AMERICANS
FOR FINANCIAL REFORM
ACCOUNTABILITY * FAIRNESS * SECURITY

**Americans for Financial Reform**
**1629 K St NW, 10th Floor, Washington, DC, 20006**
**202.466.1885**

August 27, 2012

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

Re: RIN Number 3038–AD57 ; Cross-Border Applications of Certain Provisions of the Commodity Exchange Act

Dear Mr. Stawick:

On behalf of Americans for Financial Reform, thank you for the opportunity to comment on the proposed exemptive order regarding compliance with certain swaps regulations. Americans for Financial Reform is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, religious and business groups as well as independent experts and academic economists.

## SUMMARY AND OVERVIEW

### Significance of This Guidance

Modern financial markets are inherently global in scope. We have learned this lesson in many crises, most recently and painfully in the world financial collapse of 2008. Nowhere is the globalization of financial markets more evident than in the derivatives market. As CFTC Chair Gary Gensler has stated with respect to this rule:

> "Swaps executed offshore by U.S. financial institutions can send risk straight back to our shores. It was true with the London and Cayman Islands affiliates of AIG, Lehman Brothers, Citigroup and Bear Stearns. A decade earlier, it was true, as well, with Long-Term Capital Management. The nature of modern finance is that large financial institutions set up hundreds, if not thousands of ''legal entities'' around the globe… Many of these far-flung legal entities, however, are still highly connected back to their U.S. affiliates."

Chairman Gensler's statements are confirmed by extensive experience and data. Bloomberg News has documented that large Wall Street banks routinely transact well over half of their

swaps business through foreign subsidiaries.[1] Furthermore, these large institutions manage their revenues as integrated global entities, making little distinction based on the locations of gains and losses. As one scholar has stated:[2]

> "Despite their corporate complexity, LCFIs [Large Complex Financial Institutions] tend to be managed in an integrated fashion along lines of business with only minimal regard for legal entities, national borders or functional regulatory authorities. In most cases, the nominal location of the swaps transaction makes little difference to the risk that transaction poses to the parent company."

These realities underline the importance of this guidance. The decisions made by the CFTC with regard to its cross-border jurisdiction are enormously important to the success of derivatives regulation as a whole. Inadequate cross-border regulation will make it simple to evade derivatives oversight by simply shifting transactions to foreign affiliates. Congress clearly recognized the significance of this issue, as it directed that the CFTC apply its regulations to any derivatives activity anywhere in the world with a "direct and significant connection with activities in, or effect on, commerce of the United States".[3] In the same section, the CFTC is given extensive anti-evasion authority to pursue cross-border transactions that are undertaken for the purpose of regulatory arbitrage.

**Overview Of Recommendations**

This guidance takes some real positive steps in affirming CFTC jurisdiction over a variety of cross-border transactions. However, it falls well short of closing potential cross-border loopholes. It is crucial that participants in the derivatives markets are not able to shift the nominal location of transactions that impact U.S. markets in order to evade Dodd-Frank rules, while potentially leaving the risk of the transaction with U.S. taxpayers. At the entity level, this is an application of the basic principle of consolidated supervision of internationally active financial holding companies, as recommended by the Bank of International Settlements.[4] At the transaction level, it is critical for ensuring full application of standards designed to ensure the safety and stability of the market. This proposal does not achieve that goal.

The problems with the proposed guidance are organized around two crucial weaknesses. The first is the decision to exempt even guaranteed subsidiaries of U.S. firms from the definition of 'U.S. person'. Combined with the narrow range of direct CFTC supervision for non-U.S. persons, this opens up significant scope for the vast network of foreign affiliates of U.S.

---

[1] See Brush, Silla, "Goldman Sachs Among Banks Lobbying To Exempt Half of Swaps From Dodd Frank", Bloomberg News, January 30, 2012.
[2] Herring, R. and J. Carmassi, 2009, "The Structure of International Financial Conglomerates: Complexity and Its Implications for Systemic Risk," Chapter 8 in the *Oxford Handbook of Banking*, edited by A. Berger, D. Molyneux, and J. Wilson, Oxford University Press
[3] Section 2(i) of the Commodity Exchange Act, as added by Section 722 of the Dodd Frank Act.
[4] Bank of International Settlements, "Core Principles for Effective Banking Supervision", Consultative Document, December, 2011.

companies to escape full regulatory oversight. Guaranteed subsidiaries should be classified as US persons.

