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August 27, 2012

Submitted electronically

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

Re: *Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57) (77 Fed. Reg. 41,214 (July 12, 2012))*

Dear Mr. Stawick:

Covington & Burling LLP is pleased to submit these comments in respect of the above-cited proposed interpretive guidance and policy statement (the "*Proposed Guidance*") issued by the Commodity Futures Trading Commission ("*CFTC*").

We appreciate the CFTC's efforts to clarify the extraterritorial scope of regulation under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*"). Congress provided that Dodd-Frank's swaps provisions "shall not apply to activities outside the United States" unless those activities "have a direct and significant connection with activities in, or effect on, commerce of the United States" or contravene anti-evasion rules promulgated by the CFTC.[1] Drawing a clear line between entities and transactions subject to U.S. swaps regulation, on the one hand, and entities and transactions not subject to U.S. swaps regulation, on the other, is essential to orderly implementation of derivatives regulation in the United States and around the world. Market participants need clear guidance to be able to structure their businesses to comply both with new comprehensive regulation by the CFTC and with the regulations of other countries where they do business, and potentially to avoid or manage the risk of duplicative regulation. In this regard, we respectfully request that the CFTC resolve several ambiguities in the definition of "U.S. person" in the Proposed Guidance.

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[1] Section 2(i) of the Commodity Exchange Act ("*CEA*") (7 U.S.C. § 2(i)).

We fully support the Commission's proposed interpretive guidance 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."[2] This guidance is consistent with Dodd-Frank's direction that U.S. swaps regulation generally "shall not apply to activities outside the United States,"[3] and with the CFTC's final guidance that the swap dealer and major swap participant designations will apply at the level of the legal entity.[4] Such an entity-level approach also draws a clear and sensible line that will allow non-U.S. affiliates or subsidiaries of U.S. persons to structure their business in compliance with local regulation, rather than with both U.S. and local regulation.

We respectfully urge the Commission to clarify this point because, on the same page that the Proposed Guidance makes clear that "a foreign affiliate or subsidiary of a U.S. person would be considered a non-U.S. person," clause (i)(B) of the proposed U.S. person definition includes "any corporation . . . 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."[5] Although the Proposed Guidance does not define the phrase "responsible for the liabilities," this clause might be read to encompass non-U.S. subsidiaries whose swap-related obligations are guaranteed by a U.S. parent. It could also be interpreted more broadly to encompass families of entities the liabilities of which are consolidated from a financial reporting point of view, or require counterparties to perform veil-piercing or course of dealing analyses under state corporate law to determine if corporate separateness would in fact be honored. These outcomes are incompatible with how markets operate and, particularly with respect to subjective veil-piercing or course of dealing analyses, unworkable in practice. Counterparties would be unable to meaningfully evaluate whether a U.S. affiliate is responsible for the liabilities of the non-U.S. entity facing the counterparty. We believe that clause (i)(B) of the proposed U.S. person

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2 Proposed Guidance, 77 Fed. Reg. at 41,218.

3 CEA Section 2(i) (7 U.S.C. § 2(i)).

4 *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30,596, 30,624 (May 23, 2012) (to be codified at 17 C.F.R. pts. 1 & 240)

> Consistent with the Proposing Release, the Commissions interpret 'person' as used in the swap dealer and security-based swap dealer definitions to refer to a particular legal person. Accordingly, the dealer definitions will apply to the particular legal person performing the dealing activity, even if that person's dealing activity is limited to a trading desk or discrete business unit, unless the person is able to take advantage of a limited designation as a dealer. (footnotes omitted).

5 Proposed Guidance, 77 Fed. Reg. at 41,218.

definition would impose new and impracticable due diligence requirements, thus introducing regulatory uncertainty regarding the treatment of particular transactions. This potential reach also would be incompatible with the focused extraterritorial principle in the statutory text of Dodd-Frank, noted above.

Even if "responsible for" is construed to apply only to explicit guarantees, we believe this is an ill-advised approach. We acknowledge the CFTC's discussion of the impact on the U.S. financial markets of the activities of certain non-U.S. subsidiaries of troubled U.S. financial institutions when the U.S. parents guaranteed the transactions of the offshore subsidiaries (*e.g.*, AIG, Lehman). We respectfully suggest, however, that reliance upon these precedents is misplaced as a justification to regulate non-U.S. subsidiaries as U.S. persons solely due to the presence of a U.S. parent guarantee. Among the primary purposes of Dodd-Frank is to enhance the ability of U.S. regulators to effectively regulate the activities of systemically important participants in the U.S. financial markets. The ability of the Financial Stability Oversight Committee to designate entities as systemically important, and thus subject to heightened prudential regulation, is a fundamental component of Dodd-Frank. Enhancements to the transparency of the derivatives market effected by Dodd-Frank are also an important response to this concern. We understand that Congressional intent in adopting these and other provisions of Dodd-Frank was to provide U.S. regulators with the tools needed to address the next AIG or Lehman before such an entity becomes a systemic threat to the U.S. financial system.

While the breakdowns noted by the CFTC were indeed troubling, we believe that the appropriate regulatory response is to enhance the ability of the CFTC and other U.S. regulators to more effectively regulate systemically important U.S. financial institutions at the parent level. Dodd-Frank already provides these tools. Seeking to achieve this result by sweeping the activities of non-U.S. subsidiaries into a definition of U.S. person for purposes of extending regulatory scope on a heretofore unprecedented extraterritorial basis is not necessary to achieve that result. In addition, we believe this approach would not be justified on a cost-benefit basis, and would also violate existing international law principles, as well as long-standing principles of comity.

We therefore believe the reference accompanying footnote 2 above is the correct approach, and urge the CFTC to clarify this intent by striking the inconsistent statement occurring later in the Proposed Guidance.

On a related point, we believe that under well-established principles of extraterritorial jurisdiction in the global financial markets, a fund or other collective investment vehicle that is organized outside of the United States would not be viewed as a U.S. person, and this conclusion would not be affected if the fund's investment manager (or other service provider) were located in the United States. While nothing in the Proposed Guidance specifically addresses this point, given the scope of the changes to existing concepts of the scope

of the definition of "U.S. person" that is contained in the Proposed Guidance, we believe it is important for the CFTC not to adopt any interpretation of that term that would capture such a fund. Such a result would flatly contradict long-standing principles of domestic and international law, and impose significant costs and inefficiencies upon the global funds market. We also note that such an outcome would impair the ability of U.S. investors to avail themselves of investment opportunities provided by non-U.S. funds, and also impair the ability of U.S.-based investment managers to compete in the market for non-U.S. based funds. There is no policy basis to so fundamentally reorder existing regulatory practice in this area.[6]

Finally, we believe that the U.S. person definition should not be subject to ongoing regulatory uncertainty. The proposed definition states that "the term 'U.S. person' would include, *but not be limited to*" certain categories of persons.[7] Because market participants need to know whether or not they are U.S. persons, we respectfully urge the Commission to state exactly which entities are U.S. persons, so that those entities that do not fall within the listed categories can be sure they are not U.S. persons and will not be subject to U.S. swaps regulation unless otherwise made subject to that regulation by other provisions of the interpretive guidance.

We are aware of a number of other commenters that have suggested that the CFTC defer the effectiveness of the definition of U.S. person for purposes of these rules, so that the market and the regulators can devote the time needed to address these and other issues. We strongly support that suggestion.

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6 We note that this point has also been made in the comment letter on the Proposed Guidance submitted by Cleary Gottlieb Steen & Hamilton LLP on behalf of the several firms named therein (August 16, 2012). We fully support the position on this point set forth in that letter.

7 Proposed Guidance, 77 Fed. Reg. at 41,218 (emphasis added).

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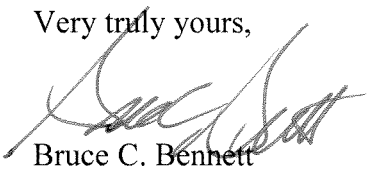
We appreciate the opportunity to comment on the Proposed Guidance. If we can be of any further assistance regarding these matters, please feel free to contact Bruce C. Bennett (212-841-1060; bbennett@cov.com) or Allison P. Lurton (202-662-5576; alurton@cov.com) of Covington & Burling LLP.

Very truly yours,



Bruce C. Bennett

cc: Honorable Gary Gensler, Chairman
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott D. O'Malia, Commissioner
Honorable Mark P. Wetjen, Commissioner
Carlene S. Kim, Assistant General Counsel
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