February 6, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Comment on the CFTC's recent actions regarding the cross-border application of certain swaps regulations, RIN 3038-AD85

Dear Ms. Melissa Jurgens,

On January 7, 2013, the Commodity Futures Trading Commission (''CFTC'') issued a Final Exemptive Order and Further Proposed Guidance regarding the extraterritorial application of Dodd-Frank. This letter is submitted in response to the CFTC's request for comment on the Final Exemptive Order and Further Proposed Guidance.

In 2008-2009, the American taxpayer absorbed a multi-trillion-dollar cost to prevent a worldwide Second Great Depression, caused in large part by the unregulated, over-the-counter derivatives market. The foreign subsidiaries, affiliates, branches, agencies, and other related entities of U.S. firms contributed substantially to the insolvency of the U.S. parent financial institutions that required rescue, experienced bankruptcy, or were bailed out by the U.S. taxpayer. For example, the U.S. insurance conglomerate, AIG, required a $182 billion bailout after its U.K. subsidiary, AIG Financial Products, "nearly toppled the U.S. economy"[1] because of hundreds of millions of dollars uncollateralized and under-capitalized bets through naked credit default swaps that subprime borrowers would pay off their mortgages. Citibank and Bear Stearns suffered significant losses due to trades by their Cayman Island affiliates,[2] and JPMorgan recently lost $6.2 billion on swaps trades performed by the "London Whale."[3] Clearly, foreign subsidiaries and affiliates of U.S. entities pose a direct risk to the U.S. and world economy, requiring the U.S. taxpayer to be the lender of last resort for those U.S. parent companies

Despite the critical issues at stake, when drafting the Final Exemptive Order and Further Proposed Guidance, the CFTC completely ignored substantial and significant comments from those who wanted to emphasize the key policy which should under pin issues on extraterritoriality: protection of U.S. taxpayers' interests. No mention in these orders was made

[1] Financial Crisis Commission Report, p. 350 *Available at*: http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf
[2] Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act; Proposed Rule, Appendix 2 – Statement of Chairman Gary Gensler, 77 Fed. Reg. 41238, (July 12, 2012) (hereinafter "Gensler Statement").
[3] *Id*.

of the August 27, 2012 comments filed by, for example, Americans for Financial Reform,[4] Public Citizen's Congress Watch,[5] and Better Markets, [6] and the below signatories arguing the subsidiaries and affiliates of U.S. parent financial institutions need to immediately be made subject to Dodd-Frank as the language and purpose of Section 722(d) of that statute requires.

Instead, the CFTC focused its complete and exclusive attention on the August 27, 2013 comments from the financial services industry, domestic and foreign banks, as well as international regulators, who are opposed any extraterritorial reach authorized by Section 722(d) without any consideration of the exposure of U.S. taxpayers to another round of multi-trillion dollar bail outs of U.S parent financial institutions who will otherwise fail because of reckless trading by their foreign subsidiaries and affiliates.[7] As we show below, the U.S. taxpayer was also asked to bail out completely foreign banks for their foreign transactions in order to prevent their collapse causing cascading systemic risk. Accordingly, the only policy balance was that of weighing the interests of the worldwide financial services industry and foreign regulators without a word about protecting the U.S. taxpayer from a repeat of 2008-2009 or worse – that further bail outs are unlikely because of political and economic reasons, thereby leading to worldwide economic collapse.

We respectfully but strongly disagree with the CFTC's one-sided presentation of the record herein (taking into account only those August 27 comments of Wall Street and the foreign regulators), and oppose the Further Proposed Guidance, particularly with regard to the proposed alternative definition of U.S. person, which by excluding U.S. financial institutions' foreign subsidiaries and affiliates during the exemptive period contravenes not only the essential purposes of Dodd-Frank generally, but the broad authority given the CFTC in Section 722(d) to protect U.S. taxpayer and U.S. economic interests.

If the CFTC maintains its present course, it should frankly state that it is willing to put the U.S. taxpayer, the U.S economy, and perhaps the world economy at risk by considering only the interests of foreign regulators and Wall Street when establishing policy under the broad reach of Section 722 of Dodd-Frank and when deciding that Wall Street is now given a road map to encourage outsourcing of swaps trading (and avoid Dodd-Frank) by choosing to execute trades

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[4] Americans for Financial Reform, Comment Letter to CFTC, "RIN Number 3038-AD57; Cross Boarder Applications of Certain Provisions of the Commodity Exchange Act." August 28, 2012. Available at http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2012/08/AFR-CFTC-Cross-Border-Comment-letter-8-27-12.pdf. Americans for Financial Reform is a coalition of more than 250 national, state and local consumer, labor, investor, civil rights, community, small business, and senior citizen organizations that have come together to spearhead a campaign for real reform, fighting for a banking and financial system based on accountability, fairness and security.

[5] Public Citizen's Congress Watch is a group dedicated to public education and advocacy on a variety of issues including consumer financial protection. *See* http://www.citizen.org/congress/ for additional information.