The second is the apparent failure to define the term 'guaranteed' in a way that will reliably capture the large grey area between the most obvious and explicit guarantees and less formal guarantees. This proposal would make non-guaranteed affiliates of U.S. firms almost completely exempt from transaction-level derivatives requirements such as clearing, margining, documentation, and execution. Thus, the apparently extensive possibilities for classifying affiliates as non-guaranteed could create a truly major loophole in derivatives regulation. Given the difficulties of determining the distinction between guaranteed and non-guaranteed affiliates on a case by case basis, this issue is best addressed through a rebuttable presumption that affiliates are guaranteed.

A third issue involves the problems with the extensive use of substituted compliance in this proposal. The past record of substituted compliance at the CFTC raises deep concerns about the scope proposed in this guidance.

The recommendations below address the problems with this proposal. As the first two recommendations would also greatly narrow the scope of substituted compliance in the proposal, they are particularly important.

1) Guaranteed affiliates of U.S. persons should be defined as U.S. persons: This step would recognize the economic reality that a guarantee of a foreign affiliate transfers risk to the U.S. economy and U.S. taxpayers. The refusal to acknowledge this is the source of many of the potential loopholes in derivatives oversight that would be created by this proposal. However, it is easily addressed by making clear that a 'U.S. person' includes a guaranteed affiliate.

2) Create a rebuttable presumption that affiliates are guaranteed, and require affirmative demonstration that a subsidiary is not guaranteed: A critical feature of this proposal is that non-guaranteed foreign subsidiaries of companies active in the U.S. swaps market can escape a wide range of crucial requirements for derivatives transactions. Yet the vast number of subsidiary entities in global financial corporations, the complex range of guarantees that can exist, and the vagueness of the definition of 'guarantee' in this guidance, mean that it will be almost impossible for the CFTC to reliably determine which subsidiaries are actually guaranteed. This is potentially a major loophole. This issue should be addressed by requiring affiliates to demonstrate that they are not guaranteed through legal documentation of an effective firewall. Documentation of this firewall should be shared with all derivatives customers as well as with regulators.

3) Eliminate or significantly narrow the scope for 'substituted compliance' or the substitution of foreign regulation for Dodd-Frank regulation: This guidance would create

a vast new scope for substituted compliance. Making substituted compliance available to all guaranteed affiliates of U.S. persons as well as all non-U.S. persons would expand the potential eligibility for substituted compliance beyond anything in the CFTC's history. The historical record indicates that this is a deeply impractical and problematic path. Substituted compliance has historically been extraordinarily unreliable. The limited resources available to the agency mean that there will be a great temptation to allow substituted compliance to become a meaningless rubber stamp and a form of de facto deregulation, which all too often it has been in the past.

4) To the extent any substituted compliance is used, the comparability determination process must be extensive and real: Unless it is backed up by a real and thorough process to determine genuine comparability between regulatory regimes, substituted compliance is simply a form of disguised deregulation. One strength of the current proposal is the stated commitment to a thorough and detailed process of comparability determination. This commitment must be maintained, and industry calls for a 'principles based' comparability procedure must be resisted. Such calls are simply an effort at backdoor deregulation.

The four recommendations above are discussed in detail below. An additional issue, not discussed in detail in this submission, is the fact that this proposal would create a near-complete exemption of transactions between foreign affiliates of U.S. companies that are not designated swaps entities (swap dealers or major swaps participants) from key Dodd-Frank derivatives requirements such as clearing and margining.[5] In general, AFR does not favor this sweeping exemption. Besides eliminating derivatives protections for some level of transactions, it would deprive swaps exchanges and clearinghouses of transaction volume necessary to reach efficient scale. However, the exact magnitude of the exemption depends on the ability of sizable swaps market players to evade entity designation. We are continuing to examine this issue.

