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May 11, 2015

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: Initial Response to District Court Remand Order in *Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission*, RIN 3038-AE27[1]

Secretary Kirkpatrick:

The Institute of International Bankers (the "Institute") welcomes the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") in response to the above-captioned proposal to supplement the cost-benefit analysis contained in certain rulemaking preambles (the "Proposal"). The Proposal requests comment on, among other matters, whether the costs and benefits of the extraterritorial application of certain Commission rules under Section 2(i) of the Commodity Exchange Act (the "CEA") are different from the costs and benefits of the domestic application of those rules.

The Institute appreciates the Commission's efforts to obtain public input with respect to its cost-benefit analysis. As discussed in this letter, we have identified significant differences in the costs and benefits of the application of Commission rules to (i) swaps entered into between a non-U.S. swap dealer and a non-U.S. person, neither of which is a guaranteed or conduit affiliate ("Non-U.S. Swaps"), as compared to (ii) swaps involving at least one U.S. person or guaranteed or conduit affiliate counterparty ("U.S. Swaps"). We believe that the

1 80 Fed. Reg. 12,555 (Mar. 10, 2015). This letter addresses the rulemakings identified in footnote 3.

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

Commission should take these differences into account when determining whether or how to apply its rules to Non-U.S. Swaps.

BACKGROUND

In its order in *Securities Industry and Financial Markets Association, et al. v. United States Commodity Futures Trading Commission*, No. 13-1916 (D.D.C. Sept. 16, 2014) ("*SIFMA v. CFTC*"),[2] the United States District Court for the District of Columbia remanded eight swaps-related rulemakings to the Commission to address what the court held to be inadequacies in the Commission's explanation of its consideration of the costs and benefits in those rulemakings.[3] In response, the Commission has proposed to supplement the preambles of those rulemakings by explaining that, where the Commission did not specifically refer to matters of location, its discussion of costs and benefits in those preambles referred to the effects of its rules on all business activity subject to its regulations, whether by virtue of the activity's physical

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2 --- F.Supp.3d ---, 2014 WL 4629567 ("Op.").

3 The remanded rulemakings are: Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1,182 (Jan. 9, 2012) ("Real-Time Reporting Rule"); Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2,136 (Jan. 13, 2012) ("SDR Reporting Rule"); Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2,613 (Jan. 19, 2012) (the "Swap Entity Registration Rule"); Swap Dealer and Major Swap Participant Recordkeeping, Reporting and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20,128 (Apr. 3, 2012) ("Daily Trading Records," "Risk Management," and "Chief Compliance Officer" Rules); Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant", 77 Fed. Reg. 30,596 (May 23, 2012) ("Entity Definition Rule"); Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 Fed. Reg. 35,200 (June 12, 2012) ("Historical SDR Reporting Rule"); Confirmation, Portfolio Reconciliation, Portfolio Compression, and Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants, 77 Fed. Reg. 55,904 (Sept. 11, 2012) ("Portfolio Reconciliation Rule"); and Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33,476 (June 4, 2013) ("SEF Registration Rule"). This letter addresses each of the remanded rulemakings, except the Swap Entity Registration Rule and the Entity Definition Rule, as well as the following rulemakings that the court did not remand: Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) ("Clearing Determination Rule"); Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management, 77 Fed. Reg. 21,278 (Apr. 9, 2012) ("Straight-Through Processing Rule"); Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the [CEA], 78 Fed. Reg. 33,606 (June 4, 2013) ("Trade Execution Rule"); Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9,734 (Feb. 17, 2012) ("EBC Rule"); Large Trader Reporting for Physical Commodity Swaps, 76 Fed. Reg. 43,851 (July 22, 2011) ("Large Trader Reporting Rule"); Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 Fed. Reg. 59,898 (Proposed Oct. 3, 2014) ("OTC Margin Rule"); Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 78 Fed. Reg. 66,621 (Nov. 6, 2013) ("OTC Segregation Rule"); and Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27,802 (Proposed May 12, 2011) ("Capital Rule").

location in the United States or by virtue of the activity's connection with or effect on U.S. commerce under Section 2(i) of the CEA.[4]

During the period when the Commission sought public comment on its swap-related rules, the Commission's policy with respect to the cross-border application of those rules was not yet final. Its proposed policy focused solely on the U.S./non-U.S. status of the parties to a swap and certain of their affiliates.[5] Also, except in the case of certain entity-level rules eligible for substituted compliance, the Commission's proposed cross-border policy did not seem to contemplate that Non-U.S. Swaps would be subject to Commission rules. Not until the publication of the Commission's final cross-border guidance (the "Final Guidance") in July 2013,[6] Commission Staff Advisory No. 13-69 ("Advisory 13-69") in November 2013[7] and the Commission's comparability determinations in December 2013[8]—after the comment periods for the relevant substantive rulemakings had closed—did the full extent to which the Commission might apply its rules to Non-U.S. Swaps become clear.

The potential application of Commission rules to Non-U.S. Swaps went further than most market participants had previously anticipated, based on their understanding of Section 2(i) of the CEA.[9] As a result, commenters on the Commission's swap-related

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[4] See Proposal, 80 Fed. Reg. at 12,558.

[5] See Cross-Border Application of Certain Swaps Provisions of the [CEA], 77 Fed. Reg. 41,214 (Proposed July 12, 2012).

[6] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013). In the Final Guidance, the Commission declined to make the Large Trader Reporting Rule eligible for substituted compliance, and it included an ambiguously worded footnote regarding the application of transaction-level rules to the U.S. branches of non-U.S. swap dealers and major swap participants. See id. at 45,350, 45,350 n.513.

[7] Staff Advisory No. 13-69 (Nov. 14, 2013).

[8] Comparability Determination for Australia: Certain Entity-Level Requirements, 78 Fed. Reg. 78,864 (Dec. 27, 2013); Comparability Determination for Hong Kong: Certain Entity-Level Requirements, 78 Fed. Reg. 78,852 (Dec. 27, 2013); Comparability Determination for Japan: Certain Entity-Level Requirements, 78 Fed. Reg. 78,910 (Dec. 27, 2013); Comparability Determination for Japan: Certain Transaction-Level Requirements, 78 Fed. Reg. 78,890 (Dec. 27, 2013); Comparability Determination for Switzerland: Certain Entity-Level Requirements, 78 Fed. Reg. 78,899 (Dec. 27, 2013); Comparability Determination for Canada: Certain Entity-Level Requirements, 78 Fed. Reg. 78,839 (Dec. 27, 2013); Comparability Determination for the European Union: Certain Entity-Level Requirements, 78 Fed. Reg. 78,923 (Dec. 27, 2013); and Comparability Determination for the European Union: Certain Transaction-Level Requirements, 78 Fed. Reg. 78,878 (Dec. 27, 2013).

[9] In particular, as discussed in the Institute's March 10, 2014 comment letter regarding Advisory 13-69, the Commission's jurisdiction to apply transaction-level rules to Non-U.S. Swaps under Section 2(i) should extend, at the most, to the related activities of front office personnel located in the United States. See Letter from Sarah A.

rulemakings generally did not address the cost and benefits of applying those rules to Non-U.S. Swaps.

To fill this gap, our comments below address all the key swap-related rules that the Commission has applied or is considering applying to Non-U.S. Swaps, including but not limited to the remanded rulemakings.[10] Our comments at this time do not address swap-related rules that the Commission has not applied or proposed to apply to Non-U.S. Swaps.[11]

DISCUSSION

I. Transaction-Level Rules

We understand that the Commission continues to consider whether to apply its transaction-level rules to Non-U.S. Swaps regularly arranged, negotiated or executed by U.S. personnel or agents acting on behalf of a non-U.S. swap dealer. Accordingly, our discussion of the costs and benefits of applying transaction-level rules to Non-U.S. Swaps focuses on the costs and benefits associated with the adoption of such a "U.S. personnel test."

Miller, Chief Executive Officer, the Institute, to Melissa D. Jurgens, Secretary, the Commission, dated Mar. 10, 2014, attached as the appendix to this letter.

[10] The court in *SIFMA v. CFTC* dismissed the plaintiffs' challenge to the Trade Execution Rule for lack of standing. Op. at *23. The court also granted summary judgment with respect to the plaintiffs' challenge to the Large Trader Reporting Rule, the Clearing Determination Rule and the Straight-Through Processing Rule because the plaintiffs did not identify comments submitted to the Commission during those rules' rulemaking proceedings that raised issues regarding the extraterritorial application of those rules or the associated costs and benefits. Id. at *36 n.30. Finally, the plaintiffs did not challenge the EBC Rule, the OTC Margin Rule, the OTC Segregation Rule or the Capital Rule. Yet, because the application of those rules to Non-U.S. Swaps would give rise to significantly different costs and benefits relative to their application to U.S. Swaps, we have addressed those rules in this letter.

[11] In particular, we have not addressed the Swap Entity Registration Rule or the Entity Definition Rule because the Commission has not applied or proposed to apply those rules to Non-U.S. Swaps. We support the Commission's approach in this regard. Although we recognize that the U.S. Securities and Exchange Commission (the "SEC") has recently proposed to include security-based swaps between non-U.S. persons that involve U.S. personnel for purposes of its security-based swap dealer *de minimis* threshold calculation, we do not believe that such inclusion would be appropriate and we intend to provide comments to the SEC expressing our concerns. See Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed By Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent, Fed. Reg. forthcoming] (the "SEC U.S. Personnel Test Proposal"). We also believe that, before adopting any approach similar to this aspect of the SEC's proposal, the Commission should, consistent with its obligations under Section 15(a) of the CEA, seek public input as to the cost and benefits of such an approach.

A. General Considerations

i. Market Fragmentation and Obstacles to Effective Risk Management

By way of background, when non-U.S. swap dealers use U.S. front office personnel in connection with Non-U.S. Swaps, they typically do so for two reasons. First, the traders with the greatest expertise and familiarity with certain markets and swaps are located in the United States.[12] To manage their associated risks effectively, non-U.S. swap dealers accordingly rely on U.S.-based traders to price and hedge swaps. In some cases, non-U.S. counterparties may interact with those traders, for example to obtain up-to-date market color or pricing information. Second, non-U.S. counterparties sometimes interact with traders or salespeople located in the United States for time zone reasons. This occurs in connection with swap markets that trade on a 24-hour basis (such as many foreign exchange markets) as well as non-U.S. counterparties (such as those based in Latin America or Canada) who do business primarily during U.S. market hours.

We believe that these activities are highly desirable, if not required under Commission rules governing swap dealer risk management,[13] because effective risk management requires the centralization of pricing and hedging responsibilities. For example, a swap dealer often offers liquidity in a swap simultaneously across its global customer base and adjusts its pricing for that swap dynamically based on changes in the market price for the swap and the swap dealer's risk exposure. To make those adjustments effectively, it is generally necessary to centralize pricing, hedging and other risk management responsibilities with the trading personnel who have the greatest market expertise and familiarity. The sales personnel who interact with counterparties must also be able to coordinate with those trading personnel, so that the sales personnel do not assume unwarranted risk when they arrange, negotiate or execute swaps.

We are concerned that these centralized risk management practices would be impeded by the adoption of a U.S. personnel test. A U.S. personnel test would require non-U.S. counterparties that interact with U.S. front office personnel to bear the costs of compliance with transaction-level rules in circumstances where, unlike U.S. counterparties, they can avoid those costs just by interacting with front office personnel located elsewhere. A U.S. personnel test also would, as discussed in Section I.A.ii. below, impose unique costs on non-U.S. swap dealers and their non-U.S. counterparties, which would not be implicated by the application of transaction-level rules to U.S. Swaps.

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12 For instance, the traders who have the most expertise in trading USD-denominated interest rate swaps are typically located in the United States, and they may also trade, or work closely with colleagues who trade, related products (such as U.S. government securities and USD-denominated interest rate futures).

13 See, e.g., Commission Regulations § 23.600(c)(1)(ii) (requiring a swap dealer's risk management program to be integrated into risk management at the consolidated entity level).

To avoid these costs, many non-U.S. counterparties are likely to refuse to interact with U.S. front office personnel. To accommodate those non-U.S. counterparties, a non-U.S. swap dealer would need to have front office personnel located abroad who could interact with them in connection with U.S.-centric markets and swaps, as well as during U.S. market hours. The geographic dislocation of those non-U.S. personnel from U.S. colleagues, counterparties and markets would necessarily inhibit the swap dealer's ability to engage in centralized risk management practices. Artificial barriers between sales and trading personnel and the regionalization of risk management could cause a non-U.S. swap dealer to execute swaps with non-U.S. counterparties at prices and in sizes that do not reflect current market prices or the swap dealer's current risk appetite. To minimize the likelihood of executing such swaps, the non-U.S. swap dealer would need to offer less competitive prices and provide less depth of liquidity. It also may need to relocate front office personnel from the United States, resulting in lost U.S. jobs.

In addition, if a large number of non-U.S. counterparties avoid interactions with U.S. front office personnel, as we expect would likely occur under a U.S. personnel test, then the benefits, if any, of that test would be largely illusory. The existence of any such benefits is also highly doubtful as a threshold matter, since Non-U.S. Swaps do not give rise to risks to the U.S. financial system because they do not involve a counterparty that is a U.S. person, a guaranteed or conduit affiliate or even, in many cases, a non-U.S. swap dealer that is a subsidiary of a U.S. person.[14] We also do not believe that there are meaningful competitive parity benefits to be obtained by adopting a U.S. personnel test because, even if the Commission believes that an un-level playing field exists between U.S. and non-U.S. swap dealers when each uses U.S. front office personnel (which view would ignore the applicability of non-U.S. rules to non-U.S. swap dealers), a U.S. personnel test would create a new and even less desirable competitive disparity between U.S. and non-U.S. front office personnel.

ii. <u>Unique Costs of a U.S. Personnel Test</u>

Adoption of a U.S. personnel test would impose unique costs on non-U.S. swap dealers and their non-U.S. counterparties, which would go beyond the costs implicated by the application of transaction-level rules to U.S. Swaps. Those unique costs would include:

- ***Conflicts with Foreign Laws.*** Non-U.S. Swaps currently are, or soon will be, subject to risk mitigation, transparency and sales practice rules in other jurisdictions that duplicate or conflict with U.S. rules. For example, the European

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[14] The Commission has often justified the extraterritorial application of its rules based on historical examples involving entities with U.S. parent companies. <u>See</u>, <u>e.g.</u>, Declaration of Sayee Srinivasan, Chief Economist, the Commission, submitted in support of the Commission's cross-motion for summary judgement in *SIFMA v. CFTC*, No. 13-1916, Document 28-2 (Mar. 14, 2014).

Union ("EU") has implemented rules governing swap trading relationship documentation, portfolio reconciliation and compression, trade confirmations and daily trading records.[15] It will soon implement mandatory clearing requirements[16] and margin and segregation requirements for uncleared swaps.[17] The EU is also in the process of implementing rules governing public dissemination of derivatives data, mandatory trading of derivatives, and enhanced sales practice requirements,[18] which are anticipated to come into effect by January 2017.[19] Although some of these EU rules may be eligible for relief where the Commission's rules are "equivalent," such equivalence relief does not apply if both parties to the swap are established in the EU.[20] In such circumstances, absent relief from the Commission, the parties would simultaneously have to comply with duplicative, and in some respects inconsistent, U.S. and EU rules.[21]

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15 See Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP.

16 See European Securities and Markets Authority ("ESMA"), Final Report: Draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives (Oct. 1, 2014); ESMA, Revised Opinion: Draft RTS on the Clearing Obligation on Interest Rate Swaps (Mar. 6, 2015); and Letter from Steven Maijoor, Chair, ESMA, to Jonathan Faull, Director General, Internal Market and Services, European Commission (Nov. 20, 2014).

17 See European Banking Authority, European Insurance and Occupational Pensions Authority, and ESMA, Consultation Paper: Draft regulatory technical standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012 (Apr. 14, 2015).

18 See generally Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU; Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012; ESMA, Consultation Paper: MiFID II/MiFIR (Dec. 19, 2014); and ESMA, Addendum Consultation Paper: MiFID II/MiFIR (Feb. 18, 2015).

19 See ESMA, MiFID II Timeline, available at http://www.esma.europa.eu/page/Markets-Financial-Instruments-Directive-MiFID-II.

20 See Commission Delegated Regulation (EU) No 285/2014 of 13 February 2014 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on direct, substantial and foreseeable effect of contracts within the Union and to prevent the evasion of rules and obligations.

21 For example, inconsistencies could arise in the context of the margin rules due to different requirements for when, and to what account, bilateral margin must be delivered/received.

- ***Implementation Costs for Non-U.S. Swap Dealers.*** Implementing a U.S. personnel test for transaction-level rules would be very costly for non-U.S. swap dealers. Because there was no indication that the Commission was contemplating a U.S. personnel test for non-U.S. swap dealers until Advisory 13-69's publication in November 2013, which was several months after most of the transaction-level rules had come into effect, non-U.S. swap dealers did not design their swap compliance systems, controls, policies or procedures in a manner that tracked which personnel were involved in arranging, negotiating or executing a swap. Tracking such personnel is not an easy task because it is common for personnel located in multiple jurisdictions to take part in arranging, negotiating or executing a swap, often through multiple communication media (*e.g.*, telephone, chat and instant messaging). To comply with a U.S. personnel test, a non-U.S. swap dealer would need to track the location of each individual who used these media to communicate with a non-U.S. counterparty, as well as the content of each such individual's communications. That information would then need to feed systematically into multiple front-, middle- and back-office systems (which can vary by rule requirement, business line/asset class and region/booking entity), as well as the surveillance systems relied upon by supervisory, compliance and audit personnel.[22] Non-U.S. swap dealers would also need to develop new policies, procedures and training materials and bear the ongoing costs of monitoring for and enforcing compliance with the U.S. personnel test.

- ***Implementation Costs for Non-U.S. Counterparties.*** Even if not directly subject to a U.S. personnel test, non-U.S. counterparties would also bear costs in connection with such a test.[23] Some of the rules proposed to be triggered by a U.S. personnel test (such as mandatory clearing, mandatory trade execution and real-time public reporting) apply to both parties. Even the rules that apply solely to a swap dealer, such as swap trading relationship documentation rules or sales practice rules, typically require that the swap dealer's counterparty change its documentation and practices.[24] To address these rules, a non-U.S. counterparty would need to track the location of a non-U.S. swap dealer's personnel, which may not be transparent to the counterparty (*e.g.*, it may not know the location from which an individual has logged onto a messaging platform). In addition, a

[22] We note that particular implementation difficulties would arise in the context of portfolio reconciliation and compression requirements, where a U.S. personnel test would result in some subset of swaps within a portfolio becoming subject to the rules.

