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

Re: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, RIN 3083-AD57 (the "Proposed Guidance")[1]

Dear Mr. Stawick:

The Institute of International Bankers (the "Institute") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") with respect to the Proposed Guidance. The Institute agrees with the Commission that, due to the interconnected, global nature of the swap markets, the extent to which the swap provisions of the Commodity Exchange Act (the "CEA"), as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), apply to cross-border activities is critically important. The Institute also agrees with the Commission that, in exercising its authority with respect to swap activities outside the United States, consideration of international comity is appropriate.

These two points are integrally related: global interconnections within the swap markets require cross-border regulatory cooperation and harmonization, as no one national regulator is equipped with the resources necessary to regulate comprehensively every participant in its local market nor every market in which its local institutions participate. At the same time, these global interconnections increase the potential for conflicting national implementation of regulatory reform to have adverse effects on the markets and market participants, especially if applied extraterritorially.

[1] 77 Fed. Reg. 41214 (July 12, 2012).

Conversely, with the appropriate assignment of home/host country regulation and regulatory responsibilities, they afford a framework for the efficient allocation of regulatory responsibilities across national supervisors.

We believe that the Proposed Guidance is generally a thoughtful first step toward addressing these considerations. In particular, we support the Commission's efforts to categorize its requirements into Transaction-Level and Entity-Level Requirements and its proposal for a regime of substituted compliance by non-U.S. registrants.

We have concerns, however, that certain aspects of the Commission's proposal would likely give rise to conflicts with foreign rules and, in so doing, impede cross-border market participation and regulatory coordination.[2] As described in more detail below, we have suggested ways in which the Commission can modify its proposal to avoid those consequences without undermining its overall objectives of mitigating risk to the United States and preventing evasion of Dodd-Frank. We believe that these modifications, together with those suggested in our August 9, 2012 letter to the Commission[3] regarding the proposed phase-in exemption (the "Proposed Exemption")[4] released as a companion to the Proposed Guidance, would help assure an orderly and coordinated implementation of derivatives reforms across the major global financial centers.[5]

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[2] In this regard, we note that similar concerns have been expressed by several foreign regulators. See, e.g., Letter from Belinda Gibson et al., Australian Securities and Investments Commission, Hong Kong Monetary Authority, Monetary Authority of Singapore, Reserve Bank of Australia and Securities and Futures Commission, Hong Kong, to David Stawick, the Commission, dated Aug. 27, 2012 (the "Asia-Pacific Regulators' Letter"); Letter from Jonathan Faull, the European Commission (the "EC"), to David Stawick, the Commission, dated Aug. 24, 2012 (the "EC Letter); Letter from David Lawton, United Kingdom Financial Services Authority, to David Stawick, the Commission, dated Aug. 24, 2012 (the "UKFSA Letter"); and Letter from Jun Mizgughi, Financial Services Agency, Japan and Bank of Japan, to David Stawick, the Commission, dated Aug. 13, 2012 (the "JFSA/Bank of Japan Letter"); Letter from Pierre Moscovici et al., French Ministry of Economy and Finance, Autorite de controle prudentiel, and Autorite des marches financiers, to David Stawick, the Commission, dated July 27, 2012; and Letter from Patrick Raaflaub and Mark Branson, Swiss Financial Market Supervisory Authority, to Gary Gensler, the Commission, dated July 5, 2012.

[3] See Letter from Sarah A. Miller, the Institute, to David Stawick, the Commission, dated Aug. 9, 2012.

[4] Exemptive Order Regarding Compliance With Certain Swap Regulations, 77 Fed. Reg. 41110 (Jul. 12, 2012).

[5] Because market participants will likely be required to comply with Dodd-Frank before the Proposed Guidance is finalized, it is very important for the Commission to provide market participants enough time to implement the final guidance.

BACKGROUND

Before discussing the Institute's specific recommendations, we believe it important to identify those foundational aspects of the Commission's proposed approach that must effectively balance U.S. and non-U.S. regulatory interests in order to succeed in fostering stronger global standards, using Commission resources effectively and preserving liquid markets.

The Commission's regulatory interest is greatest when regulating U.S. markets and participants in those markets. This principle is embodied within Section 2(i) of the CEA, which prohibits the application of the swap provisions of Title VII of Dodd-Frank to activities outside the United States unless those activities have "a direct and significant connection with activities in, or effect on commerce of, the United States" or where application of Dodd-Frank is necessary to prevent evasion.

At the same time, conflicts with local, non-U.S. law can be minimized by appropriate limitations on the application of Commission rules extraterritorially. In large part, the proposed framework would seek to accomplish this by categorizing certain Commission rules as Transaction-Level Requirements that do not apply to swaps between non-U.S. persons, since the U.S. interest in regulating those transactions is low and local regulatory interest is high. The proposed framework would also seek to avoid conflicts with local law through deference to comparable local entity-level regulation. In both cases, limited Commission resources would be preserved to focus on effective supervision and regulation of U.S. market participants and activities within the United States, consistent with the Commission's traditional approach under Part 30 of its rules.

The first foundational aspect of this approach, then, is the scope of market participants subject to Commission rules. Scope is addressed under the Proposed Guidance through a proposed definition of "U.S. person," application of Transaction-Level Requirements to swaps between non-U.S. persons in the context of certain guarantees or "conduit" activity, and application of swap dealer or major swap participant ("MSP") registration requirements to non-U.S. persons interacting with U.S. persons. In each case, we believe that the Proposed Guidance should be modified to balance more appropriately foreign interests in regulating non-U.S. activity and non-U.S. persons against the Commission's interest in addressing direct and significant risk to the United States and preventing evasion.[6]

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[6] In this regard, we agree with the concerns expressed by the EC that the breadth of the proposed "U.S. person" definition would give rise to "potentially irreconcilable conflicts of laws." EC Letter at 2. The EC also explained that, if the EU were to exercise its authority under the European Market Infrastructure Regulation to regulate transactions between non-EU entities that have a "direct, significant and foreseeable effect" on the EU in a manner similar to the Proposed Guidance, then that would lead to the "application of multiple rules to US firms." EC Letter at 5.

The second foundational aspect of the proposed approach is the categorization of requirements as Transaction-Level or Entity-Level. This is far from a mechanical exercise of identifying whether the locus for a particular requirement is a given transaction or trading relationship as opposed to entity-wide conduct. That analysis, while important, is largely a proxy for identifying the objective of a particular requirement and evaluating the relative U.S. and non-U.S. supervisory interest in achieving that objective.

It is, of course, important for this categorization to be comprehensive and internally consistent. We have therefore suggested below certain additions and modifications to the proposed framework. To the extent that U.S. rules apply extraterritorially on the basis of non-traditional factors, such as guarantees or "conduit" status, it is also important that the requirements imposed are limited to those that address the potential for risk to flow back to the United States. In other cases the level of risk to the United States is too contingent, remote or low to justify application of U.S. regulation in the face of strong and more direct non-U.S. regulatory interests. Further, it is important to recognize those circumstances in which even conduct directly with U.S. persons is subject to a stronger competing foreign regulatory interest.

The third and final foundational aspect of the proposed approach is substituted compliance. In this area, the Commission has been a leader, with a long tradition under its Part 30 rules of recognition of foreign comparable regulation. And while the Proposed Guidance indicates a somewhat similar approach is appropriate here, it simultaneously sets forth a rule-by-rule analysis that does not comport with international regulatory expectations of a substituted compliance regime.

To balance these considerations, we have suggested an approach based on regulatory recognition of emerging global norms in the regulation of OTC derivatives. In particular, entity-level regulation of OTC derivatives market participants has taken place outside the United States for years, and in many respects Dodd-Frank represents U.S. efforts to address that gap. Transaction-level regulation of OTC derivatives, in turn, is being driven by the G-20 consensus and harmonization efforts within Basel and IOSCO, particularly in areas such as clearing and margin. This distinction suggests that a pragmatic and balanced approach to analyzing comparability would be to make principles-based, holistic evaluations of a jurisdiction's Entity-Level Requirements, on the one hand, and Transaction-Level Requirements, on the other.

DISCUSSION

I. Cross-Border Scope of Title VII

A. "U.S. Person" Definition

Under the Proposed Guidance, the term "U.S. person" would include, but not be limited to:

(i) any natural person who is a resident of the United States;

(ii) any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund, or any form of enterprise similar to any of the foregoing, in either case either (A) organized or incorporated under the laws of the United States or having its principal place of business in the United States or (B) in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. person;

(iii) any individual account (discretionary or not) where the beneficial owner is a U.S. person;

(iv) any commodity pool, pooled-account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which a majority ownership or equity interest is held, directly or indirectly, by a U.S. person(s);

(v) any commodity pool, pooled-account, or collective investment vehicle the operator of which would be required to register as a commodity pool operator under the CEA;

(vi) a pension plan for the employees, officers, or principals of a legal entity with its principal place of business inside the United States; and

(vii) an estate or trust, the income of which is subject to United States income tax regardless of source.

Consistent with Dodd-Frank, the Commission's "U.S. person" definition should be based on whether (1) U.S. regulation of a person's swap activities or transactions is appropriate because of the person's location within the United States or (2) the person's activities or transactions outside the United States have a direct and significant effect on U.S. commerce, such as where a foreign swap dealer transacts directly, from abroad, with a U.S person located in the United States.[7] In addition, a clear "U.S. person" definition is a prerequisite to determining whether Dodd-Frank is or is not applicable to: (i) such a person; (ii) a swap with such a person; and (iii) a putative registrant trading with such a person. We believe that certain modifications to

[7] We believe that this criterion is consistent with the Commission's proposed approach. *See* Proposed Guidance at 41218 ("For purposes of this interpretive guidance, the Commission proposes to interpret the term ''U.S. person'' by reference to the extent to which swap activities or transactions involving one or more such person have the relevant effect on U.S. commerce.").

the Commission's proposed definition are necessary, however, to accomplish this result and give effect to these principles.

1. Funds and Other Collective Investment Vehicles

The Commission's proposed definition would capture a fund or other collective investment vehicle based on: (1) majority direct or indirect ownership by U.S. persons or (2) the registration status of the fund's operator. We are concerned that, left unmodified, the first prong would be impossible to administer, and that each prong would be overly broad, giving rise to unnecessary conflicts with foreign laws by bringing within scope funds operated offshore and subject as such to foreign regulation.

a. Majority Direct or Indirect U.S. Ownership

As the Commission is aware from its recent experience adopting rules further defining the "eligible contract participant" definition,[8] any look-through to indirect investors in a pool would result in significant practical obstacles and market disruption due to uncertainties about the pool's status arising from an inability of the pool to ascertain or control the status of its indirect investors. Accordingly, we respectfully recommend that the Commission delete the reference to indirect ownership.

In addition, while we agree that majority direct U.S. ownership is the minimum threshold under which an otherwise non-U.S. fund should be deemed to constitute a U.S. person, we note that there are a number of practical considerations that must be addressed for a percentage ownership test to be administered. First, fund sponsors and operators ascertain the status of investors through subscription materials and other documentation provided at the time of an initial investment. In addition, any transfer restrictions or rights to force an investor redemption due to a change in investor status will typically have been agreed at that time. Naturally, this documentation cannot reflect the Commission's "U.S. person" definition until that definition is finalized. Therefore, we respectfully request that any test based on fund ownership apply only to funds formed after the effective date of the final "U.S. person" definition, so that fund underwriters and sponsors would be in a position to draft their documentation to reflect Commission requirements.[9]

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[8] See 77 Fed. Reg. 30596, 30659 (May 23, 2012) (Commission acknowledgement of commenters' concerns about applying an indefinite look-through to every direct and indirect participant of a forex pool).

[9] In this regard, we note that a fund the interests in which are initially offered in the United States to U.S. residents would be captured by a separate prong of Institute's recommended "U.S. person" definition applicable to fund operators, discussed below.

A second key practical consideration is that the composition of fund ownership commonly shifts over time. Not only may new investors be admitted to a fund, but existing investors may redeem their investments or contribute capital. As a result, a fund's U.S. person status could fluctuate significantly, thereby giving rise to significant adverse consequences for the fund and its swap counterparties (such as changing margin, clearing, reporting and registration requirements, even with respect to existing swaps). Accordingly, consistent with the Commission's efforts to address analogous issues in the context of its MSP definition, we respectfully request that a fund's U.S. person status be evaluated on the basis of its average ownership composition over a fiscal quarter, subject to a reevaluation period of an additional fiscal quarter if the U.S. ownership level of a fund that was a non-U.S. person as of the end of the previous quarter exceeds 50 percent but does not exceed 60 percent.

A third key practical consideration is that publicly offered and listed funds cannot track, restrict or ascertain their beneficial ownership composition. U.S. persons are typically able, whether through their broker or directly when acting outside the United States, to purchase shares in a publicly listed fund, and beneficial owners are not generally identified on the company's ownership register. Accordingly, the Commission should exclude from U.S. person status any public fund that is initially offered outside the United States (in a manner compliant with Regulation S under the Securities Act of 1933) and whose principal listing exchange is located outside the United States.

Finally, since other jurisdictions are likely to regulate locally organized funds, even if those funds are majority-owned by U.S. persons, an ownership test is likely to give rise to conflicts with local law.[10] At the same time, if that jurisdiction is one that the Commission has determined to apply a comparable regulatory regime, then the potential for risk and evasion as a result of U.S. participation in that fund is highly limited. Accordingly, we recommend that the Commission adopt an exclusion from the fund ownership prong for a fund organized in a foreign jurisdiction that applies a regulatory regime that the Commission has determined to be comparable to Dodd-Frank.[11]

b. Registration Status of Fund Operators

As noted above, the Commission has proposed to deem a fund to be a U.S. person based on whether the fund's operator is required to register as a commodity pool operator ("CPO") under the CEA. However, the CEA's CPO registration requirements are intended to serve investor protection objectives that are not calibrated to the systemic risk mitigation and transparency objectives of Dodd-Frank. Stated differently, in many cases whether a fund's operator is registered as a CPO will have little connection to whether the fund's swap activities

[10] See UKFSA Letter at 4.

[11] Cf. UKFSA Letter at 5 and EC Letter at 2.

have an effect on U.S. commerce, or to the ownership percentage of U.S. investors. As a result, CPO registration would be an over-inclusive criterion, because the level of U.S. ownership required for the operator of an otherwise foreign pool to register is less than 50 percent. The test would also be under-inclusive, because it would not cover funds whose operators can rely on an exemption or exclusion from CPO registration.

We believe it would be more appropriate to base the test on whether a fund is domiciled and principally operated in the United States (but without regard to whether it has a U.S. investment manager). For these purposes, for example, a fund whose operator solicits U.S. residents from within the United States would be deemed to be a U.S. person.

2. Foreign Branches and Agents of U.S. Swap Dealers

The Proposed Guidance would generally treat the foreign branch of a U.S. swap dealer as a U.S. person. However, the Commission recognized in several contexts that it would be appropriate to treat foreign branches differently than other U.S. persons. For instance, the Commission proposed that, in determining whether the swap dealer de minimis threshold is met, a non-U.S. person may exclude the value of dealing transactions with the foreign branches of registered U.S. swap dealers. It also permitted such foreign branches to comply with Transaction-Level Requirements through substituted compliance with comparable foreign requirements. Finally, such foreign branches would be eligible for a limited exception for activities in so-called emerging market jurisdictions.

This approach, however, leads to several inconsistencies (described below) that could well undermine the Commission's efforts to balance the need to address the potential risks arising from foreign branches' extraterritorial activities with the goal of preserving their role as key participants in many foreign markets, and recognizing the interests of foreign regulators in regulating foreign branch activities involving host country counterparties. To address these inconsistencies, we respectfully request that the Commission exclude the foreign branches of U.S. swap dealers from the definition of "U.S. person," provided that such branches would still be subject to Entity-Level and Transaction-Level Requirements (or substitute foreign requirements) as made applicable to them by the Commission.

a. Swap Dealer Registration by Non-U.S. Counterparties

As noted above, the Commission proposed that, in determining whether the swap dealer de minimis threshold is met, a non-U.S. person may exclude the value of dealing transactions with the foreign branches of registered U.S. swap dealers. This proposal could be read to mean that, even if the non-U.S. person's trades with U.S. persons were solely with the foreign branches of registered U.S. swap dealers, it would still need to analyze whether it qualified for the de minimis exception. The non-U.S. person would then, under the Proposed Guidance, be required to aggregate its U.S. swap dealing with that of its non-U.S. affiliates in determining its eligibility for the exception. This raises the question whether a non-U.S. person that deals in swaps solely with the foreign branches of U.S. swap dealers might nevertheless be

subject to U.S. swap dealer registration on the basis of swap dealing transactions by its non-U.S. affiliates with U.S. persons.

Clearly, this is not the intended result of the Commission's proposal. Defining the non-U.S. branch of a swap dealer as a non-U.S. person would address this issue by clarifying that a non-U.S. person trading solely with such branches and other non-U.S. persons is simply outside the scope of U.S. swap dealer registration.

b. <u>MSP Registration by Non-U.S. Counterparties</u>

Although the Proposed Guidance included an exception from swap dealer registration noted above for swaps by a non-U.S. person with the foreign branch of a U.S. swap dealer, it did not include a similar exception from MSP registration. Left unchanged, this would substantially undermine the effectiveness of the swap dealer exception, particularly for foreign dealers who commonly provide liquidity to U.S. swap dealers seeking to hedge their risks in local markets. Other non-U.S. market participants have also expressed concern about their need to avoid transacting with foreign branches based on MSP registration concerns. Both an effective exclusion of foreign branches of U.S. banks from overseas markets, and the resulting illiquidity effects of market fragmentation, are clearly undesirable.

At the same time, as the Commission notes, the risk-based focus of the MSP definition presents a different set of policy considerations than the swap dealer definition. This requires the Commission to balance competing interests: the Commission's legitimate interests in mitigating the transmission of significant risk to the United States through the foreign branches of U.S. swap dealers, on the one hand, and, on the other hand, (1) the strong comity interest against taking the relatively unprecedented step of comprehensively regulating a non-U.S. person on the basis of activities conducted by it solely outside the United States and (2) the public and regulatory interest in deep and liquid global markets.

Given these considerations, we believe that the Commission should seek alternative measures to address risk to the United States before extending MSP registration extraterritorially based on exposures of foreign branches of U.S. banks who are subject both to U.S. and non-U.S. regulation. Specifically, before subjecting non-U.S. persons to MSP registration based on their swap exposures with foreign branches of U.S. swap dealers, we respectfully recommend that the Commission instead address this risk through its oversight of the relevant U.S. swap dealers.

We note that the Commission will have direct access to comprehensive and aggregable data about exposures of U.S. swap dealers, individually and collectively, to non-U.S. persons, each specifically identifiable by LEI. The Commission will have access to this data both through its direct supervision of such registrants (and their foreign branches) and through swap data reporting. The Commission will thus be in a position to monitor the scope and concentrations of those exposures and take appropriate remedial actions. For instance, the Commission, in coordination with the relevant U.S. swap dealers' prudential regulators (as

applicable), could direct those U.S. swap dealers to take steps to limit their net uncollateralized exposures to a non-U.S.-based putative MSP or to hold additional collateral or capital against those exposures. We would expect that the Commission would be in a position to take these steps well within the time frame in which a non-U.S.-based putative MSP would have to register initially. (Under the Commission's rules, this is effectively a five-month period.[12]) We believe a focus on addressing significant swap exposures through existing Commission regulation of U.S. registrants is, as a matter of comity and other public policy considerations, the most appropriate way to prevent a non-U.S. person's outward exposures to U.S. swap dealers from posing direct and significant risk to the United States, while preserving the important policy objectives noted above.

c. Transaction-Level Requirements for Non-U.S. Counterparties

Another inconsistency in the proposed approach to foreign branches of U.S. swap dealers is that, while those branches would be eligible for substituted compliance and the emerging market exception, their non-U.S. counterparties would still be required to regard them as U.S. persons. We do not believe the Commission intended for such non-U.S. person counterparties to comply with U.S. Transaction-Level Requirements in the context of swaps with such foreign branches,[13] since doing so would undermine substituted compliance and the emerging market exception. However, since the Commission also has generally stated that a non-U.S. person must comply with U.S. Transaction-Level Requirements for swaps with U.S. persons,[14] the U.S. person status of such foreign branches has raised questions about what requirements should apply. Treating foreign branches of U.S. swap dealers as non-U.S. persons who remain subject to U.S. Entity-Level Requirements and who are eligible to rely on substituted compliance in connection with their own swap dealing activities for Transaction-Level Requirements would address this inconsistency.

d. Foreign Agents of U.S. Swap Dealers

When the foreign branch of a U.S. swap dealer enters into a swap with a non-U.S. person, the Commission views the U.S. swap dealer itself to be the principal counterparty to the transaction because it regards the branch as a corporate extension of the U.S. swap dealer – in other words, the foreign branch is essentially an agent of its U.S. head office.[15] It stands to

[12] Commission Rule 1.3(hhh)(3) provides that a person is not required to register as an MSP until two months after the end of the fiscal quarter in which its average outward exposures exceeds one of the MSP thresholds.

[13] See Proposed Guidance at 41228 ("Accordingly, the Commission proposes to interpret section 2(i) in a manner so as to require non-U.S. swap dealers and non-U.S. MSPs to comply with Transaction-Level Requirements for all of their swaps with U.S. persons, other than foreign branches of U.S. persons, as counterparties") (emphasis added).

[14] See Proposed Guidance at 41234.

[15] See Proposed Guidance at 41221.

reason, then, that a U.S. swap dealer that is committed to a swap with a foreign counterparty by an affiliate outside the United States acting as its agent should be treated in the same way as a U.S. swap dealer acting through its foreign branch. In both cases, a U.S. swap dealer has entered into a swap with a foreign counterparty through an agent outside the United States, and whether the agent happens to be a branch or a standalone affiliate is not relevant to the balance of U.S. and non-U.S. interests implicated by the swap. At the same time, applying Title VII differently depending on whether the agent is a branch or an affiliate would advantage one corporate structure over another, while also reducing the depth and liquidity of global markets. Accordingly, we recommend that a swap between a U.S. swap dealer and a foreign counterparty solicited and negotiated by a foreign affiliate of the U.S. swap dealer acting as agent be eligible for substituted compliance and excluded from the determination of whether the foreign counterparty must register as a swap dealer or an MSP.

3. Reliance on Representations; Changes in Status

The Commission has recognized, in the context of its external business conduct rules, that it is appropriate that swap dealers and MSPs be permitted to rely reasonably on written representations from their counterparties as to status, as well as on covenants by their counterparties to provide notice of any material updates to those representations. We believe a similar approach is warranted here, particularly if the Commission adopts a "U.S. person" definition that looks to information not obtainable by the swap dealer or MSP (such as the composition of investors in a fund).

In addition, we believe that it would be appropriate to adopt a transition period for changes in status. If a counterparty's status were to change from a non-U.S. person to a U.S. person, then the non-U.S. swap dealers and MSPs that trade with it would need to engage in substantial changes to their internal systems and documentation to come into compliance with U.S. margin, clearing, trading, reporting, documentation and external business conduct requirements. In some cases, the swap dealer or MSP may need to re-train the personnel who interact with that counterparty, or change those personnel, to assure compliance with these requirements. If the counterparty had been trading with an unregistered non-U.S. affiliate, then it would need to be onboarded with a registered swap dealer affiliate. To address these issues, we suggest that non-U.S. persons trading with a counterparty whose "U.S. person" status changes be granted 90 days after they are notified or otherwise become aware of that change before they are required to come into conformance with applicable Commission rules for new swaps with that counterparty.

4. Technical Clarifications

The "U.S. person" definition, as proposed, also raises a number of technical questions that make its intended application unclear:

- The definition uses the terms "including, but not limited to," which implies that it is a non-exclusive list. Because market participants need legal

certainty as to whether they or their counterparties are or are not U.S. persons, the definition should constitute a definitive list of criteria.

- Multiple prongs of the definition could potentially apply to market participants such as funds or pension plans. For instance, do either of the fund prongs apply to pension plans? Does the legal entity prong apply to funds or plans? Again, to provide legal certainty, prongs intended to apply to specific types of market participants should be the exclusive prongs applicable to those types of market participants.

- Prong (ii)(B) of the definition (pertaining to a legal entity in which one or more direct or indirect U.S. owners are responsible for liabilities of the entity) could be read to include as a U.S. person a non-U.S. person whose obligations are guaranteed by a U.S. parent. However, in the very next paragraph after the Commission proposed its "U.S. person" definition, it stated that "a foreign affiliate or subsidiary of a U.S. person would be considered a non-U.S. person, even where such an affiliate or subsidiary has certain or all of its swap-related obligations guaranteed by the U.S. person."[16] To avoid confusion, we believe that prong (ii)(B) should be deleted.

- Prong (vi) of the definition (pertaining to pension plans) differs from the standard typically used to distinguish foreign pension plans under ERISA, which looks to whether an employee benefit plan is for the benefit of U.S.-domiciled employees of U.S. persons.[17]

- Prong (vii) of the definition (pertaining to an estate or trust) is based on Commission Rule 4.7, which relates to whether an investor is a non-U.S. person for purposes of exemptions from certain CPO compliance obligations premised on a pool being composed of qualifying investors. However, outside of this limited area, market participants do not commonly identify an estate or trust's regulatory status on the basis of its tax status. Doing so would require non-U.S. persons to plan their swap trading activities with estates and trusts around changes to the U.S. tax laws. It is more common, instead, to look to status of the executor, administrator or trustee.

[16] Proposed Guidance at 41218.

[17] The technical language that could be used to accomplish a result consistent with ERISA would be: "Any plan within the meaning of Section 3(3) of ERISA, excluding any plan maintained outside the United States primarily for the benefit of persons substantially all of whom are nonresident aliens."

- ***Recommendation***: *The Commission should adopt the below "U.S. person" definition:*

  "U.S. person" means—

  (i) *Any natural person who is a resident of the United States;*

  (ii) *Any corporation, partnership, limited liability company, business or other trust, association, joint stock company or any form of enterprise similar to the foregoing (other than a collective investment vehicle, employee benefit plan, estate or trust) that is organized or incorporated under the laws of the United States or having its principal place of business in the United States; provided that an agency or branch of a U.S. person located outside the United States shall not be a "U.S. person" if the U.S. person is registered as a swap dealer with the Commission;*

  (iii) *Any individual account (discretionary or not) (other than a collective investment vehicle, employee benefit plan, estate or trust) where the direct beneficial owner is a U.S. person under the criteria in clause (i) or (ii);*

  (iv) *Any commodity pool, pooled account or collective investment vehicle that is either—*

  (a) *organized or incorporated under the laws of the United States;*

  (b) *domiciled and principally operated within the United States (but without regard to whether its investment manager is a U.S. person); or*

  (c) *(I) formed after the effective date of this definition; (II) directly majority-owned, on average as of the end of a fiscal quarter, by U.S. persons (other than a person that is a U.S. person solely under the criteria of this subclause (c)); (III) not a publicly offered collective investment vehicle that is initially offered outside the United States (in a manner compliant with Regulation S under the Securities Act of 1933) and listed principally on an exchange located outside the United States and (IV) not organized in a jurisdiction for which the Commission has recognized substituted compliance with Transaction-Level Requirements; provided that, if a commodity pool, pooled account or collective investment vehicle that was not a U.S. person as of the end of the previous fiscal quarter meets the criteria of this subclause (c) as a result of average U.S. ownership in a fiscal quarter of less than 60 percent, it will not be deemed a U.S. person until and unless, on average as of the end of the next fiscal quarter, it is directly majority-owned by U.S. persons;*

(v) *A plan within the meaning of Section 3(3) of the Employee Retirement Income Security Act of 1974, excluding any plan maintained outside the United States primarily for the benefit of persons substantially all of whom are nonresident aliens; or*

(vi) *An estate or trust of which the executor, administrator or trustee is a U.S. person under the criteria of clause (i) or (ii), unless (A) an executor, administrator or trustee that is not a U.S. person has sole or shared investment discretion with respect to the assets of the estate or trust, (B) in the case of an estate, the estate is governed by foreign law and (C) in the case of a trust, no beneficiary of the trust (and no settlor if the trust is revocable) is a U.S. person under the criteria of clause (i) or (ii).*

- ***Recommendation:*** *A swap between a U.S. swap dealer and a non-U.S. counterparty solicited and negotiated by a non-U.S. affiliate of the U.S. swap dealer acting as agent should be eligible for substituted compliance and excluded from the determination of whether the non-U.S. counterparty must register as a swap dealer or an MSP.*

- ***Recommendation:*** *Consistent with the Commission's practice in other contexts (such as its external business conduct rules), a counterparty to a person should be permitted to determine the person's U.S. person status by reasonable reliance on written representation provided by the person.*

- ***Recommendation:*** *Non-U.S. persons trading with a counterparty whose "U.S. person" status changes should be granted 90 days after they are notified or otherwise become aware of that change before they are required to come into conformance with applicable Commission rules for new swaps with that counterparty.*

B. Treatment of Non-U.S. Counterparties with U.S. Guarantees and Swap "Conduits"

Under the Proposed Guidance, a non-U.S. swap dealer or MSP that trades with a non-U.S. person generally would not be subject to Transaction-Level Requirements. However, the Commission proposed an exception from this general interpretation when either (i) the non-U.S. counterparty's performance under the swap is guaranteed by (or otherwise supported by) a U.S. person or (ii) the non-U.S. counterparty operates as a swap "conduit." A non-U.S. counterparty would be considered a swap conduit if (1) it is majority-owned, directly or indirectly, by a U.S. person, (2) it regularly enters into swaps with one or more other U.S. affiliates or subsidiaries of the U.S. person and (3) its financials are included in the consolidated financial statements of the U.S. person. In those cases, the non-U.S. swap dealer or MSP would

be required to comply with "Category A" Transaction-Level Requirements[18] or comply on a substituted basis with comparable foreign regulations. "Category B" Transaction-Level Requirements would not apply.[19]

We understand that this proposed treatment of guarantees and "conduit" activity is based on Commission concerns that the U.S. guarantor (in the case of a non-U.S. counterparty whose swap is guaranteed by a U.S. person) or the U.S. affiliate (in the case of a non-U.S. counterparty that operates as a conduit) is exposed to risks incurred by the non-U.S. affiliate. We believe that in each case, the Commission's approach is unduly broad and, in the case of conduit affiliates, both unclear and lacking any connection between policy concerns and regulatory outcomes.

1. Guarantees

Guarantees are a very common way for U.S. multinational corporations (both financial and non-financial) to provide credit support for their non-U.S. subsidiaries (particularly, but not exclusively, their unrated subsidiaries). Parent credit support enables these subsidiaries to hedge their risks cost-effectively in the markets in which they operate. Simply put, guarantees reduce the cost of risk management, and therefore the costs of operations.

The imposition of significant regulatory and compliance costs as a result of such guarantees undermines the risk- and cost-reducing objectives of guarantees and, as a result, should be considered only in those cases where circumstances clearly warrant such a result – that is, where the existence of a guarantee gives rise to direct and significant risks to the United States. Not all guarantees necessarily have this effect; any risk flowing back to the guarantor is, of course, contingent under any circumstance. If the guarantee covers a swap entered into by a subsidiary for hedging or risk mitigation purposes, the net effect can be risk reducing or risk neutral. If the level of the subsidiary's swap activity is insubstantial in relation to the net equity of the subsidiary, the contingent risk will be insubstantial. If the aggregate contingent liability of the guarantor in respect of its foreign subsidiary's swap activity is insubstantial in relation to the net equity of the guarantor, the risk to the United States will not be significant.

To comport with the territorial framework established under Dodd-Frank, the application of U.S. rules to the extraterritorial activities of U.S.-guaranteed foreign subsidiaries must be supported by establishing the significance of the risk to the United States arising from the underlying guaranteed activity. As discussed below, however, there are several

[18] As proposed, these would include clearing and swap processing, margin (and segregation) requirements for uncleared swaps, mandatory trade execution, swap trading relationship documentation, portfolio reconciliation and compression, real-time public reporting, trade confirmation and daily trading records requirements.

[19] As proposed, these would include external business conduct standards.

circumstances under which the risk associated with the guaranteed activity clearly will not reach a level that satisfies Dodd-Frank's requirement for "significance."

a. Non-U.S. End Users with U.S. Guarantees

The Commission has proposed to require a non-U.S. swap dealer to comply with U.S or substituted non-U.S. Transaction-Level Requirements when transacting with a foreign end user subsidiary having its swap obligations guaranteed by its U.S. parent. The swap activities of most end user subsidiaries, however, are not likely to justify this treatment, nor would this treatment provide meaningful incremental benefits in most cases.

The first reason is that, as noted above, a guarantee of a swap that is entered into by a subsidiary for hedging or risk mitigation purposes is not necessarily a net source of risk to the United States, much less a source of significant and direct risk. It will more likely be a source of net risk reduction to the U.S. group. The second reason is that there is no meaningful incremental benefit to applying U.S. rules to extraterritorial swap activity if the result achieved is an outcome little different than if the rules had not been applied in the first place. Applying U.S. rules in this context would undermine international comity. The Commission implicitly recognized this principle when it proposed to permit substituted compliance for swaps with U.S.-guaranteed foreign subsidiaries. But this principle applies equally to circumstances where, apart from whatever foreign regulations apply, applying the U.S. rules directly would be unlikely to mitigate any material incremental risk.

In particular, even within the United States, there are exceptions (or proposed exceptions) from clearing and margin requirements for swaps with non-financial entities. This is in recognition of the fact that the systemic risk mitigation benefits of requiring non-financial entities to clear their swaps or post margin are outweighed by the costs of increased liquidity demands and increased credit and operational risk (to the clearing member, swap dealer counterparty or custodian) that would arise from subjecting non-financial entities to mandatory clearing or margin requirements. This is even truer in the case of swaps by foreign non-financial entities, since the systemic risk mitigation benefits to the United States would be even more attenuated.

The Commission's proposed swap trading relationship documentation, portfolio reconciliation and compression and trade confirmation requirements, in turn, are similarly focused on improving practices for swaps between swap dealers/MSPs. To the extent those rules have application in other contexts, it is by requiring a swap dealer/MSP to establish, maintain and enforce specified policies and procedures. In many foreign markets, particularly those that do not have technological infrastructure and market conventions that are as well developed as those in the United States, enforcing those policies and procedures would be inconsistent with prevailing market conventions, placing U.S.-registered swap dealers at a competitive disadvantage in a context where the Commission does not have direct jurisdiction over their foreign counterparties. At the same time, even in the absence of such requirements, U.S.-registered swap dealers will still be required to comply with U.S. or comparable foreign risk

management and capital requirements on an entity-wide basis, which will address in a more general manner the objectives underlying the proposed swap trading relationship documentation, portfolio reconciliation and compression and trade confirmation requirements (*i.e.,* by limiting, or providing absorbency against, losses on swap transactions).

In addition, as described more fully in Part II.B below, we strongly believe that the remaining "Category A" Transaction-Level Requirements – mandatory trade execution, real-time public reporting and daily trading records – relate to customer protection and market structure objectives similar to the external business conduct rules, and so likewise should apply to foreign swap dealers and MSPs only in the context of swaps with U.S. persons, as defined.

- ***Recommendation**: The Commission should adopt an exception from its proposed treatment of a non-U.S. counterparty with a guarantee from a U.S. person if the non-U.S. counterparty is not a financial entity and is entering into the transaction for hedging or risk mitigation purposes.*

- ***Recommendation**: As discussed in more detail in Part II.B below, the Commission should re-categorize mandatory trade execution, real-time public reporting and daily trading records as "Category B" Transaction-Level Requirements.*

b. Non-U.S. Swap Dealers with U.S. Guarantees

The Commission has proposed a requirement that non-U.S. swap dealers having their swap obligations guaranteed by a U.S. affiliate register with the Commission as a swap dealer. Although technically not U.S. persons under the proposal, the Commission would also require other non-U.S. swap dealers to comply with U.S or substituted non-U.S. Transaction-Level Requirements when transacting with these guaranteed affiliates.

The Commission has justified this proposal by reference to the risk to the U.S. affiliate that arises from the guarantee. For the most common scenarios in which these arrangements arise, we do not believe the Commission's proposal satisfies Dodd-Frank's standards for the extraterritorial application of Title VII. This is for two reasons:

- First, as noted above, when the level of the subsidiary's swap activity is insubstantial in relation to the net equity of the subsidiary, the contingent risk to the guarantor will be insubstantial. The Commission has already implicitly acknowledged this elsewhere when it determined that effective capital regulation of an entity whose swap positions are guaranteed effectively addresses concerns regarding risk to the guarantor.[20] By the same logic, in

[20] See 77 Fed. Reg. 48208 (the "Product Definitions") at note 188 (Aug. 13, 2012) (discussing the treatment of guarantees of swaps for swap dealer and MSP registration purposes).

circumstances where the foreign affiliate is subject to regulation of its swap dealing activities and U.S. or comparable foreign capital requirements, the risk to the United States is neither direct nor necessarily significant. As a matter of comity and comparable national treatment, it would be appropriate for the Commission to treat foreign capital regulation consistent with the Basel Accord the same way as U.S. capital regulation for these purposes.

- More important, in the case of a bank holding company guarantor, a subsidiary's activities are consolidated with the guarantor's and, accordingly, the holding company's capital requirements already require capital against the risks arising from the guaranteed subsidiaries' activities. The capital regime established by the Board of Governors of the Federal Reserve System (the "Board") for bank holding companies is a Dodd-Frank compliant capital regime. As a result, a guarantee by a bank holding company of a foreign subsidiary's swaps cannot be said to create direct and significant incremental risk to the United States warranting the extraterritorial application of Dodd-Frank, without at the same time saying that the Board's capital requirements do not adequately address swap risk – a judgment that is clearly at odds with Congress's own judgment.

➢ ***Recommendation**: The Commission should adopt exceptions from its proposed treatment of a non-U.S. counterparty with a guarantees from a U.S. person if either (i) the counterparty is subject to U.S. capital requirements or comparable foreign (i.e., Basel-compliant) capital requirements or (ii) the guarantor is a U.S. bank holding company.*

2. "Conduit" Affiliates

Because many U.S. corporations centralize their treasury and asset-liability management functions, a non-U.S. subsidiary that enters into a swap with a local non-U.S. dealer to hedge its local interest rate or foreign exchange risk may enter into swaps with its U.S. affiliate so that those risks can be managed centrally in the United States. As a result, subjecting foreign subsidiaries of U.S. corporations to Transaction-Level Requirements because of these common risk management practices would increase their costs and put them at a potentially significant disadvantage when competing abroad. In addition, the Institute is concerned that those of our members who register with the Commission as swap dealers due to their trading with U.S. persons would also be put at a disadvantage vis-à-vis non-U.S. firms that do not have a U.S. swap dealing business, since only U.S.-registered swap dealers would be obligated to comply with Transaction-Level Requirements for transactions with these "conduit" (as well as with U.S.-guaranteed) subsidiaries. We do not believe the Commission would intend to foster such a result.

Like the Commission's proposal on guarantees, the Commission's proposal for the "conduit" treatment of a foreign entity that "regularly" engages in back-to-back swaps with a U.S. affiliate is unjustifiably broad. Additionally, the Commission's proposed second criterion

for "conduit" status is too vague. The term "regularly" lacks the substantive clarity that firms require in order to ensure their compliance with Commission requirements. The proposed standard is also inconsistent with the statutory standards for the extraterritorial application of Title VII; as in the case of guarantees, there is simply no basis to conclude, in the abstract, that inter-affiliate swaps create direct and significant risk to the United States simply because they occur "regularly." For all the Commission can discern *a priori*, they may be "regularly" reducing risk to the United States.

a. Swap Dealer "Conduit" Affiliates

For a variety of historical reasons involving regulatory compliance (and not regulatory circumvention), many U.S. financial groups conduct swap dealing activity through regional affiliates. Under this structure, transactions by a regional affiliate with local counterparties may involve an underlying asset category that is generally dealt in by another affiliate. A UK affiliate may enter into a CDS with a European counterparty on a U.S. issuer. A U.S. affiliate may enter into a Yen swap with a U.S. counterparty. A Japanese affiliate may enter into a U.S. Dollar rate swap with a Japanese counterparty.

In each of these cases, consolidating the trading relationship between the regional dealer and its native regional counterparties is both efficient, potentially necessary for local regulatory compliance purposes, and produces risk reducing netting benefits, both to the dealer and to its counterparty. These risk reducing effects benefit both the regional dealer and the U.S. group as a whole.

Additionally, because the U.S. dealer has the largest natural portfolio of U.S. credit risk, and the trading expertise to manage that risk, it is risk reducing for the regional affiliates and the group as a whole for the UK affiliate to back-to back the market risk of its CDS to the U.S. affiliate where there is the greatest potential for an internal risk offset (and associated cost efficiencies) and the most experienced trading personnel (located in the appropriate market and time zone) to manage any residual market risk. The same analysis applies equally to the U.S. dealer's Yen swap (for which the Yen exposure is most appropriately managed as part of the Tokyo affiliate's Yen risk portfolio) and the Japanese dealer's U.S. Dollar rate swap (for which the Dollar rate exposure is most appropriately managed as part of the New York affiliate's Dollar rate risk portfolio).

These arrangements are, individually and in the aggregate, risk reducing and beneficial. They cannot, in the abstract, be fairly described as giving rise to direct and significant risk to the United States. Nor can they accurately be described as evidencing any form of evasion. These are global, entity-wide risk management operations that the Commission and its international counterparts should want these affiliates to conduct. Indeed, the Commission has recognized that "there may be advantages for the corporate group and

regulators if risk is appropriately managed and controlled on a consolidated basis and at a single affiliate."[21] These arrangements should therefore neither be discouraged nor result in excessive and costly duplicative regulation that would undo their cost and risk mitigation efficiencies.

Additionally, these arrangements are not undertaken outside the ambit of U.S. or comparable foreign supervision and oversight. The risk to the United States that would arise from a foreign affiliate's back-to-back swap to a registered U.S. swap dealer is, in the first instance, market risk. (The Commission should note in this regard that back-to-back swap transactions transfer market risk, but they do not transfer credit risk. This is a significant distinction that should be taken into account by the Commission in any risk evaluation.) Market risk is already directly addressed by market risk deductions to the registered U.S. swap dealer's capital under Dodd-Frank. So, too, the registered U.S. swap dealer's credit risk to its foreign affiliate arising from these transactions is accounted for as a deduction to capital. In the case of significant inter-affiliate exposures, credit concentration charges come into effect and prudential supervisors may additionally require collateralization of excess credit risk concentrations. In the case of a foreign affiliate that is subject to Basel-compliant capital oversight and other regulation of its swap activities, risks to the registered U.S. swap dealer become even more attenuated and concerns about evasion even less justified. Further, where the foreign affiliate is a subsidiary of a U.S. bank holding company, the group's outward-facing credit and market risk – including that incurred by the foreign affiliate – will be accounted for under the Board's consolidated capital requirements.

The arrangements described above stand in stark contrast to circumstances where an unregulated "shell" affiliate is established abroad for the purpose of entering into significant swap dealing activity abroad outside the scope of Dodd-Frank and systematically transferring both the market and credit risks arising from that activity to a U.S. affiliate. The Commission has already adopted an anti-evasion rule intended to address such evasive schemes.[22]

b. End User "Conduit" Affiliates

Many corporate groups aggregate and net their swap exposures in one or more regional subsidiaries. To accomplish this, affiliates engage in inter-affiliate transactions with the group's corporate "aggregator" who, in turn, engages in outward-facing transactions to hedge the group's net risk with third parties. These arrangements reduce hedging costs and provide risk reducing netting benefits by consolidating credit exposures in the corporate aggregator. These arrangements are clearly risk reducing. From the perspective of risk to the group, these arrangements do not cease to be risk reducing merely because one of the affiliates is organized

[21] 77 Fed. Reg. 50425, 50427 (Aug. 21, 2012) ("Proposed Clearing Exemption").

[22] See Commission Rule 1.6(c).

outside the United States. These arrangements are even more evidently risk reducing where the inter-affiliate transaction hedges a risk faced by the non-aggregator affiliate.

As in the case of swap dealers described above, these arrangements stand in stark contrast to situations in which a "shell" entity is created in an unregulated jurisdiction for the purpose of conducting the swap activities of a group, enters into transactions to create rather than hedge exposures, and systematically transfers all of the risks of such transactions to a U.S. affiliate relying on inter-affiliate regulatory exemptions. We note in this regard that these concerns also can be addressed through rules on cross-border inter-affiliate swaps, as the Commission has proposed to do in the context of the exemption from the mandatory clearing requirement for qualifying inter-affiliate trades.[23]

The statutory policy considerations that authorize the extraterritorial application of Title VII are simply not presented in the typical case described above. The risk of circumvention clearly is not present in the context of a non-U.S. corporate entity that has local operations and enters into inter-affiliate swaps for the purpose of managing risks arising from those operations. Similarly, it is not present in the context of an affiliate that is organized or operating in a jurisdiction having G-20 compliant swap rules.

- ***Recommendation:*** *In light of the foregoing, we believe the Commission should withdraw its proposal on "conduit" affiliates. Instead, it should rely, where there is clear circumvention, on its existing anti-evasion authority, and it should address any specific concerns it may have as to the risks created by the cross-border inter-affiliate swaps in the context of its rules governing regulatory exemptions for such transactions.*[24]

C. Swap Dealer and MSP Registration

Under the Proposed Guidance, a non-U.S. person generally would be required to register with the Commission as a swap dealer if it engages in more than a de minimis level of swap dealing with U.S. persons, excluding the foreign branches of U.S. swap dealers. The Proposed Guidance also provides that a non-U.S. person would be required to register as an MSP if the aggregate value of any swap positions (A) between it and a U.S. person (excluding swap positions where the non-U.S. person's obligations are guaranteed by a U.S. person) and (B)

[23] Proposed Clearing Exemption at 50431. We recognize that this proposal would apply only to swaps subject to mandatory clearing. However, for other types of swaps, requiring the foreign end user affiliate to transact with external counterparties subject to comparable margin requirements would not reduce risk to the end user or its U.S. affiliate; instead, it would require the foreign affiliate to post margin to its own detriment.

[24] If the Commission does not accept this recommendation, we believe that the exceptions that we described above from the proposed treatment of guarantees would be equally relevant for the treatment of "conduits," since the risk to the U.S. affiliate from its swaps with the non-U.S. "conduit" is, like the risk to the U.S. guarantor, contingent on the nature of the underlying foreign swaps and the foreign affiliate engaging in them.

between another non-U.S. person and a U.S. person, where it guarantees the obligations of the non-U.S. person thereunder, exceeded the MSP thresholds.

The Proposed Guidance additionally addressed considerations relating to (1) aggregation of swaps by non-U.S. persons for purposes of qualification under the swap dealer de minimis exception, (2) the application of the swap dealer "regular business" exception to a non-U.S. person, (3) the relevance of guarantees, (4) the treatment of foreign affiliates or subsidiaries of U.S. persons and (5) the treatment of U.S. branches, agents, affiliates or subsidiaries of non-U.S. persons.[25] We address each of those topics in turn below.

1. Aggregation of Swaps

The Proposed Guidance would require a non-U.S. person, in determining whether it qualified for the swap dealer de minimis exception, to aggregate its swap dealing transactions with U.S. persons with swap dealing transactions with U.S. persons by its non-U.S. affiliates. A non-U.S. person would not be required to aggregate its U.S.-facing swap dealing transactions with swap dealing transactions by its U.S. affiliates, although it appears that the U.S. affiliates would be required to aggregate their swap dealing transactions with those of their non-U.S. affiliates. Additionally, the Commission requests comments on whether, to the extent that a non-U.S. affiliate is registered as a swap dealer, the notional value of dealing swaps entered into by such registered swap dealer should be excluded from aggregation with the notional value of dealing swaps entered into by its non-U.S. affiliates.

We understand that the purpose of the aggregation rule is to prevent persons from avoiding dealer regulation by dividing up dealing activity in excess of the notional thresholds among multiple affiliates. However, as we and other commenters have noted, the aggregation rule effectively eliminates the de minimis exception when it is applied to any financial holding company group already containing a registered swap dealer.

Left unchanged, the aggregation rule would significantly increase the number of entities subject to swap dealer registration. For example, some foreign jurisdictions require firms to operate through local subsidiaries, each of which would become subject to dealer registration if providing even just one U.S. customer with access to its local market. In addition, many foreign banks also own independently managed U.S. commercial bank subsidiaries that from time to time provide swaps as part of their overall service offerings to their customers, although not necessarily in connection with loan origination. Under the aggregation rule, these subsidiaries would become subject to registration even if their swap activity, standing alone, is well below the de minimis threshold.

[25] The Proposed Guidance also addressed the treatment of foreign branches and agencies of U.S. swap dealers, which we addressed in Part I.A.2 above.

This ongoing activity was taking place well before Dodd-Frank and so was not in any way structured to avoid swap dealer regulation. Activity conducted by the registered swap dealer itself of course also does not constitute evasion. Moreover, we see no reason why otherwise de minimis swap dealing activity by one or more affiliated entities should present any different concerns when those entities are affiliated with a registered swap dealer.

As noted above, the Commission has requested comments on whether, to the extent that a non-U.S. affiliate is registered as a swap dealer, the notional value of dealing swaps entered into by such a registered swap dealer should be excluded from aggregation with the notional value of dealing swaps entered into by its non-U.S. affiliates. While we strongly agree that transactions by a non-U.S. affiliate registered as a swap dealer should be excluded, we see no basis for distinguishing between U.S. or non-U.S. registered swap dealers in this context. Indeed, if the Commission were to adopt this exclusion without extending similar treatment to U.S. affiliates, then that would incentivize groups having their principal swap dealer located outside the United States to relocate offshore any residual swap dealing activity conducted by U.S. affiliates to avoid registering additional entities as swap dealers. This incentive does not seem to have been intended by the Commission.

In addition, while we appreciate the Commission's efforts to prevent aggregation of positions with U.S. affiliates, the Commission's proposed implementation of disaggregation could give rise to unintended distortions. For instance, requiring all non-U.S. affiliates to aggregate their U.S.-facing swap dealing activity with each other – but not requiring them to aggregate their activity with swap dealing by U.S. affiliates – would benefit an affiliated group the principal swap dealer of which is located in the United States vis-à-vis a group having its principal swap dealer outside the United States. The reason is that, in the former case, the group could have a non-U.S. subsidiary engage in $8 billion notional in swap dealing with U.S. persons without triggering registration; whereas in the latter case, a single swap dealing transaction by an unregistered non-U.S. affiliate would subject that affiliate to registration.

A better approach would be to interpret the aggregation rule as applying only amongst affiliates operating within the same jurisdiction (excluding any affiliate that is a registered as a swap dealer), unless activities by affiliates outside the United States were willfully structured to evade swap dealer registration in contravention of Commission Rule 1.6. In this regard, there are many types of activities that clearly do not constitute evasion. For instance, many non-U.S. jurisdictions (such as some in Eastern Europe and Latin America) require financial activities (such as swap dealing) to be conducted by a locally organized subsidiary. To the extent such a subsidiary was established and conducting swap dealing with U.S. persons prior to the adoption of the de minimis exception, no evasion has occurred. Evasion is also highly unlikely to occur in cases where a subsidiary is subject to local licensing and capital requirements, since capitalizing multiple entities would make an evasive scheme based on fragmentation of swap dealing activity very costly. Nor is evasion likely in cases where a subsidiary is required by local law or otherwise to operate with separate, independent management from its parent and other affiliates.

Under this approach, a foreign entity engaged in de minimis swap dealing with U.S. persons would still be subject to many U.S. requirements, including mandatory clearing and trading requirements and both real-time and regulatory reporting. These requirements would help protect U.S. persons. They also would assure that the Commission has access to the data necessary to detect and address evasion.

Importantly, this approach would help preserve U.S. end users' access to emerging market jurisdictions. It also would address concerns by foreign regulators that a locally regulated entity operating under their jurisdiction (such as Japan) could be required to register as a swap dealer as a result of activity conducted by a swap dealer affiliate in another non-U.S. jurisdiction (such as the UK) and subject as such to regulation in that other jurisdiction.[26]

- ***Recommendation:*** *Whether as part of its final cross-border guidance, or as an exemption or statement of Commission enforcement policy, the Commission should exclude swap dealing transactions by an affiliate that is registered as a swap dealer from the aggregation rule within the de minimis exception.*

- ***Recommendation:*** *In addition to excluding swaps by a registered swap dealer affiliate, the Commission should interpret the aggregation rule to apply only amongst affiliates operating within the same jurisdiction, unless activities by affiliates outside the United States were willfully structured to evade swap dealer registration in contravention of Commission Rule 1.6.*

2. Regular Business

Under the Proposed Guidance, a non-U.S. person without a guarantee from a U.S. person applying the swap dealer definition should determine first whether its swap activities with respect to U.S. persons as counterparties qualify as swap dealing activity under the rule further defining the term "swap dealer" and the exclusion of swap activities that are not part of "a regular business," even if the non-U.S. person is engaged in swap dealing as part of "a regular business" with respect to non-U.S. persons as counterparties.

We agree with this proposal, both as a matter of legal interpretation and as a matter of policy. From a legal perspective, in light of Section 2(i) of the CEA, whether a non-U.S. person without a guarantee engages in swap dealing with non-U.S. persons should not be relevant for purposes of whether it is subject to swap dealer registration in the United States. From a policy perspective, the ability for non-U.S. swap dealers to access U.S. markets to hedge exposures arising from their non-U.S. business is critical, and does not present any material

[26] See JFSA/Bank of Japan Letter at 4.

policy concerns because the non-U.S. person would be acting within the United States solely as a financial end user.

➢ ***Recommendation**: The Commission should, as proposed, require a non-U.S. person to register as swap dealer only if it engages in swap dealing with U.S. persons as part of a regular business, regardless of the person's swap activities with non-U.S. persons.*

3. Relevance of Guarantees

The Proposed Guidance addresses the relevance of a guarantee of the swap obligations of a non-U.S. person for purposes of whether the non-U.S. person or its guarantor is subject to registration as a swap dealer or an MSP. In addition, the Commission has separately determined that a guarantee of a swap is a swap.[27] In both cases, the Commission has generally taken the view that the guarantor of the swap obligations of an entity subject to capital regulation by the Commission or the Securities and Exchange Commission (the "SEC") (i.e., swap dealers, security-based swap dealers, MSPs, major security-based swap participants, futures commission merchants and broker-dealers) or regulated as a bank in the United States is not subject to registration as a swap dealer or MSP as a result of its guarantee.

However, the Commission has not expressly addressed a guarantee by a non-U.S. person of the swap obligations of a subsidiary trading with U.S. persons. Clearly, in the case of a subsidiary subject to U.S. capital regulation, whether the guarantor is a U.S. person or non-U.S. person should not affect the analysis. Further, as a matter of international comity and comparable national treatment, it would be appropriate for the Commission to treat foreign capital regulation consistent with the Basel Accord equivalently to U.S. capital regulation.

Additionally, there may be circumstances under which a wholly-owned subsidiary of a person already registered as a swap dealer enters into swaps with U.S. persons where its obligations are guaranteed by the swap dealer. For many foreign banks, for instance, their global holding company is the foreign-headquartered bank that, under the Proposed Guidance, would be required to register as a swap dealer to continue its trading with U.S. persons. Foreign banks also often establish subsidiaries in other non-U.S. jurisdictions to comply with local regulatory licensing and other rules, and those subsidiaries' swaps may be guaranteed by the foreign bank. In such a case, the liabilities of the subsidiary will already be consolidated with the bank's liabilities for capital purposes, the subsidiary's activities will be subject to the bank's risk management policies and systems, and the subsidiary's swap trading personnel will be considered a part of the swap dealer's "business trading unit." If the subsidiary additionally complies with Transaction-Level Requirement for its swaps with U.S. persons, and it and its parent accept joint and several liability for violations of Commission requirements, then requiring the subsidiary to separately register with the Commission would be redundant.

[27] See Product Definitions at 48225-27.

➢ ***Recommendation**: A non-U.S. parent or other guarantor who guarantees swap positions of a person (i) that is subject to capital regulation by the Commission or SEC, (ii) that is regulated as a bank in the United States, or (iii) where the guarantor or the person is subject to foreign capital standards consistent with the Basel Accord, should not be subject to registration as a swap dealer or MSP as a result of the guarantee.*

➢ ***Recommendation**: Swaps by a majority-owned subsidiary of a registered swap dealer should be attributed to the swap dealer if (i) the swap dealer guarantees the swap obligations of the subsidiary, (ii) the subsidiary complies with Transaction-Level Requirements or comparable foreign requirements, as and to the extent applicable and (iii) the subsidiary and the registered swap dealer agree to be jointly and severally liable for violations by the subsidiary of Commission requirements.*

4. Foreign Affiliates or Subsidiaries of U.S. Persons

The Proposed Guidance describes certain "central booking" arrangements under which a non-U.S. person dealing in swaps with other non-U.S. persons "books" those swaps to a U.S. affiliate, whether directly (by the U.S. person becoming a party to the swap) or indirectly (by way of a back-to-back swap or other arrangement). The Proposed Guidance provides that, under such an arrangement, the U.S. affiliate would be required to register as a swap dealer. In addition, while not entirely clear, one reading of the Proposed Guidance is that the non-U.S. affiliate would separately be subject to swap dealer registration if its activities with non-U.S. persons met the definition of a swap dealer.

The Institute's members are concerned that these proposed interpretations might call into question the treatment of traditional risk management practices under which a financial institution utilizes inter-affiliate swaps to enable expert personnel of one its affiliates to manage centrally a particular type of risk. While we understand that the Commission may be concerned about the possibility for these arrangements to transfer risk from non-U.S. swap dealing activities to the United States, we believe that these risks are addressed for an institution headquartered outside the United States so long as any entity trading swaps directly with unaffiliated U.S. persons is registered as a swap dealer. This would be consistent with the exclusion from the swap dealer definition for swaps by a person with its majority-owned affiliates.

➢ ***Recommendation**: The Commission should confirm that, absent contravention of anti-evasion rules, a direct or indirect subsidiary of a non-U.S. person will not become subject to swap dealer registration as a result of swaps by the subsidiary with majority-owned affiliates.*

5. U.S. Branches, Agents, Affiliates and Subsidiaries of Non-U.S. Persons

a. Limited Designation

The Commission proposed that, when a non-U.S. person is the booking entity to swaps solicited or negotiated by its U.S. branch, agent, affiliate or subsidiary, then the non-U.S. person would be subject to Dodd-Frank requirements, including the registration requirement, applicable to swap dealers. In this regard, however, we continue to believe that it would be appropriate for the Commission to exercise its limited designation authority in a context where all of a foreign bank's swaps with U.S. persons are solicited and negotiated solely by personnel of its U.S. branch or affiliate.

In this context, we envision limited designation more closely resembling the manner in which the Board regulates U.S. branches of foreign banks, rather than the manner in which the Commission has proposed to apply its limited designation authority to agricultural, energy and other commercial firms engaged in swap dealing. Specifically, the entire bank would register and be subject to entity-wide prudential requirements, such as capital and risk management, for which it would be eligible for substituted compliance. However, the application of Transaction-Level Requirements would be limited solely to the U.S. branch or affiliate, and regulation and examination by the Commission and National Futures Association ("NFA"), including the application of non-prudential governance requirements (such as registration of principals) would focus on the branch's or affiliate's activities.[28]

- ***Recommendation**: A foreign bank conducting all of its U.S. swap dealing business through personnel of its U.S. branch or affiliate should be eligible for limited designation.*

b. Application of Transaction-Level Requirements

Under the Proposed Guidance, a swap between a non-U.S. swap dealer and a non-U.S. person (not guaranteed by a U.S. person) would not be subject to U.S. Transaction-Level Requirements.[29] This is the case whether or not personnel located in the United States at a U.S. branch or affiliate are involved in the solicitation or negotiation of the swap as agents of the non-U.S. swap dealer. In our view, this is the correct result for several reasons. First, because a non-U.S. person is a party to each side of the swap, foreign regulators have a strong supervisory interest in regulating the swap, including by application of their own clearing, trading and margin

[28] We believe a similar approach would be warranted in distinguishing between a financial institution's swap dealing activities and its non-dealing swap activities (such as its treasury or asset-liability management activities).

[29] See Proposed Guidance at Appendix B.

requirements. Applying U.S. Transaction-Level Requirements would therefore likely give rise to a conflict with foreign law.[30] Conversely, the Commission's interest in regulating the swap is low since there is no U.S. person at risk. In addition, if U.S. Transaction-Level Requirements applied, then non-U.S. counterparties would have an incentive solely to trade abroad. This would encourage personnel based in the United States to relocate elsewhere. Further, to the extent that the Commission becomes concerned about competitive disparities arising within the United States, then that concern could more easily be addressed by permitting U.S. swap dealers to be eligible for substituted compliance for their swaps with non-U.S. persons.

- ***Recommendation**: As proposed, a swap between a non-U.S. swap dealer and non-U.S. person should not be subject to U.S. Transaction-Level Requirements, regardless of whether personnel located in the United States are involved in the solicitation or negotiation of the swap as agents of the non-U.S. swap dealer.*

II. Entity-Level and Transaction-Level Requirements

A. Swap Dealer/MSP Registration and Related Requirements

While the Proposed Guidance addresses the scope of the swap dealer/MSP registration requirements, it does not address whether a non-U.S. person can be eligible for substituted compliance with those requirements. As a number of foreign regulators have observed, the most efficient and effective way to avoid overlapping requirements applicable to non-U.S. persons dealing in swaps with U.S. persons would be to limit the application of the registration requirement itself.[31] We believe that the Commission could effect this result by treating swap dealer/MSP registration (and the related requirements described below) as an Entity-Level Requirement eligible for substituted compliance. Under this approach, the non-U.S. swap dealer/MSP would still be required to apply to the Commission for substituted compliance and comply with other Entity-Level or Transaction-Level Requirements to the extent not eligible for substituted compliance.

At a minimum, if the Commission does not agree with this approach, then it should address principal registration and other rules applicable to swap dealers and MSPs in connection with the registration process. As discussed below, certain of those rules impose substantive obligations that we believe should be addressed within the Commission's proposed framework for Transaction-Level and Entity-Level Requirements.

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[30] See UKFSA Letter at 2.

[31] See, e.g., JFSA Letter at 2 and EC Letter at 4. The EC also noted that the Commission's "proposed registration requirements could put the adoption of the [proposed EU third-country exemption] into question as it is difficult to envisage that the EU would adopt rules which would create an imbalance in treatment of EU firms under US law compared to the treatment granted to US firms under EU law." EC Letter at 3.

1. Principal Registration

Commission Rule 3.10(a)(2) requires each applicant for swap dealer or MSP registration to file, together with its Form 7-R, a Form 8-R executed by each natural person who qualifies as a "principal" of the applicant. Subject to an exemption for non-executive directors, each principal is also required to submit a completed fingerprint card for background check purposes. Principals include, among others, the officers and directors of the applicant, as well as any person in charge of a principal business unit, division or function subject to regulation by the Commission.

As a result, in the context of a non-U.S. applicant, the Form 8-R filing requirement implicates the applicant's governance much in the way as other Entity-Level Requirements, such as risk management and chief compliance officer rules. This is relevant for at least two reasons. First, some non-U.S. jurisdictions have different corporate governance from the United States under which the respective roles of management and the board may be inconsistent with the policy objectives of the principal registration requirement (e.g., if the board's authority to direct the actions of management is constrained). Second, non-U.S. swap dealers are typically subject to home country requirements relating to the qualifications of their board and senior management, which may serve as a basis for substituted compliance.[32]

- ***Recommendation**: Registration of a swap dealer's or MSP's officers and directors as principals should be categorized as an Entity-Level Requirement for which a non-U.S. swap dealer or MSP would be eligible for substituted compliance. Registration of a person in charge of a principal business unit, division or function subject to regulation by the Commission (i.e., U.S.-facing swap dealing) would still be required.*

2. Associated Persons

Commission Rule 23.22 prohibits a swap dealer or MSP from permitting an associated person subject to statutory disqualification as defined by the CEA from effecting or being involved in effecting swaps on behalf of the swap dealer or MSP, if the swap dealer or MSP knows, or in the exercise of reasonable care should know, of the statutory disqualification.[33] Associated persons include any partner, officer, employee, agent (or any natural person occupying a similar status or performing similar functions), in any capacity that

[32] In this context, we believe that comparability should be evaluated based on the substance of home country governance regulation, not based on technical considerations, such as whether the home country jurisdiction imposes a "registration" requirement for officers and board members.

[33] In addition, Form 7-R requires a swap dealer or MSP applicant to make representations consistent with this requirement.

involves the solicitation or acceptance of swaps or the supervision of any person or persons so engaged.

This requirement to screen associated persons for statutory disqualification generally serves customer protection objectives similar to the Commission's external business conduct standards. At the same time, however, differing legal standards for criminal and other offenses and personal privacy laws across various foreign jurisdictions make application of the CEA's statutory disqualification standard to foreign residents far from a straightforward exercise. Foreign regulators also commonly impose disqualification standards similar in nature to the CEA's.

- ***Recommendation**: Only those individuals who are directly involved in soliciting or accepting swaps with U.S. persons, or directly supervising individuals so involved, should be regarded as "associated persons" of a non-U.S. swap dealer or MSP, and substituted compliance with home/host country disqualification standards in lieu of U.S. statutory disqualification standards should be permitted for personnel located outside the United States.*

3. Information Access

Under Commission Rule 3.10(1)(v)(B), the filing of the Form 7–R and accompanying documentation by a swap dealer or MSP applicant authorizes the Commission to conduct on-site inspection of the applicant to determine compliance with certain Commission regulations applicable to it. Form 7-R, in turn, requires a non-U.S. applicant to represent that it "is not subject to any blocking, privacy or secrecy laws which would interfere with or create an obstacle to full inspection of the applicant's books and records by" the Commission, the NFA or the Department of Justice. It also requires the applicant to provide a wide range of specified disciplinary, financial and other information, and to agree to produce books and records at a location within the United States upon 72-hours prior notice.

As the Commission is aware, the unfettered application of these requirements and representations without regard to geographical or jurisdictional scope stands likely to conflict with foreign blocking, privacy, secrecy, data protection and similar laws. The Commission has also recognized that the execution of Memoranda of Understanding or other information sharing arrangements with the home country regulators of non-U.S. swap dealers and MSPs is an essential element of its proposed substituted compliance framework. It is critical that the Commission reconcile these two considerations.

- ***Recommendation**: The Commission should provide a safe harbor deeming a non-U.S. swap dealer or MSP to be in compliance with Commission or NFA information access requirements and representations with respect to information located outside the United States if the non-U.S. swap dealer or MSP either (1) complies with the terms of any applicable information sharing arrangement between its home or other non-U.S. host country regulator and the Commission or (2) pending the effectiveness of any such*

arrangement, seeks authorization from its home or other non-U.S. host country regulator before providing such information to U.S. regulatory authorities.

4. 4s Implementing Regulations Submissions

Commission Rule 3.2 requires a swap dealer or MSP applicant to submit to the NFA documentation establishing the applicant's compliance or ability to comply with "Section 4s Implementing Regulations." Under the Proposed Guidance, however, a non-U.S. swap dealer or MSP may instead be permitted to comply with its home country requirements in lieu of otherwise applicable Section 4s Implementing Regulations. In connection with this, the Commission has effectively proposed a substitute for the submission of 4s Implementing Regulations documentation in the form of (i) a compliance plan describing the applicant's plans surrounding substitute compliance to be submitted 60 days after registration and (ii) an application to the Commission for a comparability determination to enable substituted compliance. It should be clear, therefore, that these requirements supplant any need to submit 4s Implementing Regulations documentation for requirements eligible for substituted compliance under the Proposed Guidance or delayed compliance relief under the Proposed Exemption; any other interpretation would give rise to unnecessary (but potentially substantial) costs and diversion of resources away from coming into compliance with those Dodd-Frank requirements that actually will apply.

- ***Recommendation**: The Commission should confirm that Rule 3.2 does not require the submission of 4s Implementing Regulations documentation for requirements eligible for substituted compliance under the Proposed Guidance or delayed compliance relief under the Proposed Exemption.*

B. Local Customer Protection and Market Structure Requirements

As noted above, we support the Commission's proposed categorization of requirements as Entity-Level or Transaction-Level. We believe that this is an important step toward calibrating the application of Dodd-Frank outside the United States because, for the most part, it identifies whether the balance of U.S. and foreign regulatory interests supports application of a particular requirement. This is because local regulators generally have an interest in regulating their local markets and transactions entered into by their local market participants. In addition, foreign home country regulators have a strong interest in preserving their role as the primary supervisors of registrants based in their jurisdictions.

Nevertheless, simply looking to whether a particular requirement relates to entity-wide, as opposed to transaction- or relationship-level, conduct is not a perfect proxy for analyzing the underlying policy objective of the requirement. The Commission implicitly recognized this distinction when it decided, as part of the Proposed Guidance, to classify external business conduct or "sales practice" requirements as "Category B" Transaction-Level Requirements and treat them differently from other "Category A" Transaction-Level Requirements due to the diminished U.S. regulatory concerns associated with application of

those requirements to swaps between non-U.S. persons taking place outside the United States. We believe a similar logic applies to certain other requirements, as described below.

1. Internal Conflicts of Interest

Under the Proposed Guidance, Commission Rule 23.605, which requires the adoption of policies and procedures (including informational barriers) to prevent conflicts of interest relating to research and clearing, would be categorized as an Entity-Level Requirement. To be sure, this requirement relates to internal organizational matters similar to certain other Entity-Level Requirements, such as risk management. However, the objective of Rule 23.605 is quite different. Internal research conflicts of interest procedures are intended to promote the integrity of research reports provided to customers. Internal clearing conflicts of interest procedures are intended to promote client access to clearing and prevent conflicts of interest that could deny client access to better pricing on execution and clearing. Neither requirement relates to the safety and soundness of the registrant.

The Commission's interest in promoting these objectives for foreign customers and clients is low. In addition, the different structure of financial services institutions outside the United States, and in particular the common co-location of research, clearing and execution within single legal entities, would make the application of Rule 23.605 outside of the United States very disruptive.

- ***Recommendation**: Internal conflicts of interest requirements (Commission Rule 23.605) should be categorized as a new, "Category B" Entity-Level Requirement, such that they would be applicable to a non-U.S. swap dealer or MSP only in connection with personnel of its research department or clearing unit preparing research reports for use with, or providing clearing services to, respectively, U.S. persons.*[34]

2. Daily Trading Records

Under the Proposed Guidance, Commission Rule 23.202, which requires a swap dealer to make and retain detailed pre- and post-execution information for swaps and related cash and forward transactions, would be categorized as a "Category A" Transaction-Level Requirement. As a result, it would generally be applicable only to swaps by a non-U.S. swap dealer or MSP with U.S. persons, except that it would also apply to swaps with U.S.-guaranteed or "conduit" non-U.S. counterparties.

[34] We note that such categorization of the internal conflicts of interests requirement applicable to swap dealers (Commission Rule 23.605) as a new "Category B" Entity-Level Requirement would result in such requirement effectively being complied with upon compliance with the parallel internal conflicts of interests requirement applicable to the foreign swap dealer's U.S. futures commission merchant affiliate (Commission Rule 1.71).

In categorizing Rule 23.202, the Commission notes that the rule can serve to greatly enhance a firm's internal supervision, as well as the Commission's ability to detect and address market abuses. These objectives, however, are most relevant when a non-U.S. swap dealer or MSP is trading with a U.S. person to whom it owes U.S. sales practice obligations and for whom the Commission's interest in detecting and addressing market abuses is highest. These interests are not present for swaps with U.S.-guaranteed or "conduit" non-U.S. counterparties, as indicated by the Commission's decision not to apply sales practice rules to those swaps. It is also in the context of swaps with non-U.S. persons where the principal component of Rule 23.202 – its obligation to make and retain records of pre-execution oral conversations – is most likely to conflict with foreign privacy laws. Finally, to the extent that the Commission is interested in the retention of transaction documentation for systemic risk monitoring purposes, other recordkeeping requirements (such as Rule 23.201's transaction records requirements) should adequately satisfy that interest.

- ***Recommendation**:* *Daily trading records requirements (Commission Rule 23.202) should be categorized as a "Category B" Transaction-Level Requirement.*

3. Trade Execution and Real-Time Public Reporting

Under the Proposed Guidance, Section 2(h)(8) of the CEA, which is Dodd-Frank's mandatory trade execution requirement, and Part 43 of the Commission's rules, which contains its real-time public reporting requirements, would be categorized as "Category A" Transaction-Level Requirements. Therefore, like daily trading records, they would generally be applicable only to swaps by a non-U.S. swap dealer or MSP with U.S. persons, except that they would also apply to swaps with U.S.-guaranteed or "conduit" non-U.S. counterparties.

The primary objectives of those requirements, similar to Dodd-Frank's external business conduct requirements, are to change the information balance within the marketplace and in so doing give customers enhanced access to the best pricing. These objectives must be balanced against adverse effects on liquidity, particularly for large, bespoke or illiquid swaps. Moreover, because they go to the heart of information availability in the marketplace, mandatory trade execution and public reporting requirements are core market structure regulations that affect not only the direct parties to the swap in question, but also every other participant in the market in which those parties trade. To raise a concrete example, if some participants in the European CDS market are required to disseminate their trading interest to at least five dealers and to have their transaction and pricing information disseminated publicly within 30 minutes of execution, then that affects the balance of information for the European CDS market as a whole.

As the Commission is aware from its own swap execution facility and public reporting rulemakings, balancing the costs and benefits of liquidity and transparency entails difficult policy decisions integrally tied to the nature of the markets in question. Different regulators and legislators can and do strike different balances even while striving toward similar overall policy objectives.

For these reasons, application of these pre- and post-trade requirements to swaps between non-U.S. persons outside the United States would raise serious, unprecedented concerns relating to the sovereignty of foreign markets. Market structure regulation has always been the province of the local market regulator. For instance, even in instances where the Commission's interest in regulating foreign markets has been the highest – such as in the case of foreign boards of trade providing direct terminal access within the United States for the trading of U.S.-linked contracts – the Commission has not gone so far as to prescribe the methods for executing trades on that foreign market nor the time at which executed trades are reported to the public. This is with good reason: doing so would be an invitation for foreign regulators similarly to export their market structure regulation to the United States.

At the same time, the rationales for applying Dodd-Frank's pre- and post-trade transparency requirements extraterritorially are not very compelling. For instance, the Commission asserts that the trade execution requirement is "[i]ntegrally linked to the clearing requirement."[35] In our view, this statement misconstrues the status of mandatory clearing as a prerequisite for mandatory trading – which exists because Congress believed that a swap must be liquid enough to support mandatory clearing before it could support mandatory trading – as an indication that the two requirements serve the same objective. Mandatory clearing, however, is intended to reduce systemic risk by addressing the interconnectedness amongst financial institutions. Mandatory trading, in contrast, is intended to promote investor protection and best execution, as noted above.

In addition, the Commission notes that trade execution and real-time reporting requirements "provide important information for risk management purposes."[36] While it is true that additional pricing information does assist in risk management, the sort of real-time pre- and post-trade pricing information mandated by Dodd-Frank's trade execution and real-time reporting requirements both goes much further than what is required for risk management purposes and, for some products, still does not provide enough. Specifically, for standardized products suitable for mandatory clearing, the central counterparty already will typically obtain and make available daily settlement pricing sufficient for margining and valuation purposes. For bespoke and illiquid products, on the other hand, the trade execution requirement will not apply in any event, and real-time public data reports often will not provide sufficient data about the terms of the swap to enable third parties to use those reports for their internal risk management purposes.

[35] Proposed Guidance at 41226.

[36] Proposed Guidance at 41228.

Although the Commission refers to these rules as contributing to financial stability, this connection is far too attenuated to satisfy the significant and direct connection to the United States that Dodd-Frank mandates.[37]

- ***Recommendation:*** *Trade execution (CEA Section 2(h)(8)) and real-time public reporting (Part 43 of the Commission's rules) should be categorized as "Category B" Transaction-Level Requirements.*

C. Emerging Market Exception

The Proposed Guidance would make the foreign branch of a U.S. swap dealer eligible for an "emerging market" exception for swaps in countries where foreign regulations are not comparable, provided that (i) the aggregate notional value (expressed in U.S. dollars and measured on a quarterly basis) of the swaps of all foreign branches and agencies in such countries does not exceed 5 percent of the aggregate notional value of all the swaps of the U.S. swap dealer and (ii) the U.S. swap dealer maintains records with supporting information to verify its eligibility for the exception and to identify, define and address any significant risk that may arise from non-application of the Transaction-Level Requirements.

Assuming that the Commission maintains its proposed treatments of U.S.-guaranteed and "conduit" non-U.S. counterparties, the proposed emerging market exception would provide an advantage to U.S. swap dealers when competing in emerging markets against non-U.S. swap dealers, since non-U.S. swap dealers would not be eligible for the exception from Transaction-Level Requirements when trading with U.S.-guaranteed and "conduit" non-U.S. counterparties. We are also not aware of any basis for providing a broader exception to U.S. swap dealers in this context than for non-U.S. swap dealers.

- ***Recommendation:*** *Branches of non-U.S. swap dealers located in so-called emerging market jurisdictions should be eligible for an exception on the same terms as the branches of U.S. swap dealers.*

D. Conflicts with Local Law

The Proposed Guidance's treatment of Transaction-Level Requirements for swaps with non-U.S. persons and its framework for substituted compliance with Entity-Level Requirements has the potential to mitigate the most serious ways in which Dodd-Frank could conflict with local laws outside the United States. However, it may not address all of them. For instance, in some jurisdictions, even the disclosure of data for swaps with U.S. persons may be restricted. In addition, some jurisdictions are contemplating requiring that their local market

[37] The interest of foreign regulators is even more pronounced in the case of swaps involving underliers that are not U.S.-centric underliers.

participants clear swaps denominated in the local currency at a local central counterparty. Substituted compliance for swaps between U.S. and non-U.S. persons would help to address these issues. Also, because swap market regulations outside the United States are still emerging in many cases, it is difficult to identify each circumstance under which these conflicts might occur, making it useful to have a framework for addressing conflicts as they arise.

- ***Recommendation**: The Commission should permit non-U.S. swap dealers and MSPs and their U.S. counterparties to be eligible for substituted compliance with comparable Transaction-Level Requirements.*

- ***Recommendation**: The Commission should delegate authority to its staff, upon request by one or more similarly situated market participants (which request will be deemed approved if not acted upon within 60 days (or such sooner period as necessary for a requirement scheduled to take effect sooner than 60 days after the delegation), to grant relief from any particular Dodd-Frank requirement compliance with which is found to create a reasonable risk of violating the law of a foreign jurisdiction, provided that the staff may establish such conditions to the relief as they determine necessary to minimize possible adverse effects on the public interest.*

V. Substituted Compliance and Comparability

The Proposed Guidance would permit a non-U.S. swap dealer or MSP, once registered with the Commission, to comply with the requirements of the relevant home jurisdiction's law and regulations, in lieu of compliance with the CEA and Commission regulations, if the Commission finds that such requirements are comparable to cognate requirements under the CEA and Commission regulations. We strongly support this proposal.

Our comments, therefore, focus on the manner in which the Commission proposes to evaluate comparability, recommendations for addressing gaps in either the substance or timing of foreign regulations, and the procedural steps for making substituted compliance applications and Commission comparability determinations.

A. Principles-Based Approach

We support the Commission's decision to focus on whether foreign regulations are "designed to meet the same regulatory objectives" as Dodd-Frank,[38] and its indication that it will exercise "broad discretion to determine that the objectives of any program elements are met,

[38] Proposed Guidance at 41232.

notwithstanding the fact that the foreign requirement(s) may not be identical to that of the Commission."[39]

However, we have some concerns about the Commission's proposal to make comparability determinations on an "individual requirements basis." We understand that the Commission's intent in proposing this approach is to permit greater flexibility for non-U.S. registrants.[40] Nevertheless, this approach suggests that the Commission intends to evaluate comparability at a relatively granular level, potentially giving rise to a patchwork of U.S. and non-U.S. requirements applicable to a single registrant. To the extent that other jurisdictions take a more holistic approach to comparability – as the EU is doing – then the Commission's approach could invite disproportionate reciprocal determinations by those jurisdiction's authorities.[41]

To balance these considerations, we suggest that the Commission instead make principles-based, holistic evaluations of a jurisdiction's Entity-Level Requirements, on the one hand, and Transaction-Level Requirements, on the other. Because entity-level and transaction-level regulations have generally been handled separately outside the United States, this would be consistent with an overall approach based on regulatory recognition of emerging global norms in the regulation of OTC derivatives.

For instance, because foreign jurisdictions have not generally excluded OTC derivatives dealers from regulation as credit or investment intermediaries, entity-level regulation of swap dealers typically already exists outside the United States. Foreign banks, in particular, are already largely subject to capital regulation determined to comply with Title VII by the Board.[42] Additionally, in the context of permitting a foreign bank to establish a U.S. branch, the Board evaluates whether the foreign bank is subject to "comprehensive consolidated supervision" by its home country authorities – an evaluation that necessarily covers a wide range

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[39] Proposed Guidance at 41233.

[40] See Proposed Guidance at 41229 (noting that, in the Commission's view, an individual requirements approach would "allow for a more flexible registration process").

[41] See EC Letter at 4-5 (comparing the Commission's proposal to the EU's).

[42] See 76 Fed. Reg. 27564, 27582 (May 11, 2011) (proposing to apply the Board's existing capital requirements for foreign banks operating in the United States – under which foreign capital standards consistent with the Basel Accord are sufficient – to foreign banks that register as swap dealers). So too, for swaps conducted by (i) foreign nonbank entities that are subject to direct supervision by a foreign regulator and (ii) U.S. and foreign nonbank subsidiaries of a foreign financial holding company that is subject to consolidated prudential supervision, deference to home country consolidated capital requirements is appropriate under Title VII where those requirements are consistent with the Basel Accord.

of risk management and internal prudential standards.[43] Even in the case of the relatively more recent advent of swap data reporting, many foreign banks are also already committed to reporting transaction data to the global trade repository established in consultation with the OTC Derivatives Supervisors' Group, of which the Commission is a member.[44] Taken together, these minimum standards should in many cases provide a basis for the Commission to evaluate the comparability of foreign entity-level regulation.

Transaction-level regulation of OTC derivatives, on the other hand, has largely come about since the 2009 G-20 Pittsburgh summit. Nevertheless, for the "Category A" Transaction-Level Requirements for which comparability would be relevant as described in this letter – such as clearing, margin and enhanced documentation practices – progress is being made toward harmonization across many major jurisdictions (due in part of course to efforts by the Commission and other U.S. regulators). In light of this progress, the Commission should be in a position to determine whether a foreign jurisdiction applies requirements that, taken as a whole, establish a regime comparable to the "Category A" Transaction-Level Requirements, based on whether the jurisdiction has followed through on, or taken up, the G-20 commitments and taken steps to adopt margin requirements consistent with the final standards ultimately adopted by the Basel-IOSCO working group.

- ***Recommendation:*** *Rather than evaluating comparability on an individual requirements basis, the Commission should evaluate holistically a jurisdiction's entity-level regulation, on the one hand, and transaction-level regulation, on the other, based on whether substituted compliance with either regime is sufficient to mitigate direct and significant risks to the United States.*

B. Addressing Gaps in Foreign Regulation

To the extent that the Commission identifies a significant gap in a foreign jurisdiction's requirements, whether that gap forms a basis for rejecting comparability should be determined by whether the gap is so significant that compliance with the jurisdiction's overall entity-level or transaction-level regime, as applicable, would give rise to direct and significant risks to the United States. In this regard, there should be a presumption that foreign rules are comparable to Title VII when they are consistent with the agreed G-20 principles.[45] For

[43] See 12 CFR 211.24(c)(1)(ii) (describing the factors considered by the Board in making these determinations).

[44] We note that positional data obtained from reports to the global trade repository might also provide a basis for the Commission to derive physical commodity swap open interest levels in a manner comparable to Part 20 of its rules.

[45] See UKFSA Letter at 4 (encouraging the Commission to take into consideration compliance with relevant international standards in the determination of acceptability for substituted compliance); see, also Asia-Pacific Regulators' Letter at 4 (suggesting that a point of reference for substituted compliance assessment would be the foreign regime's compliance with applicable global standards set by international standard-setting bodies like the CPSS, IOSCO and the Basel Committee).

instance, if a jurisdiction has or is implementing margin requirements consistent with the standards agreed within the Basel/IOSCO working group, then those requirements should be presumed to qualify as a basis for substituted compliance. If the Commission were still to determine that a foreign regime is not comparable, then we believe that it would be appropriate for it to discuss with the relevant non-U.S. swap dealer(s) or MSP(s) and foreign regulator how to remediate the gap before formally rejecting comparability.

Additionally, where a gap identified by the Commission is one of timing, rather than substance, it would be inappropriate in our view for the Commission simply to reject comparability. Doing so would effectively require a registrant to engage in wholesale modification of its compliance program, business structure and customer relationships to address a temporary inconsistency. Such a result would be particularly troubling given that the phase-in of Dodd-Frank has put foreign swap dealers and MSPs in the position of registering with the Commission before the comparability analysis has even begun.

A better approach would be to extend the duration of the Commission's Proposed Exemption for a particular jurisdiction until it has implemented comparable reforms. Alternatively, the Commission should make a finding of comparability on the basis of whether the jurisdiction is actively working toward implementation of such reforms, which would be consistent with the Board's approach in making comprehensive consolidated supervision determinations with respect to foreign banks seeking to establish a U.S. branch or agency.[46] If, after an appropriate period of time, the jurisdiction still had not implemented comparable reforms, then the Commission could seek public input on a withdrawal of its determination.

We also note that a timing gap may arise not only in connection with the implementation of comparable reforms in a foreign jurisdiction, but also in the finalization of a Memorandum of Understanding or equivalent arrangement between the Commission and relevant foreign regulatory authorities. As the Commission is aware, negotiation of these arrangements can be very time-intensive, particularly in an environment where the resources of the Commission and its foreign counterparts are stretched. We believe that the Commission should address timing gaps in this area in the same ways as substantive gaps, as described above.

- ***Recommendation:*** *The Commission should reject comparability only if it identifies a gap in foreign regulation so severe that compliance with the jurisdiction's overall entity-level or transaction-level regime, as applicable, would give rise to direct and significant risks within the United States.*

[46] See 12 USC 3105(d)(6)(A)(i).

- ***Recommendation**: The Commission should address timing gaps by either extending its Proposed Exemption for the relevant jurisdiction or a finding of comparability based on whether the jurisdiction is actively working toward implementation of comparable reforms.*

C. Application and Determination Process

It is important for the Commission to provide a clear, transparent framework for its comparability determinations. In particular, given the far-reaching substantive impact of a comparability determination or non-determination, market participants and the public generally must have an opportunity to provide comments to the Commission before its determination is final.

In this regard, the manner in which the Commission has approached mandatory clearing determinations serves as a useful precedent. First, as part of the final guidance, the Commission would clearly identify the information a registrant, group of registrants or foreign regulator are to provide to the Commission as part of the substituted compliance application. Next, after a specified period of time from the date at which an application was made (with extensions possible with the consent of the applicants), the Commission would publish for public comment its proposed determination for a particular jurisdiction. Only then after receiving and considering public comments would the Commission publish its final comparability determination.

Finally, if the Commission's final determination was to reject comparability, then existing registrants in the relevant jurisdiction should be permitted an appropriate period either to come into compliance with Commission requirements or to restructure or discontinue their U.S. businesses and withdraw from registration. Future registrants would then have an opportunity to make their own applications, although the Commission would not be required to re-visit its determination unless it also determines that the jurisdiction had remediated the gap(s) it initially identified.

- ***Recommendation**: The Commission should establish a clear, transparent process for comparability determinations modeled on its mandatory clearing determination process.*

- ***Recommendation**: The Commission should provide existing registrants located in a jurisdiction for which comparability was rejected an appropriate transition period to come into conformance.*

INSTITUTE OF INTERNATIONAL BANKERS

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The Institute appreciates the Commission's consideration of these matters. If the Commission or its staff has any questions regarding this letter, please do not hesitate to contact the undersigned at (212) 421-1611.

Respectfully submitted,

Sarah A. Miller
Chief Executive Officer