As a final note, the guidance offers the Commission the ability to ensure a U.S. leadership role in setting a high standard for global derivatives regulation. The principles of derivatives oversight have been agreed on among the G-20 countries and the International Association of Securities Commissions (IOSCO). However, the U.S. is leading the way in fleshing out the details of these principles and potentially creating a strong implementation framework for them. A strong cross-border guidance will make clear that the U.S. intends to follow through on properly implementing these principles and will not enable a 'race to the bottom' in which incentives are created for derivatives affiliates of global banks are able to relocate to areas of lax regulation to take advantage of an inadequate 'substituted compliance' regime. This will not only ensure beneficial safeguards for both U.S. taxpayers and the global financial system, it will protect U.S. jobs by removing possible incentives to conduct derivatives business overseas.

[5] See Appendix C on CFR 41237-41238.

The Commission should rise to this challenge by setting the bar at a high level for global swaps regulation in the final guidance. Doing so will create natural incentives for other countries to properly implement their own derivatives protections. In contrast, an ability for foreign affiliates of U.S. banks to evade Dodd-Frank derivatives safeguards through slapdash 'substituted compliance' will create incentives for foreign countries to establish regulatory havens, in order to attract U.S. firms who wish to engage in unregulated financial activity. Although the jobs resulting from such relocation will go overseas, the risk will remain with U.S. taxpayers.

## DETAILED DISCUSSION OF RECOMMENDATIONS

### Guaranteed Affiliates Of U.S. Persons Should Be Defined As U.S. Persons (Question 1a)

A major weakness of this proposal is the ambivalence concerning whether guaranteed foreign affiliates of U.S. persons or companies are defined as U.S. persons. (The Commission requests comment on this issue in Question 1a of the proposal). Guaranteed affiliates of U.S. persons should absolutely be defined as U.S. persons. If this single step were taken, many weaknesses of the proposal would be immediately improved, ranging from the overreliance on substituted compliance to the ability to evade entity designation and Dodd-Frank regulation by routing transactions through foreign affiliates.

At numerous points such guaranteed affiliates are explicitly distinguished from U.S. persons and stated to be non-U.S. persons. But when combined with other provisions in the guidance, classifying guaranteed affiliates of U.S. companies as non-U.S. persons would create major and dangerous limitations on the regulatory coverage of the Dodd-Frank Act. This decision would render effectively all foreign affiliates of any U.S. company eligible for substituted compliance, could allow major swaps participants and swap dealers to evade proper designation by dealing with guaranteed foreign affiliates of U.S. counterparties, and finally exempts all foreign affiliates of US companies not designated as swap dealers or MSPs from any Dodd-Frank coverage whatsoever.

However, it is worth noting the actual definition of 'U.S. Person' in the guidance would appear to include guaranteed subsidiaries. The definition (CFR 41218) states that U.S. person includes:

> "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 each case that is either (A) organized or incorporated under the laws of the United States or having its principal place of business in the United States 29 (''legal entity'') 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"

Prong (B) of this definition would seem to capture guaranteed affiliates of U.S. companies as U.S. persons. In such cases a U.S. person clearly is responsible for the liabilities of the subsidiary entity. Yet the proposal immediately (CFR 41218) goes on to state that:

> "By contrast [with a branch], 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."

Simply on the face of it this statement conflicts with the definition of 'U.S. person' immediately beforehand. The contrast between guaranteed subsidiaries and branches does not usefully distinguish subsidiaries, as the fact that the subsidiary is guaranteed eliminates even the theoretical bankruptcy remoteness of the subsidiary, which is the major difference between the two types of entities that would justify differential treatment.[6]

A 2011 report by the International Monetary Fund explicitly compares subsidiary and branching structures and makes the point that the distinction is often more apparent than real.[7] The report acknowledges a theoretical distinction between the structures, but emphasizes that in practice the differences are often limited:

> "Despite a clear legal distinction between branches and subsidiaries, however, they may in practice sometimes be operated and managed in a similar fashion. In some countries, branches work effectively as independent entities. In others, subsidiaries may function similarly to branches, subject to centralized risk management established at the group level and funding decisions, and are dependent on their parents for funding." (p. 7)

This would clearly be the case for guaranteed subsidiaries.

The implication in the initial definition that guaranteed subsidiaries will be classified as U.S. persons is the correct decision and should be held to throughout the guidance. The Commission should make clear that guaranteed affiliates of U.S. companies are U.S. persons. The guidance should be revised to eliminate any implication or ruling that they are not, or that any separate category of 'non-U.S. persons guaranteed by U.S. persons' exists.

