FINANCIAL SERVICES ROUNDTABLE

March 10, 2014

Ms. Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Comment Letter on the 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 Ms. Jurgens:

The Securities Industry and Financial Markets Association ("**SIFMA**"), the Futures Industry Association ("**FIA**") and The Financial Services Roundtable ("**FSR**") (together, the "**Associations**")[1] appreciate the opportunity to provide the Commodity Futures Trading Commission (the "**Commission**") with comments on the advisory issued by the Commission staff on November 14, 2013 (the "**Staff Advisory**").[2] The Staff Advisory addresses the applicability of certain Commission regulations to activity in the United States of swap dealers ("**SDs**") and major swap participants ("**MSPs**") registered with the Commission that are established in jurisdictions other than the United States.[3]

[1] Further information about the Associations is available in Annex C.

[2] CFTC Staff Advisory No. 13-69, Division of Swap Dealer and Intermediary Oversight Advisory Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/13-69.pdf.

[3] 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, 79 Fed. Reg. 1,347 (Jan. 8, 2014) ("**Request for Comment on Staff Advisory**").

Over the past several months, the Commission's introduction of elements of a personnel-based test to the cross-border application of its swaps rules has concerned us greatly. The location of personnel involved in a swap transaction does not alter the risk posed by the swap transaction, making the location of personnel inapposite to the risk-reduction goal of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Title VII**" of the "**Dodd-Frank Act**"). In addition, a personnel-based approach is impractical for the swaps markets and inconsistent with the Commission's general cross-border approach to the application of its Title VII rules, which our members have spent, and are continuing to spend, significant time and resources building towards over the past several months.

We believe the Commission misreads Section 2(i) of the Commodity Exchange Act ("**CEA**") to require a personnel-based test. Section 2(i) of the CEA is a restriction on the Commission's cross-border jurisdiction that is to be read in light of the Dodd-Frank Act's broader purpose, rather than in isolation. Title VII of the Dodd-Frank Act was adopted, in significant part, to decrease risk in the U.S. swaps markets through risk-based regulation. Thus, if a swap transaction does not import risk into the United States, it should not be subject to Title VII or the Commission's rules thereunder. Accordingly, Section 2(i) of the CEA should be read as a limitation on those circumstances where the Commission can assert jurisdiction, not as an invitation to the Commission to adopt a personnel-based approach to swaps regulation in the absence of such a risk-based nexus.

A personnel-based approach to swaps regulation is impractical for the swaps markets. It is hard enough to determine, even on a counterparty-by-counterparty basis, whether a specific market participant is a "U.S. person," "guaranteed affiliate" or "conduit affiliate" and to apply swaps rules accordingly. It is virtually impossible, however, to be able to determine on a trade-by-trade basis whether each specific contact with a counterparty or potential counterparty has some nexus to the United States that could trigger application of the Commission's requirements.

Finally, no cost-benefit analysis has been undertaken, and personnel-based tests cannot be justified by cost-benefit analysis. The Commission's entity-based requirements are themselves broad, and the burden they impose will be compounded, with no discernible benefit for U.S. markets, by adoption of a personnel-based approach that differs significantly from, and is inconsistent with, the existing entity-based approach. To expect market participants to create additional systems to determine—on a trade-by-trade basis—whether a swap meets the Commission's new personnel-based tests would be economically, technologically and operationally impracticable for these market participants, with no discernible benefit.

We strongly believe that the Commission can only solve these fundamental issues by abandoning the personnel-based elements it has recently sought to impose. We

emphasize that the Commission's approach should ensure that competitive imbalances are not created and proper account is taken of comparable foreign regulation.

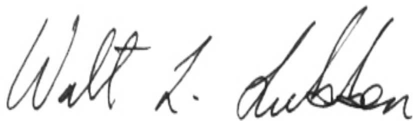
We describe these concerns in greater detail below. In case the Commission nonetheless decides to impose a personnel-based approach, we also provide detailed suggestions and specific responses to the Commission's questions in Annex A of this letter. Annex B includes a summary chart.

* * *

We thank the Commission for its consideration of our comments. Please feel free to contact the Associations should you wish to discuss this letter.

Respectfully submitted,

Kenneth E. Bentsen, Jr.
President and Chief Executive Officer
SIFMA



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ANNEX A

Recommendations in Response to Issues Presented in the Staff Advisory

Recommendation 1: The Commission should eliminate all personnel-based tests, including in the Staff Advisory. Personnel-based tests (i) misread Section 2(i) of the Commodity Exchange Act, which is in fact a limitation on the Commission's cross-border jurisdiction, (ii) require a trade-by-trade analysis that is impractical to implement for the swaps markets and (iii) have not been subject to, and cannot be justified by, cost-benefit analysis.

In its Cross-Border Rule,[4] the Commission largely adopted an "entity-based approach" that looks to the status of the counterparties to a swap in determining the applicability of its swap rules. Under this approach, the extent to which the Commission's swap-related rules apply to a transaction generally depends on whether the counterparties fit within the broad definitions of "U.S. person," "guaranteed affiliate" or "conduit affiliate."

Over the past several months, we have become increasingly concerned by a pattern of the Commission introducing, on top of its entity-based approach, a "personnel-based approach" to the cross-border application of its Title VII swap rules. Though it takes a number of different forms, the personnel-based approach generally looks to the location of personnel or agents, in addition to the legal entities into which the swap risk is being booked, in determining the applicability of the Commission's Title VII swap rules, with no consideration of whether there is a "direct and significant connection with . . . or effect on" U.S. commerce or activities. Examples within the Commission's Cross-Border Rule, staff advisories and staff guidance (collectively, the "**Cross-Border Provisions**") include:

- *the Staff Advisory*, which looks to whether a non-U.S. SD regularly uses personnel or agents located in the United States to arrange, negotiate or execute swaps with a non-U.S. person;[5]

- *prong (i) of the factors to consider whether a swap is "with" a foreign branch in the Cross-Border Rule*, which looks to whether employees negotiating and agreeing to the terms of the swap are located in the foreign branch or in another foreign branch of the U.S. bank;[6]

[4] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).

[5] Staff Advisory at 2.

[6] Cross-Border Rule, 78 Fed. Reg. at 45,330.

- *footnote 513 of the Cross-Border Rule*, which would require a U.S. branch of a non-U.S. SD to comply with Transaction-Level Requirements, without the availability of substituted compliance;[7]

- *Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities*,[8] which would require a non-U.S. multilateral trading platform to register with the Commission as a swap execution facility ("**SEF**") if it provides U.S. persons or persons located in the United States with the ability to trade or execute swaps on or pursuant to the rules of the platform, whether directly or indirectly through an intermediary; and

- *footnote 44 of CFTC Letter 14-16*, which would revoke the no-action relief granted to qualifying multilateral trading facilities overseen by competent authorities designated by European Union Member States ("**Qualifying MTFs**") in circumstances where a significant proportion of the market participants that a Qualifying MTF permits to effect transactions are U.S. persons or U.S.-located persons or where a significant proportion of a Qualifying MTF's trading volume is attributable to U.S. persons or U.S.-located persons.[9]

We believe that personnel-based tests (i) misread Section 2(i) of the CEA, which is in fact a limitation on the Commission's cross-border jurisdiction, (ii) require a trade-by-trade analysis that is impractical to implement for the swaps markets and (iii) have not been subject to, and cannot be justified by, cost-benefit analysis. A personnel-based test is particularly flawed when applied in conjunction with, and in addition to, the entity-based approach that the Commission already has deployed toward swaps regulation. The Commission justified its entity-based framework—which itself is overbroad—with reference to whether risk was (in the Commission's judgment) being introduced to U.S. markets or for U.S. market participants. The personnel-based approach the Commission is proposing to use compounds the excessive breadth and burden of the existing, entity-based regulatory structure by approaching swaps regulation from an entirely different direction, layering even more requirements and burdens onto market participants, and doing so in the absence of any discernible risk to U.S. markets. In short, the personnel-based approach cannot rationally be reconciled with the Commission's entity-based requirements, and in circumstances where the Commission should be seeking to reduce the scope

[7] *See id.* at 45,350 n.513.

[8] Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities (Nov 15, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/dmosefguidance111513.pdf ("**SEF Guidance**").

[9] *See* CFTC Letter No. 14-16, Conditional No-Action Relief with respect to Swaps Trading on Certain Multilateral Trading Facilities Overseen by Competent Authorities Designated by European Union Member States (Feb. 12, 2014), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/14-16.pdf ("**CFTC Letter 14-16**").

and costs of its improper entity-based requirements, it is unnecessarily increasing regulatory burdens instead.

The Commission misreads CEA Section 2(i) to require a personnel-based test; in fact, Section 2(i) limits the Commission's ability to impose a personnel-based test

Section 2(i) of the CEA provides that the swap provisions of the CEA "shall not apply to activities outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States or (2) [are evasive]."[10]

We understand that the Commission reads the fact that Section 2(i) "**shall not apply to activities outside the United States** unless" one of two conditions are met to mean that Title VII swap rules *must* apply to activities within the United States, where "activities" include conduct of personnel. We believe this reading is mistaken for two reasons.

First, the introduction to Section 2(i) does not say that the Commission's Title VII swap rules "shall apply to activities within the United States." Instead, it is a limiting factor, stating that the Commission cannot assert jurisdiction outside the United States unless certain criteria are met. Requiring that a rule *not* apply to a situation does not require that the rule apply to all other situations. If Congress had intended to write that all Commission rules must apply whenever there is any sort of "activity" within the United States, it could have written Section 2(i) as defining the Commission's jurisdiction within the United States rather than limiting the Commission's jurisdiction outside the United States.

Second, we do not believe that "activities" in this context should be read by the Commission to include conduct by non-U.S. entities using personnel in the United States. The term "activities" must be interpreted in light of the goals of the statute into which it appears. As stated above, the "activity" that poses risk in the swaps markets is the ongoing payments between swap counterparties that pose credit risk. Risk mitigation concerns are not implicated, however, where two non-U.S. persons use U.S. personnel or agents to arrange, execute or negotiate a swap contract from within the United States. In fact, we believe the personnel-based test could potentially *increase* the risk of systemically important financial institutions by discouraging and limiting their ability to rely on U.S. expertise in managing U.S.-related risks if a large number of these positions are relocated in response to the imposition of the personnel-based test.

The trade-by-trade analysis of personnel-based tests is impractical in the swaps markets

Swap transactions between the same counterparties may be arranged, negotiated and executed by different personnel in different locations. As a result, personnel-based tests necessitate a trade-by-trade analysis to determine the application of personnel-based Commission regulations. Such a personnel-focused, trade-by-trade analysis is not feasible and does not comport with the modern model of international financial institutions. Even if such trade-by-

[10] CEA Section 2(i).

trade tracking of personnel were possible, demanding that a particular swap between two non-U.S. persons (including non-U.S. persons that are guaranteed affiliates of U.S. persons), or between a foreign branch of a U.S. SD and a non-U.S. person, be completely isolated from the United States would severely hamper these markets and the market participants worldwide that use swaps to hedge risks.

Such trade-by-trade tracking of personnel prevents counterparties from predicting with certainty at the outset of a swap trading relationship what regulatory requirements will apply to their swap transactions. As an example, a non-U.S. counterparty may transact in interest rate swaps with non-U.S. SDs (including non-U.S. SDs that are guaranteed affiliates of U.S. persons) that are not subject to the Commission's mandatory clearing and trade execution requirements under the Cross-Border Rule.[11] As a result, the non-U.S. counterparty may not have established clearing relationships with futures commissions merchants or entered into the requisite onboarding agreements with SEFs. To suddenly require, based on the location of the SD's personnel, that certain of the counterparty's swaps be subject to the Commission's Transaction-Level Requirements, including clearing and trade execution, would have a number of unexpected and costly consequences for such counterparties.[12] Similarly, if a foreign branch of a U.S. SD transacts with a non-U.S. person using certain U.S. personnel, the trade would not be considered "with" the foreign branch and, as a result, the non-U.S. counterparty would be required to count that transaction towards its *de minimis* threshold. It would be extremely difficult, if not impossible, for SDs to accurately and adequately monitor compliance with this personnel-based test on a trade-by-trade basis.

In some markets, personnel-based tests could capture swap transactions that occur within the United States merely as a function of time of day. For example, a typical foreign exchange ("**FX**") business is run as a global book, with the trading book "passed" around the globe to follow the sun. These markets remain open throughout the day, and their potential volatility requires that market participants must have personnel worldwide to monitor and dynamically manage the risk of existing trades. Assuming that the risk of these trades is booked to a non-U.S. entity (including a non-U.S. SD that is a guaranteed affiliate of a U.S. person) or a foreign branch of a U.S. SD, there appears to be no justification for increasing the risk to the firm globally by prohibiting personnel in New York from dynamically managing the risk after business hours in London and Tokyo. As a consequence, many non-U.S. clients will no longer transact with the U.S. offices of their U.S. SD and non-U.S. SD counterparties.

In addition, because the swaps markets are international, the negotiation, execution and booking of swap transactions will, in many cases, occur in multiple jurisdictions, which could

[11] Cross-Border Rule, 78 Fed. Reg. at 45,352-53.

[12] Similar considerations would arise if the Commission's external business conduct standards were to be suddenly applied to a transaction between a non-U.S. counterparty and a non-U.S. SD (including a non-U.S. SD that is a guaranteed affiliate of a U.S. person) or foreign branch of a U.S. SD for which the counterparties had not previously entered into the requisite documentation to ensure compliance with those requirements.

cause confusion as to whether the swap falls within the scope of the personnel-based tests. As noted above, to comply with this requirement, market participants would have to develop complex systems to assess on a trade-by-trade basis whether the Commission's personnel-based regulations apply. The complexity of this personnel-based approach likely could lead to two counterparties reaching different and contradictory conclusions with respect to the same transaction.

No cost-benefit analysis has been undertaken, and any such cost-benefit analysis would not justify a personnel-based test

As discussed above, the Commission already has imposed extensive—and, we believe, improper—requirements based on an entity-based approach toward swaps regulation. Over the past two years, market participants have been engaged in the difficult task of developing systems to comply with the Commission's entity-based approach as described in the Cross-Border Rule and have invested significant time and resources towards compliance with such an approach. It is arbitrary and capricious to impose yet more burdens on market participants based on an entirely new regulatory rationale. Since a personnel-based approach requires a transaction-by-transaction analysis that tracks personnel used throughout the transaction not required in the Commission's entity-based approach, it would necessitate rethinking and rebuilding much of the infrastructure developed, and still being developed, over the past two years, increasing the ongoing costs with no clear benefit.

As a legal matter, it is well established that, in adopting regulations under the CEA, the Commission must assess the relevant costs and benefits and adopt regulations that minimize the cost of regulations to the extent possible. Given two ways to implement a regulation with significantly differing costs to market participants, the Commission must choose the option with lower cost unless the difference in benefits justifies the additional cost.[13] The personnel-based test in the Staff Advisory, like the Cross-Border Rule itself, was not subject to any cost-benefit analysis. As a result, the Commission has not assessed and weighed the relative costs and benefits associated with a personnel-based test.

We believe that the personnel-based test is unnecessary and cannot be justified by cost-benefit analysis, either in isolation or when viewed in light of the Commission's existing entity-based approach, which market participants have already put significant resources into implementing.

Given the enormous difficulty and cost of engaging in a personnel-focused, trade-by-trade analysis to determine the applicability of requirements, the benefits of adopting the Staff Advisory would need to be large in order to justify the cost. We firmly believe this is not the

[13] 7 U.S.C. § 19(a); *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1151 (D.C. Cir. 2011) (interpreting similar obligation of the SEC to require considering "cost[s] at the margin"); *see also* Exec. Order 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993) at § 1(b)(6) (requiring agencies to choose the most cost-effective of competing regulatory alternatives).

case. The fact that a swap is conducted using personnel within the United States between two counterparties that are not U.S. persons, or between a non-U.S. person and a foreign branch of a U.S. SD, does not import the risk of the swap transaction into the United States, and therefore does not address the Dodd-Frank Act's key concern with swap market risk mitigation. As a result, the additional benefits of capturing entities through the imposition of a personnel-based approach layered on top of an existing entity-based approach are minimal and fall far short of the cost it imposes.

A personnel-based test could have significant negative consequences for U.S. jobs, which may not have been considered by the Commission to this point. Non-U.S. SDs and foreign branches of U.S. SDs are under increasing pressure from their non-U.S. counterparties to ensure that their trades are not subject to the Commission's Title VII swap rules due to the overwhelming complexity and potential conflicts that will arise when attempting to comply with both Title VII swap rules and similar rules adopted by other G-20 countries. As a result, many non-U.S. SDs, and many U.S.-based firms with foreign branches or affiliated non-U.S. SDs, may face increasing pressure from their counterparties to relocate or move U.S. jobs to non-U.S. locations if the personnel-based test is adopted in the Staff Advisory or maintained in the Cross-Border Rule.

Finally, we believe that the personnel-based test fails to give due recognition to the compelling supervisory interests of home regulators in the jurisdictions in which these transactions occur. Such an approach would depart from the Path Forward Agreement entered into between the Commission and the EU in July 2013, where the Commission and the EU stated that:

> EU registered dealers who are neither affiliated with, nor guaranteed by, US persons, would be generally subject only to US transactional rules for their transactions with US persons or US guaranteed affiliates. . . .
>
> We will not seek to apply our rules (unreasonably) in the other jurisdiction, but will rely on the application and enforcement of the rules by the other jurisdiction.[14]

Recommendation 2: To the extent the Commission adopts the Staff Advisory, it must be adopted as a rule pursuant to the Administrative Procedure Act.

We believe that the Staff Advisory, like the Cross-Border Rule itself, is a "rule" under the Administrative Procedure Act ("**APA**") and a "regulation" under the CEA. Accordingly, we believe that in issuing the Staff Advisory, the Commission is required to observe the rulemaking procedures contemplated by the APA and the CEA, including the provision of a thorough and detailed cost-benefit analysis and the opportunity for public comment on a rule proposal. Instead,

[14] Cross-Border Regulation of Swaps/Derivatives Discussions between the Commodity Futures Trading Commission and the European Union – A Path Forward (July 11, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/jointdiscussionscftc_europeanu.pdf.

the personnel-based test was adopted in the form of a staff advisory that was not subject to a cost-benefit analysis and was not voted on by the Commission.

As Commissioner O'Malia correctly notes, "the CFTC needs to do away with the reflexive rule implementation process via staff no-action and advisories that are not voted on by the Commission. It should be the goal of the Commission to develop rules that adhere to the APA and ensure proper regulatory oversight, transparency and promote competition in the derivatives space."[15]

We believe that the Commission's personnel-based test should be subject to a rigorous cost-benefit analysis, open to public comment and voted on by the Commission. These procedural safeguards would provide market participants with much-needed clarity as to the justifications for, and scope and enforceability of, any personnel-based test that the Commission seeks to adopt.

Recommendation 3: To the extent the Commission adopts a personnel-based test, there must be a single, uniform test that is clear, objective and ascertainable, with any variations to that test explicitly described by the Commission and based on differences in the purposes for which the personnel-based test is used.

As described above, the Commission has sought to impose a hybrid entity- and personnel-based approach by introducing elements of personnel-based tests in several of the Cross-Border Provisions. These tests, however, are neither uniform nor consistent, and no particular logic is expressed for the differences among the personnel-based tests. Instead, in each instance a different personnel-based test is used to determine whether personnel or activities within the United States would be sufficient to enable the Commission to exercise jurisdiction over such activities, and it is unclear whether the differing language has independent meaning or is simply different words used to get to the same result. For example:

- *Prong (i) of the factors to consider whether a swap is "with" a foreign branch in the Cross-Border Rule.* "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."[16]

- *Footnote 513 of the Cross-Border Rule.* "[A] U.S. branch of a non-U.S. swap dealer or MSP would be subject to Transaction-Level Requirements, without substituted compliance . . . the Commission also recognizes its strong supervisory interest in

[15] Request for Comment on Staff Advisory, 79 Fed. Reg. at 1,349.

[16] Cross-Border Rule, 78 Fed. Reg. at 45,330.

regulating the dealing activities that occur within the United States, irrespective of the counterparty . . . ."[17]

- *The Staff Advisory*. "DSIO is of the view that a non-U.S. [SD] (whether an affiliate or not of a U.S. person) regularly using personnel or agents located in the U.S. to arrange, negotiate, or execute swaps with a non-U.S. person generally would be required to comply with the Transaction-Level Requirements."[18]

- *Division of Market Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities*. "The Division expects multilateral swaps trading platforms located outside the United States that provide U.S. persons or persons located in the U.S. (including personnel and agents of non-U.S. persons located in the United States) with the ability to trade or execute swaps on or pursuant to the rules of the platform, either directly or indirectly through an intermediary, to register as a SEF or DCM."[19]

- *Footnote 44 of CFTC Letter 14-16*. "Additionally, DMO and/or DSIO could determine that certain relief is no longer warranted, and that alternatively SEF or DCM registration is necessary, in circumstances where a significant proportion of the market participants that an MTF permits to effect transactions are U.S. persons or U.S.-located persons; or where a significant proportion of an MTF's trading volume is attributable to U.S. persons or U.S.-located persons. In order to monitor these levels of participation and volume from U.S. persons and U.S.-located persons, MTFs that receive no-action relief pursuant to this no-action letter may be required as a condition of that relief to submit periodic reports to CFTC staff concerning those levels of participation and volume, as well as the levels of participation and volume attributable to non-U.S. person and non-U.S.-located persons."[20]

As these examples illustrate, the Commission has failed to adopt a single, consistent personnel-based test, which has resulted in further confusion among market participants that are continually forced to reassess whether their activities comply with the Commission's expanding web of complex rules, advisories and guidance.

In each of these personnel-based tests, no guidance is provided to market participants as to the meaning of each of the critical terms used. For example, the Commission does not clarify the meaning of the phrase "negotiating and agreeing to the terms of the swap" in the Cross-Border Rule to determine if a swap is considered "with" a foreign branch of a U.S. SD, nor does

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[17] *See id.* at 45,350 n.513.

[18] Staff Advisory at 2.

[19] SEF Guidance at 2.

[20] CFTC Letter 14-16 at 10-11 n.44.

the Commission staff provide guidance as to the meaning of the phrase "arrange, negotiate, or execute a swap" in the Staff Advisory. The phrases are similar, though not identical, which causes confusion as to whether they should be interpreted in a similar manner.

To the extent that the Commission adopts a personnel-based approach, it is critical that market participants are able to look to a uniform, clear, objective and ascertainable personnel-based test to determine whether their transactions are subject to the Commission's requirements, with any variations to that test explicitly described by the Commission and based on differences in the purposes of the personnel-based test. A workable test must be clear, must provide a bright line with respect to whether a given entity is or is not subject to the Commission's requirements and must rely only on information that counterparties can reasonably and systematically diligence. The definition should seek to preserve the Commission's legitimate interest in protecting the U.S. financial system from undue systemic risk while decreasing regulatory complexity and uncertainty.

Recommendation 4: To the extent the Commission adopts a personnel-based test, it should only apply the test to those requirements that implicate conduct concerns.

In the Cross-Border Rule discussion of the application of Transaction-Level Requirements, the Commission notes that "a major purpose of Title VII is to control the potential harm to U.S. markets that can arise from risks that are magnified or transferred between parties via swaps."[21] As a result, the Commission imposes Category A Transaction-Level Requirements, which are "designed to constrain such risk mitigation and transfer."[22]

The risks that many of these Transaction-Level Requirements are "designed to constrain" are not dependent upon, or heightened as a result of, the location of personnel or agents that are involved in such transactions. As a result, to the extent the Commission adopts a personnel-based test, that personnel-based test should not apply to Category A Transaction-Level Requirements.

For example, where a non-U.S. SD (including a non-U.S. SD that is a guaranteed affiliate of a U.S. person) and a non-U.S. person enter into a swap transaction using personnel located in the United States, no additional risk is imported into the United States that would justify the application of the clearing requirement. The use of U.S.-based agents or personnel does not change the fact that the credit risk remains between the non-U.S. counterparties to the swap. Similarly, where a foreign branch of a U.S. SD transacts with a non-U.S. person, the involvement of U.S. personnel does not alter the risk between these counterparties, which is addressed through the application of Category A Transaction-Level Requirements. In other

[21] Cross-Border Rule, 78 Fed. Reg. at 45,353.

[22] *Id*.

words, the location of agents or personnel in the United States has no bearing on where the credit risk of a swap resides and therefore should not dictate whether clearing is required.

Similarly, a non-U.S. multilateral trading platform does not import any risk into the United States because it uses U.S.-based agents or personnel in the execution of swaps between non-U.S. persons that would justify requiring the non-U.S. platform to register as a SEF. Relatedly, where a non-U.S. SD (including a non-U.S. SD that is a guaranteed affiliate of a U.S. person) executes an anonymous trade with a non-U.S. person through a trader in the United States, the presence of the trader does not alter the risk profile of that swap transaction and should not dictate that trade execution be required. Moreover, the Commission's transparency and market integrity concerns are already addressed by its regulation of transactions executed on registered DCMs and SEFs.

Margin and segregation requirements for uncleared swaps, as another example, do not implicate conduct concerns; these requirements are designed to reduce risk exposures between counterparties by requiring such exposures to be fully collateralized.[23] Under the Staff Advisory, however, a non-U.S. SD (including a non-U.S. SD that is a guaranteed affiliate of a U.S. person) may be required to collect initial margin from non-U.S. counterparties with respect to certain products and not others based on the use of U.S.-based personnel or agents. For example, a non-U.S. SD may use U.S. personnel to complete FX trades that exceed the local time zone in Europe. As a result, it would be required to collect margin from its non-U.S. counterparties for these FX trades notwithstanding the absence of any additional risk being imported into the United States as a result of the presence of the U.S.-based personnel.

The inconsistent application of portfolio reconciliation and compression requirements that could arise as a result of the personnel-based test is yet another example of the impracticalities of such an approach. For example, a non-U.S. SD (including a non-U.S. SD that is a guaranteed affiliate of a U.S. person) and a non-U.S. counterparty enter into swaps that are not subject to Transaction-Level Requirements under the Cross-Border Rule. If the non-U.S. SD uses U.S. personnel for certain swaps with that same counterparty that trigger the application of Transaction-Level Requirements for those swaps, it is not clear which swaps would have to be reconciled and compressed—the portfolio of swaps subject to the Commission's Transaction-Level Requirements or the entire portfolio of swaps between the counterparties.

If the Commission chooses to apply Category B Transaction-Level Requirements in these circumstances, we believe that the Commission should distinguish between those Category B Transaction-Level Requirements that apply at the counterparty relationship level and those that apply to the specific transaction for which a counterparty could reasonably expect U.S. laws to apply.[24] Category B Transaction-Level Requirements that apply on a relationship level do not

[23] *See id.* at 45,334.

[24] We would urge the Commission to confirm that non-U.S. persons would not be considered "special entities" within the meaning of 17 C.F.R. 23.401(c), other than certain foreign endowments (see Business Conduct

implicate the conduct concerns that the Commission is concerned with addressing and thus, with respect to those relationship-level requirements, the Commission should defer to local regulators that impose similar obligations on market participants in the jurisdictions in which those transactions occur. There is a greater rationale for applying transaction-specific requirements based on a personnel-based test, which include the disclosure of material information, including the requirement to provide counterparties with a pre-trade mid-market mark,[25] and clearing disclosure requirements.[26]

It is also critical that a reasonable and realistic phase-in period be provided to market participants to ensure the orderly and successful implementation of these transaction-specific requirements. The phase-in period should provide affected market participants with sufficient time to educate their counterparties and to obtain from them the requisite documentation to come into compliance with these requirements. The Commission's approach should ensure that competitive imbalances are not created and proper account is taken of comparable foreign regulation.

Recommendation 5: To the extent the Commission adopts the specific personnel-based test in the Staff Advisory, the Commission must clearly define what triggers the personnel-based test. Specifically, only *direct communications by personnel in the United States with counterparties that commit the SD to the execution of the transaction* should trigger application of the Staff Advisory.

The Commission's personnel-based test in the Staff Advisory would require any non-U.S. SD that "regularly" uses personnel or agents in the United States to "arrange, negotiate, or execute" a swap with a non-U.S. person to comply with Transaction-Level Requirements. The terms "regularly" and "arrange, negotiate, or execute" are not defined.

We believe that the Commission should clarify and simplify what triggers the application of Title VII swap requirements through the personnel-based test. In justifying the purpose of the Staff Advisory, the staff notes that "DSIO believes that persons regularly arranging, negotiating, or executing swaps for or on behalf of an SD are performing core, front-office activities of that SD's dealing business."[27] We believe that the Commission should thus be more explicit that the personnel-based test in the Staff Advisory is limited to "front-office" activities with counterparties. Specifically, only *direct communications by personnel located in the United States with counterparties that commit the SD to the execution of the transaction* should trigger

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Standards for Swap Dealers and Major Swap Participants With Counterparties, 77 Fed. Reg. 9734, 9776 (Feb. 17, 2012)). Such an exclusion would be consistent with congressional intent and would avoid conflicts with foreign law.

[25] 17 C.F.R. 23.431.

[26] 17 C.F.R. 23.432.

[27] Staff Advisory at 2.

application of the requirements under the Staff Advisory.[28] If there is no direct communication between personnel located in the United States and the swap counterparty that commits the SD to the execution of the specific swap transaction, there is no reason for the swap counterparty to have a reasonable expectation that U.S. laws will apply to its transaction.[29]

Middle- and back-office operations, including arranging and negotiating trading relationships and legal documentation and providing legal advice as well as providing credit terms and technical terms, market color, market research or a general discussion of the swap transaction, do not implicate concerns that the Dodd-Frank Act, and the CEA, are designed to address. Standards such as "arranging" or "negotiating" have created tremendous confusion among market participants. The successful implementation of any Commission standard hinges on clear, simple and bright-line rules, based on objective criteria, that can easily be applied by market participants. We believe that the test proposed above, which looks to whether personnel have committed the SD to the execution of the transaction, satisfies these criteria. This proposed approach is also consistent with the legal and accounting treatment of swap transactions—once there is a committed trade, whether by written or oral agreement, the trade is booked and constitutes a committed trade.

Further, rarely do the personnel at the counterparty making swap business decisions interact with these middle- and back-office functions with respect to executing a specific swap. Further, these functions often are centralized for efficiency reasons. As a result, the presence of middle- or back-office personnel that perform these functions in a particular locale should not be indicative of that jurisdiction's connection to a particular swap transaction.

The Commission does not provide any clarity as to the meaning of "regularly" engaging in these core, front-office activities. This concept should be removed from the Staff Advisory and replaced with the proposed standard that looks to whether U.S. personnel have committed the SD to the execution of the swap. This standard is clear and simple and can be easily applied by market participants. In recognizing the challenges of applying any personnel-based approach, SDs must make diligent, good faith efforts to adhere to any U.S. personnel-based approach. Rare deviations, such as when a trader is on vacation or temporarily in the United States, should be viewed in the context of the SD's reasonable and good faith efforts to fully comply with the terms of the Staff Advisory.[30]

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[28] For these purposes, "counterparties" refer to market participants that are not registered with the Commission as SDs or MSPs.

[29] This would therefore exclude any electronic trading that does not involve direct interaction between personnel of both the SD and the counterparty in executing a particular swap (e.g., "click-to-trade").

[30] Such an approach is consistent with that expressed by the Commission in the Final Exemptive Order Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 858, 874 (Jan. 7, 2013).

Recommendation 6: To the extent the Commission adopts a personnel-based test, substituted compliance should be available for requirements triggered solely by the personnel-based test.

The Staff Advisory would not allow substituted compliance for requirements triggered by its personnel-based test. We believe that, to the extent the Commission adopts a personnel-based test, substituted compliance should be available for requirements triggered solely by the personnel-based test, as the nexus to U.S. risk is no greater than for other instances for which the Commission has authorized the use of substituted compliance.

Under the Cross-Border Rule, a non-U.S. SD would be eligible for substituted compliance to satisfy Category A Transaction-Level Requirements for swaps with non-U.S. persons that are guaranteed and conduit affiliates.[31] While no substituted compliance for Category B Transaction-Level requirements is available, this is because a non-U.S. SD (including a non-U.S. SD that is a guaranteed affiliate of a U.S. person) or a foreign branch of a U.S. SD is not required to comply with Category B Transaction-Level Requirements for swaps with all non-U.S. persons.[32]

We believe that the U.S. nexus of a non-U.S. SD required to comply with Transaction-Level Requirements due to the use of U.S. personnel is no greater than the nexus of guaranteed or conduit affiliates, and therefore these same international comity principles dictate permitting non-U.S. SDs to rely on substituted compliance for any Transaction-Level Requirement that is implicated by the personnel-based test when dealing with all non-U.S. persons. Giving due recognition to the "stronger supervisory interest"[33] of its home regulator would ensure that the non-U.S. SD is not subject to multiple, and possibly duplicative, sets of regulations.

We would also urge the Commission to clarify that if one counterparty to a swap can rely on substituted compliance, the swap as a whole should be eligible for substituted compliance. If the Commission's requirements are triggered as a result of a personnel-based test, we submit that substituted compliance should be permitted for the *transaction* rather than the counterparty.

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[31] Cross-Border Rule, 78 Fed. Reg. at 45,353.

[32] *See id* at 45,361.

[33] *See id.* at 45,360.

ANNEX B

Summary Chart of Recommendations in Response to Issues Presented in the Staff Advisory

Question in Staff Advisory	Recommendations	Page in Letter
Q1; Q2; O'Malia Q1; O'Malia Q2; O'Malia Q4	The Commission should eliminate all personnel-based tests, including in the Staff Advisory. Personnel-based tests (i) misread Section 2(i) of the Commodity Exchange Act, which is in fact a limitation on the Commission's cross-border jurisdiction, (ii) require a trade-by-trade analysis that is impractical to implement for the swaps markets and (iii) have not been subject to, and cannot be justified by, cost-benefit analysis.	A-1
Q1; O'Malia Q4	To the extent the Commission adopts the Staff Advisory, it must be adopted as a rule pursuant to the Administrative Procedure Act.	A-6
Q1; Q5	To the extent the Commission adopts a personnel-based test, there must be a single, uniform test that is clear, objective and ascertainable, with any variations to that test explicitly described by the Commission and based on differences in the purposes for which the personnel-based test is used.	A-7
Q2; O'Malia Q3	To the extent the Commission adopts a personnel-based test, it should only apply the test to those requirements that implicate conduct concerns.	A-9
Q5; Q6	To the extent the Commission adopts the specific personnel-based test in the Staff Advisory, the Commission must clearly define what triggers the personnel-based test. Specifically, *only direct communications by personnel in the United States with counterparties that commit the SD to the execution of the transaction* should trigger application of the Staff Advisory.	A-11
Q4	To the extent the Commission adopts a personnel-based test, substituted compliance should be available for requirements triggered solely by the personnel-based test.	A-13

ANNEX C

About the Signatories

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