



Mr. David Stawick
Secretary
Commodity Futures Trading Commission (CFTC)

August 27, 2012

Re: Proposed Interpretive Guidance and Policy Statement (“Guidance”): Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57)

Dear Mr. Stawick,

The Institute for Agriculture and Trade Policy (IATP) is a nonprofit, 501(c)(3) nongovernmental organization, headquartered in Minneapolis, Minn., with an office in Washington, D.C. Our mission states, “The Institute for Agriculture and Trade Policy works locally and globally at the intersection of policy and practice to ensure fair and sustainable food, farm and trade systems.” To carry out this mission, as regards commodity market regulation, IATP has participated in the Commodity Markets Oversight Coalition (CMOC) since 2009, and has submitted several comments on CFTC rulemaking, and on consultation papers of the International Organization of Securities Commissions, the European Securities and Markets Authority and the European Commission’s Directorate General for Internal Markets.

This proposed Guidance pertains to all asset classes of swaps. Agricultural swaps are a fraction of the 0.6 percent of annual gross notional value of commodity derivatives in the approximately \$300 trillion U.S. swaps market, according to the most recent quarterly report of the Office of the Comptroller of Currency.ⁱ However, according to the same report, commodity revenues accounted for more than \$2.2 billion of about \$19 billion in bank holding company revenues for the first quarter of 2012.ⁱⁱ Because bank holding companies are allowed to trade physical commodities, as well as Over the Counter (OTC) commodity swaps and agricultural contracts bundled into OTC commodity index funds, the Commission’s proposed Guidance will have important consequences for both the U.S. and global agricultural swaps markets.

Furthermore, with the explosion of High Frequency Trading of both exchange and OTC agricultural contracts, the opportunities for inducing price volatility through excessive speculation, unrelated to supply demand fundamentals, has increased markedly.ⁱⁱⁱ Finally, insofar as agricultural futures and swaps contract prices are benchmarks for the Freight on Board prices paid by net food import developing countries, this Guidance, as well as other CFTC swaps-related rulemaking, has an indirect bearing on import-related food security in developing countries.^{iv} For these reasons and more, IATP takes a great interest in the Commission’s proposed Guidance.

This short comment addresses some of the proposed guidance questions with their corresponding question number, as requested by the Commission. We group the questions under two topics: 1) which entities should be subject to the cross-border application of Dodd-Frank; 2) how will the Commission determine whether “substituted compliance” with Dodd-Frank can be carried out by regulatory regimes comparable to that of the Commission. The responses to the Commission’s questions are prefaced by a General Comment.

General comment

OTC swaps, a critical mass of them originated by the non-U.S. subsidiaries, branches and agents (henceforth “affiliates”) of U.S. Swaps Dealers (SDs), nearly bankrupted major private institutions of the global financial industry in 2008-2009. The Troubled Asset Relief Program and the Federal Reserve Bank’s \$29+ trillion in emergency loans to private firms and central banks from 2007-2010 were among the public measures that kept major U.S. and European financial institutions technically solvent.^v About \$10 trillion of the Fed’s emergency loans went to foreign central banks, with more than \$8 trillion going to the European Central Bank alone.^{vi} About \$16 trillion of the \$19 trillion the Fed lent to private financial institutions went to six European banks, seven U.S. banks and to the American Insurance Group.^{vii}

The Federal Reserve Bank of New York did not have even a schematic understanding of the “shadow banking” rescued by its emergency loans until the summer of 2010.^{viii} The recklessness of the SDs, fueled by a Securities Exchange Commission waiver of capital reserve requirements in September 2004 at the behest of then Goldman Sachs CEO Henry Paulson^{ix}, left the Fed with no option but to abjure “moral hazard” and recapitalize its most imprudent members.

The banks’ and AIG’s swaps default cascades that triggered these loans largely were initiated by European affiliates of U.S. banks and by U.S. affiliates of European banks, as well as by the U.S. and European parent banks. As the Commission finalizes its interpretative guidance about the cross-border application of “Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010” (“Dodd-Frank”), it should define “U.S. person” so as to cover all the actors organizationally responsible for structurally destabilizing the global financial and commodity markets. The guidance states, “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 had certain or all of its swap-related obligations guaranteed by a U.S. person ” (FR 41218).

If the Commission hobbles the cross-border application of Dodd-Frank by exempting foreign affiliates and subsidiaries of U.S. parent companies from the definition of “U.S. person,” it likely will open the gateway to regulatory arbitrage in foreign jurisdictions with inadequate laws and regulatory resources. The substituted compliance procedures that allow access to U.S. market by foreign affiliate SDs of U.S. parent companies, provided that the home countries of the foreign affiliates have a “comparable comprehensive oversight and regulation” to that of Dodd-Frank (Sec. 738 1a)), may slow the volume of dark market trades that will pass through the narrow proposed definition of “U.S. person.” But IATP considers substituted compliance procedures to be an inferior option to direct compliance with Commission regulations. Effective cross-border application should begin with a definition of “U.S. person” that encompasses the foreign affiliates SDs of U.S. banks whose swaps have the “direct and significant effect” on the U.S. economy that is the normative requirement for Dodd Frank’s cross-border application.

The Commission does not violate principles of international comity by extending the cross-border application to cover how “U.S. persons” operate in foreign jurisdictions. Particularly when those jurisdictions lack the laws and/or regulatory capacity to prevent damage to the U.S. economy resulting from counterparty defaults originating in foreign affiliate swaps, the Commission must define “U.S. person” to reflect how global banks operate in foreign jurisdictions, and not how the SDs’ lawyers define the activities of their clients.