The Commission itself has provided in the guidance a succinct summary of why guaranteed affiliates of U.S. persons are for all intents and purposes U.S. persons. Referring to situations where the U.S. person guarantees the derivatives activities or liabilities of its foreign affiliate, the Commission states (CFR 41218):

> "In such situations, the risk of the swaps executed abroad are effectively transferred to or incurred by the U.S. person. Or stated differently, the risk of the affiliate's swap transactions have a direct and significant connection to, or effect on, the U.S. person that is the guarantor."

---

[6] As discussed in the next subsection, the bankruptcy remoteness of even technically non-guaranteed subsidiaries is questionable.

[7] Fiechter, Johnathan et. al, IMF Staff Discussion Note, "Subsidiaries or Branches: Does One Size Fit All?", International Monetary Fund, March 7, 2011. p. 4

For all intents and purposes, the activities of the guaranteed foreign affiliate are the activities of the U.S. parent, since any risks of such activities are transferred by the guarantee. This certainly meets the 'direct and significant' test and it directly exposes U.S taxpayers and the U.S. economy to harm created by the failure of such an affiliate. It is crucial that this economic reality be properly reflected in the guidance. Based on the rules applying to non-U.S. persons in rest of the proposal, the failure to do so would have significant negative effects. These include an inappropriate expansion of the scope of substituted compliance, issues regarding entity designation, and a broad scope of exclusion for U.S. persons that are not designated swaps entities.

**Create A Rebuttable Presumption That Subsidiaries Are Guaranteed, and Require Affirmative Demonstration That a Subsidiary is Not Guaranteed**

A major potential loophole in this proposal is the exclusion of non-guaranteed subsidiaries of U.S. firms from all transaction-level derivatives requirements. Transactions between two non-guaranteed subsidiaries of U.S. firms, or transactions between a guaranteed and non-guaranteed subsidiary, would be completely exempt from clearing, margining, trade execution, portfolio compression, and documentation requirements. Not even substituted compliance would apply. This includes cases where the subsidiaries were affiliated with U.S. based swap dealers, or are themselves designated as swap dealers that were not U.S. persons.[8]

It is true that certain entity-level requirements would continue to apply to non-guaranteed foreign subsidiaries of U.S. swaps entities, on a substituted compliance basis. Yet even leaving aside the issue of the adequacy of substituted compliance (discussed below), this is not sufficient to accomplish the goals of the Dodd-Frank Act. Entity level requirements such as capital requirements and swaps data reporting are helpful steps and it is a positive step to require them of all subsidiaries. This requirement should certainly be maintained – if it were dropped from the guidance the door would be opened even wider to large-scale evasion of derivatives protections.

However, transaction-level requirements provide crucial protections that are not replicated by entity level protections. Clearing and margin requirements are central systemic protections that are not adequately replicated by institution-level capital requirements. Prudential regulators have found that aggregate capital requirements were arbitraged and evaded in ways that would be far more difficult for transaction-level margin and clearing requirements to be gamed or avoided.[9] And execution and public reporting requirements provide forms of price transparency that are crucial to rendering derivatives markets more reliable and creating price competition to benefit end users.

[8] A small amount of protection is offered here by the maintenance of transaction-level requirements swaps solicited by a foreign affiliate but booked in the U.S. parent. But this will not prevent the outsourcing of swaps to be booked in foreign affiliates.

[9] See Basel Committee on Banking Supervision, 2009, "Strengthening the Resilience of the Banking Sector, Bank for International Settlements".

The Commission has nonetheless proposed to create a broad exemption from transaction level requirements for transactions through non-guaranteed affiliates. This is apparently justified by the claim that the U.S. economy is insulated from transactions conducted by non-guaranteed affiliates as such transactions may be bankruptcy remote. This justification is deeply flawed.

Identifying Whether An Affiliate Has a Guarantee Is An Extraordinarily Complex Task, And Must Take Into Account Implicit As Well As Explicit Guarantees

The claim that subsidiaries without an explicit guarantee are bankruptcy remote and insulated from the US economy, or that their liabilities do not affect the financial health of the wider holding company is at best a classroom argument. It can be theoretically true under certain circumstances but is highly likely to fall apart in the real world. There is extensive historical experience showing that for reputational reasons financial institutions may find it necessary to take on the liabilities of subsidiaries that are not explicitly guaranteed. In addition, the complexity of internationally active financial institutions makes the interdependencies between subsidiaries extraordinarily hard to determine.