[23] We note that we support the Commission's decision, to date, not to apply a U.S. personnel test based on the location of a non-U.S. counterparty's personnel or agents. We observe that this decision is consistent with the SEC's recent personnel test proposal. See SEC U.S. Personnel Test Proposal, Fed. Reg. forthcoming.

[24] For example, a non-U.S. counterparty would need to change its credit support arrangements, confirmation processes and swap valuation policies and procedures.

non-U.S. counterparty would need to obtain advice from U.S. counsel to understand the steps it would need to take to comply with Commission rules. For example, it would need to understand the meaning of Commission rules cited in representation letters it is expected to sign and the credit risks it assumes when clearing through a U.S. futures commission merchant. These costs are likely to be viewed as quite significant relative to the benefits of interacting with U.S. front office personnel, especially if the non-U.S. counterparty's intended interactions with such personnel are isolated (*e.g.*, for particular types of swaps or during off-market hours).

B. Cost-Benefit Analysis for Specific Transaction-Level Rules

i. Risk Mitigation Rules[25]

The Commission's mandatory clearing and swap processing rules, margin and segregation requirements for uncleared swaps, swap trading relationship documentation rules, portfolio reconciliation and compression rules, trade confirmation rules and daily trading records rules are all intended to mitigate risks to the U.S. financial system.[26] The risks that those rules are intended to address are not borne by the personnel who arrange, negotiate or execute a swap, but rather by the legal entities that are parties to the swap. In the case of a Non-U.S. Swap, however, neither counterparty is a U.S. person, guaranteed affiliate, or conduit affiliate, and thus the risks of the swap do not flow back to the U.S. financial system.[27]

As a result, applying these risk mitigation rules to Non-U.S. Swaps would not help to achieve their intended benefit. However, the market fragmentation effects and other costs resulting from a U.S. personnel test, as described in Sections I.A.i. and I.A.ii above, would nonetheless apply. In light of these cost-benefit considerations, we believe that the Commission's risk mitigation rules should not apply to Non-U.S. Swaps, regardless of whether U.S. personnel or agents are involved in arranging, negotiating or executing such swaps.

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[25] The rulemakings covered in this section are the Clearing Determination Rule, the Straight-Through Processing Rule, the Portfolio Reconciliation Rule, the OTC Margin Rule, the OTC Segregation Rule, and the Daily Trading Records Rule.

[26] See Final Guidance at 45,366-68.

[27] The potential for risk flow back is even more indirect and attenuated where no swap dealer involved in the swap is even a subsidiary of a U.S. person.

ii. Transparency Rules[28]

In the Final Guidance, the Commission linked its mandatory trade execution and real-time public reporting requirements to the CEA's financial stability and risk reduction goals, categorizing them as "Category A" transaction-level rules along with the risk mitigation rules addressed in the preceding section of this letter.[29] As described in that section, there would be no risk mitigation benefits to applying transaction-level rules to Non-U.S. Swaps because (a) the parties to those swaps lack a direct and significant connection with the United States and (b) the involvement of a non-U.S. swap dealer's U.S. front office personnel in arranging, negotiating or executing those swaps does not give rise to any risk to the U.S. financial system.

As a result, the only arguable basis for applying a U.S. personnel test to mandatory trade execution and real-time public reporting requirements would be to promote pre- and post-trade price transparency as an end in itself.[30] Yet, for several reasons, even if increased transparency is the Commission's ultimate objective, applying a U.S. personnel test to mandatory trade execution and real-time public reporting requirements is not likely to materially help to achieve that objective. Similar considerations also apply in connection with the swap execution facility ("SEF") registration requirement.

a. Mandatory Trade Execution

The CEA expressly requires a swap to be subject to the mandatory clearing requirement before it can become subject to the mandatory trade execution requirement.[31] As the Commission noted in the Final Guidance, the mandatory trade execution requirement is "[i]ntegrally linked to the clearing requirement" and "intended to bring the trading of mandatorily cleared swaps that are made available to trade onto regulated exchanges or execution facilities."[32] In connection with the parallel provisions of the Dodd-Frank Act applicable to security-based swaps, the SEC has likewise explained that, "under the statutory framework, a security-based swap is potentially subject to the trade execution requirement only

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28 The rulemakings covered in this section are the Trade Execution Rule, the Real-Time Reporting Rule, and the SEF Registration Rule.

29 See Final Guidance, 78 Fed. Reg. at 45,367-68.

30 We note that, because the Commission has addressed regulatory reporting requirements separately from real-time public reporting requirements, applying the latter to Non-U.S. Swaps is not necessary for the Commission to obtain data regarding those swaps. We address regulatory reporting requirements in Section II of this letter.

31 See Section 2(h)(8) of the CEA.

32 Final Guidance, 78 Fed. Reg. at 45,367.

if it is first subject to the clearing requirement."[33] The SEC went on to state, "[a]ccordingly, to the extent that the clearing requirement does not apply to a particular security-based swap transaction, the trade execution requirement also would not apply."[34]

In our view, this statutory linkage between mandatory clearing and mandatory trade execution requires that, if the Commission does not apply the mandatory clearing requirement to Non-U.S. Swaps, as we believe should be the case, then neither should it apply the mandatory trade execution requirement to those swaps. Requiring uncleared Non-U.S. Swaps to be executed on a U.S. SEF or designated contract market ("DCM") in such circumstances would contradict the statute without providing any meaningful transparency benefits in connection with the mandatorily cleared swaps that Congress intended to subject to mandatory trade execution.

Another reason to strongly doubt the potential transparency benefits of applying a U.S. personnel test to the mandatory trade execution requirement is that non-U.S. counterparties would have no incentive to subject themselves to that requirement. A non-U.S. counterparty can already obtain the benefits of trading on a U.S. SEF or DCM by doing so voluntarily, effectively free riding on the liquidity already available on those platforms due to the domestic application of the mandatory trade execution requirement. In contrast, when a non-U.S. counterparty wants the flexibility to negotiate a swap bilaterally, it could do so by contacting a non-U.S. swap dealer's front office personnel located outside the United States. Avoiding contacts with U.S. front office personnel would also help the non-U.S. counterparty to minimize the costs described in Section I.A.ii. above.

These cost-benefit considerations would strongly encourage non-U.S. counterparties to refuse to interact with U.S. front office personnel. This step would prevent non-U.S. swap dealers from triggering the U.S. personnel test and becoming subject to the mandatory trade execution requirement, thereby significantly reducing the extent of any increased price transparency due to a U.S. personnel test. If non-U.S. swap dealers chose to relocate front office personnel to non-U.S. locations in order to accommodate non-U.S. counterparties, then those swap dealers could even lose the ability to provide liquidity effectively on U.S. SEFs and DCMs. Such market fragmentation not only would reduce market transparency, but it would also inhibit effective risk management and result in lost jobs within the United States, as described in Section I.A.i. above.

This potential market fragmentation is more than hypothetical. As a recent research note from the International Swaps and Derivatives Association ("ISDA") shows, the

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[33] See SEC U.S. Personnel Test Proposal at n.301.

[34] Id.

introduction of the SEF registration requirement in October 2013 and the mandatory trade execution requirement in February 2014 resulted in fragmentation of the EUR-denominated interest rate swap market along regional lines, as well as a sharp decline of trading in those swaps within the United States.[35] We are concerned that the application of a U.S. personnel test to the mandatory trade execution requirement would have a similar effect.

In light of the foregoing considerations, we believe that the Commission's mandatory trade execution requirement should not apply to Non-U.S. Swaps, regardless of whether U.S. personnel or agents are involved in arranging, negotiating or executing such swaps.

b. Real-Time Public Reporting

Similarly to the mandatory trade execution requirement, a non-U.S. counterparty can effectively free ride and obtain the benefits of the CEA's real-time public reporting requirements by accessing publicly available price data and taking that data into account when negotiating its swaps. Yet, trading in a manner that subjects the non-U.S. counterparty's own swaps to real-time public reporting requirements would potentially cause the non-U.S. counterparty to receive worse execution pricing on those swaps. The reason for this adverse outcome is that a swap dealer, when providing a price for a swap subject to real-time public reporting, must account for the possibility that the swap dealer will not be able to hedge the swap fully before it is publicly disclosed. Once that public disclosure occurs, other market participants can front run the swap dealer's hedges. To counteract this risk, a swap dealer may widen its bid-ask spread for publicly reportable swaps. To avoid this dynamic, a non-U.S. counterparty would prefer to trade in circumstances where its own swaps are not subject to real-time public reporting. Applying a U.S. personnel test to real-time public reporting requirements would accordingly encourage non-U.S. counterparties to refuse to interact with U.S. front office personnel, with resulting adverse consequences as described in Section I.A.i. above.

In addition, as discussed in Section I.A.ii. above, adopting a U.S. personnel test would impose great implementation costs on non-U.S. swap dealers. These costs would be particularly significant in the context of real-time public reporting requirements because swap dealers have implemented those requirements through the use of back-office systems that run based on static data regarding the status of the counterparties to a swap. This system design was based on the "status-based approach" contained in the Commission's proposed cross-border guidance and trade reporting rules in other major jurisdictions. To modify its back-office reporting systems in connection with a U.S. personnel test, a non-U.S. swap dealer would need to install or modify a trade capture system capable of tracking, on a dynamic, trade-by-trade basis, the location of front-office personnel. A non-U.S. swap dealer would then need to feed that data

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[35] See ISDA, Cross-Border Fragmentation of Global Derivatives: End-Year 2014 Update (Apr. 22, 2015), available at http://www2.isda.org/functional-areas/research/research-notes/.

into its back-office reporting system and re-code that system to account for the different rules that apply to Non-U.S. Swaps depending on whether they are regularly arranged, negotiated or executed by U.S. front office personnel.[36] In addition, to avoid the conflicts with blocking, privacy and secrecy laws that would otherwise arise when reporting Non-U.S. Swaps to U.S. swap data repositories ("SDRs") for onward public dissemination, non-U.S. swap dealers and U.S. SDRs would need to reengineer their systems to disable "single-stream" reporting under Parts 43 and 45 of the Commission's Regulations. These costs could be significant enough to lead some non-U.S. swap dealers to prevent their U.S. front office personnel from interacting with non-U.S. counterparties.

We note that an exception to the foregoing cost-benefit considerations exists in the context of Non-U.S. Swaps voluntarily executed on a registered SEF, DCM or foreign board of trade ("FBOT"). In that context, the non-U.S. counterparties have already determined that the benefits of Commission regulation, including real-time public reporting requirements, outweigh the costs. Those costs are also mitigated by virtue of the Commission's assignment of reporting responsibility to the SEF, DCM or FBOT.

Accordingly, we believe that the Commission's real-time public reporting requirements should not apply to Non-U.S. Swaps, regardless of whether U.S. personnel or agents are involved in arranging, negotiating or executing such swaps, except in the case of Non-U.S. Swaps that the parties voluntarily execute on a registered SEF, DCM or FBOT

c. SEF Registration

We have similar concerns in connection with the Commission staff's guidance that a non-U.S. multilateral swaps trading platform must register as a SEF if it provides U.S. personnel and agents of non-U.S. persons with the ability to trade or execute swaps on or pursuant to the rules of the platform, either directly or indirectly through an intermediary.[37] This guidance has led some non-U.S. multilateral swaps trading platforms to prevent access by U.S. personnel in order to avoid the costs of SEF registration. Those costs include the application of rules relating to execution methods for Required Transactions, block trades, real-time public reporting, impartial access and straight-through processing requirements to Non-U.S. Swaps executed on the platform. Because U.S. personnel are not required to trade on multilateral swaps trading platforms in the first place, the staff guidance on SEF registration in effect encourages such personnel to trade bilaterally over-the-counter, contrary to the Commission's overall transparency objectives.

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[36] The non-U.S. swap dealer would also need to train its front office personnel in the use of this new trade capture system and develop policies, procedures and controls to require, track and test the proper use of that system.

[37] Division of Market Oversight Guidance on Application of Certain Commission Regulations to [SEFs] (Nov. 15, 2013).

These issues raised by the staff guidance on SEF registration are exacerbated significantly by the guidance's treatment of indirect access by U.S. personnel acting through an intermediary.[38] Such indirect access has not been a basis for requiring registration of FBOTs,[39] including those that list swaps, nor has the SEC proposed to treat it as a basis for requiring registration of security-based SEFs.[40] The incremental benefits of requiring a non-U.S. multilateral swaps trading platform to register as a SEF due to indirect access are highly attenuated, since the involvement of a Commission-regulated intermediary in the transactions already provides significant customer and market integrity protections.

In light of these cost-benefit considerations, we believe that the CEA's SEF registration requirement should not extend to a non-U.S. multilateral swaps trading platform solely on the basis of access provided to U.S. personnel or agents acting on behalf of non-U.S. persons.[41] Such a platform should still be permitted, however, to register as a SEF or FBOT voluntarily.

iii. Sales Practice Rules[42]

The Commission's external business conduct (or "sales practice") rules are generally designed to enhance counterparty protection by expanding the obligations of swap dealers in dealing with their counterparties.[43] In our view, these rules can be divided into three

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[38] The legal basis for the staff's position in this regard is unclear. Although the staff guidance is framed as an interpretation of Section 2(i) of the CEA, that section requires a "direct and significant" connection with activities in, or effect on, U.S. commerce. Yet the U.S. connection or effect of a non-U.S. multilateral swaps trading platform's offshore activities is indirect at best in an indirect access scenario. In addition, the Commission has stated that it "views the CEA section 5h(a)(1) registration requirement as applying only to facilities that meet the SEF definition in CEA section 1a(50)." See 78 Fed. Reg. 33,476, 33,481 (June 4, 2013). That definition requires that, to qualify as a SEF, a platform must provide a multilateral execution functionality "through any means of interstate commerce." See CEA Section 1a(50). As used in the CEA, as well as other federal statutes, "interstate commerce" is a term of art connoting purely domestic activity. See CEA Section 1a(30). A non-U.S. multilateral swaps trading platform accessed solely indirectly by U.S.-located persons is not engaged in activity within U.S. interstate commerce.

[39] See Registration of [FBOTs], 76 Fed. Reg. 80,674, 80,688 (Dec. 23, 2011).

[40] See Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 Fed. Reg. 30,968, 31,504-55 (May 23, 2013).

[41] At a minimum, consistent with existing Commission precedent, registration should not be required on the basis of indirect access by U.S. personnel or agents through an intermediary.

[42] The rulemaking covered in this section is the EBC Rule.

[43] See Final Guidance, 78 Fed. Reg. at 45,368.

categories: (a) trading relationship rules; (b) Special Entity rules; and (c) communication-based rules.

a. **Trading Relationship Sales Practice Rules**

Trading relationship sales practice rules include: know your counterparty; true name and owner; reasonable reliance on representations; manner of disclosure; verification of counterparty eligibility; disclosure of daily marks; and counterparty suitability. These rules apply across a swap dealer's overall trading relationship with a counterparty. A swap dealer typically satisfies these rules through counterparty relationship documentation and due diligence executed or conducted upon the establishment of a trading relationship. For many Non-U.S. Swaps, the non-U.S. swap dealer's relationship with its non-U.S. counterparty will have been established by non-U.S. personnel.

In those circumstances, a non-U.S. counterparty is likely to be surprised by any need to sign documents or fill out questionnaires designed to comply with U.S. requirements that may only potentially apply in the future should U.S. front office personnel arrange, negotiate or execute isolated swaps with the counterparty. The non-U.S. counterparty is moreover likely to have concerns if the documents and questionnaires differ significantly from what it expects based on local, non-U.S. onboarding requirements. Faced with these concerns and additional documentation burdens, the non-U.S. counterparty is likely to refuse to interact with U.S. front office personnel, with resulting adverse consequences as described in Section I.A.i. above. For these reasons, applying a U.S. personnel test to trading relationship sales practice rules is likely to result in costs that exceed the benefits.

b. **Special Entity Sales Practice Rules**

Special Entity sales practice rules include: requirements for swap dealers acting as advisors to Special Entities; requirements for swap dealers and major swap participants acting as counterparties to Special Entities; and requirements relating to political contributions by certain swap dealers. The first two of these rules, like the trading relationship sales practice rules described above, are typically satisfied by swap dealers through counterparty relationship documentation. The Commission's political contribution rule, in turn, only applies to governmental Special Entities, a category that does not include non-U.S. counterparties. In addition, absent an affirmative election to the contrary, non-U.S. pension plans are not considered Special Entities. Although non-U.S. endowments are considered Special Entities, a non-U.S. endowment is unlikely to expect special U.S. legal protections when it transacts with a non-U.S. swap dealer.

Yet, to comply with a U.S. personnel test in connection with Special Entity sales practice rules, a non-U.S. swap dealer would need to obtain representations from most of its non-U.S. counterparties as to their Special Entity status. These counterparties would need to consult U.S. counsel to understand what to represent and, in the case of foreign pension plans, the costs and benefits of electing Special Entity status. More likely, when faced with a request for an

unfamiliar representation, many non-U.S. counterparties will opt to avoid interacting with U.S. front office personnel. As a result, as with other transaction-level rules that impose burdens on non-U.S. counterparties, applying a U.S. personnel test to Special Entity sales practice rules is likely to result in costs that exceed the benefits.

c. Communication-Based Sales Practice Rules

In contrast to the other sales practice rules described above, a different analysis may be relevant to communication-based sales practice rules. These rules include: policies and procedures to ensure compliance with external business conduct rules; prohibition on fraud, manipulation and other abusive practices; disclosures of material information (other than daily marks); clearing disclosures; communications-fair dealing; product suitability (not counterparty suitability); and external business conduct record retention. They are focused on regulating the activities of front office personnel in the context of particular communications and transactions.

There may be some modest benefit to applying these rules uniformly to all front office personnel located in the United States. In addition, compliance with these rules typically does not entail wholesale modifications to counterparty relationship documentation or onboarding processes, so long as a non-U.S. swap dealer is permitted to satisfy disclosure rules applicable to Non-U.S. Swaps through disclosure delivered through whatever means are acceptable for the disclosure of material information under the rules of the relevant non-U.S. jurisdiction(s).[44] Nor is compliance with these rules typically effected through back-office systems that are difficult to redesign and modify. The incremental costs of compliance are therefore unlikely to be as significant in these circumstances.

d. Recommendation

Based on the cost-benefit considerations described above, we believe that it may be warranted for the Commission to apply its communication-based sales practice rules to Non-U.S. Swaps regularly arranged, negotiated or executed by U.S. front office personnel, but the Commission's trading relationship and Special Entity sales practice rules should not apply to Non-U.S. Swaps, regardless of whether U.S. personnel or agents are involved in arranging, negotiating or executing such swaps.[45]

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[44] If a non-U.S. counterparty was required to consent in writing to specific methods of disclosure under Commission rules, the resulting costs and consequences would be similar to applying trading relationship sales practice rules to Non-U.S. Swaps.

[45] If the Commission decides to apply any of its sales practice rules to Non-U.S. Swaps, it should consider allowing sophisticated non-U.S. counterparties to "opt-out" of those rules, thereby allowing them to continue to trade under their existing documentation rather than requiring them to agree to U.S.-specific documentation that they may find more confusing than helpful.

C. "Regularly Arranging, Negotiating or Executing"

If the Commission adopts any sort of U.S. personnel test, it will be critical for the Commission to clarify the scope of that test. Ambiguity surrounding when U.S. "front office" personnel are considered to "regularly" "arrange, negotiate or execute" Non-U.S. Swaps is likely to discourage non-U.S. swap dealers from using, and non-U.S. counterparties from interacting with, U.S. personnel, even in circumstances where the Commission's policy interest in applying transaction-level rules is not implicated. It also is likely to discourage activities that are beneficial from a risk management perspective.

For example, even if they do not solicit, receive trading inquiries from, negotiate economic terms with, or agree to execute swaps with non-U.S. counterparties, U.S. traders commonly provide general market color or pricing information to non-U.S. salespeople who arrange, negotiate or execute Non-U.S. Swaps from outside the United States. A U.S. trader may also provide this information to a non-U.S. counterparty in circumstances where a non-U.S. salesperson remains responsible for negotiating and committing the non-U.S. swap dealer to any swap with the non-U.S. counterparty. In addition, U.S. traders can contribute to how a non-U.S. swap dealer prices swaps executed on electronic trading platforms accessed by non-U.S. counterparties from outside the United States, even though the U.S. trader does not interact directly with any of those non-U.S. counterparties. In each of these cases, the U.S. trader serves a very important role in providing the expertise necessary for the non-U.S. swap dealer to manage its risk effectively. Also, in each case, the non-U.S. counterparty is unlikely to expect the protections of U.S. law because it did not inquire with, receive a solicitation from, or negotiate or agree to a swap with any U.S. personnel. The Commission should not consider the U.S. trader to "arrange, negotiate or execute" a Non-U.S. Swap in these circumstances.

A U.S. trader or salesperson also may, for time zone reasons, commit a non-U.S. swap dealer to a swap with a non-U.S. counterparty outside the counterparty's local market hours. When the U.S. trader or salesperson engages in this activity, it typically does so pursuant to product, credit, and market risk parameters established by non-U.S. personnel of the non-U.S. swap dealer. Given the exceptional nature of such trading, which is typically adjunct to a customer relationship managed by the non-U.S. swap dealer's personnel located abroad, a non-U.S. counterparty is unlikely to expect the protections of U.S. law in connection with its interactions with U.S. personnel in these circumstances. On the other hand, applying transaction-level rules to Non-U.S. Swaps arranged, negotiated or executed by U.S. personnel in these circumstances would present a significant obstacle to continued U.S. participation in markets that operate across multiple time zones. To accommodate non-U.S. counterparties, non-U.S. swap dealers would likely need to maintain an "after-hours" staff in non-U.S. jurisdictions, which may be composed of front office personnel re-located from the United States. To prevent these adverse consequences, the Commission should not consider U.S. personnel to "regularly" arrange, negotiate or execute Non-U.S. Swaps based on interactions with a non-U.S. counterparty that take place outside the counterparty's local market hours, where the U.S. personnel act pursuant to product, credit, and market risk parameters established by non-U.S.

personnel of the non-U.S. swap dealer. This clarification would be consistent with exceptions for "passing the book" that the Commission has recognized in analogous contexts.[46]

The Commission also should not consider front office personnel who are normally based outside the United States, but who happen to arrange, negotiate or execute a Non-U.S. Swap while travelling within the United States, to "regularly" arrange, negotiate or execute such swaps. This clarification would help to ensure that non-U.S. front office personnel who make business or personal trips to the United States are not prevented from engaging in incidental contacts with their non-U.S. clients during those trips.[47]

Finally, U.S. personnel in legal, compliance, back-office and middle-office support areas commonly provide important services to non-U.S. swap dealers in connection with Non-U.S. Swaps. The Commission should clarify that, since these personnel are not performing the sort of "core, front-office activities" referenced by Advisory 13-69,[48] their activities in connection with Non-U.S. Swaps will not trigger the application of any transaction-level rules.

D. Substituted Compliance

In addition to adopting a U.S. personnel test, Advisory 13-69 would not have permitted substituted compliance in connection with swaps covered by that test. This approach would represent a significant divergence from the Commission's general recognition, in the Final Guidance, of the supervisory interests of foreign regulators in connection with swaps between non-U.S. persons.[49]

Where a transaction would already be subject to foreign regulation, the marginal benefits of dual regulation are likely to be outweighed by the costs of compliance with duplicative or conflicting regulation and resulting incentives for market fragmentation. Major non-U.S. jurisdictions now have adopted or are poised to adopt reforms in such key areas as trade reporting, mandatory clearing, mandatory trade execution and margin and segregation for

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[46] See, e.g., Interpretive Letter No. 93-83 (Aug. 9, 1993); Advisory for Interpretive Letter No. 93-21 (Apr. 1, 1993). We note that the SEC has not proposed to exclude such "passing the book" activity from its U.S. personnel test. See SEC U.S. Personnel Test Proposal. We intend to provide comments to the SEC expressing our concerns with this aspect of their proposal.

[47] This clarification would also be consistent with how the SEC has proposed to address this fact pattern. See SEC U.S. Personnel Test Proposal at text accompanying n.187.

[48] See Advisory 13-69 at p. 2. See, also SEC U.S. Personnel Test Proposal at n.178-180 and accompanying text.

[49] See, e.g., Final Guidance, 78 Fed. Reg. at 45,353.

uncleared swaps.[50] It would thus be appropriate for the Commission, in any case where it decides to apply a transaction-level rule to a Non-U.S. Swap, to permit substituted compliance in connection with that rule.[51]

We note, however, that simply permitting substituted compliance would not eliminate all of the costs described above. For example, some "emerging market" jurisdictions lack the sort of well-developed swaps markets that would lead them to adopt comparable swaps rules. The Commission has previously recognized the benefits of granting an exception to the application of transaction-level rules to swaps involving counterparties located in those jurisdictions.[52] Also, any conditions or limitations on substituted compliance, especially the imposition of a "stricter-rule applies" approach, are likely to result in many of the same implementation costs and adverse market incentives as applying transaction-level rules in the absence of substituted compliance. Accordingly, while we believe that substituted compliance should be an important component of any Commission regime for Non-U.S. Swaps, it does not obviate the need to consider whether the benefits of applying transaction-level rules to those swaps outweigh the costs.

II. Entity-Level Rules[53]

The Commission has generally sought to address the increased costs associated with the application of its entity-level rules to Non-U.S. Swaps through substituted compliance. However, because some comparability determinations have not yet been made by the Commission (*e.g.*, for regulatory reporting) and others are limited as to their scope (*e.g.*, for chief compliance officer reports and risk reports), non-U.S. swap dealers remain subject to obligations to provide information to the Commission or U.S. SDRs regarding Non-U.S. Swaps.

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50 See generally Financial Stability Board, OTC Derivatives Markets Reforms: Eighth Progress Report on Implementation (Nov. 7, 2014).

51 A non-U.S. swap dealer should be eligible for substituted compliance in connection with a Non-U.S. Swap in any circumstances where that swap is subject to comparable foreign requirements, regardless of whether those requirements are applied by the home country regulator of the non-U.S. swap dealer, the home country regulator of its non-U.S. counterparty or both.

52 See Final Guidance, 78 Fed. Reg. at 45,351 (volume-based exception from transaction-level rules for foreign branches of U.S. banks transacting with non-U.S. counterparties outside Australia, Canada, the EU, Hong Kong, Japan and Switzerland). We note that adopting a similar, volume-based exception for Non-U.S. Swaps with non-U.S. counterparties outside those jurisdictions would be consistent with the notion that U.S. front office personnel do not "regularly" arrange, negotiate or execute swaps with such counterparties.

53 The rulemakings covered in this section are SDR Reporting Rule; Historical SDR Reporting Rule; Capital Rule; Large Trader Reporting Rule; Risk Management Rule; Chief Compliance Officer Rule; and Straight-Through Processing Rule.

Applying these obligations to Non-U.S. Swaps often leads to conflicts with local privacy, blocking, secrecy and similar laws. Many of these laws are statutory in nature, cannot be waived by counterparties and are enforceable through criminal sanctions. In addition, non-U.S. swap dealers often provide the relevant information about Non-U.S. Swaps to non-U.S. regulators and trade repositories. Requiring them to provide that information directly to the Commission or a U.S. SDR thus results in duplication and additional costs that could be avoided if the Commission had the means to obtain the information from those non-U.S. regulators and trade repositories.

We strongly support the Commission's efforts to address the obstacles to obtaining information through these more efficient means, in particular the Commission's efforts to obtain memoranda of understanding with non-U.S. regulators and its leadership in the Financial Stability Board's initiative to promote data standardization and remove legal obstacles to cross-border access to trade repositories. We also support the no-action relief granted by Commission staff while these efforts remain ongoing.[54] We believe that the Commission should formalize this relief on a longer-term basis while continuing its efforts to achieve permanent solutions.

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[54] See No-Action Letter Nos. 14-131 (Nov. 24, 2014) (relief from swap data reporting for Non-U.S. Swaps involving certain non-U.S. swap dealers) and 15-01 (Jan. 8, 2015) (relief from reporting certain identifying information subject to foreign blocking, privacy or secrecy laws).

INSTITUTE OF INTERNATIONAL BANKERS

The Institute appreciates the Commission's consideration of these matters. If the Commission or its staff has any questions regarding this letter, please do not hesitate to contact the undersigned at (212) 421-1611.

Respectfully submitted,

Sarah A. Miller
Chief Executive Officer
Institute of International Bankers

cc: Timothy G. Massad, Chairman
Mark P. Wetjen, Commissioner
Sharon Y. Bowen, Commissioner
J. Christopher Giancarlo, Commissioner

Thomas Smith, Interim Director, Division of Swap Dealer and Intermediary Oversight
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INSTITUTE OF INTERNATIONAL BANKERS

APPENDIX

IIB Comment Letter on Staff Advisory 13-69 (March 10, 2014)

INSTITUTE OF INTERNATIONAL BANKERS

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March 10, 2014

Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, DC 20581

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[1]

Dear Secretary Jurgens:

The Institute of International Bankers (the "Institute") welcomes the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") with respect to the issues raised by the staff advisory published by the Commission's Division of Swap Dealer and Intermediary Oversight ("DSIO") on November 14, 2013 ("Advisory 13-69").[2] Because the Commission's final cross-border guidance (the "Final Guidance")[3] and its predecessor proposals and exemptions[4] generally focused on a "status-based" approach to the

1 79 Fed. Reg. 1,347 (Jan. 8, 2014).

2 Division of Swap Dealer and Intermediary Oversight, Applicability of Transaction-Level Requirements to Activity in the United States, CFTC Staff Advisory No. 13-69 (Nov. 14, 2013).

3 Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).

4 See Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214 (July 12, 2012); Exemptive Order Regarding Compliance With Certain Swap Regulations, 77 Fed. Reg.

(footnote continued on next page . . .)

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

application of U.S. rules to cross-border transactions, the important legal, policy, and practical issues raised by the "personnel-based" approach envisioned by Advisory 13-69, under which Commission regulations would apply to swaps between non-U.S. swap dealers and their non-U.S. counterparties solely as a result of the involvement of personnel or agents of the non-U.S. swap dealer located in the U.S., have not previously been the subject of public comment. While we do not consider it to be a substitute for a comprehensive cross-border rulemaking in compliance with the Administrative Procedure Act (the "APA") and the cost-benefit provisions of the Commodity Exchange Act (the "CEA"), we support the Commission's decision to grant relief from the application of Advisory 13-69[5] in order to seek input from market participants and the public on these complex and consequential issues. For the reasons described below, we do not believe that the Commission should adopt the personnel-based approach contained in Advisory 13-69.

BACKGROUND

During the year preceding the Commission's adoption of the Final Guidance, including a period of over six months during which non-U.S. swap dealers were registered with the Commission and complying with Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[6] the Commission's proposed and actual application of "transaction-level" requirements under the CEA[7] to swaps involving non-U.S. swap dealers depended entirely on the U.S./non-U.S. person status of a non-U.S. swap dealer's counterparty. Accordingly, non-U.S. swap dealers, as well as market participants more generally, have established and continue to implement extensive policies, procedures, documentation and systems premised on this status-based approach. At the same time, non-U.S. swap dealers and other market participants are in the process of implementing measures to comply with swaps rules coming into effect in a number of foreign jurisdictions that likewise have been adopting cross-border regulations that do not involve personnel-based approaches. In this regard, we note

(. . . footnote continued from previous page)

41,110 (July 12, 2012); Final Exemptive Order Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 858 (Jan. 7, 2013); Further Proposed Guidance Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 909 (Jan. 7, 2013).

5 See CFTC No-Action Letter No. 13-71 (Nov. 26, 2013); CFTC No-Action Letter No. 14-01 (Jan. 3, 2014).

6 Pub. L. 111-203, 124 Stat. 1376 (2010).

7 For this purpose, "transaction-level" requirements include 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.

that the "Path Forward" agreement between the Commission and European authorities never contemplated a personnel-based approach.[8]

Implementing a status-based approach to the application of Title VII of Dodd-Frank is fundamentally different from implementing a personnel-based approach. A given swap transaction often involves activity occurring in multiple jurisdictions: each counterparty's performance of its obligations under the swap, the location of which depends on its booking location; and the activities of the personnel arranging, negotiating or executing the swap, which could occur in one, two or potentially more locations spanning several jurisdictions, depending on how and over what period of time the swap is executed. (In this regard, the over-the-counter ("OTC") swap market differs significantly from listed financial markets.) As a result, a personnel-based approach requires firms to account for a range of factors encompassing all the different permutations under which two parties could arrange, negotiate or execute a swap transaction.

Moreover, the Final Guidance's status-based approach reflects a belief by the Commission that this approach was necessary to achieve Dodd-Frank's systemic risk mitigation objective. But this approach departs from pre-Dodd-Frank markets regulation in the U.S. and abroad, which generally embrace a more territorial approach focused on customer protection. Applying one approach *simultaneously* with the other leads to irreconcilable jurisdictional conflicts and market fragmentation, without any marginal mitigation of risk, systemic or otherwise.

Against this backdrop, the position taken by Commission staff in Advisory 13-69 that they would consider U.S. transaction-level rules to apply to a non-U.S. swap dealer's swaps with non-U.S. counterparties based on the U.S. location of personnel or agents of the non-U.S. swap dealer has raised great concern for our members and the global markets more broadly.

DISCUSSION

A. Key Issues

The potential application of U.S. transaction-level rules to a swap between non-U.S. persons, as envisaged by Advisory 13-69, raises several important questions.

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[8] See "Cross-Border Regulation of Swaps/Derivatives: Discussions between the Commodity Futures Trading Commission and the European Union – A Path Forward" (July 11, 2013) at p. 2 ("For example, 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 guaranteed affiliates.").

i. Commission Jurisdiction Under Section 2(i)

As a threshold matter, the Commission must determine whether Section 2(i) of the CEA authorizes it to regulate a swap between non-U.S. persons based on the arrangement, negotiation or execution of the swap by U.S.-based personnel or agents. Section 2(i) states that the swaps provisions of the CEA and the Commission's rules thereunder "shall not apply to activities outside the United States" unless those activities have a "direct and significant connection with activities in, or effect on, commerce of the United States" or are undertaken to evade Commission rules.

Advisory 13-69's analysis of the Commission's jurisdiction under Section 2(i) is premised on DSIO's belief 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."[9] However, in the case of a swap between non-U.S. persons that is arranged, negotiated or executed by U.S. personnel or agents, the only activities that occur within the U.S. are those of the U.S. personnel or agents. Those personnel or agents are engaged in front office activities occurring solely at the inception of the swap. In contrast, the legal entities that are the parties to the transaction—both non-U.S. persons—are responsible for the ongoing performance of obligations under the swap from its inception until its expiration or termination, and accordingly those non-U.S. persons have incurred all of the risks attendant to the swap transaction. As a result, the Commission's jurisdiction over activities "inside" the U.S. must be limited, at most, to jurisdiction over the front office activities actually performed in the U.S. Commission jurisdiction over any other activity not performed in the U.S. or non-U.S. counterparties must satisfy the requirements and limitations of Section 2(i) of the CEA.

Accordingly, Commission jurisdiction over the non-U.S. legal entities that are the counterparties to the swap depends on whether the front office activities of their U.S. personnel or agents at the inception of the swap give rise to a "direct and significant" connection with activities in, or effect on, U.S. commerce when the related risks and obligations that arise over the life of the swap reside entirely with legal entities that are non-U.S. persons.[10] The Commission's stated policy is to interpret Section 2(i)'s "direct and significant" prong "in a manner consistent with the overall goals of [Dodd-Frank] to reduce risks to the U.S. financial system and avoid future financial crises."[11] Given that a swap between non-U.S. persons gives

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[9] Advisory 13-69 at p. 2.

[10] We have assumed, for purposes of our discussion, that neither non-U.S. person is a guaranteed or conduit affiliate. We note, however, that even if that were not the case, the activities of U.S. personnel or agents would not affect the risk profile of the activity, and that the salient aspects of the guarantee or conduit relationship would be addressed by other aspects of the Final Guidance.

[11] Final Guidance at 45,300.

rise to no risks to the U.S. financial system, regardless of where that swap is arranged, negotiated or executed, under the Commission's construction of Section 2(i)'s "direct and significant" prong there is not a sufficient basis for Commission jurisdiction over the non-U.S. persons' performance of the swap.

ii. International Comity Principles and Cost-Benefit Considerations

Assuming, *arguendo*, that limited U.S. activity of personnel or agents of a non-U.S. swap dealer could form the basis for Commission jurisdiction under Section 2(i), the Commission is presented with the further question of whether and how it should appropriately exercise that jurisdiction. In this regard, the Commission has stated that it will, consistent with the principles of international comity, evaluate both its interests and those of other jurisdictions.[12]

The Commission's interest in the swaps covered by Advisory 13-69 is generally limited; as noted above, they present no risks to the U.S. financial system. In addition, unless the parties choose to transact on a U.S. designated contract market ("DCM") or swap execution facility ("SEF"), a fact pattern not at issue here, their activities do not affect the integrity of trading on a Commission-regulated platform or facility. Indeed, it is the very application of transaction-level rules set forth in Advisory 13-69 that would give rise to a basis for the exercise of Commission jurisdiction by requiring that non-U.S. persons trade on a U.S. DCM or SEF, clear through a U.S. derivatives clearing organization and report data to a U.S. swap data repository for dissemination to the U.S. public. It would stand international comity on its head for the Commission affirmatively to foster U.S. supervisory interests, where none existed in the first place, by taking the position that the limited activities of U.S. personnel or agents should serve as the basis for imposing regulatory requirements that mandate non-U.S. firms to engage in the wider range of U.S. activities necessary for the Commission's broader assertion of jurisdiction over those firms.

The home country regulators of the non-U.S. person counterparties to a swap, in contrast, have strong supervisory interests in the risks arising from the swap wherever they are incurred, just as the Commission has found itself to have such interests in connection with swaps entered into by U.S. persons abroad. Particularly with respect to swaps involving non-U.S. counterparties located in the G20 jurisdictions, it is highly likely that such transactions would fall under the direct supervisory jurisdiction of the parties' home country regulators and the parties could not evade non-U.S. requirements through the arrangement, negotiation or execution of their swaps by U.S. personnel or agents. The imposition of U.S. law in such situations would directly violate principles of comity, resulting in duplicative and potentially conflicting dual

[12] Final Guidance at 45,301.

regulatory regimes. For example, under Advisory 13-69, a non-U.S. swap dealer established in the EU and trading through U.S. personnel or agents with a counterparty also established in the EU would be subject simultaneously to both U.S. and EU laws without any possibility of substituted compliance or equivalence. At a minimum, in this example and others, compliance with comparable foreign requirements that otherwise separately apply to the swap should obviate the need for specific compliance with U.S. law.

In addition, where a transaction would already be subject to foreign regulation, the marginal benefits of dual regulation are likely to be outweighed by the costs of compliance with duplicative or conflicting regulation and resulting incentives for market fragmentation. In this regard, the Commission is directed by the CEA to consider the costs and benefits of its actions.[13]

Finally, to the extent that the Commission is concerned with promoting competitive parity between U.S. and non-U.S. swap dealers, we note that Dodd-Frank sought to address competitive parity issues by mandating international harmonization.[14] In this regard, substantive swaps rules are in the process of being implemented in key non-U.S. jurisdictions.[15] Until those rules are fully implemented, it is not possible for the Commission to evaluate the long-term competitive impact of a personnel test because the costs and benefits of U.S. rules relative to non-U.S. rules are not yet fully knowable. Once the relevant non-U.S. rules are in place, and assuming that they are comparable to U.S. rules, any competitive concerns will be substantially reduced or eliminated. Applying a personnel test in the interim would therefore address a potential issue that is only temporary in nature, in circumstances where the test is not necessary, either for U.S.- or non-U.S. swap dealers, to mitigate risks to the U.S. financial system, all at great cost to market participants and with significant disruption of global markets.

B. Principled and Practical Solutions if the Commission Adopts Any Personnel Test

In light of the foregoing considerations, it is clear that the Commission should not adopt Advisory 13-69 or any other personnel-based approach to transaction-level rules. A personnel-based approach would not subject any activity with a direct and significant effect on, or connection with, the U.S. to Commission regulation that is not already subject to Commission regulation under the Commission's very broad status-based approach contained in its Final

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[13] CEA § 15(a). As discussed below, in order to obligate market participants to follow Advisory 13-69, the Commission must treat it as a rulemaking under the CEA.

[14] See § 752 of Dodd-Frank.

[15] See Financial Stability Board, OTC Derivatives Market Reforms: Sixth Progress Report on Implementation (Sept. 2, 2013).

Guidance. Additionally, the Commission has separate authority to regulate the activity of U.S.-based agents and personnel, whether through its direct regulation of the U.S. DCMs and SEFs on which they might choose to transact, or through direct regulation of the U.S. activity of introducing brokers and associated persons. A separate personnel test for the application of transaction-level rules is not necessary.

However, if the Commission does decide to adopt any guidance under which the activity of U.S. personnel or agents acting on behalf of a non-U.S. swap dealer is relevant to the application of U.S. transaction-level rules to swaps between the non-U.S. swap dealer and its non-U.S. counterparties, policy and practical considerations make it imperative that the Commission do so under different circumstances and with greater nuance than Advisory 13-69.

i. Appropriate Rulemaking Procedures

Despite its presentation as "guidance" and a "policy statement," the Final Guidance and its related substantive modifications of previously adopted Commission rules clearly represents a binding, normative rulemaking subject to legislative rulemaking requirements under the APA[16] and the cost-benefit analysis requirement applicable to Commission regulations under the CEA.[17] Accordingly, the Commission should only adopt cross-border policies (however labeled) through a comprehensive rulemaking process involving the full Commission, and not through advisories (such as Advisory 13-69) or other communications from the Commission's staff or "guidance" that contravenes the APA and the CEA. It is through such processes that the Commission will be able to properly assess the costs and benefits associated with a personnel-based approach.

The personnel-based approach described in Advisory 13-69 would require global firms to redesign and overhaul their operational and compliance infrastructure to evaluate factors beyond their status and the status of their counterparties. It is important to note in this regard that there are significant practical limitations with respect to any compliance regime that is predicated on the location of front office personnel in connection with the application of rules to inherently global transactions. For example, systems are not designed to take into account the location of individual actors who may touch a transaction only because of the time of day of the counterparty's order or the underlier for the transaction.[18] A more likely result is that non-U.S.

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16 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 rule making through submission of written data, views, or arguments").

17 CEA § 15(a), supra Note 13.

18 For example, consider a G10 foreign exchange options book, which dealers are typically required to operate as a truly global book given the volatility of the underlying and the fact that there is no "closed" time for G10 foreign exchange markets. Global clients who actively use these instruments to manage their risks are also

(footnote continued on next page . . .)

swap dealers, in order to accommodate the demands of their non-U.S. counterparties, move front office personnel outside the U.S. and impose policies generally prohibiting U.S.-based personnel from interacting with non-U.S. counterparties. In other words, a personnel test would fragment previously global markets into separate U.S. and non-U.S. markets, resulting in increased market risk, particularly with respect to transactions with U.S. underliers.

Additionally, given the scale and complexity of the changes that would be necessary to implement a personnel test, if the Commission adopts one it will be critical to provide a substantial transition period before any personnel test comes into effect.

ii. Distinctions Between Transaction-Level Rules

The Institute does not believe that any transaction-level rules should apply to swaps between non-U.S. swap dealers and non-U.S. counterparties. To the extent, however, that the Commission decides to apply transaction-level rules to those swaps based on the activity of U.S.-based personnel or agents, the determination of which transaction-level rules should apply should be based on the nature of that activity. When a separately organized U.S. affiliate of a non-U.S. swap dealer acts on behalf of a non-U.S. swap dealer, that affiliate will already be subject to specific regulation of its activities under the CEA and Commission rules.[19] Those are the regulations that should appropriately apply to the affiliate's activities. Further, when U.S. personnel of a U.S. branch of a non-U.S. swap dealer engage in activity on behalf of the non-U.S. swap dealer, only the regulations relevant to the activity performed by those personnel should be implicated.

Accordingly, because the activity of front office personnel alone does not give rise to risk, the Commission's "Category A" transaction-level rules should not apply to a swap between non-U.S. persons solely as a result of the U.S. location of front office personnel.[20]

(. . . footnote continued from previous page)

required to monitor their risk on a 24-hour basis. They therefore need to have dealer coverage in different regions, depending on the time of day.

[19] We note that the Commission previously determined that agency activity does *not* constitute swap dealing activity. See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30,596, 30,610 n.202 (May 22, 2012). Instead, the Commission has specifically recognized the position of agent affiliates of swap dealers and has granted them relief from introducing broker and commodity trading advisor registration in certain circumstances where such affiliates were subject to regulation in another capacity. See CFTC No-Action Letter No. 12-70 (Dec. 31, 2012).

[20] We recognize that, to the extent a swap is not only negotiated and agreed to by the personnel of a U.S. branch of a non-U.S. swap dealer but also booked to the branch, additional U.S. supervisory interests may be implicated. While we do not believe it to be necessary, if the Commission did choose to recognize a distinction between U.S. and non-U.S. branches of a non-U.S. swap dealer, we believe the Commission must appropriately

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Allowing front office personnel in different regions, including the U.S., to book transactions with non-U.S. persons in a global non-U.S. booking entity has significant risk management and liquidity benefits for the global dealer as well as for the financial system at large. Diversification and netting of exposures across transactions and counterparties allows for the overall reduction of market and credit risk. Furthermore, such risk will not flow back to the U.S. due to the activity of U.S. front office personnel; rather, the risk remains with the legal entities to which the swap is booked, both of which are non-U.S. persons.

Based on the Commission's analysis in the Final Guidance, "Category A" transaction-level rules include risk mitigation rules, such as mandatory clearing, margin and segregation for uncleared swaps, swap trading relationship documentation, portfolio reconciliation and compression, and swap confirmation.[21] The Commission also took the view in the Final Guidance that transparency-related rules, such as real-time public reporting and mandatory trade execution, are underpinned by the objective of risk mitigation and by their relationships with mandatory clearing, and it included those rules in "Category A" as well.[22]

Accordingly, we believe that, consistent with the categorization of transaction-level rules in the Final Guidance, both risk mitigation and transparency-related rules should not be triggered by a personnel test, if any, adopted by the Commission. We note, however, that the Commission's pre- and post-trade transparency and market integrity rules would continue to apply to U.S. markets through their application to all transactions involving U.S. persons, as well as all transactions executed on or subject to the rules of DCMs and SEFs subject to registration with the Commission. Thus, any incremental diminution of market transparency in the U.S. would occur only with respect to those transactions with the barest of ties to U.S. markets, *i.e.*, OTC trades between non-U.S. persons, many of which have a U.S. connection only because U.S. front office coverage was needed to accommodate the time of day when the swap was executed.

