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Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
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1155 21st Street NW
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Re: Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States

Dear Secretary Jurgens:

Société Générale ("SG") appreciates the opportunity to provide feedback to the Commodity Futures Trading Commission (the "Commission") on its request for comments on certain cross-border issues (hereinafter, the "Comment Request").[1] The Comment Request focused mainly on a staff advisory published in November 2013 (hereinafter, the "Staff Advisory")[2] by the Division of Swap Dealer and Intermediary and Oversight, which in turn interpreted a footnote in the Commission's Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (the "Guidance"),[3] promulgated under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act").[4] In this letter, we respectfully provide answers to the Commission's questions set forth in the Comment Request.

[1] "Request for Comment on Application of Commission Regulations to Swaps between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States," Fed. Reg. Vol. 79, No. 5 (January 8, 2014).

[2] Division of Swap Dealer and Intermediary Oversight Staff Advisory, "Applicability of Transaction-Level Requirements to Activity in the United States" (Nov. 14, 2013).

[3] "Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act," Fed. Reg. Vol. 77, No. 134 (July 12, 2012).

[4] Public Law 111-203, 124 Stat 1376 (2010).

Part I. Questions Posed by the Comment Request

1. **The Commission invites comment on whether the Commission should adopt the Staff Advisory as Commission policy, in whole or in part.**

The Commission should not adopt the Staff Advisory, in whole or in part, because it reflects an unsupported and inconsistent view of the Commission's positions on the regulation of swap activity. The Staff Advisory stated that "the Commission intended substituted compliance to be available, or Transaction-Level Requirements to not apply, [only] where the activities of the non-U.S. SD take place outside the United States."[5] SG disagrees that a majority of the Commissioners intended to regulate swap activity that takes place in the United States (referred to herein as an "activity test"). In fact, until the publication of the Guidance in July 2013, the Commission had, for more than two years, taken the position that swap activity should be regulated based on where the ultimate risk lies, and whether such risk can flow back into the U.S.[6] Based on this position, the Commission focused the jurisdictional scope of its Title VII rulemakings on the entities entering into the trades. The Commission's "Path Forward" agreement with European authorities also contemplated such an entity-based approach.[7]

This position led to the complex definition of U.S. person set out in the Guidance. The Guidance devotes more than sixteen pages to this definition, which has eight prongs, two adjuncts (guaranteed and conduit affiliates) that are treated as U.S. persons even though they are not defined as such, and a five-pronged set of requirements defining when foreign branches of U.S. banks should be treated as U.S. persons. In contrast, the Guidance includes an ambiguous footnote ("Footnote 513") that suggests an activity test might be relevant. Footnote 513 is so unclear that it prompted the Staff Advisory. Given the long-term effort the Commission undertook in defining U.S. person, it is highly unlikely that it intended to endorse or promulgate an unmentioned activity test. Indeed, there is no evidence of this intent in any of the thousands of pages of regulations published by the Commission with respect to the Act until the appearance of Footnote 513 and an unexpected footnote in the SEF rules.[8]

In reliance on the Commission's consistent focus on U.S. person status rather than the location of activity, non-U.S. swap dealers built complex Title VII compliance systems that focus on whether the counterparty is, or must be treated as, a U.S. person. In order to utilize an activity test in addition to such entity-based test, the systems and logic built across the industry would need to be revised at substantial cost. Yet the costs of further modification of non-U.S. banks' Title VII compliance systems to include the activity test would significantly outweigh any perceived benefits. An activity test would extend the reach of the Commission's regulations only to entities that are not U.S. persons or deemed U.S. persons and to swaps whose risk lies totally offshore. This is hardly a set of persons or transactions that pose high risk to the United States financial system.

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[5] Staff Advisory, at 2.

[6] See, e.g., Gary Gensler, Banque de France Financial Stability Review "International Swaps Market Reform – Promoting Transparency and Lowering Risk" No. 17 (April 2013); "Remarks of Chairman Gary Gensler before the Institute of International Bankers" (March 4, 2013); Testimony of Gary Gensler, before the U.S. Senate Banking, Housing and Urban Affairs Committee, Washington (February 14, 2013).

[7] "Discussions between the Commodity Futures Trading Commission and the European Union – A Path Forward" (July 11, 2013).