A recent example of the importance of implicit guarantees is the collapse of Bear Stearns, which was brought down by the failure of non-guaranteed hedge fund affiliates. These hedge funds were foreign affiliates technically not guaranteed by the parent, and the investment by the parent company in the funds was minimal. However, the firm was forced to try to save the funds for reputational reasons and also because a fire sale of subsidiary assets could have seriously impacted correlated positions held by the parent company.[10] The reputational impact of the funds' eventual failure was catastrophic and created an immediate downgrade of the parent company and eventually a run on the bank by trading partners.[11]

The example of Bear Stearns is only one among many instances where parent companies have been forced to rescue failing affiliates even in the absence of an explicit guarantee. Another striking and prominent recent example of the difficulty of determining whether an implicit guarantee is available is the practice of implicit recourse for securitization vehicles.[12] Indeed, SPVs were specifically designed to be as independent as possible from the initially sponsoring bank, yet reputational concerns made widespread assistance necessary during the financial crisis even in the face of serious solvency concerns for the sponsoring banks.

Expert examinations of the subsidiary structure as it actually plays out in global financial firms almost uniformly state that the distinction between branches and subsidiaries is far murkier in practice than in theory. As in the case of Bear Stearns, reputational concerns and market

[10] Creswell, Julie and Vikas Bijaj, "$3.2 Billion Move By Bear Stearns to Rescue Fund", NY Times, June 23, 2007.
[11] Ryback, William, "Case Study on Bear Stearns", Toronto Centre on Financial Supervision,
[12] Acharya, Viral V., Schnabl, Philipp and Suarez, Gustavo, Securitization Without Risk Transfer (October 20, 2011). AFA 2010 Atlanta Meetings Paper.

expectations can be overwhelming regardless of explicit guarantees. As Walter Wriston, the former chair of Citibank, stated flatly in testimony before Congress[13]:

> "It is inconceivable that any bank would walk away from any major subsidiary of its holding company"

Or to quote a more recent piece by the General Counsel of the New York Federal Reserve[14]:

> "As a general rule, banks do not become insolvent independently of their affiliates because a loss of confidence in any bank affiliate affects the bank."

The previously cited report by the International Monetary Fund also emphasizes the role of reputational factors in creating implicit guarantees:[15]

> "Under either structure [branches or subsidiaries], however, reputational risks and confidence effects may limit the ability to limit contagion, with problems in one part of the group quickly threatening the viability of the rest." (p. 4)

The complexity of the corporate structures of large, internationally active financial institutions makes the issue even more tangled. Scholars have found that such institutions have 2.5 times as many subsidiaries as large internationally active manufacturing firms, and evolve still more complexity in their subsidiary structures for the purposes of regulatory and tax arbitrage.[16] Even the nature of explicit guarantees can require extensive research into legal documents.

Adding to the complexity is the fact that global banks are run as unified business entities where funding flows within the structure in ways that do not align with legal entities[17]:

> "Despite their corporate complexity, LCFIs [Large Complex Financial Institutions] tend to be managed in an integrated fashion along lines of business with only minimal regard for legal entities, national borders or functional regulatory authorities. Moreover, there are often substantial interconnections among the separate entities within the financial group. Baxter and Sommer (2005) note that, in addition to their shared (although possibly varying) ownership structure, the entities are likely to be linked by cross-affiliate credit relationships, cross-affiliate business relationships and reputational relationships."

---

[13] Wriston, W. (1981). "Testimony," Hearings before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, Part II, 97th Congress, 1st session, October 29, 589-590.
[14] Baxter, Thomas C., Jr., Joyce Hansen, and Joseph H. Sommer, 2004, "Two Cheers for Territoriality: An Essay on International Bank Insolvency Law", *The American Bankruptcy Law Journal* 78(1), Winter, 57–91.
[15] Fiechter, Johnathan et. al, IMF Staff Discussion Note, "Subsidiaries or Branches: Does One Size Fit All?", International Monetary Fund, March 7, 2011. p. 4
[16] Herring, R. and J. Carmassi, 2009, "The Structure of International Financial Conglomerates: Complexity and Its Implications for Systemic Risk," Chapter 8 in the *Oxford Handbook of Banking*, edited by A. Berger, D. Molyneux, and J. Wilson, Oxford University Press
[17] Herring and Carmassi op. cit.

Thus, funding relationships coexist with and may differ from any legal guarantee structure. Such funding relationships can create dependencies within the holding company that differ from legal vulnerability to bankruptcy claims, and create additional motivations for implicit guarantees.

The point is not that it is impossible for a financial institution to walk away from a subsidiary, this can and has happened. (Although it seems doubtful that an institution would choose to book derivatives in such a subsidiary, as counterparties would insist on a risk premium). The point is that the question of whether a guarantee exists for any subsidiary is an extraordinarily complex and challenging one. The question must incorporate implicit as well as explicit guarantees. It requires assessing market expectations across numerous markets, and also requires penetrating a very complex corporate and transactional structure.

The Commission Must Presume a Guarantee Exists And Require That Subsidiaries Affirmatively Demonstrate That They Are Not Guaranteed

Given the complexity of determining the implicit and explicit guarantee status of potentially hundreds if not thousands of significant subsidiaries, and vastly more derivatives transactions within those subsidiaries, the Commission would face almost insurmountable practical barriers to accurately determining the nature of guarantees. A clear solution to this problem is to establish a rebuttable presumption that subsidiaries are guaranteed. To rebut this presumption should require the affirmative demonstration of a genuine firewall between subsidiary activities and the parent company. This removes the burden of demonstrating guarantees from the Commission to the regulated entity.

Such an affirmative demonstration should include legal documentation that clearly states that the parent company (or other guaranteed subsidiaries of the parent company) will not assist the non-guaranteed subsidiary in case it cannot meet its liabilities, along with evidence that such legal documentation is routinely shared with counterparties. Furthermore, the subsidiary seeking non-guaranteed status should provide evidence that other activities within the holding company are not dependent on transfers of funding from the subsidiary, and also that lending and derivatives relationships with the subsidiary are priced as though the subsidiary is a stand-alone company. Finally, the issue of market expectations and the question of whether the subsidiary failure would result in a credit rating downgrade for the parent company must be examined.

This type of rebuttable presumption is clearly justified by the extensive evidence of routine implicit guarantees within financial conglomerates, the interdependent funding relationships within such conglomerates, and the complexity of determining the presence of even explicit guarantees. The burden of proof must be on the subsidiary or institution seeking relief from Dodd-Frank rules to ensure the lack of a direct connection to U.S. commerce and to insure that the health of the U.S. financial system is insulated from the possible failure of a subsidiary.

**The Commission Should Eliminate or Significantly Narrow the Scope for Substituted Compliance**

The Historical Record Indicates Substituted Compliance is Unreliable

As detailed in other comments on this Guidance (e.g. the comments by Michael Greenberger and Public Citizen), the record of such substituted compliance is deeply problematic. For example, the well-known 'London loophole' that permitted oil traders to evade U.S. limits on oil speculation was a result of a substituted compliance arrangement with the British Financial Services Authority.[18] Even after more recent CFTC actions such as no-action letters in 2008, the regulation of foreign exchanges permitted to access the U.S. market under substituted compliance was not truly comparable with that required under U.S. law.[19] The comment by Professor Greenberger details a long history of other examples of lax regulation and evasion of CFTC rules enabled by 'substituted compliance' decisions. This includes examples of inadequate regulation of foreign entities permitted to operate in the United States under the lax rules of their home country supervisor, as well as instances of U.S. entities evading adequate regulation by locating activities overseas.

Yet despite these proven difficulties this guidance creates a very large role for substituted compliance. This guidance permits substituted compliance for essentially any requirement applying to affiliates of U.S. companies located outside the United States, no matter how tightly integrated they are in the overall global corporate structure or the level of guarantees from the parent company. This is far too broad a role. One step towards narrowing the scope of substituted compliance would be to define guaranteed affiliates of U.S. entities as U.S. persons, as discussed above.

Extensive Use of Properly Controlled Substituted Compliance Will Be Impractical

The Commission only has 10 FTEs currently devoted to international negotiation and coordination.[20] Since 1986, the Commission has averaged roughly one international Memorandum of Understanding completed each year, and these MOUs were in areas far less complex than the full suite of Dodd-Frank derivatives regulation. As further discussed below, the Commission has correctly pointed out in this guidance that determinations of comparability will require careful, detailed comparisons of both foreign regulatory regimes and their enforcement across a large number of specific areas of derivatives regulation. To be done correctly, these comparability determinations will and should take time and resources. (The statement on CFR 41233 of the proposal that the Commission will 'work closely with the National Futures Association' to develop this procedure is hardly reassuring with respect to these resource shortages, as it could involve outsourcing some of the key decisions in the entire derivatives regime to an outside body). If the Commission attempts to rely on substituted compliance for all foreign affiliates of US companies, it will be under enormous pressure to either delay proper

[18] Mandaro, Laura, "CFTC Moves To Close 'London Loophole' ", Wall Street Journal Market Watch, June 17, 2008.
[19] http://www.cantwell.senate.gov/public/index.cfm/press-releases?ID=dc9be816-9f02-4f6c-a737-b8ff54f063aa
[20] A request to Congress for expansion to 16 FTEs has been made but it is unclear whether this request will be met.

application of Dodd-Frank requirements or to simply 'rubber stamp' foreign oversight as acceptable.

**If substituted compliance is permitted, the comparability determination process must be thorough and ensure both rules and enforcement are truly comparable**

If and where substituted compliance is permitted, making it work at all will require an entirely new and much deeper commitment by the CFTC to establishing an effective procedure for determining comparability. Past examples of informal, broad, so-called 'principles-based' comparability determinations are simply not acceptable or practical in this context. As the Commission must recognize from its own work, effective derivatives regulation rests on the nature and enforcement of many specific and detailed requirements across a wide range of areas.

The Strengths of The Comparability Procedure In This Guidance Must Be Maintained

It is a positive aspect of this proposal that it does lay out a more comprehensive and thorough process of comparability determination. A key element of this process is the separate determinations of comparability in 14 enumerated areas of derivatives regulation, with substituted compliance only allowed in those areas specifically determined to be comparable.[21] Another important commitment is the statement that comparability will be determined based not only on the regulations of the foreign jurisdiction, but also based on the compliance program used to enforce those rules. Rules without enforcement are not effective, so this is crucial as well.

The stated commitment to a thorough and detailed process of comparability determination must be maintained in the final guidance. The Commission must resist calls from industry to substitute a 'principles-based' process, and to determine comparability based only on whether the U.S. regime shares 'broad regulatory goals' with the foreign jurisdiction.[22] Such a process simply would not determine actual comparability. A generalized commitment to 'mandatory clearing' is worthless if local regulators exempt the great majority of swaps from the mandate and do not consistently enforce the mandate even for required swaps. This example can be repeated across many areas. Indeed, the fact that the G-20 nations have already agreed on very high-level principle for derivatives oversight could be used to argue that under a 'principles-based' regime the Commission should simply rubber-stamp all signatory countries as compliant with Dodd-Frank derivatives protections – an obvious absurdity.

The detail included in the Dodd-Frank statutory language shows that Congress intended that regulators enforce a complete and detailed derivatives regime. It would be ironic and deeply disturbing if, having worked two years to specify the details of U.S. derivatives rules, the

[21] Footnote 122 CFR 41233.
[22] Comment by International Swaps and Derivatives Association on RIN 3038-AD57, available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58356&SearchText=

Commission simply permitted foreign affiliates of U.S. companies to transact free of those rules in any jurisdiction that made a vague conceptual commitment to derivatives oversight.

The Comparability Procedure Should Be Made More Transparent And An Opportunity For Public Comment Should Be Added

The only commitment to public transparency for comparability determinations in this guidance is the statement that comparability determinations will be posted on the internet once made. But it is important that the process be made transparent earlier in the determination process, before any comparability determination is made. The public should be allowed to comment with the Commission on requests for substituted compliance. To this end, applications for comparability should be made public, and the key documentation supporting a determination of comparability should be made available to the public online.

We appreciate the opportunity to comment on the proposed rule. If you have any questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

Americans for Financial Reform

## Following are the partners of Americans for Financial Reform.

*All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.*

- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services

- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners

- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

***List of State and Local Signers***

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH

- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter,  National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon

- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

***Small Businesses***

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET