ISDA Safe, Efficient Markets

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May 11, 2015

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Initial Response to District Court Remand Order in SIFMA et al. v. CFTC (RIN 3088-AE27)

Dear Mr. Kirkpatrick:

The International Swaps and Derivatives Association, Inc. ("**ISDA**")[1] and the Securities Industry and Financial Markets Association ("**SIFMA**")[2] appreciate the opportunity to provide their views to the Commodity Futures Trading Commission (the "**Commission**") in response to the request for comment contained in the aforementioned release (the "**Cost-Benefit Release**").

The Commission states that the Cost-Benefit Release is its initial response to the District Court's order in *SIFMA v. CFTC*[3] remanding eight swaps-related rulemakings to the Commission. In the Cost-Benefit Release, the Commission supplements the preambles of the eight rulemakings to indicate that its discussion therein of costs and benefits referred to the effects of its rules on all business activity subject to its regulations, whether by virtue of the activity's physical location in the United States or by operation of section 2(i) of the Commodity Exchange Act. In order to assist the Commission in determining whether any further consideration is needed to respond to the remand order, the Commission requests comment on how costs and benefits differ between

[1] Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 62 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

[2] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[3] __ F. Supp. 3d __, 2014 WL 4629567.

domestic and overseas application of its rules governing swaps activities, and on the implications of such differences for the substantive requirements of its rules.

General Observations

As ISDA and SIFMA have consistently maintained, many of the current cross-border challenges facing the swaps market exist due to the Commission's nearly exclusive focus on the domestic effects of its rules and the limited scope and restrictive application of its substituted compliance mechanism. Simple redeployment of the Commission's apparently domestic previous cost-benefit analysis will yield no new information, distill no lessons from experience to date with the Commission's swaps rulemaking, and, were it to be the entirety of the Commission's response to the remand order,[4] miss a valuable opportunity to contribute to the global discussion regarding resolution of cross-border issues. In-depth consideration of the differential effects between domestic and overseas application of swaps rules is needed in order to make headway in realizing the G-20 mandate to "implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage" and to advance Chairman Massad's announced priority of regulatory harmonization.

ISDA and SIFMA caution against an overly narrow conception of the burdens resulting from extraterritorial application of Commission rules as comprising only registration fees, NFA membership dues, and expenses to construct and administer compliance systems, however formidable these costs may be. When foreign market participants are subject to Commission rules, they must engage with an unfamiliar, non-domestic regulator and face uncertainty regarding the ramifications of being subject to a new regime. A full-bore legal investigation (which may leave unresolved issues) and substantial management attention are prerequisites in any responsible entity to becoming subject to a foreign regulator. The addition of specially trained staff is a common adjunct. Internal conflicts and customer resistance frequently may follow. It is unsurprising that non-U.S. market participants simply may be unwilling to take on this burden. These costs and uncertainties function as barriers to entry and to continued engagement in U.S. markets, potentially resulting in market fragmentation and *decreased liquidity available to U.S. persons* as foreign market participants change their business practices so as not to subject themselves to Commission regulation. This situation inevitably makes it more expensive for end users to hedge.

The foregoing costs – both the direct and readily-identifiable, and the far greater costs stemming from their market impact – must be weighed against the attenuated or minimal benefits accruing from overlaying Commission regulations onto foreign regulations that meet the objectives outlined by the G-20 jurisdictions.[5]

[4] We recognize that the Commission has characterized the Cost-Benefit Release as only its initial response to the remand order, and it is not our purpose in this letter to express a view on what further actions are necessary in order to satisfy the "reasonable consideration" and related requirements of the remand order.

[5] An evaluation of costs and benefits should also take into account not only overlapping foreign rules, but also the existence of other Commission rules that adequately serve the Commission's purposes. For example, the Commission's constant anti-fraud and manipulation authority is a very powerful tool. The presence of anti-fraud and manipulation authority also responds to the staff concerns expressed in Staff Advisory 13-69 which, although not a subject of remand, remains subject to Commission review.

Specific Examples

The cost-benefit considerations discussed above are general and apply to each of the remanded rulemakings. We illustrate them below with reference to specific examples drawn from ISDA research, as well as observations from ISDA and SIFMA members. We urge the Commission to analyze each remanded rulemaking with these considerations in mind, drawing upon swap data repository and other data available to the Commission in order to provide a firm empirical foundation to its analysis.

ISDA research[6] demonstrates that, since the compliance date of the SEF registration rule in October 2013, liquidity in the interest rate swaps market has split into U.S. and non-U.S. pools as E.U. dealers have opted to limit their trading of euro-denominated interest rate swaps (IRS) to other E.U. persons. The average cross-border volume of euro-IRS transacted between European and U.S. dealers as a percentage of total euro-IRS volume was approximately 29% in September 2013. In October 2013, the comparable figure fell to 9% and, in May 2014 only 6% of euro-IRS transactions were between a U.S. and a European dealer.