The Commodity Exchange Act (CEA), as amended by Dodd-Frank, provides the Commission with the statutory authority to regulate swaps trading by foreign affiliates of U.S. SDs, and of Major Swaps Participants (MSPs), insofar as these foreign affiliate swaps affect the central booking arrangements of SDs and through them the U.S. economy. Whether the affiliates are legally characterized as “branches” or “majority-owned subsidiaries” is irrelevant in terms of the

reputation of the parent firm and the herd behavior of SDs and MSPs when it appears that an SD affiliate will default on a swap. The herd behavior may occur whether or not a foreign affiliate counterparty default is guaranteed by the U.S. parent firm or not.^x

According to the Office of the Comptroller of Currency's latest report on derivatives, "Swaps contracts, notwithstanding the decline in the first quarter [of 2012] represent the bulk of the [U.S.] derivatives market at 61%."^{xi} Four banks, Bank of America, the Goldman Sachs Group, Citibank and JP Morgan Chase control more than 93 percent of all derivatives contracts and 57 percent of all swaps contracts.^{xii} These firms' deposits are all guaranteed by the Federal Deposit Insurance Corporation and ultimately by the U.S. taxpayer. The SD operations of these banks, their MSP counterparties, and their foreign affiliates must comprise the primary regulatory target of CEA regulation in general and this interpretive Guidance in particular. Failure to effectively regulate U.S. SDs, MSPs and their foreign affiliates poses a continuing systemic risk to the U.S. economy. Dodd-Frank provides no statutory obligation to ensure the profitability of these firms by providing the myriad exemptions, exclusions and waivers from Dodd-Frank they have demanded of the Commission.

The proposed Guidance outlines several cases in which swaps trades by the foreign affiliates of U.S. SDs have had multi-billion dollar negative impacts on U.S. commerce. Notwithstanding the economic damage inflicted on U.S. persons and the U.S. economy resulting in part from regulatory failure, the European Investment Bank has threatened to refuse to trade OTC derivatives in U.S. markets unless U.S. regulators refrain from applying Dodd-Frank cross-border authorities.^{xiii} U.S. SD lobbyists have advised their Asian clients to avoid doing business under Dodd-Frank authorized rules.^{xiv} IATP is pleased and grateful that the Commission has ignored these and similar threats and released the interpretive guidance on the cross-border application of the CEA as amended by Dodd-Frank. The legislation, if effectively implemented and enforced, by the CFTC or less preferably by foreign regulatory authorities under substitute compliance arrangements, will prevent excessive speculation and achieve other normative requirements of the CEA.

Despite the efforts of regulators under Dodd-Frank authorities to bring transparency, adequate capital reserves and other prudential measures to the dark markets of OTC swaps, the global financial system remains structurally vulnerable to another collapse. Indeed, as the annual report of the Bank for International Settlements stated, "in 2012, the general conditions in the banking sector are similar to the conditions that prevailed after the collapse of Lehman Brothers."^{xv}

Nevertheless, global financial firms and MSPs who prefer to hedge their commercial risks in commodities in dark markets, have furiously resisted a robust implementation of Dodd-Frank and its cross-border application to the foreign affiliates of U.S. SDs. The American Banking Association's attempt to throttle the proposed Guidance prior to its release for comment^{xvi} is just one more example of the campaign to pervert Dodd-Frank authority to keep financial and commodity market regulation weak and ineffective. The threat of the Investment Industry Association of Canada to call on the government of Canada to attack the Volker Rule through the World Trade Organization dispute settlement process is a related tactic to "reform" financial regulatory reform.^{xvii}

If the Volker Rule were rescinded in whole or in part to satisfy a WTO ruling, federally guaranteed depositor's money, as part of the U.S. person's guarantee against counterparty default of swaps by non-U.S. affiliates of U.S. SDs, would continue to be at risk. The existence of the U.S. person's guarantee is a crucial criterion for the Commission's determination of whether a non-U.S. person would be subject to compliance with Dodd-Frank or whether substituted

compliance by a foreign jurisdiction with a comparable and comprehensive regulatory regime would satisfy Dodd-Frank requirements. If the funds of the U.S. person's guarantee continue to be those of retail commercial banking (commingled with the proprietary funds of the SDs), the U.S. person's guarantee would continue to expose U.S. retail depositors to all the risks of the U.S. SD and its non-U.S. affiliates. However, defaults of non-guaranteed swaps by foreign affiliates of U.S. parent companies could likewise trigger default cascades, if market participants judge the parent company to be too imperiled to cover losses resulting from foreign affiliate swaps.

Finally, IATP asks the Commission to consider whether effective cross-border application can be achieved, given the Commission's exclusions and exemptions for SDs from swaps clearing and processing, under the recently approved rule on swaps-related definitions. As far as we can determine, the Guidance mentions exemptions only once ("Clearing and Swap Processing," FR 41226) and poses no questions about the effects of SD and MSP exclusions and exemptions on the cross-border application of Dodd Frank. We agree with the July 23 comment by Better Markets that this rule provides SDs with exclusions from Dodd-Frank authority contemplated nowhere in Dodd-Frank.^{xviii} For example, the Commission has granted SDs some of the hedging exemptions that Dodd-Frank stipulates only for MSPs hedging commercial risk.

IATP is very concerned that the Commission will grant foreign affiliates of U.S. SDs and non-U.S. SDs the exclusions and exemptions it has granted to U.S. SDs under the mistaken belief that Dodd-Frank provided the Commission with discretion to grant such exclusions and exemptions. Hopefully, as the Commission investigates the swaps trading strategies behind the multi-trillions of dollars of LIBOR interest rate price-fixing^{xix}, it will find ample factual grounds to justify rescinding the exclusions it has granted the SDs in the Interim Final Rule on swaps-related definitions.

Which entities will be subject to cross-border application requirements?