[6] Better Markets, Comment Letter to CFTC, "Proposed Interpretive Guidance and Policy Statement: Cross Boarder Application of Certain Swaps Provisions of the Commodity Exchange Act , RIN Number 3038–AD57." August 27, 2012. Available at http://bettermarkets.com/sites/default/files/CFTC-%20CL-%20Cross%20Border%20Application%20of%20swaps%20provisions%208-27-12.pdf. Better Markets is a nonprofit organization that promotes the public interest in the capital and commodity markets, including in particular the rulemaking process associated with the Dodd-Frank Act.

[7] Discussed in further detail *infra*.

in foreign subsidiaries and affiliates that are controlled by Wall Street and other big U.S. financial interests.

**Scope of this Comment Letter**. This comment letter will proceed in five parts. First, it will assert that the CFTC contravenes the spirit of the Administrative Procedure Act by describing the entirety of the record as one-sided portrayal of the issues at stake in the cross-border application of Title VII of Dodd-Frank. Second, our comments will assert that none of the definitions of U.S. person provided by the CFTC to date are sufficient to protect the U.S. taxpayer from the risks of foreign subsidiaries and affiliates of U.S. financial institutions. This is because the broad definitions of U.S. person essentially mean that very few entities will be classified as U.S. persons, which will allow all systemically risky institutions to easily avoid Dodd-Frank by trading through foreign subsidiaries and affiliates. Third, this letter will urge the CFTC to avoid any further delays of the exemptive period past July 13, 2013 because foreign regulators' are moving slowly to establish substituted compliance regimes. Fourth, our comments will address the alternate proposal for aggregation of affiliates' swaps transactions outlined in the Further Proposed Guidance. Finally, the comments will advocate that where substituted compliance applies, it must be utilized as a last resort and be strictly construed as a meaningfully effective alternative to Title VII of Dodd-Frank.

## I. The CFTC has prevented meaningful participation in this proceeding by only considering the August 27 comments of Wall Street and foreign regulators and by ignoring all comments filed with protection of the U.S. taxpayer and the U.S. economy in mind.

By wholly ignoring the substantial and fully developed comments made in a host of August 27, 2012 comments emphasizing the importance of protecting the U.S. taxpayer and the U.S. economy, the CFTC contravenes at the very least the spirit of the Administrative Procedure Act ("APA").[8] Under Section 553(c) of the APA (a provision embedded in due process), the CFTC must afford notice, a meaningful opportunity to comment, and a meaningful response to the comments filed.[9] In order to develop a record for potential judicial review, courts have required agencies to "identify the major issues in the proceeding; explain the agency's reasoning on those issues; and establish that the agency has indeed identified and taken a hard look at all the relevant factors."[10] Thus, while an agency need not "discuss every item of fact or opinion included in the submissions made to it in informal rule making," courts expect a rulemaking record to show "what major issues of policy were ventilated by the informal proceedings and why the agency reacted to them as it did."[11] That was not done in the orders at issue here.

While we understand that the CFTC has been careful to avoid calling the Proposed Guidance documents a rule-making per se, in fact both are labeled as a "proposed rule" in the Federal Register and the substance of these orders will likely be more meaningful than the form

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[8] Pub. L. 79-404, 60 Stat. 237 (1946) (codified at 5 U.S.C. §500 et. seq.) (hereinafter "APA").

[9] 5 U.S.C. § 553(c).

[10] H.R. Rep. No. 112-294 at p. 17 (citing Auto. Parts & Accessories Assn. v. Boyd, 407 F.2d 330, 338 (D.C. Cir. 1968) and US v. Nova Scotia Food Prod. Corp., 568 F.2d 240, 252-53 (2d Cir. 1977). *Available at*: http://www.gpo.gov/fdsys/pkg/CRPT-112hrpt294/pdf/CRPT-112hrpt294.pdf

[11] Auto. Parts, 407 F.2d at 338.

chosen by the CFTC in determining the public's right to comment here.[12] In this regard, one of the basic purposes of the APA is to provide for public participation.[13] The APA commands that an agency "give interested persons an opportunity to participate in the rulemaking."[14] Additionally, "[matters] of great importance, or those where the public submission of facts will be either *useful to the agency or a protection to the public*, should naturally be accorded more elaborate public procedures."[15]

Needless to say, in responding to the comments filed on February 6, 2013, the CFTC can mostly cure the problem identified above by expressly dealing with the substantive comments made by us, AFR and Better Markets on August 27th, as well as giving the same consideration to the comments filed herein. What we are worried about is a repeat of the one sided analysis going forward, i.e., the CFTC continuing to only consider and worry about the grievances of Wall Street and foreign regulators with no consideration of the exposure these decisions have, inter alia, on the U.S. taxpayer. In that vein, we have resisted the temptation of a whole sale repetition of the August 27, 2012 comments. Again, we ask that those comments be re-read and we incorporate by reference all of those comments, hoping that they will be fully taken into consideration going forward.