The Commission, as previously noted, requests comment on the implications of a cost-benefit analysis for the substantive requirements of its rules. It follows from our discussion above of the behavioral consequences of overseas application of Commission rules that greater clarity around the scope of Commission rules and greater use of safe harbors could mitigate certain of these costs. For example, persons utilizing the de minimis exemption from swap dealer status may be avoiding transactions with U.S. swap dealers due to uncertainty regarding whether their swaps hedging their own financial risks would be considered to be entered into "in connection with dealing activity." Expansion of the safe harbor now restricted to physical commodity hedging, so as to encompass a broader array of hedging transactions, could mitigate this effect. As another example, the Commission should re-examine the provisions of Regulation 45.2 that require non-registrants "subject to the jurisdiction of the Commission" to make books and records available to the Commission and other U.S. authorities.

Greater harmonization with foreign jurisdictions' rules could also alleviate the costs discussed above. With regard to SEF registration and core principles, we note the stark contrast between the very rigid execution methods (which are not mandated by statute) under the Commission's rules and the greater flexibility afforded to "organized trading facilities" under MiFID II in the European Union. We urge the Commission to re-examine its approach to SEF execution methods in light of the cost-benefit considerations discussed above.[7] As a further example, implementation of trade reporting mandates in different jurisdictions is producing a disjointed and costly framework of overlapping reporting obligations, in some cases in conflict with local laws, with market participants reporting to a multiplicity of trade repositories on different bases. Despite having access to tremendous amounts of information, regulators are unable to consolidate, aggregate and effectively use that information.

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[6] *See* ISDA Research Notes: "Cross-Border Fragmentation of Global OTC Derivatives: An Empirical Analysis" (January 2014); and "Revisiting Cross-Border Fragmentation of Global OTC Derivatives: Mid-Year 2014 Update" (July 2014).

[7] *See* ISDA's "Path Forward for Centralized Execution of Swaps" for a fuller discussion of the implications of certain substantive requirements of the Commission's SEF rules.

In addition to the costs related to the cross-border application of the Commission's Title VII rules as finalized, there are significant costs that would be incurred should the Commission seek to implement a personnel-based test as outlined in CFTC Staff Advisory No. 13-69.[8] It is important to highlight that the costs of such an impactful change in approach could not have been contemplated by the Commission when it adopted the individual remanded rules, as Staff Advisory 13-69 was released subsequent to the finalization of those individual rulemakings. As we noted in our previous submissions[9], a personnel-based approach would require a transaction-by-transaction analysis that tracks the location of personnel employed throughout the life of a transaction. This personnel-location approach significantly differs from the Commission's established entity-based approach to swaps regulations, and would require investing in the development of new technological and operational infrastructure, imposing further costs on market participants with no clearly articulated additional benefits. Further, consideration should be given to the potential impact of such a requirement, including the movement of jobs out of the U.S. as non-U.S. clients protected under suitable foreign regulatory regimes begin to insist that they will not transact with a dealer that uses U.S. personnel to arrange, negotiate or execute transactions.

In this regard, it is important to note that the Securities and Exchange Commission (SEC) has indicated that it does not plan to impose mandatory clearing or mandatory trade execution requirements on a security-based swap (SBS) transaction between two non-U.S. persons solely because one or both counterparties arrange, negotiate or execute the SBS using personnel located in the United States. According to the SEC, "the counterparty credit risk associated with these transactions resides primarily outside the United States, and the Commission's preliminary view is that imposing the mandatory clearing requirement would not significantly advance the key objectives of the clearing requirement, namely the mitigation of systemic and operational risk in the United States."[10] The SEC further noted that "[b]ecause mandatory trade execution applies only to transactions that are subject to the mandatory clearing, these transactions also would not be subject to mandatory trade execution." [11]

Finally, the *SIFMA v. CFTC* court suggested that although the CFTC might not have had duplicative foreign regulations to consider when it first promulgated many of its rules, that may no longer be the case. The court also raised the possibility of substituted compliance as a mitigant of the burdens of duplicative regulation. ISDA and SIFMA firmly agree that broad, holistic, genuinely outcomes-based substituted compliance can be of substantial help. We remind the CFTC that there has been little additional progress towards substituted compliance since the highly-granular reviews of December 2013. We propose that the CFTC adopt the

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

[9] *See* comments submitted by ISDA (available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59777&SearchText) and SIFMA (with the Futures Industry Association and the Financial Services Roundtable) (available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=59793&SearchText) in response to the CFTC's "Request for Comment on Application of Commission Regulations to Swaps Between Non-U.S. Swap Dealers and Non-U.S. Counterparties Involving Personnel or Agents of the Non-U.S. Swap Dealers Located in the United States," 79 Fed. Reg. 1347 (January 8, 2014).

[10] *See* SEC Fact Sheet (April 29, 2015).

[11] *Id*.

framework of its "essentially identical" findings with regard to EU risk mitigation rules[12] as a basis for a principled and cost-effective approach to substituted compliance. To do so, and to take the steps outlined above, would do much to ease the costs and enhance the benefits of extraterritorial application of the Commission's rules, and would give effect to the harmonization principle of section 752 of the Dodd-Frank Act, as well as the word and spirit of the original G-20 principles.

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Thank you for your consideration of these concerns. Please feel free to contact the undersigned should you wish to discuss this letter.

Sincerely,

Steven Kennedy
Global Head of Public Policy
ISDA

Kyle Brandon
Managing Director, Director of Research
SIFMA

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
Phyllis Dietz, Acting Director, Division of Clearing and Risk
Vincent A. McGonagle, Director, Division of Market Oversight

[12] *See* CFTC Letter No. 13-45 (July 11, 2013).