[8] See, e.g., footnote 88,"Core Principles and Other Requirements for Swap Execution Facilities," Fed. Reg. Vol. 78, No. 107 (June 4, 2013).

2. **The Commission invites commenters to provide their views on whether transactional requirements should apply to Covered Transactions with non-U.S. persons who are not guaranteed or conduit affiliates of U.S. persons. Please provide a detailed analysis of any such view and its effect on other aspects of the Commission's cross-border policy, if any.**

Transaction-Level Requirements should not apply to Covered Transactions[9] with non-U.S. persons who are not guaranteed affiliates of U.S. persons. SG, as well as most other non-U.S. banks that have registered as a swap dealer, are subject to home-country regulations that are more than sufficient to cover such Transactional-Level Requirements[10] and to protect non-U.S. persons. For this reason, SG disagrees with the Staff Advisory's view that "the Commission has a strong supervisory interest in swap dealing activities that occur within the United States, regardless of the status of the counterparties."[11] In fact, relevant home-country regulators have a much stronger supervisory interest in regulating swap activity between two non-U.S. persons, not only because the risk of such swaps sits within their countries but also because they have the primary responsibility for monitoring such risk and for coordinating the prudential oversight of such entities.

As an example, consider a hypothetical USD-denominated swap between a Dutch client and a French swap dealer, booked in Paris. Because it is linked to a USD instrument, it may be sold by a salesperson based in the United States acting on behalf of a global booking model or entered into the swap dealer's trading system by a trader based in the United States. But the ultimate economic risk of this swap lies in Europe and not the United States. Another example is a hypothetical swap with a counterparty from Latin America. When a non-U.S. swap dealer trades in Latin America markets, under the Staff Advisory, this swap would need to follow the Transaction-Level requirements, the relevant EMIR rules and any local market rules. This potential three-way regulation of a Covered Transaction further complicates the processing of the swap and undermines the regulatory interest of both relevant home country regulators, where the risk to the financial system are located.

If such swaps are "made available to trade" and of the type being traded on a Commission-registered swap execution facility ("SEF"), the swaps will be traded on a SEF and cleared in a clearinghouse ("DCO") chosen by the client. If the execution platform or DCO is in the United States, the Commission's regulations of those utilities will, of course, apply and, if not, similar European rules will apply.[12] If the client uses a DCO registered by the Commission, it will need a futures commission merchant to act as its agent and the rules regarding segregation of collateral will then apply. The swaps

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[9] "Covered Transaction" is defined in the Comment Request as a transaction "arranged, executed, or negotiated by personnel or agents located in the United States of non-U.S. SDs (whether affiliates or not of a U.S. person) regularly using personnel or agents located in the U.S. to arrange, negotiate or execute swaps with non-U.S. Persons." Comment Request at 1348.

[10] The Transaction-Level Requirements are: mandatory clearing and swap processing, mandatory trade execution, margin and segregation for uncleared swaps, swap trading relationship documentation, portfolio reconciliation and compression, trade confirmation, real-time public reporting, daily trading records, and external business conduct requirements.

[11] Staff Advisory at 2.

[12] "European Market Infrastructure No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade Repositories" ("EMIR"), Articles 4 and 5 (providing the general requirement for OTC derivative contracts to be submitted for clearing, unless one of the parties is not subject to the clearing obligation or is eligible for an exemption).

will be reported regardless of whether the Commission's rules apply, as both the European Union[13] ("EU") and the Commission require trade reporting. Portfolio reconciliation,[14] portfolio compression,[15] trade confirmation[16] and margin rules will apply to the swaps, as both the EU and the U.S. already require or, in the case of margin rules, will soon require, all such rules. Likewise, the EU has swap trading relationship documentation[17] and recordkeeping[18] regulations. The Commission is well aware of the equivalence between its rules and those of Europe and has already issued its substituted compliance determinations confirming the equivalence of many of its Transaction-Level Requirements and those of the EU.[19]