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balance the interests of the swap dealer's home and host country regulators. Therefore, if the Commission makes such a distinction, as it did in footnote 513 of the Final Guidance, it should clarify that the additional application of transaction-level rules to a swap entered into by a U.S. branch is triggered only if the swap meets all five prongs of the test for determining when a swap is considered to be one that is executed "with the foreign branch" of a U.S. bank, subject to modifications to the first prong of that test to ensure the consistent application of a personnel test, if any, across all the fact patterns and for all purposes that the test is relevant. See Final Guidance at 45,330. In such a case, given the strong supervisory interests of the counterparties' home country regulators in applying their rules to such a swap due to the fact that the risks arising from it are ultimately borne by non-U.S. persons, the swap should be eligible for substituted compliance with respect to any transaction-level rules that may apply to it.

[21] See Final Guidance at 45,366-68.

[22] See id.

With respect to the Commission's "Category B" transaction-level rules, *i.e.*, external business conduct rules, we believe that only the rules relevant to the types of communications that occur between U.S. front office personnel and non-U.S. counterparties should apply. In our view, those rules comprise only the requirements to provide disclosures of material information, as well as anti-fraud, anti-manipulation, and fair and balanced communication rules.[23] In this regard, we believe a non-U.S. swap dealer should be permitted to satisfy disclosure rules applicable to swaps with non-U.S. counterparties through disclosure the content of which is consistent with Commission requirements and which the swap dealer delivers through means acceptable for the disclosure of material information under the rules of the relevant non-U.S. jurisdiction(s).

In contrast, the other, relationship-wide external business conduct rules should not apply based on specific communications by U.S. personnel or agents under the personnel test. Such an approach would require wholesale amendments to relationship documentation merely because of communications that may not even be material to the overall trading relationship. Given that these relationships are already governed by non-U.S. law and regulation, and non-U.S. counterparties are unlikely to be familiar with Dodd-Frank and Commission rules, requiring these counterparties to amend their documentation to comply with Dodd-Frank and Commission rules is likely to act as a strong disincentive to interacting with U.S. personnel or agents.

However, even if the Commission did decide to apply the personnel test to relationship-level external business conduct rules, foreign regulators have a strong supervisory interest in regulating sales practices between non-U.S. persons, as the Commission has recognized.[24] As a result, at a minimum, substituted compliance should be available with respect to relationship-level external business conduct rules so that non-U.S. counterparties subject to comparable protections under local sales practices rules that apply to their transactions can comply with those rules instead of complying with Commission rules.[25]

In this regard, we note that the objectives of many of the Commission's relationship-level external business conduct rules would be adequately addressed through

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23 See 17 C.F.R. §§ 23.410(a)-(b), 23.431 and 23.433.

24 See Final Guidance at 45,340 ("[T]he Commission believe that the foreign jurisdiction in which non-U.S. persons are located are likely to have a significant interest in the type of business conduct standards that would be applicable to transactions with such non-U.S. persons within their jurisdiction.").

25 The Commission should also clarify that if one counterparty to a swap is subject to comparable foreign regulation, the entire transaction is eligible for substituted compliance. For example, if a non-U.S., non-EU swap dealer enters into a swap with an EU counterparty through the swap dealer's U.S. branch, the swap should be eligible for substituted compliance with relevant EU rules (even if the home jurisdiction of the swap dealer has not received a comparability determination from the Commission).

compliance with home country or other applicable non-U.S. laws, particularly in the jurisdictions where most non-U.S. swap dealers are located.[26] For example, it is typical for these jurisdictions to have rules providing special protections to (or prohibiting) OTC derivatives activity with retail customers, which accomplish the same goals as the Commission's counterparty eligibility requirements.[27] Similarly, pursuant to coordinated international anti-money laundering efforts, most foreign jurisdictions have implemented "know your customer" ("KYC") rules similar to the Commission's KYC and true name and owner rules.[28] Key foreign jurisdictions have also enacted disclosure and suitability requirements for dealers when recommending transactions to counterparties, akin to the Commission's institutional suitability requirements.[29] In contrast, while other jurisdictions have largely failed to adopt enhanced protections for counterparties that are Special Entities, these protections would generally not be relevant to a substituted compliance analysis because non-U.S. persons would not generally fall within the definition of a Special Entity.[30]

iii. Need for a Clear, Objective and Ascertainable Test

The Commission should provide a clear, objective and ascertainable test for when it intends to regulate the activities of U.S. personnel or agents. As discussed above, in our view, only disclosure, anti-fraud, anti-manipulation, and fair and balanced communication rules are relevant to communications between the U.S.-based front office personnel of non-U.S. swap dealers and non-U.S. counterparties. The key objective of those rules is to provide protection to counterparties in their interactions with front office personnel in circumstances where they would

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26 To the extent the swap dealer's or its counterparty's home country jurisdiction does not apply comparable sales practice requirements, the Commission should consider, as a matter of policy, allowing sophisticated non-U.S. institutional counterparties to "opt-out" of Commission sales practice rules, thereby allowing those counterparties to continue to trade under their existing documentation rather than requiring them to agree to U.S.-specific documentation that they may find more confusing than helpful.

27 See 17 C.F.R. § 23.430.

28 See 17 C.F.R. §§ 23.402(b) and (c).

29 See 17 C.F.R. § 23.434.

30 In this regard, we note that the Securities and Exchange Commission, interpreting the parallel definition of "Special Entity" under the Securities Exchange Act of 1934, has found that non-U.S. persons, including foreign endowments, do not fall within that definition. See Securities and Exchange Commission, Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants; Proposed Rule, 78 Fed. Reg. 30,968, 30,997 n.286 (May 23, 2013) (noting that Special Entities "would be U.S. persons because they are legal persons organized under the laws of the United States"). We believe that the Commission should also take this position or, at a minimum, should, as a matter of policy, not apply its Special Entity requirements to swaps between non-U.S. swap dealers and non-U.S. counterparties.

reasonably expect the protection of such rules. When entering into transactions with non-U.S. swap dealers, non-U.S. counterparties may reasonably expect the protection of the sales practice rules applicable in the jurisdiction of the personnel responsible for committing the non-U.S. swap dealer to the swap. Conversely, it would not be reasonable for a non-U.S. counterparty to expect the protection of sales practice rules applicable in the jurisdiction of personnel who merely provide ancillary services, such as personnel providing market color or pricing or legal, compliance, or back-office support services. Likewise, it would not be reasonable for a non-U.S. counterparty trading with a non-U.S. swap dealer on a non-U.S. trading platform or through a non-U.S. broker to expect the protection of U.S. sales practice rules since in these circumstances the non-U.S. counterparty cannot readily determine the location of the non-U.S. swap dealer's personnel or agents.

The Commission also should make clear that U.S. personnel or agents of a non-U.S. swap dealer, acting pursuant to product, credit, and market risk parameters established by non-U.S. personnel of the non-U.S. swap dealer, who commit the non-U.S. swap dealer to swaps with a non-U.S. counterparty outside the counterparty's local market hours, do not trigger U.S. rules. The involvement of U.S. personnel or agents, on an exception basis, under such circumstances is provided only as an accommodation to the counterparty to allow trading in off-market hours. Given the exceptional nature of such trading, a counterparty to such a swap would reasonably expect the sales practice rules of its or the non-U.S. swap dealer's home country jurisdiction to continue to apply instead of U.S. rules. This clarification would facilitate continued U.S. participation in markets that operate across multiple time zones, consistent with exceptions that the Commission has long recognized in similar contexts.[31]

Not only would the above approach be consistent with the customer protection objectives of the Commission's sales practice rules, but it is the only approach that could reasonably be implemented as a personnel test. In contrast, any other approach would, if implemented in other jurisdictions, result in the possibility that a single swap transaction could be subject to multiple jurisdictions' rules based on the location of personnel alone.

To reiterate, the location of the counterparty's personnel or agents should not be relevant to the analysis. The Commission already addressed the location of counterparty personnel in the Final Guidance through the "principal place of business" prong of the U.S. person definition. Separately incorporated U.S. agents acting on behalf of a non-U.S. counterparty will already be subject to Commission regulation as introducing brokers, futures commission merchants, or commodity trading advisors, depending on their role and relationship with the counterparty. At the same time, since swap transactions are so commonly negotiated

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[31] See, e.g., CFTC Interpretive Letter No. 93-83 (Aug. 9, 1993); CFTC Advisory for Interpretive Letter No. 93-21 (Apr. 1, 1993) (permitting U.S. futures commission merchants to "pass the book" to non-U.S. affiliates by allowing non-U.S. affiliates to enter U.S. customer orders into CME Globex terminals outside regular U.S. trading hours without requiring the non-U.S. affiliates to register with the Commission).

over e-mail, instant messaging and electronic trading platforms, swap dealers cannot readily determine the location of their counterparty's personnel or agents. Thus, the benefits of looking to the location of the counterparty's personnel or agents would be limited at best, but the costs and potential for inadvertent non-compliance under that approach would be extremely significant.

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The Institute appreciates the Commission's consideration of these matters. If the Commission or its staff has any questions regarding this letter, please do not hesitate to contact the undersigned at (212) 421-1611.

Respectfully submitted,

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