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Secretary of the Commission

Commodity Futures Trading Commission ("CFTC" or "Commission")

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Request for Comment on Application of Commission Regulations to Swaps Between non-U.S. Swaps Dealers and Non-U.S. Counterparties Involving Personnel or Agents of Non-U.S. Swaps Dealers Located in the United States[1]

The Institute for Agriculture and Trade Policy (IATP)[2] appreciates this opportunity to respond to questions raised by the Staff Advisory of November 14, 2013,[3] concerning the above-captioned Request for Comment, and the questions posed by Commissioner Scott O'Malia in his dissent against releasing this Request. The following comment is comprised of three parts: 1) contexts of the Staff Advisory; 2) responses to questions posed in the Request; 3) responses to questions posed by Commissioner O'Malia in the context of the Securities Industry and Financial Market Association (SIFMA), International Swaps and Derivatives Association (ISDA) and Institute of International Bankers (IIB) lawsuit[4] to delay and/or prevent the application of the Commission's Guidance[5] on the cross-border application of Commission rules to non-U.S. persons.

Contexts of the Staff Advisory

Over the Counter derivatives market participants have posed questions about whether they must comply with Transaction-Level Requirements of the Guidance by non-U.S. affiliates of OTC broker dealers (swaps dealers) entering into swaps with non-U.S. persons located in the United States. Some of these questioners have further alleged that confusion about one footnote in the Guidance is resulting in decisions by U.S. swaps dealers (SDs) to book their trades on non-U.S. venues, resulting in putative "market fragmentation", because of trade reporting rules to Swaps Execution Facilities (SEFs).[6] In our view, the global structure and trading practices of U.S. headquartered SDs, and not CFTC rulemaking on SEFs, drive market fragmentation. The seven largest U.S. headquartered bank holding companies, all major OTC derivatives broker dealers, have about 5,700 foreign subsidiaries in dozens of foreign jurisdictions.[7]

The Commission does not have the legislative authority to undertake rulemaking concerning the global structure of bank holding companies, much less concerning the global corporate structure of major swaps participants. However, as the Staff Advisory states, "pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Commission has a strong supervisory interest in swaps dealing activities that occur within the United States, regardless of the status of the counterparties." IATP strongly supports the staff's efforts to focus its interpretation of the Transaction Level Requirements in the Guidance on swaps dealing activities in the United States, rather than the jurisdictional status of the swaps counterparties.

It should be self-evident that the swaps activities in the United States of non-U.S. persons fall under the Commission's jurisdiction. But the global structure of U.S. SDs enables them to use non-U.S. affiliates to structure their swaps in one jurisdiction, negotiate a price in another, trade them in third and clear them

in a fourth. IATP believes that if any or all of these swaps dealing activities occur in the United States, non-U.S. persons must comply with the Transaction Level Requirements of those activities.

Questions about compliance of non-U.S. person transacting swaps in the United States also have been predicated on liability-oriented concerns that reporting such transactions to the CFTC could result in multi-jurisdictional reporting with respect to reporting required by regulators in the jurisdictions of the non-U.S. persons. Such "duplicative" reporting, according to the questioners, would not only result in an onerous cost of conducting business, but could conflict with non-U.S. jurisdictions reporting requirements, resulting in legal uncertainty and vulnerability for the U.S. parents of the non-U.S. affiliates. [8]

IATP believes that there are two baseline contexts for responding to the aforementioned concerns. First, the Commission requires comprehensive and high quality OTC trade data in order to implement and enforce the cross-border application of Dodd Frank authorized rules. As the Commission knows and major SDs should know, the quality and comprehensiveness of OTC trade data is far from what is required to enable cross-border regulatory cooperation for effective monitoring of the swaps dealing activities of transnationally structured SDs. The Senior Supervisors' Group of financial regulators reported in January to the Financial Stability Board, "Five years after the financial crisis, firms' progress toward consistent, timely, and accurate reporting of top counterparty exposures fails to meet both supervisory expectations and industry self-identified best practices. The area of greatest concern remains firms' inability to consistently produce high-quality data."[9] If the Commission were to exempt non-U.S. affiliates of U.S. SDs and non-U.S. persons transacting swaps in the United States from reporting their transactions to Commission, the ongoing failure of major SDs to produce high quality data for regulator surveillance would be exacerbated. IATP strongly urges the Staff not to interpret the cross-border Guidance as permitting such an exemption.

The second baseline context to respond to the ISDA et al concerns about multi-jurisdictional data reporting is a more hopeful one. The Financial Stability Board's (FSB) Aggregation Feasibility Study Group (AFSG), co-chaired by a Commission staffer, has outlined in a Consultation Paper options for minimizing OTC data reporting duplication to Trade Data Repositories and for harmonizing trade data reporting requirements in a data aggregation mechanism.[10] IATP responded to this excellent Consultation Paper (the FSB has not yet posted responses[11]). We will not paraphrase our response here except to say that FSB help is on the way to respond to the legitimate SD concerns about OTC data reporting to the Commission and to the jurisdictions of the non-U.S. affiliate of the U.S. swaps dealers. To the extent that the data reporting requirements of a non-U.S. jurisdiction did not qualify for full or substituted compliance under the cross border Guidance, trades by the non-U.S. affiliate would be in conflict with rules applied according to the Guidance.

However, if the ISDA and other plaintiffs in the lawsuit against the Commission's Guidance were to support the FSB development of the AFSG outlined aggregation mechanism, their concerns about legal vulnerability regarding reporting requirements, which results from their frequent practice of structuring a swap in one jurisdiction and trading it in another, should be allayed. The AFSG proposes the means to remove duplicative reporting data by both the SDs and the SD clients according to a harmonized data reporting format. Full implementation of the aggregation mechanism will make it easier for multi-jurisdictional SDs both to produce the high quality reporting data required by regulators and make it easier for them to comply fully and efficiently with OTC data reporting rules across FSB jurisdictions.

It is in these two broader contexts that we believe the Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) should evaluate responses to the questions it has posed in the Request for Comment.

Responses to Questions Posed by the DSIO in the Request for Comment

1. *"The Commission invites comment on whether the Commission should adopt the Staff Advisory as Commission policy in whole or in part."* In view of the comments above, IATP believes that the Commission should adopt the whole Staff Advisory as Commission policy.

2. *". . . whether transactional requirements should apply to Covered Transactions with non-U.S. persons who are not guaranteed or conduit affiliates of U.S. persons."* An answer to this question should begin with a common understanding of the purpose of the application of transactional requirements to the non-U.S. guaranteed and conduit affiliates of U.S. persons for swaps transacted in the United States. The reporting of transactions by guaranteed and conduit affiliates of U.S. Persons, in addition to those of the U.S. parent SD, enables the Commission to understand the total risk exposure of U.S. registered SDs, and the exposure of the U.S. taxpayer to bailing out SD default cascades. According to a Commission fact sheet explaining the Guidance, only "a non-U.S. person that is not a guaranteed or conduit affiliate may exclude [from aggregation] any swaps that are entered into anonymously on a registered DCM [Designated Contract Market], SEF [Swaps Execution Facility] of FBOT [Foreign Board of Trade] and cleared."[12]

Our first assumption about this statement is that swaps accepted for trade on a DCM, SEF or FBOT and entered into by a non-U.S. person that is not a guaranteed or conduit affiliate of a U.S. parent are aggregated and reported to the competent authority in the jurisdiction of the non-U.S. person, with which the Commission has a Memorandum of Understanding. A second assumption is that the Commission does not require aggregation of swaps by such a non-U.S. person because the clearing of those swaps on U.S. registered Centralized Clearing Platforms (CCP) removes the risk of counterparty default, unless the CCP itself becomes insolvent. A third assumption, is that if such a non-U.S. person transacts swaps in the United States but clears them on a foreign CCP, the Commission has granted full or substituted compliance regarding clearing in the jurisdiction of that CCP. A fourth assumption is that the number of non-U.S. persons that are not guaranteed or conduit affiliates of U.S. SDs, but that transact swaps in the United States, is quite small, and that the gross notional value of their swaps would not reach the Commission's very generous per SD aggregation de minimis. (IATP agrees with the critics of the Commission's decision to increase the SD aggregation de minimis from $100 million to $8 billion.[13]) If these assumptions are correct, IATP would agree that a non-U.S. Person that is not a guaranteed or conduit affiliate of a U.S. Person does not have to aggregate its swaps positions for reporting to the Commission, provided that those swaps are cleared and thus do not transfer risk of default to U.S. counterparties.

3. *" . . . whether there should be any differentiation in treatment of swaps with non-U.S. counterparties depending on the nature of the SD (i.e. whether it is a guaranteed affiliate or a conduit affiliate of a U.S. person)."* Depending on how the guarantee is defined, the U.S. parent is liable for covering part or all of losses incurred by the guaranteed non-U.S. affiliate. The Commission does not formally define "conduit affiliate," but based on the Commission's non-exhaustive description of the characteristics of the conduit affiliate, including the administrative control by senior personnel of the U.S. SD, the U.S. SD's majority ownership of the conduit affiliate, and the booking of conduit affiliate revenues and expenses with the US SD parent, it is exceedingly difficult to understand why there would not be an implied guarantee by the U.S. SD for the Covered Transactions of a conduit affiliate. If Commission understands that such an implied guarantee is part of the conduit affiliate relationship with the U.S. DS parent, IATP believes that there is no reason

to differentiate treatment of swaps with non-U.S. counterparties, depending on whether they are guaranteed or conduit affiliates.

4. *To the extent a non-U.S. SD must comply with the transactional requirements when entering a Covered Transaction, should the non-U.S. SD be able to rely on substituted compliance program for purposes of complying with the relevant transactional requirements?* IATP agrees with the DSIO interpretation of the cross-border guidance: substituted compliance with Transaction Level Requirements may be available "where the activities of the non-U.S. SD take place outside the United States." The Commission did not intend to apply substituted compliance to non-U.S. counterparties, regardless of whether the counterparty is a non-U.S. guaranteed or conduit affiliate, for swaps activities in the United States.

5. *Comment on the degree of "arranging, negotiating or executing" swaps by non-U.S. SDs in the United States required for compliance with Transaction Level Requirements.* If a non-U.S. SD structures a swap, and negotiates the terms and price of the swap in the United States, i.e. if you are a customer-facing dealmaker, all business conduct of such activities fall under the jurisdiction of the Commission. If the non-U.S. SD executes (trades) the swaps on a foreign venue and/or clears the trade on a foreign Centralized Clearing Platform (CCP), execution and clearing fall under the respective jurisdictions of the foreign trading venue and CCP. If the non-U.S. SD, whether or not it is an affiliate, trades or clears on a U.S. venue, it is subject to the Commission's Transaction Level Requirements. The question of "degree of" is difficult for IATP to comment on, since we don't understand the circumstances under which non-U.S. SD swaps activities would not fall under the Commission's jurisdiction, save for securities-based swaps that fall under the jurisdiction of the Securities Exchange Commission.

Responses to Questions Posed by Commissioner Scott O'Malia in his Dissent to the Request for Comment

Generally, we understand Commissioner O'Malia's dissent against this DSIO Request for Comment to be a kind of amicus brief to the SIFMA, ISDA and IIB lawsuit that is seeking to invalidate the cross-border Guidance for alleged violation of the Administrative Procedures Act. We expect Commissioner O'Malia's dissent and friendly responses to the questions he poses to be cited by SIFMA et al, in the event that they appeal an adverse District Court ruling. He characterizes the DSIO's Staff Advisory as part of "the evolving jurisdictional application of the Commission's authority over cross-border trades" (FR, 1349). The characterization begins in his July 26, 2013 dissent against the approval of the Guidance, in which he charges that the majority of Commissioners' interpretation of the Commodity Exchange Act 2 (i) "essentially views the Commission's jurisdiction as boundless" (FR 45373) regarding the swaps activities of the non-U.S. affiliates of U.S. SDs.[14] In his dissent to the Request for Comment on the Staff Advisory, he writes, "It appears based on the Staff Advisory, the Commission is applying a "territorial" jurisdiction to elements of trade between non-U.S. entities" (FR 1349). IATP does not believe that the jurisdiction of the cross-border Guidance is "essentially boundless" and views the Staff Advisory as a careful delineation of the limits of the jurisdiction of Commission over non-U.S. SDs. We find no in consistency between the Guidance and the Staff Advisory