Thus, there is no compelling reason that these hypothetical swaps should be subject to Transaction-Level Requirements. Instead, the regulations that should apply to and be enforced upon such swaps are those of the European Union and, in the case of the swap with a Latin American client, also the applicable local rules. The Guidance recognizes this fact, further evidencing the Commission's views on this topic: "where a swap is between a non-U.S. swap dealer ... on the one hand, and a non-U.S. person that is not a guaranteed or conduit affiliate, on the other, ... the Commission believes that generally there may be a relatively greater supervisory interest on the part of foreign regulators with respect to transactions between two counterparties that are non-U.S. persons so that application of the Category A Transaction-Level Requirements may not be warranted."[20] Both the Staff Advisory and Footnote 513 appear to ignore the Commission's clear views in this respect by assuming jurisdiction over swaps for which the Commission is not the regulator best positioned to govern those swaps and then refusing to allow substituted compliance determinations to be made with respect to those swaps.

Additionally, applying Category B Transaction-Level Requirements (external business conduct) to these hypothetical swaps also has little merit. Complying with external business conduct rules requires swap dealers to collect voluminous information from clients, and imposes a weighty compliance burden on non-U.S. swap dealers and non-U.S. persons without a significant benefit to the safety and soundness of the U.S. financial system. External business conduct rules are focused on client protection rather than market transparency or risk mitigation. Yet, as per Commission rules, the swap markets can only be accessed by the most sophisticated investors[21] that typically need the least amount of "protection" under

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[13] "Markets in Financial Instruments Directive" ("MiFID") (Directive 2004/39/EC) and the relevant implementing measures (Directive 2006/73/EC and Regulation 1287/2006), Articles 28(1) and 30(1); "Markets in Financial Instruments Regulation" ("MiFIR") (February 14, 2014), Articles 9(1) and 20. Available at: http://register.consilium.europa.eu/doc/srv?l=EN&t=PDF&gc=true&sc=false&f=ST%206406%202014%20ADD%202.

[14] Emir, Article 11(1)(b).

[15] EMIR, Article 11(1)(b).

[16] EMIR, Article 11(1)(a).

[17] MiFID, Articles 19(7), 19(8) and 40(1) L2 and EMIR, Article 11(1)(b).

[18] MiFID, Articles 13(6), 16(7), 25(2), 50(2), 51(1) L2 and 51(4) L2 and EMIR, Article 9(2).

[19] "Comparability Determination for the European Union: Certain Transaction-Level Requirements," 78 Fed. Reg. No. 249 (Dec, 27, 2013).

[20] Guidance at 45352-3.

[21] See CFTC Regulation 23.430(a) (defining Eligible Contract Participant).

the Commission's rules. The swap market has never been and by law will not become a retail market and so application of customer protection rules has diminished value, especially when these rules could easily pass a substituted compliance determination due to the EU's strong customer protection and due diligence regulations. Moreover, most of the Commission's external business conduct rules (such as the commodity pool, special entity, ERISA-related and pay-to-play rules) are based on U.S. regulations that are not applicable to non-U.S customers.

3. The Commission invites comment on 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).

Guaranteed affiliates of a U.S. person should be treated as U.S. persons, and their swaps with non-U.S. counterparties should be fully captured under the Commission's Title VII rules. This is consistent with the treatment of guaranteed affiliates under EU rules. This is a logical conclusion of the Commission's policy to regulate the swap markets to prevent the risk of swaps flowing back into the United States. To comply with the Commission's treatment of guaranteed affiliates as U.S. persons, entities that previously were guaranteed affiliates of U.S. swap dealers have terminated the guarantees traditionally provided by their U.S. parent. These terminations are being negotiated throughout the industry and each of these entities' clients and dealers is determining whether they are willing to continue trading with these entities. Those entities that have a rating equal to or stronger than their U.S. parent are able to negotiate the termination of guarantees. Those entities that are not as strongly rated are finding such terminations more difficult, but market forces are operating as expected to assess and mitigate risks.

Conduit affiliates of a U.S. person, however, are a more complex subject, since these are hard to identify. Indeed, the Guidance does not define them and only provides a series of factors that require a case-by-case analysis of whether an entity is one. These factors include whether the non-U.S. person, in the regular course of its business, engages in swaps with non-U.S. third parties for the purpose of hedging or mitigating risks faced by, or takes positions on behalf of, its U.S. affiliates, and enters into offsetting swaps with its U.S. affiliates in order to transfer the risks and benefits of such swaps with a third-parties to its U.S. affiliates.[22] It is impossible for a swap dealer to determine whether a counterparty meets such definition; and even for clients, this definition leaves many questions unanswered. Given the ambiguities in the conduit affiliate definition, SG suggests that conduit affiliates established in a jurisdiction for which the Commission has granted substituted compliance should be regulated by the regulators of such jurisdiction. Conduit affiliates not established in such jurisdictions are candidates for Commission regulation, if an objective definition can be drafted and incorporated into a rulemaking.

Finally, SG does not see any reason to treat certain non-U.S. branches of U.S. banks differently from other non-U.S. branches or U.S. branches of U.S. banks. All non-U.S. branches of U.S. banks are, and should be treated as, U.S. persons, as any risks they take onto their balance sheets could flow back into the U.S. This is the logical conclusion of the Commission's determination not to treat bank branches

[22] The other factors are: whether the entity is a majority-owned affiliate of a U.S. person; whether the non-U.S. person is controlling, controlled by or under common control with a U.S. person; and whether the financial results of the non-U.S. person are included in the consolidated financial statements of the U.S. person.

as separate legal entities.[23] Based on this conclusion, it should not matter whether personnel in non-U.S. branches of U.S. banks negotiate ISDAs, or where the branch pays taxes or engages in other activities that the Commission determines would qualify for its non-U.S. person treatment under its five-factor test set forth in the Guidance[24] None of these factors seems to bear any relationship to where the risk of a swap ultimately resides. Furthermore, SG does not understand why this preferential treatment of non-U.S. branches of U.S. banks is a necessary conclusion of the principle of international comity, as the Commission stated in the Guidance.[25] U.S.-based branches of non-U.S. banks do not receive preferential treatment under the Commission's rules and certainly have been rejected when they requested to have branches treated in a ring-fenced manner.

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 a substituted compliance program for purposes of complying with the relevant transactional requirements? If so, should substituted compliance be available for all transactional requirements or only specific requirements? Which requirements? Would the response be different depending on the nature of the counterparty (i.e., whether the non-U.S. counterparty is a guaranteed affiliate or a conduit affiliate of a U.S. person)?**

Non-U.S. swap dealers should be able to rely on substituted compliance for all purposes with respect to Covered Transactions. As discussed in Part I (2) above, European law is comparable in all material respects to the Commission's Transaction-Level Requirements. This comparability does not, however, mean that European rules and regulations are identical to those of the Commission. If they were identical, then there would be no need for cross-border guidance.

Instead, each regulator has a different definition of the products within the scope of its rules and the types of entities within the scope of its jurisdiction. Within Dodd-Frank and EMIR, for example, there are some striking differences between the covered counterparties, particularly in consideration of EMIR's "Financial Counterparties" and "Non-Financial Counterparties" versus Dodd-Frank's U.S. person, swap dealer, major swap participant and commercial end user concepts. The lack of identical or, at minimum, compatible rules ensures that there will be conflicts of laws issues unless the Commission and its foreign regulatory counterparts agree on clear delineations of their respective jurisdictions.[26] Such conflicts are likely to be compounded as more European rules become effective, at which point the Commission's expansive definition of U.S. person and the Staff Advisory will have a profound impact.

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[23] See, e.g., Guidance at 45329.

[24] In the Guidance, the Commission stated that if the following factors are all present, a non-U.S. branch of a U.S. bank could be treated as a *de facto* non-U.S. person: "(i) The employees negotiating and agreeing to the terms of the swap (or, if the swap is executed electronically, managing the execution of the swap), other than employees with functions that are solely clerical or ministerial, are located in such foreign branch or in another foreign branch of the U.S. bank; (ii) the foreign branch or another foreign branch is the office through which the U.S. bank makes and receives payments and deliveries under the swap on behalf of the foreign branch pursuant to a master netting or similar trading agreement, and the documentation of the swap specifies that the office for the U.S. bank is such foreign branch; (iii) the swap is entered into by such foreign branch in its normal course of business; (iv) the swap is treated as a swap of the foreign branch for tax purposes; and (v) the swap is reflected in the local accounts of the foreign branch." Guidance at 45330.

[25] Id.

[26] See, e.g., Kris Devasabai, Risk Magazine, "U.S. Person Problems: Hedge Funds Caught in Transatlantic Tug-of-War" (Jan. 30, 2014). Available at: http://www.risk.net/risk-magazine/feature/2324313/us-person-problems-hedge-funds-caught-in-transatlantic-tug-of-war.

Yet, many rules simply cannot be complied with twice while others would create excessive costs if double compliance were required.

For example, both the Commission and the EU are charged with promulgating margin regulations. While the Basel Committee on Banking Supervision and the Board of the International Organization of Securities Commissions have jointly published principles[27] that participating regulators, including the Commission, have pledged to follow, there will be local differences; indeed the principles permit this. It is possible that both sets of margin rules will apply to some of the same counterparties. It is equally possible that opportunities for regulatory arbitrage designed to avoid the margin rules will develop unless the jurisdictional and definitional scope of the Commission's regulations is harmonized with that of the EU. Prior to the 2008 financial crisis, differing cross-border margin rules and plentiful liquidity led to the movement of swap business to London, where opportunities for arbitrage arguably multiplied the financial woes of some market players when the crisis commenced.

The financial markets thus need a globally compatible and consistent jurisdictional framework. If the boundaries between the Commission's and the EU's scope of jurisdiction were clear, substituted compliance determinations would be much easier to make. Overall, the Commission's rules should be designed to achieve regulatory parity between U.S. and non-U.S. banks. But regulatory parity cannot be measured based on the Commission's rules alone; it must also be viewed in light of the rules of other jurisdictions. Close coordination with foreign regulators will ultimately be more beneficial to the U.S. financial system than the jurisdictional regime set out in the Guidance and Staff Advisory.

5. **The Commission invites comment on the meaning of "regularly" in the phrase "persons regularly arranging, negotiating, or executing swaps for or on behalf of an SD" and whether such persons are performing core, front-office activities of that SD's swap dealing business. If not, what specific activities would constitute the core, front-office activities of an SD's swap dealing business? What characteristics or factors distinguish a "core, front-office" activity from other activities? Please be exhaustive in describing such activities.**

"Regularly" is an arbitrary concept that cannot be translated easily into an operational framework. On the other hand, tracking Title VII jurisdiction by entity type permits a swap dealer to code each entity in its system and have an automated process to treat swaps as required under the Commission's rules. We do not believe that it is feasible or cost-effective to develop an objective method of determining when a particular swap dealer employee should be viewed as being "regularly" engaged in arranging, negotiating or executing swaps.

6. **The Commission invites comment on the scope and degree of "arranging, negotiating, or executing" swaps as used in this context.**

Given the diversity in the way swap dealers have structured their global swap businesses, it is not possible to define which paradigms the Commission would deem to be arranging, negotiating or executing activity. Swap responsibilities are comprised of many functions such as structuring, sales, execution, booking, hedging, monitoring, and operational and are divided among front, middle and back-office teams in many different ways throughout the swap industry. For example, some swap dealers

[27] Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions," Margin Requirements for Non-Centrally Cleared Derivatives" (September 2013).

employ structurers and/or quantitative personnel who mainly design swaps and hedging solutions for the dealer and/or its clients. Such personnel may or may not have authority to book swaps and may or may not interact with clients. Some dealers have traders who never interact with clients at all. These types of personnel might book swaps that other employees of the bank have sold or negotiated or might be focused solely on risk mitigation. Sometimes traders provide pricing to salespersons who then interact with clients. Sometimes traders provide pricing directly to clients. Some salespersons have the authority to provide prices as well. The salesperson, trader, structurer or other personnel involved in the same swap could be located in multiple countries. Some dealers conduct their USD-denominated activity in the United States and clients who want to trade USD-denominated swaps deal with personnel directly or through a local salesperson; other dealers have clients interact with local salespeople only. Some dealers have 24-hour coverage of certain products so as to provide constant market access to such products – such as FX– to clients. Some clients insist on dealing with banks that have local traders who are familiar with the market trends and prices.

In short, most clients have no control or knowledge over where their swap is structured or designed, where the salesperson responsible for a particular product is located, where the booking of their swap is entered into a trading system, or where their swap is hedged. Requiring clients to know these details in order to determine the regulatory profile of their swaps is simply unworkable, especially as the swap markets become more electronic.

Given the variety of organizational structures and operational realities of the global swap business, SG believes that the Commission cannot properly define the words "arranging, negotiating, or executing" in a suitable way. Interpreting these three terms will always require a trade-by-trade analysis, which is not feasible to implement since the rules must be able to be reduced to clear logic that can be programmed into a trading system. These activities, moreover, will not determine where the risk of the swaps lies and will have no bearing on whether such risks flow back into the U.S. or not.

However, if the Commission does adopt the activity-based approach of the Staff Advisory, which SG strongly discourages, only salespersons based in the United States who deal directly with clients should be considered as arranging, negotiating, or executing a swap. The Commission should not include trading, structuring, quantitative analysis or operational activity within the definition of arranging, negotiating, or executing a swap.

If the Commission adopts an activity-based approach, many non-U.S. person clients will choose to deal with sales personnel offshore in order to avoid conflicts of laws and the burdens of Title VII compliance. Swap dealers, both non-U.S. affiliates of U.S. swaps dealers and non-U.S. swap dealers, will move personnel currently based in the United States offshore.[28] In fact, some moves have already happened and others were placed on hold when the Commission issued its no-action relief with respect to the Transaction-Level Requirements for non-U.S. swap dealers.[29] As a policy matter, promulgating regulations that incentivize banks to move personnel outside of the U.S. will reduce jobs in the U.S.,

[28] Peter Madigan, Risk Magazine, "Cross-border Vortex: Dealers Freeze Plans to Move Staff" (Jan. 30, 2014). Available at: http://www.risk.net/risk-magazine/feature/2325727/cross-border-vortex-dealers-freeze-plans-to-move-staff.

[29] Division of Swap Dealer and Intermediary Oversight, Division of Clearing and Risk, Division of Market Oversight, CFTC Letter No. 14-01, "Extension of No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers (Jan. 3, 2014).

decrease revenue in the U.S. and should only be done if there is a clear ascertainable benefit to the safety or soundness of the U.S. swap market or economy. For these reasons, SG does not believe that the implementation of the Staff Advisory could survive a cost-benefit analysis. The Commission should not implement rules that disadvantage the U.S. economy without a clear regulatory rationale for doing so.

II. Questions Posed by Commissioner O'Malia:

1. **Please provide your views on whether Covered Transactions with non-U.S. persons who are not guaranteed or conduit affiliates of U.S. persons meet the direct and significant test under CEA section 2(i). Please provide a detailed analysis of any such view and its effect on other aspects of the Commission's cross-border policy, if any. Would your view change depending on whether a non-U.S. SD is a guaranteed affiliate or a conduit affiliate of a U.S. person?**

2. **CEA section 2(a)(1) provides for the general jurisdiction of the Commission. Please provide your views on whether Covered Transactions with non-U.S. persons who are not guaranteed or conduit affiliates of U.S. persons fall within the Commission's jurisdiction under CEA section 2(a)(1) or any other provision of the CEA providing for Commission jurisdiction. Please provide a detailed analysis of any such view and its effect on other aspects of the Commission's cross-border policy, if any. Would your view change depending on the nature of the non- U.S. SD (i.e., whether it is a guaranteed affiliate or a conduit affiliate of a U.S. person)?**

Covered Transactions with non-U.S. persons that are not guaranteed affiliates of U.S. persons very clearly do not meet the direct and significant test under Commodity Exchange Act section 2(i)[30] and therefore should not fall within the Commission's jurisdiction. If the risk of a swap does not sit on, or flow back to, the books of a U.S. person, it is difficult to find a direct and significant effect on the commerce of the United States. This view is consistent with the position taken by the U.S. Supreme Court, which has on multiple occasions reviewed the meaning of "direct and significant effect." The Court has interpreted this phrase narrowly to apply only in cases where conduct abroad has "an immediate consequence" within the United States[31] and the ability to affect the U.S. economy.[32] A Covered Transaction between two non-U.S. persons that is booked outside the United States and dealt by a non-U.S. swap dealer could not reasonably be deemed to be of immediate consequence to the U.S. economy, especially when the home-country regulator of the non-U.S. swap dealer has clear jurisdiction over such transaction and has developed a set of substantially similar regulations that apply to the transaction.

Accordingly, we believe that the Commission does not have a clear Congressional mandate to regulate Covered Transactions. A cost-benefit analysis, had it been done, could not have justified the Staff Advisory's extension of Title VII rules to swaps to which no U.S. person is party and for which no

[30] Commodity Exchange Act, 7 U.S.C. 2(i)

[31] See Republic of Argentine v. Weltover, 112 S.Ct. 2160 (1992) (interpreting whether activity has a "direct effect in the United States under the Foreign Sovereign Immunities Act of 1976," the Supreme Court finds that an effect is direct if it follows "'as an immediate consequence of the defendant's . . . activity,'" (citing the Court of Appeals, 941 F.2d 145 (CA2 1991)).

[32] See, e.g., United Phosphorus, Ltd. v. Angus Chem. Co, 131 F.Supp.2d 1003 (N.D.Ill. 2001) (interpreting what conduct has a direct, substantial, and reasonably foreseeable effect, the Court states that Congress enacted the Foreign Trade Antitrust Improvements Act, which amended the Sherman Act, because it believed that American jurisdiction over international commerce should be limited to transactions that affect the American economy).

U.S. person could be liable. Without the cost-benefit analysis weighing in favor, the CFTC should not expend its limited supervisory resources on policing transactions between two-non-U.S. persons.

3. **To the extent that Covered Transactions fall within the Commission's jurisdiction, should a non-U.S. SD be required to comply with all, or only certain, Transaction-Level Requirements? Please provide a detailed analysis of any such view and its effect on other aspects of the Commission's cross-border policy, if any. Would your view change depending on the nature of the non-U.S. SD (i.e., whether it is a guaranteed affiliate or a conduit affiliate of a U.S. person)?**

Covered Transactions that are not with a guaranteed affiliate of a U.S. person should not fall within the Commission's jurisdiction, and Transaction-Level Requirements should not apply to Covered Transactions. Conversely, swaps between a guaranteed affiliate and the non-U.S. branches of U.S. banks should fall within the Commission's jurisdiction, with the full application of the Transaction-Level Requirements. Swaps with such entities could have a direct and significant connection with activities in, or effect on, commerce of the United States. SG's thoughts on conduit affiliates are set forth at Part I (4) above.

4. **In the open meeting to consider the cross-border final guidance and cross-border phase-in exemptive order, I asked about the Commission's enforcement and legal authority under the cross-border guidance. The Commission's General Counsel replied, "[T]he guidance itself is not binding strictly. We couldn't go into court and, in a count of the complaint, list a violation of the guidance as an actionable claim." 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 policy.**

Since Congress passed the Act, foreign banks have been asking the Commission to clarify the extra-territorial application of its rules. Multiple meetings have been held with the Commission and many comment letters have been submitted on cross-border issues. The Commission has been advised repeatedly that the swap market functions globally and that it is imperative to craft regulations that respect this fundamental fact. Notwithstanding the clear and frequent message on cross-border topics, the Commission did not attempt to articulate the scope of its jurisdiction until after it had published most of its proposed rules and issued many of its final rules, and even then refrained from issuing a real rulemaking on the topic, instead opting for publication of the Guidance and the Staff Advisory. As has been aptly described in the industry lawsuit brought against the Commission with respect to the Guidance,[33] the treatment of such an important topic in a guidance issued without meeting the legal requirements of the Administrative Procedures Act[34] is a violation of Federal law.

Moreover, the Guidance and the Staff Advisory have caused damage and uncertainty throughout the swaps industry.[35] For example, before the lawsuit is resolved, non-U.S. swap dealers will be required

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[33] See SIFMA, ISDA and IIB Complaint (Civil Action No. 13-CV-1916) ("Complaint") (Dec. 4, 2013).

[34] See 5 U.S.C. § 553(b) (requiring federal agencies to publish, prior to promulgating a rule, a "notice of proposed rulemaking" and to "give interested persons an opportunity to participate in the rulemaking through submission of written data, views, or arguments").

[35] The consequences of the Commission's disjointed and ambiguous rulemaking process are numerable. For example, non-U.S. swap dealers have lost access to swap execution facility liquidity. See, e.g., ISDA derivatiViews "Market Fragmentation is Becoming a Reality" (Jan. 29, 2014). Available at: http://isda.derivativiews.org/2014/01/29/market-fragmentation-is-becoming-a-reality/. (Discusses ISDA December survey, which found 68% of respondents had reduced or ceased trading activity with U.S .persons since the swap execution facility rules came into effect,

to file a Chief Compliance Officer Annual Report as to their compliance with Title VII. This report is required to be certified personally by swap dealers' compliance personnel. Non-U.S. swap dealers will also be required to file the first of their required quarterly risk exposure reports. Each of these documents will be prepared in the face of the profound legal ambiguity and confusion in the wake of the issuance of the Guidance and Staff Advisory. A requirement to make a regulatory filing attesting to compliance with guidance and staff pronouncements that have been issued in violation of the administrative law procedures, are ambiguous and are the subject of a pending lawsuit is an inherently unfair regulatory requirement. The situation is compounded by the fact that the issues in question deal with one of the most critical aspects of Title VII: its extra-territorial application.

While SG agrees that the Guidance has no force of law, the Commission and the National Futures Association, its self-regulatory organization, have clearly treated the Guidance as if it were a *bona fide* legal obligation of swap dealers.[36] There is no reason to believe that this will not continue to be the regulators' treatment of the Guidance and Staff Advisory. The Commission's time-limited no-action letter[37] delaying the effectiveness of the Staff Advisory has left the market unsure whether to commence the costly operational work required to comply with the activity test or to gamble that there will be sufficient time to do any required implementation work once the issue is resolved.

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In summary, SG hopes that the Commission will rectify the confusion surrounding the extra-territorial application of its Title VII rules and that the Commission will follow the requirements of the Administrative Procedures Act in doing so. The Commission should work with its foreign regulatory counterparts to craft a comprehensive set of regulations that will not create conflicts, overlapping regulations or the opportunity for regulatory arbitrage; that seeks to foster competitive parity among U.S. and non-U.S. swap dealers; and that respects the Congressional edict to limit its jurisdiction where another regulator has a stronger supervisory interest. The Staff Advisory should be withdrawn and its concepts should not be adopted as a final regulation. The Commission should rethink parts of the Guidance as it works with foreign regulators to craft a sustainable rulemaking setting out the cross-border effect of its Title VII rules. Finally, SG urges the Commission to provide enough time for market participants to adjust to the Commission's final rules so as to avoid the haphazard implementation that has marred some of the Commission's other rulemakings.

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while 60% had noticed a fragmentation of liquidity.) Swap execution facility liquidity has fractured, potentially leading to higher prices and volatility. See, e.g., Peter Madigan, Risk Magazine, "CFTC Cross Border Guidance 'Has The Feel of a Rule,' Lawyers Agree' (Jan. 13, 2014). Available at: http://www.risk.net/risk-magazine/feature/2320806/cftc-cross-border-guidance-has-the-feel-of-a-rule-lawyers-agree. (For example, EUR-denominated interest-rate swap liquidity trades outside of SEFs, closing off efficient access to these products by U.S. persons.) Some clients have refused to trade with U.S.-based personnel of foreign banks, or U.S. banks, for fear of getting caught in Title VII. Trading has shifted away from electronic platforms toward bilateral trading. See, e.g., International Financial Law Review, "Bumps on the EU/US Path Forward" (Dec. 11, 2013). Available at: http://www.iflr.com/Article/3288748/Bumps-on-the-EUUS-Path-Forward.html. Swap dealers have moved swap dealing personnel offshore. See, *supra* note 26. Non-U.S. affiliates of U.S person swap dealers have terminated longstanding guarantees of their businesses.

[36] See Complaint, at paragraphs 3, 4.

[37] See Commission No-Action Letter No. 14-01, *supra* and note 29.

SG appreciates having the opportunity to comment. We hope these comments have been constructive and will help the Commission's review of its cross-border jurisdiction. SG would be pleased to meet with the Commission at any time to discuss our comments.

Respectfully,

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General Counsel