## II. None of the definitions of "U.S. person" published by the CFTC to date adequately protect the U.S. taxpayer because many U.S. institutions will not be regulated by Title VII of Dodd-Frank during the exemptive period

The CFTC has published three definitions of "U.S. Person" to date, and each definition is increasingly narrower, as every new version excludes additional U.S. controlled entities from being considered a U.S person and from regulation under Title VII of Dodd-Frank during the exemptive period. As explained in this section, the definitions put forth by the CFTC provide systemically risky U.S. controlled institutions with an array of easy options to avoid Dodd-Frank regulation in the exemptive period.

This section will briefly discuss the three definitions of U.S. person either now being used or proposed by the CFTC. In so doing, we describe why each of these definitions can be used to undercut the purposes of Dodd-Frank by allowing important and systemically risky U.S. controlled financial institutions to engage in regulatory arbitrage.

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[12] *See* Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act; Proposed Rule,77 Fed. Reg. 41214 (July 12, 2012) and Further Proposed Guidance Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 909 (Jan. 7, 2013).

[13] Tom C. Clark, "Attorney General's Manual on the Administrative Procedure Act" (1947). available at http://www.law.fsu.edu/library/admin/1947i.html.

[14] 5 U.S.C. § 553(c).

[15] Administrative Procedures Act: Legislative History, S. Doc. No. 248, at 259 (1946); Charles H. Koch Jr., 1 Administrative Law and Practice 329-30 (2010) (emphasis added).

## A. July 12, 2012 proposed definition of U.S. person

On July 12, 2012, the CFTC proposed a complex definition of the term "U.S. person"[16] that, if ever adopted, would determine the scope of extraterritorial application of Title VII of Dodd-Frank in two contexts. First, all entities who are U.S. persons must fully comply with Title VII regulations.[17] Second, the definition of U.S. person will determine which foreign entities will be required to register with the CFTC as a swaps dealer, and thus comply with Dodd-Frank,[18] because a foreign entity (or non U.S. person) must register when it transacts at least $8 billion in swaps (the *de minimis* test) with U.S. persons.[19] As such, by proposing a narrow definition of U.S. person that can be gamed to exclude many U.S. controlled entities, the CFTC July definition creates a significant loophole in Dodd-Frank.

Under the July definition, business entities are U.S. persons if they are organized or incorporated under the laws of the United States, or have a principle place of business in the U.S. The July definition of "U.S. Person" also includes entities where the "direct or indirect owners" of a legal entity are one or more U.S. persons. The foreign branches or agencies of U.S. persons are also encompassed in the July definition. However, the CFTC also included a significant exclusion in the aforementioned definition of U.S. person, by exempting from Dodd-Frank, a U.S. person's foreign affiliates and subsidiaries. It appears to be true (although exceedingly difficult to confidently comprehend) that a foreign subsidiary or affiliate formally "guaranteed" by the U.S. parent revert to a U.S. person insofar as a foreign swap dealer execution of trades with that "guaranteed" foreign entity will satisfy be the $ 8 billion de minimus threshold which requires Dodd-Frank registration for trades with U.S. persons.[20]

As explained in our and AFR's August 27 comment letters, however, the "guarantee" rule in and of itself is confusing in the extreme and, at places contradicted by the CFTC in other parts of its July 12, 2012 order. As argued by Americans for Financial Reform in its August 27, 2012

[16] The full definition of U.S. person includes, but is not limited to "(i) Any natural person who is a resident of the United States; (ii) any corporation, partnership, [LLC], business…or any form of enterprise similar…that is either (A) organized or incorporated under the laws of the United States of having its principle place of business in the United States, or (B) in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more such owners is a U.S. person; (iii) any individual account…where the beneficial owner is a U.S. person; (iv) any commodity pool, pooled account, or collective investment vehicle [with majority ownership held by a U.S. person]; (vi) a pension plan for the employees…of a legal entity with its principle place of business inside the United States; and (vii) and estate or trust [whose income is subject to U.S. taxes]." 77 Fed. Reg. at 41218.

[17] 77 Fed. Reg. at 41229-30. Entities categorized as non-U.S. persons would be permitted to substitute compliance with a comparable home jurisdiction regulatory regime.

[18] If an entity must register with the CFTC, then the registration requirement triggers the other requirements of Title VII of Dodd-Frank. *See* 77 Fed. Reg. 41219. However, under the Proposed Guidance, these foreign entities would be allowed to substitute compliance with their home jurisdiction in certain circumstances, discussed *infra*. *See* 77 Fed. Reg. 41229.

[19] Similarly, "U.S. person" is also used to determine which swaps will count for determining whether an entity must register as a major swap participant.