Questions 1a-1b: IATP believes that the term "U.S. person" should include foreign affiliates and/or subsidiaries whose trades will be guaranteed by a U.S. person in the event of counterparty default. Since default on non-guaranteed swaps can have a "direct and significant effect" on U.S. parent companies, the Commission may wish to consider whether all swaps of U.S. persons must require guarantees. IATP does not believe that the Commission should adopt the Securities Exchange Commission definition of "U.S. person," as requested by several commenters, since that definition pre-dates by a decade the take-off and now dominance of OTC swaps in U.S. and global derivatives markets, relative to regulated financial instruments.

Questions 3a-3g: The Commission has asked which criteria should be used to determine which non-U.S. persons are to be subject to cross-border requirements. IATP believes the aggregate notional value of non-U.S. person swaps dealing activities with U.S. person counterparties is a necessary but not sufficient criterion for making that determination. As the Commission notes in its position limits rule, "In light of the importance of aggregation standards in an effective position limits regime, it is critical that the Commission effectively and efficiently monitor the extent to which traders rely on any of the disaggregation exemptions."^{xx} Both SDs and MSPs have sought broad exemptions from aggregation, e.g. through claims that aggregation activities among a U.S. person and its foreign affiliates is similar to anti-competitive collusion by two independent entities in a joint venture. Exemptions have been sought on the grounds that aggregation might violate local, state, federal and "international law" applicable to OTC swaps.

IATP strongly disagreed with these purported justifications for aggregation exemption in its June 29 comment to the Commission. Since there is much to be gained and nothing to be lost but lobbying costs by petitioning for such exemptions, IATP expects such petitions for "exemptive

relief” to proliferate in the transatlantic, and indeed, global campaign to eviscerate Dodd-Frank. Therefore, we contend the aggregate notional amount of SD activities should not be the sole criterion for determining the cross-border application of Dodd Frank to non-U.S. persons.

IATP believes that a non-U.S. person must register as a SD under Dodd-Frank authority whenever it is protected by a U.S. guarantee from the parent company to prevent a default cascade resulting from non-U.S. person swaps trading. Whether a legally stipulated guarantee is financially sufficient to prevent a default cascade proportional to the aggregate notional value of non- U.S. person swap dealing likely will co-determined by Commission and prudential regulators overseeing the capital reserve requirements of both the U.S. parent company and the foreign affiliate. Because it may not be possible for the Commission to determine on the basis of weekly surveillance when or how much of a non-U.S. person’s SD obligations are protected by a U.S. guarantee, we believe that the non-U.S. person affiliate should be subject to all Dodd Frank cross-border requirements even when part of its SD obligations are not protected by a U.S. guarantee.

Questions 4-5: SDs can and do execute and clear their transactions from many jurisdictions. Indeed, some SDs have threatened to move their operations to more pliable jurisdictions should they deem EU and U.S. rules and enforcement to be too onerous, i.e. they anticipate reduced profits as a result of complying with Dodd Frank rules or forgoing trade of certain swaps because of the rules.^{xxi} As the SDs have shown by their threats to regulators and legislators, the specific place of execution or clearing of a swap can be anywhere and still will be part of the parent company’s central booking arrangements. Therefore, the specific place of swaps execution or clearing is an irrelevant criterion for the Commission’s determination of whether a non-U.S. person is a SD.

Once a non-U.S. person affiliate is registered with the Commission as an SD, there is no reason why the notional value of its swaps dealing should not be aggregated with that of other non-U.S. person affiliates of a U.S. person (parent company), to enable surveillance of the totality of the SD activities in distinct asset classes. As regards commodity contracts covered under the Position Limits Rule, absent such global aggregation of swaps affecting the U.S. person’s central booking, the Commission will not be able to carry comprehensive and timely surveillance of SD activities, nor therefore take effective enforcement actions, should they prove to be necessary.

Question 8: Dodd Frank (Section 721) defines swaps dealers in terms of their self-representation and activities in market making. SDs are defined not in terms of the “substantial position in swaps” and the hedging of commercial risk that characterizes the definition of an MSP. The Commission has already stipulated in the SD definition, in our view, an exceedingly generous de minimis exemption (\$8 billion gross notional value of swaps per entity and its affiliates) before an SD must register with the Commission and be subject to all SD requirements. The Commission should not further reduce the cross-border application of Dodd-Frank by exempting from its SD determination the notional value of non- U.S. inter-affiliate swaps of a U.S. parent company. The Guidance should not allow a U.S. person to reduce its SD obligations by representing that inter-affiliate swaps should benefit from the kind of quantitative exemptions for MSPs that hedge commercial risk in physical commodities.

In our view, a crucial test for determining whether exclusions and exemptions granted by the Commission can lead to “direct and significant” damage to the U.S. economy is if the exempted swaps data flow disrupts price formation and risk management, imperiling market integrity, as well as the solvency of individual market participants. While the Commission and other regulatory agencies comprise the ultimate line of defense against such disruption, the public can

constitute an early warning system against structural disruption if it has the opportunity to evaluate the data flows historically. In the case of inter-affiliate swaps involving non-U.S. persons, as we understand the proposed inter-affiliate swap rule, only the Commission will have access to SD reporting in the swaps data repositories of foreign jurisdictions. Inter-affiliate swaps will not be publicly reported. So the question arises whether the Commission will have the capacity by itself to evaluate swap data flow quantity and quality in SDRs located in foreign jurisdictions.

The Commission should not exclude the notional value of swap transactions of a non-U.S. person affiliate from the Commission's determination of whether that value should count towards SD designation, even if the swaps are transacted between non-U.S. affiliates of the U.S. parent company. Nor should this exclusion occur if the U.S. parent provides a capped liability guarantee in a Master Agreement on the notional value of the swaps transactions of the non-U.S. affiliates. The positions taken by non-U.S. affiliate SDs are not transactions to hedge commercial risk (bona fide hedging) and therefore cannot qualify for the MSP hedging exemption. The rule on exemptions from clearing for inter-affiliate swaps, proposed by the Commission on August 16, would apply if "if the affiliate is located in a jurisdiction with a comparable and comprehensive clearing requirement."^{xix}

Non-U.S. inter-affiliate swaps may mitigate the U.S. parent company's financial risks. But since these exempted swaps are reportable only to the Commission, there is no way for the public to confirm the extent of mitigation. The Commission is not obliged to take into account the non-public and therefore alleged quantity of reduced risk for the parent company resulting from inter-affiliate swaps when making its determination about whether the activities of a non-U.S. affiliate require it to register with the Commission as a SD and fulfill all SD reporting, clearing and swap processing requirements. It is prudent for a U.S. parent company to establish U.S. liability caps for its non-U.S. affiliates, as a means of discouraging excessive risk taking by them. However, the fact or quantity of those caps should in no way be used by the Commission to reduce compliance of U.S. person foreign affiliates with Dodd Frank SD requirements.

The Commission's determination of 'substituted compliance' with Dodd-Frank

According to the Guidance, "substituted compliance means that a non-U.S. swap dealer or non-U.S. MSP is permitted to conduct business by complying with its home regulations, without additional requirements under the CEA [Commodity Exchange Act]" (FR 41229). There is considerable debate among the Commissioners as to the optimal means for achieving substituted compliance. For example, Commissioner Jill Sommers has invoked the "Commission's successful history of mutual recognition of foreign regulatory regimes spanning 20-plus years" (FR 41239) as the model for regulatory cooperation that the Guidance purportedly ignores. She further argues that "a very broad and high level review of regulatory regimes is appropriate versus a word-for word comparison of rulebooks" as the basis for determining whether the non U.S. affiliates of U.S. SDs and MSPs may comply with Dodd-Frank requirements through substituted compliance.

IATP respectfully disagrees that Mutual Recognition Agreements (MRAs) based on high level principles have been successful frameworks for cross-border market regulation. MRAs have been insufficient not only to prevent the financial market regulatory failures of the past decade: they have forestalled and sometimes even impeded the substantive discussion of regulatory and legislative differences among jurisdictions. Periodic discussion of these differences is a necessary step towards successful regulatory cooperation. "A word by word comparison of rulebooks" will not suffice to implement the cross-border application of Dodd Frank, even if such a comparison were feasible. To make substituted compliance determinations, the Commission will need to

document publicly that the normative objectives of the CEA, as amended by Dodd-Frank, can be achieved by the relevant authorities of foreign jurisdictions in which the non-U.S. affiliates of U.S. SDs and MSPs operate. Unfettered access to the Swaps Data Repositories located in foreign jurisdictions will be a necessary step towards confirming that foreign regulatory surveillance of transaction level requirements related to the swaps data flow are comparable and comprehensive.

The Guidance usefully provides an Appendix to summarize which provisions in Dodd Frank will require compliance by U.S. persons and which provisions may be subject to “substitute compliance.” In the following responses to the Commission’s questions, IATP tries to keep in the foreground the practical problems of implementing and enforcing SD and MSP requirements, particularly through “substituted compliance.”

Questions 10-11a: The regulatory reach of the Commission’s proposed cross-border application of Dodd Frank is far from “intergalactic” and “extra-constitutional”, as characterized by Commissioner Sommers.

The Commission states a firm boundary, following the principles of international comity, as to where Dodd Frank cannot apply: “the Commission proposes to interpret section 2(i) so as not to require the application of any of these Transaction-Level Requirements to swaps between a non-U.S. swap dealer or non-U.S. MSP with a non-U.S. counterparty that is not guaranteed by a U.S. person” (FR 41229). These requirements, related to clearing, trade execution, real time public reporting, Large Trade Reporting, Swaps Data Repository (SDR) reporting and swaps data recordkeeping, are all part of what is required for the comprehensive and integrated regulation of swaps the Commission proposes. While we hope that foreign jurisdictions will adopt and implement such requirements, if they are not already in place, following the principles of international comity, the Commission cannot require compliance of non-U.S. persons with these requirements for swaps that do not have “direct and significant” effects on the U.S. economy.

At the Entity Level, “the Commission proposes to interpret CEA section 2(i) so as to require non U.S. swap dealers and non U.S. MSPs [as agents of a U.S. person] to report all of their swaps to a registered SDR and require non-U.S. swap dealers to report all of their reportable positions” (FR 41227-41228). This reporting requirement allows for substituted compliance by regulators of foreign jurisdictions while ensuring that the Commission and/or foreign competent authorities with comparable and comprehensive regimes have access to registered SDRs to carry out swaps data surveillance. The Commission’s interpretation of CEA section 2(i) enables the surveillance activities, which if properly resourced, will prevent a return to the Dark Ages of swaps non-reporting and its concomitant counterparty default cascades.

Portfolio compression and reconciliation requirements are crucial not only to central U.S. risk mitigation but also to the central booking arrangements of U.S. persons and therefore should be classified as Entity-Level requirements. Likewise margin, segregation and other requirements for swaps that are so designed by non-U.S. affiliates of U.S. persons as to be unclearable should be regulated under Entity-Level requirements. Since uncleared swaps pose greater risk to the U.S. person, whether a SD or a MSP, and hence to the U.S. economy, the Commission should not group Entity and Transaction-Level requirements differently for SDs and MSPs.

Question 12: According to the Commission’s typology of swaps to which Dodd Frank applies (Appendices A and B), for which substituted compliance may be permitted, or to which Dodd Frank does not apply, Dodd Frank will apply to swaps between a non-U.S. SD or MSP and a U.S. person who is not a SD or MSP (Appendix C). IATP agrees with this proposed determination. A U.S. person who is not a SD or MSP is less likely to have the resources necessary to assess the risks of swaps with non-U.S. SDs or MSPs than would a U.S. SD or MSP. Hence, the

Commission acts prudently when it proposes to require compliance with Transaction-Level requirements for swaps between non-U.S. SDs or MSPs with these U.S. persons.

Question 14: If the structure of a swap transaction is so complex that market participants cannot determine whether the counterparties to a swap are U.S. persons, non-U.S. affiliates with U.S. parent guarantees or non-U.S. persons without U.S. guarantees, we do not understand why the Commission would allow such a swap to enter into trade. If the legal personality of a counterparty to a swap cannot be determined by market participants, it seems unlikely that the Commission would have the resources to do so, particularly given industry and Congressional attempts to reduce the Commission's resources, so as to impede the implementation and enforcement of Dodd –Frank rules.^{xxiii} Such an opaquely structured swap is likely to be unclearable, posing greater counterparty risks. Apart from procuring higher fees for the SD, it is difficult to imagine why a swap defying jurisdictional oversight should become part of any SD's business.

Questions 15-16: The Commission proposes in Appendix B (FR 41237) that swaps between non-U.S. counterparties that are guaranteed by U.S. persons be subject to substituted compliance. As a result, some commenters may regard the Commission's following question as merely rhetorical: "Should the Commission then not permit substituted compliance with respect to Entity-Level and Transaction-Level requirements in connection with transactions with U.S. persons?" (FR 41232) An answer to this question depends in part on the liability definitions and fund composition of the U.S. guarantee, and in part on the Commission's determination that the competent authority of a foreign jurisdiction has the capacity to implement and enforce a comparable and comprehensive regulatory regime to that of the Commission and other relevant regulatory agencies under Dodd-Frank.

As argued above, if the Volker Rule were to be nullified or impaired, either by a U.S. court ruling or by U.S. legislative changes to comply with a negative ruling by a WTO dispute settlement panel, U.S. retail depositors of bank holding companies would be liable for paying those companies' SD incurred losses. The funds of retail depositors and SD funds in bank holding companies would continue to be comingled following the nullification of the Volker Rule. Under such conditions, a U.S. guarantee, e.g. as stipulated in a Master Agreement of the International Swaps and Derivatives Association, would provide insufficient protection to retail depositors in the event of counterparty default, exposing the U.S. economy to "direct and significant" damage.

Non-U.S. SDs that have strongly protested the cross-border application of Dodd-Frank are supported by foreign officials who also oppose Dodd-Frank comparable and comprehensive regulatory regimes, e.g. one that would result from the revision of the Market in Financial Instruments Directive (MiFID) in Europe.^{xxiv} If the Commission decides to allow substituted compliance for swaps transacted by non-U.S. SDs and MSPs with a U.S. guarantee, it should publicly document that each competent authority exercising substituted compliance has the capacity to implement and enforce both Entity-Level and Transaction-Level requirements. IATP believes that many foreign jurisdiction regulators will have the capacity to ensure compliance with the Entity-Level requirements. Review of SD and MSP capital reserve requirements, risk management policies, and policies for swap data record keeping, SDR reporting and Large Trader reporting for physical commodities should be within the budgetary, infrastructural and human resource capacity of major market jurisdictions. Furthermore, the Commission should be able to audit these Entry-level requirements to confirm that substituted compliance is practicable in these jurisdictions.

IATP believes that substituted compliance with Transaction-level requirements for non-U.S. persons likely will pose greater challenges for many jurisdictions. The Commission should consider how it might support eventual substituted compliance with a foreign jurisdiction while not permitting substituted compliance in the initial phase of a revised Memorandum of Understanding with a foreign competent authority. Few jurisdictions, for example, presently have the capacity to enable real-time public reporting, and to monitor SDR reporting, although this reporting is crucial to market transparency and surveillance. Phased-in substituted compliance could be structured and supported by the Commission and other U.S. regulatory agencies for this resource intensive reporting. Applicable requirements should not differ for SDs and MSPs. The Commission should not permit substituted compliance for Entity-level of Transaction –level requirements of U.S. persons who are not SDs or MSPs with non U.S. SDs or MSPs.

Question 17: Some jurisdictions do not allow the reporting of swap transaction data to a centralized SDR because of client privacy (bank secrecy) laws. It is not clear how substituted compliance could work in such jurisdictions, since it will not be possible for competent authorities of a foreign jurisdiction to demonstrate to the Commission that they can carry out surveillance activities of the swaps transaction data to which they have no access. For competent authorities to do surveillance on each non-U.S. person’s SD or MSP swaps transactions will enable only surveillance of that person and not the comprehensive and integrated surveillance that is required of Dodd-Frank. U.S. tax authorities were able to persuade Swiss authorities to tear away enough of the banking secrecy veil to enable identification of the bank accounts of some U.S. tax evaders.^{xxv} Either the Commission will have to be able to persuade competent authorities to change laws to enable reporting of swaps data to SDRs, or the Commission will have to restrict market access for those jurisdictions that choose not to offer access to the swap data flow, to demonstrate the capacity for substituted compliance of a Dodd-Frank comparable and comprehensive regime.

Question 19-20: The question of how to regulate swaps by the foreign affiliates of U.S. persons in emerging markets is one that the Commission treats in response to SD commenters’ claims about the SDs’ and MSPs’ global business plan of offering a full spectrum of financial services in those markets. The Guidance states “emerging markets in many cases may not be significant but nevertheless may be an integral part of their [the U.S.SDs’] global business plan” (FR 41230). However, the statutory authority for the Guidance (Sec. 722d of Dodd-Frank) does not pertain to the economic significance for the banks of their SD operations in emerging markets but the significance of the exposure of those swaps to the U.S. economy.^{xxvi}

Commission proposes that “In limited circumstances where foreign regulations are not comparable, the Commission believes that it could be appropriate to permit foreign branches and agencies of U.S. swap dealers to comply with transaction-level requirements applicable to entities domiciled or doing business in the foreign jurisdiction, rather than the Transaction-Level Requirements that otherwise would be applicable to the U.S. person’s activities” (FR 41230). Section 738 1a) states that in deciding whether to register Foreign Boards of Trade that would transact foreign affiliate swaps the Commission “shall consider” whether the FBOT applying for registration “is subject to comparable comprehensive supervision and regulation by the appropriate governmental authorities in the foreign board of trade’s home country.” Although Sec. 738 grants the Commission to decide whether to register FBOTs that do not comply with the “comparable comprehensive” criterion, IATP believes that the Commission, by proposing an emerging market exception for the “comparable comprehensive” criteria, has used that discretion unwisely.

The Commission proposes, “To be eligible for this exception, 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 may not exceed five percent of the aggregate notional value (expressed in U.S. dollars and measured on a quarterly basis) of all the swaps of the U.S. swap dealer” (FR 41231). Let’s assume the four banks that control 57 percent of all swaps reported to the Office of Comptroller of Currency use the Commission’s proposed SD trading exception in emerging markets to its five percent maximum. For the first quarter of 2012, the aggregate notional value of the four banks swaps amounted to about \$131 trillion. A five percent share of that \$131 trillion would be about a \$6.5 trillion exposure of the U.S. economy to the possibility of foreign affiliate default in emerging market jurisdictions without “comparable comprehensive supervision and regulation” of its derivatives markets. This exposure could be yet greater if the Commission grants the SD’s and MSPs the “exemptive relief” they have sought from aggregation requirements.

Granted that even in these days of High Frequency Trade driven “flash crashes,” index-fund induced price volatility in historically uncorrelated commodity prices, price-fixing and other forms of price distortion, it is unlikely, but certainly not impossible, that all foreign affiliate swaps of U.S. SDs in emerging markets will default to the extent of the default cascades of 2008 and 2009. Furthermore, the taxpayer recapitalized SDs are in a better financial position to guarantee their emerging market affiliates’ defaults. Nevertheless, IATP does not believe that any principle of international comity can be invoked to justify the Commission’s proposal to exempt emerging market jurisdictions from Dodd-Frank’s “comparable comprehensive supervision and regulation” requirement.

For IATP, the crucial question about the Commission’s proposed emerging market jurisdiction exception from Dodd-Frank compliance is not, as the Commission poses, whether five percent of aggregate notional value is too high or too low a limit on the percentage of emerging market swaps permitted for transaction by a U.S. SD. Rather the crucial question is whether the Commission should use its regulatory discretion to authorize such an exception at all. Shouldn’t the Commission’s objective regarding emerging market regulatory jurisdictions be to enhance their capacity so they qualify for substituted compliance, rather than give U.S. SDs another source for evading compliance with Dodd-Frank? Hence, we take no position on this question of the “right” percentage for the proposed exception from Dodd-Frank compliance nor on question 20 concerning how much to adjust the SD’s de minimis aggregate notional value of trades in emerging markets required to trigger SD registration with the Commission.

The taxpayer recapitalization of the U.S. SDs and the legislation that transformed traders into bank holding companies overnight on October 4, 2008 has not changed the culture of the trader-directed banks, which continue to be focused on maximizing profitability from short-term transactions, rather than on serving long-term client relations and the economic interests of the United States.^{xxvii} Granting U.S. SDs de facto exemptive relief from Dodd-Frank compliance in emerging market jurisdictions would be tantamount to surrendering to U.S. banks’ threats to relocate their SD operations to weakly regulated jurisdictions. The trading bank’s culture will not change, if the Commission gives in to their demands for more exemptions and exceptions: only more and broader exemptions will be demanded. Much of the Commission’s courageous and indeed, heroic work to bring the swaps market under regulation will be undone, if it allows a compliance exception for foreign affiliates of U.S. SDs and MSPs in emerging market jurisdictions. IATP implores the Commission not to allow this exception.

Questions 26-30: In view of the aforementioned opposition to compliance with Dodd-Frank in the United States and to its cross-border application to foreign affiliates of U.S. SDs and MSPs,

IATP anticipates that with many jurisdictions it will be difficult to negotiate a determination of “comparable comprehensive supervision and regulation”, the fundamental criterion for substituted compliance. Furthermore, given the terms of Commissioner Scott O’Malia’s concurrence, it is not inconceivable that that the concurrence will be cited in industry litigation to weaken or prevent the cross-border application of Dodd-Frank.^{xxviii} Nevertheless, Commissioner O’Malia raises important questions about under what conditions SDs and MSPs should be allowed to de-register or to transfer their registration, and hence no longer be subject to substituted compliance. IATP will respond to these questions in our conclusion.

Because the negotiation towards a comparability determination often will be difficult, it is important that the process for that determination be transparent and that there be a procedure outlined for a foreign regulator to appeal a Commission determination on substituted compliance. The Commission’s proposed process envisions direct applications by individual non-U.S. persons to the Commission for permission to comply “with comparable requirements of its home jurisdiction, in lieu of applicable Dodd-Frank requirements” (FR 41233) to achieve substituted compliance. In view of the small size of the Commission’s international office, IATP finds it difficult to imagine how the Commission would efficiently and effectively process the many applications of non-U.S. persons from each jurisdiction that would result.

The Commission should follow a three-step process, partly implied in the Guidance: 1) the negotiation with foreign regulators of a Memorandum of Understanding or revision of an existing MoU that would form the framework for comparability determinations; 2) the Commission’s partial or full substituted compliance determinations for foreign jurisdictions, according to the foreign jurisdiction’s application as outlined in the MoU; 3) the application by non-U.S. persons to foreign regulators to access U.S. markets subject to the Commission’s substituted compliance determinations for each foreign jurisdiction. IATP understands the substituted compliance determinations to be the result of intergovernmental negotiations. Non-U.S. persons would apply for access to U.S. swaps markets according to the substituted compliance determinations granted by the Commission.

It is unlikely that the Commission will find that a foreign regulatory system is comparable and comprehensive in every respect to that of Dodd-Frank. Therefore we support the Commission’s proposal for partial substituted compliance determinations. Any such determinations should be based on the Commission’s review of foreign jurisdiction laws, regulations and other relevant official publications, on structured interviews with foreign regulators, and on on-site audits of the foreign regulators’s infrastructural capacity to implement and enforce laws and regulations that affect the foreign affiliates of U.S. SDs and MSPs.

IATP also believes that it is unlikely that foreign jurisdiction laws and regulations will be identical with those of the United States and so supports the Commission’s proposed “outcomes based approach” (FR 41232) to evaluate whether foreign regulatory requirements result in meeting Dodd-Frank normative objectives, particularly regarding Section 722d). However, demonstrating that such outcomes achieve the normative objectives of the CEA, as amended by Dodd-Frank, will not be easy. For example, if a foreign jurisdiction sought to achieve substituted compliance with the Commission’s Position Limit Rule by presenting exchange-implemented “position management” as comparable and comprehensive regulation, foreign regulators would be faced with several challenges.

In “light touch” or principle-based regulatory jurisdictions, commodity derivatives data collection and surveillance is weak, inconsistent or even non-existent. Concomitantly, enforcement is often weak, inconsistent or even non-existent. How would foreign regulators demonstrate comparable

outcomes for “position management” without foreign regulator development of at least the infrastructural capacity to collect and analyze position data to independently confirm that position management achieved prevention of excessive speculation and other normative objectives of the CEA?

To make Question 29 more specific, if foreign regulators committed to developing such capacity in the MoU, how would the Commission evaluate the applications of foreign regulators for non-U.S. persons in their jurisdictions to access U.S. markets in advance of achieving substituted compliance with applicable covered contracts under the Position Limits Rule? If foreign regulators share one Swaps Data Repository, as the draft European Commission legislation proposes, will the Commission issue an affirmative determination of Position Limit Rules substituted compliance for all EU member state jurisdictions submitting swaps data in their jurisdictions to that SDR, provided that they allow the Commission unqualified access to the data in that SDR?

Given the foreign regulatory capacity issues raised by the cross-border application of Dodd-Frank, the Commission should develop an interim substituted compliance process. However, this interim process should take into account not just the comparable laws and regulations in the process of approval and implementation, as the Commission proposes, but the infrastructural capacity for surveillance and enforcement. Indeed, the Commission will also have to evaluate, as part of interim or provisional substituted compliance determinations, the extent and quality of cooperation by non-U.S. affiliates of U.S. SDs and MSPs cooperation with foreign regulators to enable the Commission’s final, if partial, substituted compliance determinations.

The Commission anticipates relying on “prior comparability determinations” in existing MoUs to “facilitate its review of a subsequent applicant’s request for recognition of substituted compliance” (FR 41233). To the extent that these “prior comparability determinations” were processed and decided before OTC swaps formed the vast bulk of the derivatives market, IATP believes that the Commission should be very cautious in relying on these prior determinations. Indeed, in light of the well-documented damage to the U.S. economy originating in non-U.S. affiliate transactions of U.S. SDs, these prior determinations may be inadequate to achieve comparability under Dodd-Frank. The Commission should not allow invocations of “principles of international comity” to rush its judgment on the adequacy of pre-Dodd Frank comparability decisions. Neither should the Commission design the process nor evaluate the outcomes of substituted compliance in order to satisfy SD, MSP or foreign regulator interpretations of what is required for international comity. Rather the comparability and comprehensiveness determinations must be based on a process that ensures achievement of the objective of the CEA as amended by Dodd-Frank.

Once the Commission has revised prior comparability and comprehensiveness determinations and published new ones that take into account Dodd-Frank entity level and transaction level requirements, it will need to develop a process for reviewing those determinations periodically. Such reviews are needed to ensure that they are adequate relative to new swaps products and trading practices, as well as to new laws, regulations and regulatory capacity in the foreign jurisdictions that have been granted substituted compliance determinations. The review will require analysis of new foreign jurisdiction laws and major new regulations, interviews with relevant foreign officials and audits of infrastructural capacity for implementation and enforcement. The review will also require that the Commission analyze the costs and benefits to the public of substituted compliance, and not focus cost benefit analysis on erroneous claims of lost anticipated profits by the regulated industry.^{xxix} Periodicity of review will depend on the

effects of news swaps laws, regulations, products, and trading practices on the U.S. economy, per the jurisdiction under review.

Conclusion

Commissioner O'Malia's concurrence for the release of the interpretive guidance states that the staff worked for "well over one year" to produce this document (FR 41242). IATP, notwithstanding the aforementioned criticisms of some aspects of the guidance, greatly appreciates the staff's work, and the Commissioner's unanimous decision to release the guidance for comment. We look forward to reading the final interpretive guidance and to assisting the Commission to achieving the objectives of the cross-border application of the CEA as amended by Dodd-Frank.

Given the aforementioned opposition of SDs, MSPs and foreign officials to cross-border application, to say nothing of Commissioner O'Malia's concern over what he regards as the "Commission's shaky legal analysis," (FR 41242) of Dodd-Frank authorities, the questions Commissioner O'Malia poses at the end of his concurrence may seem premature. However, these questions will be posed, if they have not been posed already, by non U.S. affiliates of U.S. SDs, MSPs and/or foreign officials concerned about their future with substituted compliance.

Commissioner O'Malia asks "under what conditions should the Commission allow deregistration" (FR 41242) [of foreign SDs and MSPs, thus releasing them from having to comply with Dodd-Frank cross-border application Entity and Transaction-level requirements]? Because the U.S. swaps market has been unregulated at least since the prohibitions against regulation in the Commodity Futures Modernization Act of 2000, we anticipate it will take at least a dozen years for US SDs and MSPs to develop a culture of compliance with Dodd-Frank rules. Because foreign swaps markets have likewise been unregulated and because many foreign regulators of derivatives have little infrastructural capacity to implement swaps related laws and rules, it may take longer than 12 years for non-U.S. SDs and MSPs to develop a culture of compliance with the cross-border application of Dodd-Frank.

But even estimating a time when the swaps industry is so in compliance with Dodd-Frank that non-U.S. SDs and MSPs can deregister does not describe the "conditions under which" the Commission might allow deregistration. The SDs are a crucial part of the U.S. shadow banking industry analyzed with considerable precision, if belatedly, by the New York Federal Reserve Bank.^{xxx} Once the Commission and other U.S. financial regulators have a comprehensive understanding of the global shadow bank industry and the role of non-U.S. SDs and MSPs in it, they will have a better knowledge platform to judge whether and when deregistration might be a regulatory option to achieve Dodd-Frank cross-border compliance objectives.

ⁱ <http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq112.pdf> at 9.

ⁱⁱ *Ibid.*, at 3.

ⁱⁱⁱ E.g., David Bicchetti and Nicolas Maystre, "The synchronized and long-lasting change on commodity markets: evidence from high-frequency data," Munich Personal RePEc Archive, March 2012. <http://mpira.ub.uni-muenchen.de/37486>

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- ^{iv} *The State of Food Insecurity in the World: How does international price volatility affect domestic economies and food security?*, United Nations Food and Agriculture Organization, 2011.
<http://www.fao.org/docrep/014/i2330e/i2330e.pdf>
- ^v James Felkerson, “\$29,000,000,000,000: A Detailed Look at the Fed’s Bailout by Funding Facility and Recipient,” Working Paper No. 698, Levy Economics Institute, December 2011.
<http://www.levyinstitute.org/publications/?docid=1462>
- ^{vi} Ibid. Table 2.
- ^{vii} Ibid. Table 17.
- ^{viii} Zoltan Poszar et al, “Shadow Banking,” Federal Reserve Bank of New York, Staff report. No. 458, July 2010.
- ^{ix} Stephen LaBaton. “Agency’s ’04 Rule Let Banks Pile Up New Debt, and Risk.” *The New York Times*. October 3, 2008.
- ^x See e.g. “Price Formation in Financialized Commodity Markets: The role of information,” United Nations Conference on Trade and Development, June 2011.
- ^{xi} <http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq112.pdf> at 9.
- ^{xii} Ibid. at 14.
- ^{xiii} <http://www.investmenteurope.net/investment-europe/news/2158255/banks-lose-competitive-edge-europe-eib>
- ^{xiv} Rachel Armstrong, “As Dodd-Frank looms, Asian banks look to cut U.S. trading ties,” Reuters, August 20, 2012.
- ^{xv} <http://www.bis.org/publ/arpdf/ar2012e6.pdf> at 64.
- ^{xvi}
<http://www.aba.com/Members/Economic/Documents/CFTCPlanMayEndangerOverseasBranchingbyUSBanks.pdf>
- ^{xvii} Gretchen Morgenson, “Barriers to Change, from Wall St. and Geneva,” *The New York Times*, March 17, 2012. http://www.nytimes.com/2012/03/18/business/wto-and-barriers-to-financial-change.html?_r=1&emc=eta1
- ^{xviii} <http://www.bettermarkets.com/rulemaking/better-markets-comment-letter-further-definition-swap-dealer-major-swap-participant-etc>
- ^{xix} Ben Protess, “Libor Case Energizes a Wall Street Watchdog,” *The New York Times*, August 13, 2012.
- ^{xx} “Position Limits for Futures and Swaps,” Commodity Futures Trading Commission, Federal Register, 76:223 (November 18, 2011), 71679.
<http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-28809a.pdf>
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2011 and Tom Braithewaite, “New York lawmakers warn Bernanke over derivatives rules,” *Financial Times*, May 18, 2011. .

^{xxii} <http://www.cftc.gov/PressRoom/PressReleases/pr6328-12>

^{xxiii} E.g. John Kemp, “Wall Street and Republicans team up to curb CFTC.” Reuters, June 7, 2012. <http://www.reuters.com/article/2012/06/07/us-column-kemp-cftc-idUSBRE8560P720120607>

^{xxiv} E.g. Phillip Stafford, “UK official warms on MiFiD overreach,” *Financial Times*, June 20, 2012.

^{xxv} Catherine Bosley, “Swiss bank Pictet gave data to U.S. in tax probe,” May 6, 2012. http://articles.chicagotribune.com/2012-05-06/business/sns-rt-us-swiss-tax-pictetbre84509m-20120506_1_ubs-clients-swiss-bankers-association-banking-secrecy

^{xxvi} <http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173enr/pdf/BILLS-111hr4173enr.pdf>

^{xxvii} Wally Turbeville, “The Truth About Goldman Sachs,” *The American Prospect*, March 15, 2012. <http://prospect.org/article/truth-about-goldman-sachs>

^{xxviii} John Kemp, “Is Someone Ghost-Writing for CFTC’s O’Malia?” (Corrected Column) Reuters, July 16, 2012. <http://www.reuters.com/article/2012/07/16/column-kemp-cftc-omaliamedia-idUSL6E8IG7KM20120716>

^{xxix} See <http://www.bettermarkets.com/blogs/industrys-false-claims-about-cost-benefit-analysis>

^{xxx} Poszar et al, “Shadow Banking.”