

February 6, 2013

VIA ELECTRONIC MAIL

Ms. Melissa Jurgens  
Secretary  
U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
Washington, DC 20581

**Re: Further Proposed Guidance Regarding Compliance With Certain Swap Regulations (Cross Border), RIN 3038-AD85, 17 CFR Chapter 1**

Dear Ms. Jurgens:

The Investment Adviser Association<sup>1</sup> appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission" or "CFTC") further proposed guidance on the definition of "U.S. person" for purposes of determining the application of provisions relating to swaps in Title VII of the Dodd-Frank Act to activities outside the United States ("Further Proposed Guidance").<sup>2</sup> We applaud the Commission's further consideration of comments and continued consultation with U.S. and foreign regulators on the cross-border application of swaps regulation. We also welcome the Commission's evolving approach to cross-border guidance as the Commission engages in its review and consultation. We request, however, that the Commission further modify the definition of U.S. person in its final cross-border guidance, as discussed below.

Initial Proposed U.S. Person Definition

Under Section 2(i) of the Commodity Exchange Act ("CEA"), the swaps provisions of the CEA that were added by the Dodd-Frank Act do "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."<sup>3</sup> The Commission initially published for comment

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<sup>1</sup> The Investment Adviser Association ("IAA") is a not-for-profit association that represents the interests of investment adviser firms registered with the Securities and Exchange Commission ("SEC"). Founded in 1937, the IAA's membership consists of more than 550 firms that collectively manage in excess of \$10 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our website: [www.investmentadviser.org](http://www.investmentadviser.org).

<sup>2</sup> *Further Proposed Guidance Regarding Compliance with Certain Regulations*, 78 Fed. Reg. 909 (Jan. 7, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-31734a.pdf>.

<sup>3</sup> Section 2(i) of the CEA states, "[t]he provisions of this chapter [1 relating to commodities exchanges] relating to swaps that were enacted by the [Dodd-Frank Act] (including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States unless those activities — (1) have a direct

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a proposed order on July 12, 2012 that would grant market participants temporary conditional relief from certain provisions of the Dodd-Frank Act and also proposed for comment its interpretive guidance and policy statement (“Proposed Guidance”) regarding the cross-border application of the swap provisions of the CEA and the definition of “U.S. person” for purposes of implementing Section 2(i) of the CEA.<sup>4</sup>

In the Proposed Guidance, the Commission stated that it proposed to interpret the term “U.S. person” by reference to the extent to which swap activities or transactions involving one or more such person have the relevant effect on U.S. commerce. Specifically, the Commission stated that the term “U.S. person” “can be helpful” in determining the level of U.S. interest for purposes of analyzing and applying principles of international comity when considering the extent to which U.S. transaction-level requirements should apply to swap transactions.<sup>5</sup> In September 2012, the IAA urged the Commission to narrow its proposed definition of “U.S. person” and exclude certain non-U.S. funds because the proposed definition would capture non-U.S. entities with little nexus to the U.S. or to the U.S. swaps markets.<sup>6</sup>

#### Further Proposed U.S. Person Definition

On January 7, 2013, the Commission adopted temporary exemptive relief under an order (“Order”) that provides that a non-U.S. person that registers as a swap dealer (“SD”) or major swap participant (“MSP”) may delay compliance with certain entity-level requirements of the CEA and CFTC regulations thereunder, and non-U.S. SDs and MSPs may delay compliance with certain transaction-level requirements of the CEA and CFTC regulations thereunder, both until July 12, 2013.<sup>7</sup> For purposes of the Order, the CFTC adopted a

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and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of this chapter that was enacted by the [Dodd-Frank Act].”

<sup>4</sup> See *Exemptive Order Regarding Compliance With Certain Swap Regulations*, 77 Fed. Reg. 41110 (Jul. 12, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-16498a.pdf>; *Cross Border Application of Certain Swaps Provisions of the Commodity Exchange Act*, 77 Fed. Reg. 41214 (Jul. 12, 2012), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-16496a.pdf>.

<sup>5</sup> See Proposed Guidance, 77 Fed. Reg. at 41218.

<sup>6</sup> See *Letter from Monique S. Botkin, Assistant General Counsel, Investment Adviser Association, to Mr. David A. Stawick, Secretary, CFTC re: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act*, RIN 3038-AD57, 17 CFR Chapter 1 (Sept. 6, 2012) (“September 2012 IAA comment letter”), available on the IAA’s website at: [https://www.investmentadviser.org/eweb/docs/Publications\\_News/Comments\\_and\\_Statements/Current\\_Comments\\_Statements/120906cmnt.pdf](https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/120906cmnt.pdf).

<sup>7</sup> *Final Exemptive Order Regarding Compliance With Certain Swap Regulations*, 78 Fed. Reg. 858 (Jan. 7, 2013), available at <http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-31736a.pdf>.

temporary definition of “U.S. person,” but noted that it was not yet adopting a final definition of “U.S. person” for purposes of its cross-border guidance. Under the Order, the Commission defined “U.S. person” similarly, but not identically, to the definition of “U.S. person” in the CFTC staff’s October 12, 2012 No-Action Letter regarding SD and MSP compliance.<sup>8</sup>

At the same time the CFTC adopted the Order, it published for comment the Further Proposed Guidance regarding alternatives to two previously proposed categories of “U.S. persons” for which swaps provisions in Title VII of the Dodd-Frank Act would apply to swap transactions outside the United States, where one or both of the counterparties to the swap are “U.S. persons.” In particular, the Commission proposes alternative prong (ii)(B) relating to U.S. owners responsible for the liabilities of non-U.S. entities<sup>9</sup> and alternative prong (iv) addressing pools and funds majority-owned by U.S. persons. We comment here only with respect to alternative prong (iv).

#### Proposed Alternative Prong (iv)

The Commission’s proposed alternative prong (iv) would include as a “U.S. person:” “(iv) [a] commodity pool, pooled account, investment fund, or other collective investment vehicle that is not described in prong (ii) and that is directly or indirectly majority-owned by one or more persons described in prong (i) or (ii), except any commodity pool, pooled account, investment fund, or other collective investment vehicle that is publicly-traded but not offered, directly or indirectly, to U.S. persons.” This definition, the Commission noted, “is intended to capture collective investment vehicles that are created for the purpose of pooling assets from U.S. investors and channeling these assets to trade or invest in line with the

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<sup>8</sup> *CFTC No-Action Letter 12-22, Time-Limited No-Action Relief: Swaps Only With Certain Persons to be Included in Calculation of Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant*, (Oct. 12, 2012), available at: <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/12-22.pdf> (the CFTC Division of Swap Dealer and Intermediary Oversight stated it will not recommend that the Commission take enforcement action against certain foreign entities for failure to include a swap executed prior to the earlier of December 31, 2012, or the effective date of a definition of “U.S. person” in a final exemptive order, in its calculations required under the SD and MSP definitions, so long as the counterparty to such swap does not fall within certain enumerated categories. The no-action letter also provided similar relief concerning certain swap transactions by certain foreign entities when the counterparty is a foreign branch of a person that falls within one of the enumerated categories and that intends to register as a SD.)

<sup>9</sup> Alternative prong (ii) would read: “(ii) A 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 a state or other jurisdiction in the United States or having its principal place of business in the United States or (B) directly or indirectly majority-owned by one or more persons described in prong (i) or (ii)(A) and in which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity (other than a limited liability company or limited liability partnership where partners have limited liability).”

objectives of U.S. investors, regardless of the place of the vehicle's organization or incorporation."<sup>10</sup>

While we understand the Commission's intent in formulating the proposal, we remain concerned that proposed prong (iv) of the definition of "U.S. person" goes beyond both the Commission's intent and the jurisdictional nexus set forth in the Dodd-Frank Act. Proposed prong (iv)'s focus on majority ownership (direct or indirect) would capture non-U.S. funds that are not created for the purpose of pooling U.S. assets and would include non-U.S. entities with little nexus to the U.S. or U.S. swaps markets or impact upon U.S. commerce or the U.S. financial system. An ownership test would focus on the activities of investors rather than the purposeful activities of the fund. A non-U.S. fund may have U.S. investors without engaging in marketing or offering to U.S. persons. Indeed, non-U.S. funds may not be aware that there are U.S. investors in their funds.<sup>11</sup> Many non-U.S. funds do not know their direct or indirect owners because such interests may be purchased through an intermediary or may be held in omnibus accounts. If fund shares are held through an intermediary or in an omnibus account, the intermediary or omnibus account holder may or may not be willing or able to provide representations regarding the status of the ultimate beneficial owners. Such third parties may also face additional layers that they would have to look through. Similarly, it would be very difficult to determine ultimate "indirect" ownership in a number of fund structures (*e.g.*, fund of funds). Further, ownership in a fund alone does not necessarily indicate that the non-U.S. fund has a "direct and significant" connection with U.S. commerce, as required by Section 2(i) of the CEA.

Instead of the proposed prong (iv) approach, we recommend the Commission consider defining the term "U.S. person" with regard to non-U.S. funds using concepts found in Regulation S under the Securities Act of 1933, as amended ("Securities Act"). In particular, Regulation S provides that Section 5 of the Securities Act does not apply to offers or sales of securities that "occur outside the United States." The SEC has defined and interpreted the concept of an offshore transaction and "U.S. person" under Regulation S as it applies to securities laws with certainty over the years. Non-U.S. funds have been operating under the Regulation S regime for decades to identify U.S. persons that would be excluded from offers or sales of the fund in order to be considered an offshore fund that does not need to register its securities under the Securities Act. We understand that these firms and funds already have systems in place to identify non-U.S. persons under Regulation S. In addition, we believe funds not organized or established in the U.S. and that are not offering or selling to U.S. persons (as defined in Regulation S) do not have a direct and significant connection with activities in, or effect on, U.S. commerce. Therefore, they should not be subject to CFTC rules in addition to the rules of their home jurisdiction.

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<sup>10</sup> Further Proposed Guidance, 78 Fed. Reg. at 913.

<sup>11</sup> While we appreciate the Commission's proposal to add an exception for publicly-traded funds to address commenters' concerns regarding ownership verification, other types of funds face ownership verification obstacles.

If the Commission does not modify its approach to this prong, we urge the Commission to clarify and expand the provision related to publicly-traded funds. First, the phrase “publicly-traded” in prong (iv) should be expanded to “publicly-traded or offered.” We believe this more accurately reflects the types of non-U.S. funds that have little to no nexus to the U.S. or U.S. swaps markets. For instance, open-end non-U.S. funds may not be publicly traded but rather publicly offered continuously for purchase with an updated offering document. Second, the clause “not offered, directly or indirectly, to U.S. persons” should be clarified to better reflect the concept of intent. For example, the clause should not be interpreted to assume that simply because a U.S. person is an investor in a fund that the fund must have indirectly offered the fund to U.S. persons. As long as a fund has reasonable procedures in place to prevent offerings to U.S. persons, the fund should not be considered a U.S. person. This is consistent with the purpose of including “indirectly” in the provision, which is to prevent firms from avoiding rules by deliberately doing indirectly what they are prohibited from doing directly.

Initial Proposed Prong (v)

Finally, it is not clear whether the Commission has removed prong (v) of the definition of “U.S. person” that appeared in the Proposed Guidance. Prong (v) provided that any commodity pool, pooled account, or collective investment vehicle the operator of which “would be required to register” as a commodity pool operator is a U.S. person. As noted in our September 2012 IAA comment letter, we had a number of concerns with this proposal.<sup>12</sup> Further, we understand that the goals of prong (v) would be covered by proposed prong (iv). Accordingly, if the Commission has removed prong (v), we strongly support that determination. If not, we urge the Commission to remove this prong in its final further guidance.

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<sup>12</sup> Our letter observed that the CFTC would be capturing many non-U.S. pooled vehicles managed by registered CPOs. These non-U.S. pooled vehicles have no direct and significant connection with activities in, or effect on, commerce of the United States. We further commented that these non-U.S. pools would be required to comply with various CFTC swap rules that may conflict with or duplicate non-U.S. rules to which these pools are also subject.

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The IAA appreciates the Commission's consideration of our comments on the Further Proposed Guidance defining which funds should be considered "U.S. persons" for purposes of the CEA's swaps regulation. We encourage the Commission to continue to coordinate with the SEC and foreign regulators in developing cross border guidance. Please contact the undersigned or Karen Barr, IAA General Counsel, at (202) 293-4222 if we may provide any additional information regarding our comments.

Sincerely,

/s/ Monique S. Botkin  
Assistant General Counsel

cc: The Honorable Gary Gensler, Chairman  
The Honorable Jill E. Sommers, Commissioner  
The Honorable Bart Chilton, Commissioner  
The Honorable Scott D. O'Malia, Commissioner  
The Honorable Mark P. Wetjen, Commissioner