives
Marex Spectron
Mitsubishi UFJ Securities International Plc
Mizuho Securities USA, Inc London
Monument Securities
Morgan Stanley & Co International
Newedge Group (UK Branch)
Nomura International Plc
Rabobank International
RBC Europe Limited
Saxo Bank A/S
Scotia Bank
S E B Futures
Schneider Trading Associates
S G London
Standard Bank Plc
Standard Chartered Bank
Starmark Trading
State Street GMBH London Branch
The Kyte Group
The RBS
UBS Limited
Vantage Capital Markets LLP
Wells Fargo Securities

EXCHANGE/CLEARING HOUSES

APX Group
CME Group, Inc.
Dalian Commodity Exchange
European Energy Exchange AG
Global Board of Trade
ICE Futures Europe
LCH.Clearnet Group
MCX Stock Exchange
MEFF RV
Nasdaq OMX
Nord Pool Spot AS
NYSE Liffe
Powernext SA
RTS Stock Exchange
Shanghai Futures Exchange
Singapore Exchange
Singapore Mercantile Exchange
The London Metal Exchange
The South African Futures Exchange
Turquoise Global Holdings

SPECIALIST COMMODITY HOUSES

Amalgamated Metal Trading
BASF SE. EIL
Cargill Plc
ED & F Man Capital Markets
Glencore Commodities
Gunvor SA
Hunter Wise Commodities LLC
Koch Metals Trading Ltd
Metdist Trading Limited
Mitsui Bussan Commodities
Natixis Commodity Markets
Noble Clean Fuels
Phibro GMBH
J.P. Morgan Metals
Sucden Financial
Toyota Tsusho Metals
Triland Metals
Vitol SA

ENERGY COMPANIES

BP International IST
Centrica Energy
ChevronTexaco
ConocoPhillips Limited
E.ON EnergyTrading SE
EDF Energy
EDF Trading Ltd
International Power plc
Phillips 66 TS Limited
National Grid Electricity Transmission Plc
RWE Trading GMBH
Scottish Power Energy Trading
Shell International
SmartestEnergy Limited

PROFESSIONAL SERVICE COMPANIES

Ashurst LLP
ATEO Ltd
Baker & McKenzie
Berwin Leighton Paisner LLP
BDO Stoy Hayward
Clifford Chance
Clyde & Co
CMS Cameron McKenna
Deloitte
FfastFill
Fidessa Plc
Freshfields Bruckhaus Deringer
Herbert Smith LLP
Holman Fenwick Willan LLP
ION Trading Group
JLT Risk Solutions Ltd
Katten Muchin Rosenman LLP
Linklaters LLP
Kinetic Partners LLP
KPMG
McDermott Will & Emery LLP
Mpac Consultancy LLP
Norton Rose LLP
Options Industry Council
Orrick, Herrington & Sutcliffe LLP
PA Consulting Group
R3D Systems Ltd
Reed Smith LLP
Rostron Parry
RTS Realtime Systems
Sidley Austin LLP
Simmons & Simmons
SJ Berwin & Company
SmartStream Techologies
SNR Denton UK LLP
Speechly Bircham LLP
Stellar Trading Systems
SunGard Futures Systems
Swiss FOA
Traiana Inc
Travers Smith LLP
Trayport

APPENDIX 2

EU-US COALITION ON FINANCIAL REGULATION REPORT: "INTER-JURISDICTIONAL REGULATORY RECOGNITION: FACILITATING RECOVERY AND STREAMLINING REGULATION"

EXECUTIVE SUMMARY

EU-US Coalition on Financial Regulation Report

**"Inter-jurisdictional Regulatory Recognition:
Facilitating Recovery and Streamlining Regulation"**

Executive Summary

Background

In 2005, a group of transatlantic financial service trade associations established the EU-US Coalition on Financial Regulation with the objective of energising the transatlantic dialogue to deliver on the three 'gateways' to establishing a more coherent framework of regulation for the conduct of cross-border business, namely, regulatory recognition, exemptive relief and targeted rules' convergence. To that end, and in the years preceding the crisis, the Coalition produced a number of reports, including a 'gap analysis' of the business conduct rules of the EU, the US and Switzerland.

On 1st February 2008, the European Commission and the US SEC, in their Joint Statement on Mutual Recognition in Securities Markets, mandated their respective organisations to *"intensify work on a possible framework for EU-US mutual recognition for securities in 2008"* on the basis that *"the concept of mutual recognition offers significant promises and means for better protecting investors, fostering capital formation and maintaining fair, orderly and efficient transatlantic securities markets"*.