[20] 77 FR 41218 ("Under this interpretation, the term 'U.S. person' generally means that a foreign branch or agency of a U.S. person would be covered by virtue of the fact that it is a part, or an extension, of a U.S. person. By contrast, 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*.") (emphasis added).

comment letter, foreign bank affiliates that are clearly associated with the parent institution are generally be seen by the market as having an implicit guarantee.[21] This would certainly be the case if the majority of the subsidiary's total liabilities are explicitly guaranteed, as would apparently be permissible under these rules even if the affiliate was not classified as a U.S. person and was not classified as a guaranteed affiliate. To address this problem, the Commission should establish a rebuttable presumption that foreign affiliates are guaranteed by the parent company, and require clear evidence that the market has been explicitly informed that the parent will not stand behind affiliate liabilities in the event of a default or bankruptcy. This solution was offered by both Americans for Financial Reform and Better Markets in their comments on the July guidance, and is described in more detail there.[22]

The July order also has the bizarre effect of encouraging "outsourcing" by trading activities and thus outsourcing, for example, U.S. jobs to foreign affiliates and subsidiaries rather than execute trades directly in the U.S[23]

It is also true that the July guidance provides that a foreign entity has "direct and significant" connection to U.S. commerce (and thus is subject to Dodd-Frank) when such foreign entity transacts in at least $8 billion in swaps with U.S. person counterparties or counterparties that are guaranteed by a U.S. person.[24] In theory, these foreign entities would then be required to register with the CFTC and comply with Dodd-Frank,[25] but foreign institutions can easily avoid reaching $8 billion in swaps with U.S. persons. This is because few entities are otherwise a U.S. person, and U.S. institutions can easily route trades through their own myriad of foreign subsidiaries and affiliates so these trades always fall under the $8 billion threshold. In fact, there are reports that U.S. institutions like Morgan Stanley and Goldman Sachs are already using and advising foreign entities to in seriatim fashion to avoid going over the $ 8 billion test.[26] In short, the CFTC has yet again provided a road map for foreign affiliates and subsidiaries (as well as truly foreign banks) from having to register under Dodd-Frank.

### B. The interim definition of U.S. person in effect Until July 12, 2013 restricts even further the reach of "U.S. Person"

As of January 7, 2013, the CFTC is utilizing a substantially narrower definition of "U.S. person" than is found in the July 12 order for the period of time that the Exemptive Order applies.[27] The January 2013 Exemptive Order draws from both the July 2012 Proposed Guidance and a staff CFTC No Action Letter.[28] It is more restrictive than the July definition because it

[21] Americans For Financial Reform, Comment on CFTC Proposed Cross-Border Guidance, August 27, 2012.
[22] Americans For Financial Reform, Comment on CFTC Proposed Cross-Border Guidance, August 27, 2012; Better Markets, Comment on CFTC Proposed Cross-Border Guidance, August 27, 2012.
[23] This is particularly true since swaps that are directly executed in the U.S. must comply with Dodd-Frank and are generally ineligible for substituted compliance (discussed *infra*).
[24] 77 Fed. Reg. at 41219, 41221. Also, "U.S. person" is also used to determine which swaps will count for determining whether an entity must register as a major swap participant.
[25] Or substitute compliance with a comparable regime as discussed at 77 Fed. Reg. 41232-33.
[26] http://www.reuters.com/article/2012/12/02/us-banks-regulation-derivatives-idUSBRE8B10F220121202
[27] i.e. until July 12, 2013, at least for the time being.
[28] CFTC Letter No. 12-22, "Re: 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

excludes additional U.S. controlled entities from being U.S. persons.[29] Most notably, in addition to still excluding foreign affiliates and subsidiaries, the interim definition also excludes business entities that are directly or indirectly owned by a U.S. person even where the U.S. person is responsible for that entity's liabilities.[30] This appears to wholly undercut (without saying so expressly or clearly) that part of the July 12 order (itself completely opaque in this respect) making "guarantees" by U.S. controlled entities of their subsidiaries and affiliates a vehicle for triggering Dodd-Frank regulation. With this addition, it now appears that U.S. institutions do not need to change express guarantees to implicit guarantees to avoid Dodd-Frank. The January 2013 order now allows U.S. guarantees of foreign subsidiaries and affiliates to exist without in any way interfering with the application of Dodd-Frank.

### C. The Further Proposed Guidance for defining the term U.S. Person is even narrower (that is affects too few U.S. controlled foreign entities) than the July definition

Unfortunately, the Further Proposed Guidance is even narrower than the July definition because even more U.S, controlled entities are excluded. For example, the Further Proposed Guidance definition excludes an entity that is directly or indirectly majority-owned owned by a U.S. person unless the owner also "bears *unlimited responsibility* for the obligations and liabilities of the legal entity."[31] In contrast, the July 2012 definition included entities owned by a U.S. parent if the U.S. parent was simply "responsible for the liabilities" of the owned entity. "Unlimited responsibility" as defined in the Further Proposed Guidance means "ultimately liable for the entity's obligations and liabilities."[32] For all practical purposes, this means that a U.S. person could be responsible for 99% of an affiliate's obligations, yet that affiliate's swaps *would not be regulated by the CFTC*.

It is also possible that the January definition is an attempt to draw a distinction between guarantees of the swaps alone and unlimited responsibility for all of the entities' liabilities. Based on the combination of this new proposal and the Cross-Border Guidance proposed in July, the CFTC apparently would not classify a foreign affiliate as a U.S. person even if the entity's swaps were guaranteed by the U.S. parent. This awkward compromise will be difficult to enforce and will doubtless invite various forms of evasion. The CFTC is apparently relying on current market practice where the swap guarantor is generally listed in the ISDA master swaps agreement. Presumably when the parent company signs as a swaps guarantor for all of the affiliates, that action, too, will not cause the affiliate or subsidiary to be deemed a U.S. Person.

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Calculation of Whether a Person is a Major Swap Participant," (Oct. 12, 2012). *Available at*: http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-22.pdf

[29] 78 Fed. Reg. 863. Note, the CFTC will also not treat entities that are incorporated outside the U.S. but have a principle place of business within the U.S. as U.S. persons until April 1, 2013.

[30] 78 Fed. Reg. at 863. The interim definition also excludes commodity pools and collective investment vehicles, even where the commodity pool operator is required to register with the CFTC

[31] 78 Fed. Reg. 909, 912 (Jan. 7, 2013) (emphasis added). Compare to the July definition, which included entities owned by a U.S. person where the U.S. person was "responsible for the liabilities" of the entity. *See* 77 Fed. Reg. at 41218. Additionally, the January definition directly excludes Limited Liability Companies, and Limited Liability Partnerships, as well as excluding commodity pools and collective investment vehicles such as hedge funds.

[32] 78 Fed. Reg. at 912.

In sum, each successive definition of U.S. person adopted or proposed by the CFTC increasingly provides systemically risky, Too Big to Fail U.S. institutions with innumerable options to evade Dodd-Frank, and as such each definition should be rejected in favor of a broad definition that applies without exception to U.S. companies' foreign affiliates and subsidiaries.

### D. None of the three published definitions properly account for overseas risks presented by systemically risky institutions

None of the three definitions of U.S. person published by the CFTC should become the final guidance because in each case, the American taxpayer still retains the risk for bailing out the U.S. financial institutions; or as is most likely in the present political and economic climate, not bail out the U.S. institution and pay the prices through The Second Great Depression. This is because numerous multinational parent U.S. institutions engage in the swaps market, and operate thousands of foreign subsidiaries.[33] For example, as of late 2011, Goldman Sachs operated over 1600 foreign subsidiaries; while Morgan Stanley operated nearly 1300, and Citigroup utilized over 700, and JPMorgan held 451 foreign subsidiaries.[34] These systemically risky, Too Big to Fail institutions already have the corporate structures in place to simply route trades via one or even multiple foreign subsidiaries and, under each of the "U.S. Person" definitions avoid the $ 8 billion threshold test for foreign swaps dealer registration.

## III. The Further Proposed Guidance aggregation alternative must be drafted to avoid encouraging market participants to avoid Dodd-Frank by dividing swaps among complex subsidiary structures

As the Proposed Guidance itself points out, the complexity of the subsidiary structure for global banks means that there are opportunities for banks to split derivatives transactions between their affiliates in order to fall below *de minimis* thresholds as a general matter and just not to avoid the extraterritorial reach of Dodd-Frank. The Commission states, correctly, that a lax rule on aggregation would:[35]

> "provide an incentive for firms to spread their swap dealing activities among several unregistered affiliates rather than centralize their swap dealing in registered firms. Such a result would increase systemic risks to U.S. market participants and impede the Commission's ability to protect U.S. markets"

We share this concern and believe it is of the highest importance to avoid this outcome. Any rule that did not require significant aggregation of swaps business across subsidiaries would create the danger of risk spreading that the Commission has outlined. Dividing swap dealing between subsidiaries to evade registration would make regulatory oversight more difficult and increase systemic risk. These risks should not be disaggregated, but aggregated. Again, failure of subsidiaries self-evidently leads to the failure of the parent, thereby triggering in the Too Big to

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[33] Dafna Avraham, Patricia Selvaggi, and James Vickery, Federal Reserve Bank of New York Economic Policy Review, "A Structural View of U.S. Bank Holding Companies,"65, pp. 66-67, July 2012. *Available at*: http://www.newyorkfed.org/research/epr/12v18n2/1207avra.pdf

[34] *Id*. at p. 71.

[35] CFR 911-912.

Fail world the U.S. taxpayer Hobson's choice of multi-trillion dollar bailouts or the Second Great Depression.

At the same time, the Commission appears concerned that the current aggregation rule under regulation 1.3(ggg) (4) would lead to excessive burdens on non-U.S. affiliates engaged in genuinely *de minimis* activity, without any benefit to the public interest. To address this problem, the Commission asks for comment on two alternatives:

> "Would it be appropriate that non-U.S. persons are not required to include in the *de minimis* calculation the swap dealing transactions of their U.S. affiliates under common control? Alternatively, should non-U.S. persons be permitted to exclude from the *de minimis* calculation the swap dealing transactions of their U.S. affiliates under common control that are registered as SDs?"

It is difficult to fully assess these alternatives in the absence of more detail. For example, it is important in both alternatives to continue to require aggregation across all non-U.S. affiliates of a global bank. Such aggregation would effectively capture transactions spread across multiple foreign affiliates. Without such aggregation, it would be much easier to avoid registration. In any new aggregation rule, it is important to preserve aggregation across foreign affiliates under common control, particularly those guaranteed by a U.S. parent.

In general, we believe that the second alternative suggested by the Commission – excluding from *de minimis* calculation only the swap dealing transactions of U.S. affiliates that are registered as swap dealers – is much preferable to the first. The first alternative, permitting the broad exclusion of all swaps transactions conducted through U.S. affiliates, would apparently permit two groups of affiliates, one group within the U.S. and another non-U.S. group, to both do swaps transactions up to the *de minimis* level. This would create an incentive to split transactions between U.S. and non-U.S. subsidiaries in order to fall below the *de minimis* threshold. In contrast, the second alternative would only permit a single group of bank affiliates to take advantage of the *de minimis* threshold. Effectively, the second alternative would exclude a group of bank affiliates who both individually and collectively fell below the swap dealer *de minimis* threshold to forego registration. This seems like a sensible compromise, so long as aggregation across foreign affiliates is maintained. However, these aggregation standards will not come into effect so long as the CFTC continues to delay the compliance deadlines of Dodd-Frank. as shown immediately below.

## IV. The CFTC should not grant further delays on the cross-border reach of Dodd-Frank to U.S. controlled or dominated institutions

The Final Exemptive Order delays compliance with Dodd-Frank until July 12, 2013. U.S. controlled institutions and foreign regulators have known full well for at least two and one-half years that U.S. controlled subsidiaries and affiliates would be subject to Dodd-Frank. Congress went out of its way in enacting Section 722(d) to say that the American taxpayer cannot be exposed to cross border transactions that have a direct and significant effect on U.S. commerce. That provision seeks to prevent the foremost worry of Congress that the U.S. taxpayer not be called upon again to bail out U.S. controlled institutions that are put at risk by their foreign

entities. Similarly foreign financial institutions operating in the U.S. have also been on notice of Dodd-Frank's extraterritorial reach.

Meanwhile, the advent of high-frequency trading,[36] problems with the EU's financial stability, along with international networks of foreign affiliates allows banks to quickly move "trillions of dollars a day around the world" considerably raise the stakes that foreign entities controlled by U.S. parents will trigger a further worldwide crisis in the absence of the transparency and capital adequacy Dodd-Frank dictates to what is otherwise highly toxic financial derivatives trading[37]

Similarly, foreign banks operating within the United States pose a clear and present danger to the U.S. and world economy. For example, a Bloomberg Freedom of Information Act request to the Federal Reserve showed that numerous foreign banks sought and received emergency funds from the Federal Reserve during the 2008 financial crisis.[38] For example, the Royal Bank of Scotland borrowed $84.5 billion; Barclays borrowed $64.5 billion, Dexia, $58.5 billion, and Norinchukin Bank, $22 billion.[39] Nearly five years later, despite using the American taxpayer as an almost interest-free lender of last resort, foreign banks and their regulators are resisting, or even opposing, Dodd-Frank regulation[40] or foreign regulation akin to Dodd-Frank while the global swaps market remains largely unregulated.[41] As such, any extension of the CFTC's Final Exemptive Order prolongs the American taxpayer's exposure to market risk by exempting far too many entities from Dodd-Frank regulations until July 12, 2013. The fear is that the CFTC will slide down the slippery slope of granting further delays (and further exposure to the U.S. taxpayer and the U.S. economy) by sympathizing with important foreign governments and institutions that will not create the kinds of transparent and capital adequacy protections that mimic Dodd-Frank.[42]

The CFTC continually acknowledges that foreign jurisdictions have proven very slow to regulate, and that some jurisdictions may even abandon meaningful regulations. However, further delay beyond July 12, 2013 cannot be motivated by exclusively promoting "comity"[43]

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[36] Nick Baumann, Too Fast to Fail: Are high-speed traders hurtling toward the next FINANCIAL MELTDOWN, MOTHER JONES, Jan./Feb. 2013, available at http://www.michaelgreenberger.com/files/Mother_Jones_JANFEB_2013.pdf.

[37] *Dimon on Price Wars, Volcker Rule, Stock Prices* (Fox Business broadcast Feb. 13, 2012), *available at* http://video.foxbusiness.com/v/1450367194001/dimon-on-price-wars-volcker-rule-stock-prices/.

[38] The Fed's Secret Liquidity Lifelines, BLOOMBERG, available at http://www.bloomberg.com/data-visualization/federal-reserve-emergency-lending/#/overview/?sort=nomPeakValue&group=none&view=peak&position=24&comparelist=&search=.

[39] *Id*. This list is not exclusive, but shows that banks from many countries, including the U.K, France, and Japan received emergency loans from the Fed. In fact, numerous foreign banks received multi-billion dollar loans from the Fed during the financial crisis.

[40] The CFTC received comments from foreign banks, including Deutsche Bank, Societe Generale, the Hong Kong Association of Banks, the Japanese Bankers Association, the Institute of International Bankers, and the Australian Bankers Association.