To judge by Commissioner O'Malia's dissents regarding the application of the Guidance, it is not clear to us that he believes that the Commission has jurisdiction over swaps activities, i.e. arranging, negotiating, executing, of non-U.S. SDs in the United States. According to his first and second questions about the Staff Advisory, whether the jurisdiction of the Commission is "essentially boundless" or whether the Commission has no jurisdiction over the swaps activities of non-U.S. SDs in the United States depends on one's response to "whether Covered Transactions with non-U.S. persons who are not guaranteed affiliates or conduit affiliates of U.S. persons meet the direct and significant test under section CEA section 2(i)"

(Questions 1, Fr. 1349). Commissioner O'Malia then requests that this "test" be applied to "other aspects of the Commission's cross-border policy."

Swaps activities in the United States between the non-U.S. person guaranteed or conduit affiliates of U.S. SDs and non-U.S. persons certainly have a direct connection with U.S. economic activity. Whether that effect is "significant" is not, however, decided simply by quantification of such swaps compared to the gross notional value of swaps between, for example, the non-U.S. affiliates of U.S. swaps dealers and U.S. swap participants. For example, non-US SD affiliates could try out a new "off the shelf" algorithm in swaps with non-U.S. persons executed on U.S. venues, and subsequently expand the use of the new algorithm to structure swaps with U.S. persons, whether executed on U.S. or foreign venues. Such an expansion could have a very significant, even market disruptive, economic impact on U.S. commerce, if the swap were not cleared on U.S. or foreign CCPs, and the non-US SD defaulted. Rather than judge the term "significant" simply according to the gross notional value of swaps transacted in the U.S. with non-U.S. persons, IATP urges the Commission to evaluate the potential of an expansion of a swap "innovation" traded in small volume with non U.S. persons to become a market disruptive force when traded but not cleared in large volume with U.S. persons.

The fourth and last question posed by Commission O'Malia is based on a revealing misunderstanding or non-understanding about the difference between Guidance and a Rule. *"If the Commission adopts the Staff Advisory as Commission Policy (and not through the rulemaking process), please provide your views on the Commission's ability to enforce such a policy."* Implied in the framing of this request is the assumption that since in a meeting on the Guidance, the Commission's General Counsel correctly replied to the Commissioner that the "guidance itself is not binding strictly", the Commission cannot enforce transaction level rules entailed in the Staff Advisory. Following the Commissioner's train of though, the Commission then has no jurisdictional authority over non-U.S SD swaps dealing activities with non-U.S. Persons in the United States. Leaving aside Commissioner O'Malia's misunderstanding that a rulemaking process is necessary to adopt a Staff Advisory, we will try to respond to the Commissioner's question and its underlying assumptions.

First, the issues of cross-border OTC derivatives rule harmonization and regulatory cooperation cannot be codified in a rule. Were the CFTC's cross-border activities to be promulgated as a rule, the Commission would be obliged to attempt to enforce such a rule in all jurisdictions in which the swaps of non-U.S. affiliates of U.S. SDs could result in defaults of U.S. SDs without sufficient capital reserves to cover their losses. Enforcement of a cross-border rule would require the Commission's jurisdiction to be "essentially boundless." To the contrary, the Guidance formulates how all Commission rules for OTC derivatives will be applied to cross-border trades and provides a structure for regulatory harmonization and negotiating U.S. vs. non-U.S. jurisdictional differences in regulation. The Guidance informs market participants, foreign regulators and the public that the jurisdictional border of the Commission's Guidance stops where surveillance of data from foreign and U.S. Trade Data Depositories and CCPs verifies that demonstrates compliance with the relevant Transaction-Level requirements, per the Commission's bilateral Memoranda of Understanding with foreign regulators for harmonization and cooperation. The Guidance enables the Commission to cooperate with competent authorities of jurisdictions in which the swaps activities of non-U.S. affiliates of U.S. SDs take place, in order to prevent circumvention of Commission rules or to undertake enforcement activities if the swaps activities of non-U.S. affiliates of U.S. SDs in foreign jurisdictions have a direct and significant effect on U.S. commerce.