The subsequent emergence of the sub-prime financial crisis resulted in a refocusing of regulatory priorities away from regulatory recognition to restructuring financial services regulation at both the macro- and micro-levels. Nevertheless, the importance of developing a framework of coherent and coordinated regulation for the carrying-on of cross-border business remains as true today as it was before the crisis.

In this context, it is noteworthy that the G20, in its first post-crisis Leaders' Summit in November 2008, underscored *"the critical importance of rejecting protectionism and not turning inward in times of financial uncertainty".* For its part, the European Commission, in its first report after the crisis, cautioned that *"protectionism and a retreat towards national markets can only lead to stagnation, a deeper and longer recession and lost prosperity"* ('Driving Economic Recovery' (4/3/09)).

While it is true that the post-crisis regulatory agenda of the various transatlantic constituencies has adopted in large part the objectives and standards set by the G20, the FSB, Basel and IOSCO, regulatory convergence is nevertheless being increasingly undermined by growing regulatory differentiation, protectionism and extraterritoriality. This, in turn, has generated needless legal risk and compliance complexity, restricted customer choice and increased cost in relation to the carrying on of cross-border business.

As a result, the Coalition, noting the global importance of energising business recovery and economic growth in the current climate and recognising that the transatlantic marketplace (through which 80% of the world's financial business flows) has a potentially significant contribution to make in achieving those key targets, commissioned Clifford Chance to produce a report emphasising the post-crisis importance of an urgent resumption of the pre-crisis dialogue to establish a framework of regulatory recognition in the transatlantic marketplace. This report, called *'Inter-Jurisdictional Regulatory Recognition: Facilitating Recovery and Streamlining Regulation'* was published on 19th June 2012.

Summary of the Report's Findings

The Report emphasises that regulatory recognition must be based on acceptable comparability in shared regulatory policy objectives, standards and outcomes, but recognises that there will inevitably be regional differences in overarching legal systems, market practices, etc. It identifies the key areas where regulatory recognition should be concentrated and the kind of regulatory criteria necessary for it to be credible and reliable. The Report also recognises the critical importance of accommodating operational differentiation within Memoranda of Understanding entered into between regulatory authorities, insofar as while they may all be subjected to common regulatory objectives, standards and outcomes, they will be fundamentally different in terms of experience and resources and this will impact on the degree of operational inter-reliance that can take place between differentiated authorities.

More particularly, the report recommends:

- that the international standard setting bodies should move beyond expressing policy objectives and aspirations to defining the negotiating architecture for progressing the dialogue on regulatory recognition, setting timetables and actively 'mentoring' the dialogue;

- that the 38 IOSCO Principles and Objectives for Securities Regulation (exhibited to the Report) are the only international agreed measure regulatory adequacy and, as such, should serve as the foundation for the dialogue, but this should be supported by additional tiers of due diligence and in-depth analysis, particularly in the area of supervision and enforcement; and that the IOSCO Multilateral Memorandum of Understanding should be widely adopted and extended beyond its scope of facilitating information-sharing and evidence-gathering;

- that a dedicated working group drawn from the key regulatory authorities on both sides of the Atlantic should be established (or the work outsourced on a collective basis to a major law firm) to undertake a regulatory gap analysis; and establish a process whereby new regulations with potential extraterritorial effect or which depart from the basis for regulatory recognition are made subject to inter-regulatory consultations prior to their introduction (other than in cases of extreme market stress or urgency);

- that an advisory group comprising investment banks, non-bank broker-dealers, market infrastructures and corporate and institutional end-users of the markets should be established to identify areas of regulatory conflict which impose significant cost or other resource burdens or unnecessary complexity on financial service providers and/or consumers and/or market infrastructures (and regulatory authorities) and provide input into the dialogue in terms of ensuring that it delivers commercial and business efficiency alongside regulatory efficiency for the key 'stakeholders' in the outcome.

List of Coalition Members

American Bankers Association Securities Association (ABASA)

Association of Financial Markets in Europe (AFME) / Global Financial Markets Association (GFMA)

Bankers' Association for Finance and Trade (BAFT)

British Bankers' Association (BBA)

Futures Industry Association (FIA)

Futures and Options Association (FOA)

International Capital Market Association (ICMA)

Investment Industry Association of Canada (IIAC)

International Swaps and Derivatives Association (ISDA)

Securities Industry and Financial Markets Association (SIFMA)

Swiss Bankers Association (SBA)

Observer: European Banking Federation (EBF)