[41] The FSB's most recent report notes that some jurisdictions have made progress toward implementation of G20 OTC Derivatives commitments, but jurisdictions have been "urged" to finalize their legislation and regulations. P. 39*Available at*: http://www.financialstabilityboard.org/publications/r_121031a.pdf

[42] For additional analysis on this point, *see* Michael Greenberger, Comment Letter, (Aug. 13, 2012)

[43] 78 Fed. Reg. at 877; *See also* 77 Fed. Reg. at 41223.

and "harmonization"[44] with foreign governments. Those concerns have been given too much deference without any deference being given to the risk delay has on the U.S. taxpayer.[45] These foreign regulators who criticize the impact of Section 722 (d) and ask for indefinite delay of Dodd-Frank where U.S. interests are clearly at stake completely disregard the fact that U.S. taxpayers have already once been called upon to save the world's banks to the tune of multi-trillion dollars.

The frailty of the present July 12, 2013 deadline for applying Dodd-Frank to foreign subsidiaries and affiliates is made wholly transparent by the CFTC's express acknowledgement the CFTC "intends to consider extending the effectiveness of exemptive relief at its expiration based on, among other things, whether and when substituted compliance"[46] becomes available for foreign financial institutions. Again, the CFTC's apparent only concern here is express deference to foreign regulators without any similar expression that U.S taxpayer remains at risk during such further delays, especially during what is widely considered to be a period in which the world is still facing widespread economic weakness.

Nearly four years after international regulators met to discuss preventing future financial crises, foreign jurisdictions continue to delay complying with their G20 Pittsburgh Summit Commitments ("G20 Commitments").[47] In fact, recent activity in the European Commission ("EC") indicates that some foreign jurisdictions may even abandon meaningful swaps regulation.

On December 19, 2012, the EC adopted nine "technical standards" for implementing its G20 Commitments.[48] These technical standards are subject to a "right of scrutiny" by the European Parliament and European Council, which can last up to six months.[49] Thus, Europe's regulatory framework would only be in place when the Exemptive Order expires on July 12, 2013, provided that the Parliament or Council do not object to the technical standards. Unfortunately, the European Parliament is already showing signs of not only delaying, but rejecting meaningful swaps regulation.[50] The European Parliament's Economic and Monetary Affairs Committee voted on February 4, 2013 to hold a full parliamentary vote to consider *rejecting* two of the nine standards.[51] This would then require the European Securities and

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[44] 78 Fed. Reg. at 874.

[45] *See* Michael Greenberger, Comment Letter, Aug. 27, 2013, p. 9-16. In this comment letter, we provided detailed analysis of extraterritoriality of U.S. statutes showing that comity and harmonization of regulations cannot be used to restrict the cross-border scope of Dodd-Frank where U.S. interests are clearly at stake.

[46] 78 Fed. Reg. 861

[47] Financial Stability Board, "OTC Derivatives Market Reforms: Fourth Progress Report on Implementation," pp7-8, Oct. 31, 2012. For more information regarding the G20 Commitments, *see* Ella Kokotsis, "The G20 Pittsburgh Summit Commitments," issued Sept. 25, 2009, provided by the University of Toronto, Munk School of Global Affairs. *Available at*: http://www.g20.utoronto.ca/analysis/commitments-09-pittsburgh.html

[48] European Commission, Press Release, Dec. 19, 2012. *Available at*: http://europa.eu/rapid/press-release_IP-12-1419_en.htm

[49] European Commission, "EMIR: Frequently Asked Questions," *Available at*: http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/doc_121114_emirfaqs_en.pdf

[50] Philip Stafford, "Further Delays for Clearing Rules," Financial Times, Feb. 4, 2013. *Available at* http://www.ft.com/cms/s/0/43959c62-6f11-11e2-b6da-00144feab49a.html#axzz2KB9FDzze

[51] Huw Jones, "EU Lawmaker Panel Rejects Key Derivatives Rules," Reuters, Feb. 4, 2013. *Available at*: http://www.reuters.com/article/2013/02/04/eu-derivatives-idUSL5N0B47X820130204 *See also* Erin Coe, "EU Lawmaker Panel Shoots Down OTC Derivatives Rules," Law360, Feb. 4, 2013. *Available at*: http://www.law360.com/banking/articles/412804/eu-lawmaker-panel-shoots-down-otc-derivatives-rules

Markets Authority ("ESMA") to redraft the rejected standards.[52] If ESMA is required to redraft the technical standards, member nations would have to review the new proposals,[53] which could add months (if not years) to regulatory delay.

There is substantial evidence that other foreign jurisdictions will not have comprehensive regulations in place for years, much less by July 12, 2013. For example, Australia will not have swaps reporting regulations in place until mid-2013, and will "phase in" a reporting obligation over the course of two years,[54] meaning mid-2015 at best. Similarly, while Singapore recently passed legislation addressing the G20 Commitments, regulations will not come into effect until around the third quarter of 2013.[55] Even then, Singapore "will likely start with implementing the reporting mandate [alone because] this will help [Singapore] better formulate the implementation of clearing and other mandates[.]"[56] Thus, it is unlikely Singapore will have clearing or margin requirements until at least sometime in 2014, since these regulations will be dependent upon the results of reporting that will not begin until late 2013. Finally, there are reports that other Asian regulators claim they "cannot finalise rules of their own" until the U.S. and the EU finish regulating, and the result is that "Asian regulation and clearing infrastructure lags behind that of the US and the EU, *in many cases deliberately so*."[57] This creates a vicious cycle—the CFTC delays compliance deadlines in deference to foreign regulators, while Asian regulators delay regulatory action until the CFTC finalizes regulations. This cycle must be broken or Dodd-Frank delays will be lengthy or even perpetual.

A recent IMF study found that the present worldwide Over the Counter derivatives market is substantially under-collateralized.[58] This means that the contagion caused by a failing entity would easily spread in the financial markets because the institutions lack the collateral necessary to pay obligations that can result from counterparty risk.[59] We therefore urge the CFTC reject any further delays in cross border compliance with trades clearly affecting U.S. interests beyond the current expiration date of the July 12, 2013.[60] It is mere common sense that cross border application of Dodd Frank will prod foreign governments to move more quickly. Moreover, as a time saving measure, it is also likely that cross border compliance with Dodd-Frank will become a ready-made template for foreign regulation.

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[52] *Id*. *See also* Huw Jones, Reuters, "EU Parliament in Talks to Challenge New Derivatives Rules," Jan. 21, 2013. *Available at*: http://www.reuters.com/article/2013/01/21/eu-derivatives-idUSL6N0AQ5YI20130121
[53] *Id*.
[54] ISDA, "APAC Monthly Update," p. 3 December, 2012.
[55] Singapore Business Review, "Singapore Gears up for Derivative Regulations," Nov. 29, 2012. *Available at*: http://sg.finance.yahoo.com/news/singapore-gears-derivative-regulations-013700131.html
[56] *Id*., (*quoting* Lee Chuan Teck, Assistant Managing Director, Monetary Authority of Singapore).
[57] Justin Lee, "Lack of Clarity over Clearing Provides Problems for Asia Banks," Risk.net, Jan. 7, 2013. *Available at*: http://www.risk.net/asia-risk/feature/2233523/lack-of-clarity-over-clearing-provides-problems-for-asia-banks
[58] http://www.imf.org/external/pubs/ft/sdn/2012/sdn1212.pdf
[59] http://www.imf.org/external/pubs/ft/wp/2010/wp1099.pdf
[60] Again, for a detailed analysis of the weaknesses of substituted compliance, *see* I. Michael Greenberger and Public Citizen's Congress Watch's comment letter from Aug. 27, 2012, at p. 19-24.

## V. Substituted compliance should be a last resort but if implemented must include rigorous enforcement as a strict requirement

In addition to proposing definitions of U.S person and aggregation standards that limit the extraterritorial scope of Title VII of Dodd-Frank, the CFTC also proposes to limit its cross-border reach even further by ceding regulatory jurisdiction through a policy called substituted compliance. Substituted compliance would allow foreign entities as well many of the foreign affiliates and subsidiaries of U.S. financial institutions to comply with "comparable" regulatory regimes abroad in lieu of complying with Dodd-Frank.

We are not opposed to substitutive compliance per se. However, where substituted compliance is an option to cross border application of Dodd-Frank, the CFTC must rigorously ensure that the "substitute" is a meaningful attempt to enforce vigorously the regulatory regime of Dodd-Frank. There is ample empirical evidence of foreign regulators within the statements of foreign regulators want "any" attempted "compliance to be substitutive compliance. This was evidenced in the November 7, 2012 meeting of the CFTC's Global Markets Advisory Committee.[61]

Moreover substituted compliance is meaningless and provides no protection to the U.S. taxpayer from overseas risks if a foreign regulatory regime is unenforced. For example, the LIBOR scandal, in and of itself, provides ample evidence of the laxity of U.K. market regulation. The CFTC properly proposes to consider, as a factor for permitting substituted compliance, whether a foreign regulator has the "authority to support and enforce its oversight."[62] The meaningfulness of this statement by the fact that the CFTC proposes to "consider all relevant factors," thereby indicating that willingness to enforce may be only one of several factors in a CFTC comparability determination.[63] It must be made clear that evidence of foreign enforcement is a completely separate and an exacting pre-condition to a "substitutive compliance" determination.

In light of the foregoing, we respectfully but strongly urge the CFTC to revisit the August 27, 2012 comment letters submitted by AFR and the below signatories, as well as reconsider the narrow definition of U.S. person. We also respectfully urge the CFTC to avoid any further delays in the extraterritorial application of Dodd-Frank, and ask that the CFTC ensure that the July, 2012 and January, 2013 proposed standards for aggregation of affiliates' swaps, and the proposed standards for substituted compliance are sufficient to protect the interests of the American taxpayer.

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[61] CFTC Global Markets Advisory Committee Meeting, Nov. 7, 2012. *Available at*: http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/gmac_110712_transcript.pdf

[62] 77 FR 41233

[63] 77 FR 41233. The CFTC will consider "the scope and objectives of the relevant regulatory requirement(s)" as well as enforcement.

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