Conclusion

It took more than a decade for the Commission's waivers, exemptions and exclusions from the CEA to contribute to the U.S. and foreign SD defaults of 2008-2009. IATP does not expect that this Commission alone can repair that regulatory damage with its Dodd-Frank authorized rule making and the Guidance on the cross-border application of those rules. Compliance by U.S. SDs, their non-U.S. affiliates and swaps participants, and the cooperation of regulators in foreign jurisdictions will be necessary to change a swaps

industry culture of regulatory circumvention to one of compliance. Market participant questions about the cross-border application of Commission rules are a necessary part of that change. IATP thanks the DSIO for its response in the Staff Advisory to these questions, and looks forward to working with the Commission to enable effective application of the cross-border Guidance to implementation and enforcement of Commission regulations.

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[1] Federal Register, Vol. 79, No. 5 January 8, 2014.
http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2014-00080a.pdf

[2] The Institute for Agriculture and Trade Policy is a U.S. nonprofit, 501(c)(3) nongovernmental organization, headquartered in Minneapolis, Minn., with an office in Washington, D.C. Our mission states, "The Institute for Agriculture and Trade Policy works locally and globally at the intersection of policy and practice to ensure fair and sustainable food, farm and trade systems." To carry out this mission, as regards commodity market regulation, IATP has participated in the Commodity Markets Oversight Coalition (CMOC) since 2009, and the Derivatives Task Force of Americans for Financial Reform since 2010. IATP has submitted several comments on CFTC rulemaking, and on consultation papers of the International Organization of Securities Commissions, the Financial Stability Board, the European Securities and Markets Authority, and the European Commission's Directorate General for Internal Markets.

[3] http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-69.pdf

[4] "SIFMA, ISDA and IIB File Lawsuit Challenging Commodity Futures Trading Commission's Cross-Border Rule (sic)," International Swaps and Derivatives Association, December 4, 2013.
http://www2.isda.org/search/page/6

[5] 78 FR 45292 (July 26, 2013) available at
http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf

[6] "Footnote 88 and Market Fragmentation: An ISDA Survey," International Swaps and Derivatives Association, Research Note, December 2013. http://www2.isda.org/search/page/6

[7] Dafna Avraham, Patricia Selvaggi and James Vickery, "A Structural View of U.S. Bank Holding Companies", *FBRNY Economic Policy Review*, July 2012, Table 1: "Number and distribution of subsidiaries: Selected Top 50 Bank Holding Companies", 71.
http://www.newyorkfed.org/research/epr/12v18n2/1207avra.pdf

[8] "Cross-Border Fragmentation of Global OTC Derivatives: An Empirical Analysis," International Swaps and Derivatives Association Research Note, January 2014. http://www2.isda.org/search/page/4

[9] "Progress Report on Counterparty Data," Senior Supervisors Group, January 15, 2014,
https://www.financialstabilityboard.org/publications/r_140116.pdf

[10] "Consultation Paper: Feasibility study on approaches to aggregating OTC derivatives data, Financial Stability Board, February 4, 2014. http://www.financialstabilityboard.org/publications/r_140204.pdf

[11] IATP's comment on the Aggregation Feasibility Study Group's Consultation Paper is posted at
http://www.iatp.org/files/FSB%20aggregation%20CP%20IATP%20Final.pdf

[12] "Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swaps Regulations," Commodity Future Trading Commission, 2.
http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/crossborder_factsheet_final.pdf

[13] E.g. https://www.bettermarkets.com/blogs/industry%E2%80%99s-bogus-arguments-de-maximus-exception-swap-dealer-rules

[14] http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf