MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

September 14, 2015

Via Electronic Submission: http://comments.cftc.gov

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

Re: Proposed Rule on "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements" (RIN 3038–AC97)

Dear Mr. Kirkpatrick:

Managed Funds Association ("**MFA**")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**") on its proposed rule on "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements" (the "**Proposed Rule**").[2] MFA strongly supports a rational and proportionate approach to the extraterritorial application of the Commission's margin requirements for uncleared swaps ("**Proposed Margin Requirements**") that avoids subjecting counterparties to duplicative or conflicting margin rules. In addition, we greatly appreciate the Commission's attentiveness to the concerns of end users, and the efforts of the Commission to ensure adequate protection of end users,[3] during its rulemaking process

[1] Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] 80 Fed. Reg. 41376 (July 14, 2015), available at: http://www.gpo.gov/fdsys/pkg/FR-2015-07-14/pdf/2015-16718.pdf ("**Proposing Release**").

[3] *See e.g.*, Commission final rule on "Customer Clearing Documentation, Timing of Acceptance for Clearing, and Clearing Member Risk Management", 77 Fed. Reg. 21278 (Apr. 9, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-04-09/pdf/2012-7477.pdf; Commission final rule on "Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations", 78 Fed. Reg. 68506 (Nov. 14, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-11-14/pdf/2013-26665.pdf.

related to Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").[4]

With respect to the Proposed Rules, we understand the myriad of policies and interests that the Commission must balance as it determines how and when to regulate covered swap entities ("**CSEs**").[5] As financial end users that are CSEs' counterparties, our members want to ensure that the Commission fully considers the impact of the Proposed Rule on end users in addition to CSEs, and adopts a final cross-border approach for the Proposed Margin Requirements that balances the competing interests of, and treats fairly, all affected market participants.

I. Executive Summary

As an initial matter, MFA believes that it is important for U.S. regulators to develop a single, harmonized, U.S. approach to cross-border derivatives regulation, including with respect to margin requirements for uncleared OTC derivatives trades, to ensure that there is a consistent regulatory outcome.

In addition, MFA is concerned about the divergence of the Proposed Rule from the approach in the Commission's final cross-border guidance ("**Cross-Border Guidance Approach**"),[6] and the Commission's move towards the prudential regulators'[7] proposed cross-border approach.[8] In particular, from the CSE counterparty perspective, our members understand why the Proposed Rule gives deference to the foreign regulatory regime to which a non-U.S. CSE ("**Foreign CSE**") is subject. However, we are concerned that the Proposed Rule could result in U.S. persons and uncleared swaps with a substantial U.S. nexus being subject to a foreign jurisdiction's margin rules.

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[4] Pub. L. 111-203, 124 Stat. 1376 (2010), available at: http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

[5] *See* Proposing Release at 41381 ("[A] crossborder framework for margin necessarily involves consideration of significant, and sometimes competing, legal and policy considerations, including the impact on market efficiency and competition. The Commission, in developing the Proposed Rule, aims to balance these considerations to effectively address the risk posed to the safety and soundness of CSEs, while creating a workable framework that reduces the potential for undue market disruptions and promotes global harmonization.").

[6] *See* Commission final "Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations", 78 Fed. Reg. 45292 (July 26, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf ("**Final Cross-Border Guidance**"). *See also* Commission proposed rule and advance notice of proposed rulemaking on "Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants", 79 Fed. Reg. 59898, 59916 (Oct. 3, 2014) (Describing the Commission's cross-border approach from the Final Cross-Border Guidance), available at: http://www.gpo.gov/fdsys/pkg/FR-2014-10-03/pdf/2014-22962.pdf ("**Cross-Border ANPR**").

[7] The prudential regulators means the following five agencies: the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency (collectively, the "**Prudential Regulators**")

[8] *See* Prudential Regulators' proposed rulemaking on "Margin and Capital Requirements for uncleared swap Entities", 79 Fed. Reg. 57348 (Sept. 24, 2014), available at: http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf ("**Prudential Regulators' Proposed Approach**").

We appreciate that in any cross-border swap where the two parties are from different jurisdictions, one jurisdiction's regulatory regime will govern. Thus, one party to the swap will have to navigate the rules and requirements of multiple jurisdictions when trading the swap. However, currently approximately 105 entities have provisionally registered with the Commission as swap dealers ("**SDs**") or major swap participants ("**MSPs**").[9] In contrast, potentially thousands of entities could be CSE counterparties. Thus, we think CSEs are better positioned, and it would be less onerous on the market for the Commission to require CSEs, to be responsible for analyzing and complying with the rules of multiple jurisdictions, rather than for the Commission to require end users to shoulder these responsibilities.

Therefore, to facilitate U.S. regulatory harmonization and foster a more equitable balance between the concerns of, and burdens on, CSEs and end users, per our prior letter in response to the Cross-Border ANPR,[10] we continue to urge all U.S. regulators to adopt the Cross-Border Guidance Approach[11] with the following modifications:

(1) Retain the definition of "U.S. person" from the Proposed Rule, which appropriately excludes collective investment vehicles ("**Funds**") from being considered "U.S. persons" solely by virtue of having majority "U.S. person" ownership;[12]

(2) Modify the substituted compliance approach from the Final Cross-Border Guidance by allowing substituted compliance for trades between "U.S. persons" and non-U.S. persons (including Foreign CSEs) solely at such parties' mutual agreement; and

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[9] *See* list of swap dealers provisionally registered with the Commission as of September 1, 2015, available at: http://www.cftc.gov/LawRegulation/DoddFrankAct/registerswapdealer. *See also* list of major swap participants provisionally registered with the Commission as of March 1, 2013, available at: http://www.cftc.gov/LawRegulation/DoddFrankAct/registermajorswappart.

[10] *See* MFA letter to the Commission on its Cross-Border ANPR, filed with the Commission on December 2, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/12/MFA-Letter-to-CFTC-re-Margin-Letter.pdf ("**MFA ANPR Letter**"). In the MFA ANPR letter, MFA urged the Commission to continue to use the Cross-Border Guidance Approach; provided that the Commission:

(1) Modified its definition of "U.S. person" from the Final Cross-Border Guidance to exclude Funds that are "U.S. persons" solely by virtue of having majority "U.S. person" ownership;

(2) Modified its substituted compliance approach from the Final Cross-Border Guidance by allowing substituted compliance for Commission swap rules that apply to trades between "U.S. persons" (using our suggested modification of the definition) and non-U.S. persons at such parties' mutual agreement; and

(3) Prior to implementation of the final margin rules, coordinated with its U.S. and non-U.S. counterparts (in particular EU regulators) to ensure that prior to implementation of the final margin rules: (i) the details of how substituted compliance will work in practice are resolved; and (ii) regulatory conflicts are resolved that substituted compliance alone will not address.

[11] *See supra* note 6.

[12] For the avoidance of doubt, we agree with the Commission that, if a Fund is organized in the U.S. or has a U.S. principal place of business, it should remain a "U.S. person".

(3) Prior to implementation of the final margin rules, ensure that U.S. and non-U.S. regulators (in particular EU regulators) coordinate, resolve, and agree to: (1) the details of how substituted compliance will work in practice; and (2) how regulatory conflicts will be resolved that substituted compliance alone will not address.

MFA strongly believes that the foregoing approach reflects an appropriate balancing of the various policy goals and interests, and will facilitate continued trading of OTC derivatives on a global basis.

II. MFA Comments on the Proposed Rule

A. Developing a Single, Harmonized U.S. Cross-Border Approach

MFA requests that the Commission adopt, and encourage the Securities and Exchange Commission ("**SEC**") and the Prudential Regulators to adopt, the Cross-Border Guidance Approach with our recommended modifications for rules related to Title VII of the Dodd-Frank Act. We think it is important for U.S. regulators to ensure that there is a single, harmonized, U.S. approach to cross-border derivatives regulation, and have similarly suggested such a harmonized U.S. approach to the SEC and Prudential Regulators.[13]

As the Commission knows, Section 2(i) of the Commodity Exchange Act ("**CEA**"), as amended by Section 722 of the Dodd-Frank Act, provides that the Commission's swap rules "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".[14] In addition, Section 4s(e)(2)(A) of the CEA, as amended by Section 731 the Dodd-Frank Act, requires the Commission, SEC, and Prudential Regulators, to adopt rules jointly regarding margin requirements for CSEs related to uncleared swaps.[15] In the Proposing Release, the Commission cites these statutory mandates as guiding their determination as to the appropriate cross-border scope of the Proposed Rule.[16] However, despite the Commission, SEC, and

[13] *See* MFA letter to the SEC on its proposed rules on "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", filed with the SEC on July 13, 2015, available at: https://www.managedfunds.org/wp-content/uploads/2015/07/SEC-Re-Proposed-Cross-Border-Rules-Final-MFA-Letter-7-13-151.pdf. *See also* MFA letter to the Prudential Regulators on the Prudential Regulators' Proposed Approach, filed with the Prudential Regulators on November 24, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/11/MFA-Letter-Prudential-Regulators-Margin-Proposal1.pdf ("**MFA Prudential Regulator Letter**").

[14] *See* Proposing Release at 41377, note 8.

[15] *See id*. at 41377, referencing Section 4s(e)(2)(A) of the CEA, which specifically provides that the Prudential Regulators, Commission, and SEC, "shall jointly adopt rules for swap dealers and major swap participants, with respect to their activities as a swap dealer or major swap participant, for which there is a prudential regulator imposing . . . both initial and variation margin requirements on all swaps that are not cleared by a registered derivatives clearing organization."

[16] *See id*.

Prudential Regulators all seeking to implement the mandates of the Dodd-Frank Act in respect of the same U.S. derivatives market, it remains possible that each U.S. regulator will adopt a final cross-border approach that is different in scope, and thus, would lead to different regulatory outcomes.

In particular, after reviewing the Proposed Rules, we are concerned about the material substantive differences among the various U.S. derivatives cross-border proposals, including the Proposed Rules, the Final Cross-Border Guidance, the SEC's proposed cross-border rules for non-U.S. persons,[17] the SEC's final cross-border rules for security-based swap dealers and major security based swap participants,[18] and the Prudential Regulators' Proposed Approach.[19] Each of these proposals addresses the cross-border application of rules that govern the U.S. derivatives market under Title VII of the Dodd-Frank Act. However, each proposal also contains substantive differences from the others. In the aggregate, the differences among these various U.S. cross-border proposals are problematic because differences among U.S. regulators as to the cross-border scope of their regulations will lead to different regulatory outcomes.[20]

Therefore, to advance U.S. derivatives regulatory harmonization, MFA urges the Commission to adopt the Cross-Border Guidance Approach with our recommended modifications for its Proposed Margin Requirements, which would harmonize the cross-border application of the Commission's swap rules. Then, we request that the Commission encourage the SEC and Prudential Regulators to adopt the same approach.

B. Support for "U.S. Person" Definition

MFA strongly supports the Commission's "U.S. person" definition in the Proposed Rule, and encourages the Commission to retain this definition in its final rule while otherwise adopting the Cross-Border Guidance Approach.

Like the "U.S. person" definition in the Cross-Border Guidance Approach,[21] the Proposed Rule properly includes Funds that are organized in the U.S. or have a U.S. principal place of business

[17] SEC on its proposed rules on "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", 80 Fed. Reg. 27444 (May 13, 2015), available at: http://www.gpo.gov/fdsys/pkg/FR-2015-05-13/pdf/2015-10382.pdf .

[18] SEC final rules; interpretation on "Application of 'Security-Based Swap Dealer' and 'Major Security-Based Swap Participant' Definitions to Cross-Border Security-Based Swap Activities", 79 Fed. Reg. 47278 (Aug. 12, 2014), available at: http://www.gpo.gov/fdsys/pkg/FR-2014-08-12/pdf/R1-2014-15337.pdf.

[19] *See supra* note 8.

[20] This problem is particularly acute with respect to the credit default swap ("**CDS**") market. Specifically, given the close economic correlation between the single-name CDS market regulated by the SEC and the CDS index market regulated by the Commission, and the fact that many market participants maintain portfolios that include both sets of instruments, it is important that there is consistent regulation of the CDS market by U.S. regulators.

[21] *See* Final Cross-Border Guidance at 45316-17, which defines "U.S. person", in relevant part, as: (1) any legal entity organized or incorporated in the U.S. or having its principal place of business in the U.S.; (2) any privately-

in its "U.S. person" definition.[22] However, unlike in the Cross-Border Guidance Approach, the Proposed Rule does not classify as "U.S. persons" Funds that have majority "U.S. person ownership, where such Funds otherwise are not organized in the U.S. and do not have a U.S. principal place of business.[23]

MFA applauds the Commission's decision to modify the "U.S. person" definition in the Proposed Rule to exclude Funds that would be "U.S. persons" solely by virtue of having majority "U.S. person" ownership. MFA believes that defining a non-U.S. Fund as a "U.S. person" solely because of the proportion of its investors that are "U.S. persons" is inconsistent with the stated aims of the Dodd-Frank Act. In our view, majority "U.S. person" ownership alone is not indicative of whether the activities of a non-U.S. Fund with a non-U.S.-based manager would have a direct and significant effect on the U.S financial system.

Therefore, MFA respectfully requests that the Commission retain the Proposed Rule's "U.S. person" definition in the final rule, but otherwise adopt the Cross-Border Guidance Approach.

C. Concerns with the Hybrid, Firm-Wide Approach[24]

From an end user and CSE counterparty perspective, MFA's members have concerns with the hybrid, firm-wide approach reflected in the Proposed Rule ("**Proposed Approach**"), and its treatment of uncleared swaps between a Foreign CSE and a U.S. person. We think that in seeking to address potential regulatory conflicts for Foreign CSEs, the Proposed Rule provides too little protection for, and overburdens, U.S. end users and other non-CSE U.S. counterparties.

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offered alternative investment fund that is majority-owned by U.S. persons; and (3) other legal entity where all of the owners have limited liability and that is directly or indirectly majority-owned by U.S. persons.

[22] *See* Proposing Release at 41401, proposed §23.160(a)(10)(iii) and (vi), which provides that a Fund is a "U.S. person", if it is a Fund that: (1) is organized or incorporated under U.S. law or has a U.S. principal place of business, or (2) is a legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is owned by one or more U.S. persons and for which such person(s) bears unlimited responsibility for the obligations and liabilities of the Fund.

[23] *See id*.

[24] MFA notes that the concerns we express with respect to the Proposed Approach are the same as our concerns with the Prudential Regulators' Proposed Approach. We previously expressed these concerns to the SEC, Prudential Regulators and the Commission. *See* MFA ANPR Letter, *supra* note 10. *See also* MFA Prudential Regulator Letter *supra* note 13, in which we expressed concern with the defined term "foreign non-cleared swap or foreign non-cleared security-based swap", and that the Prudential Regulators' consideration of Funds with a U.S. principal place of business as non-U.S. persons would result in many uncleared trades with a substantial U.S. nexus being subject to foreign margin rules. Therefore, we urged the Prudential Regulators to:

> (1) Incorporate a "principal place of business" test into their definition of "foreign non-cleared swap or foreign non-cleared security-based swap"; and
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> (2) Coordinate with their regulatory counterparts in the U.S. and in foreign jurisdictions with comparable regulations (in particular EU regulators) to ensure that prior to implementation of the final margin rules: (a) the details of how substituted compliance will work in practice are resolved; and (b) regulatory conflicts are resolved that substituted compliance alone will not address.

Thus, we do not believe that this approach is an appropriate solution to the cross-border application of U.S. derivatives rules (including for the Proposed Margin Requirements), and instead urge the Commission to adopt the Cross-Border Guidance Approach for the Proposed Margin Requirements with our recommended modifications.

1. Summary of Proposed Approach

Previously, under the Cross-Border Guidance Approach, the Commission determined that certain of its requirements (including the Proposed Margin Requirements) would be transaction-level requirements, where the Commission would apply its rules on a transaction-by-transaction basis and the "U.S. person" status of both parties would be relevant factors.[25] However, under the Proposed Approach, the Commission has chosen to diverge from its prior approach, and now proposes to apply an approach to the Proposed Margin Requirements that differs from all other Commission swap rules by combining its entity- and transaction-level approaches into a hybrid approach.[26]

As a general matter, the Proposed Approach is an entity-level approach in that the Proposed Margin Requirements would apply to CSEs "on a firmwide basis, irrespective of the domicile of the counterparties or where the trade is executed".[27] However, the Commission proposes to retain a transaction-level component to the Proposed Rule's substituted compliance approach by providing that "certain uncleared swaps would be eligible for substituted compliance or excluded from the Commission's margin rules based on the counterparties' nexus to the United States relative to other jurisdictions".[28] In the case of Foreign CSE whose obligations under the relevant uncleared swap are not guaranteed by a U.S. person, the Proposed Margin Requirements would apply.[29] However, for such Foreign CSEs, the Commission would broadly permit substituted compliance, even where the Foreign CSE is transacting with a counterparty that is a "U.S. person" (*e.g.*, a Fund that it organized or has its principal place of business in the U.S. ("**U.S. Fund**"), and thus, there is a substantial U.S. nexus.[30]

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[25] *See* Final Cross-Border Guidance at 45333 (Providing that the transaction-level requirements included the following rules: (1) required clearing and swap processing; (2) margining (and segregation) for uncleared swaps; (3) mandatory trade execution; (4) swap trading relationship documentation; (5) portfolio reconciliation and compression; (6) real-time public reporting; (7) trade confirmation; (8) daily trading records; and (9) external business conduct standards.

[26] *See* Proposing Release at 41381-82.

[27] *Id*. at 41381.

[28] *Id*.

[29] *See id*. at 41387.

[30] *See id*.

2. The Proposed Rule and Proposed Margin Requirements Materially Affect End Users

MFA recognizes that the Commission has determined to apply the Proposed Rule based on a CSE's status (and only minimally based on its counterparty's status) because of the Commission's view that the purpose of the Proposed Margin Requirements is to protect the CSE.[31] However, end users that enter into uncleared swaps with CSEs for hedging and investing purposes will also be subject to the minimum margin requirements, and, at times, will collect margin from their CSE counterparties. Therefore, the Proposed Margin Requirements are intended to protect both end users and CSEs, and the Proposed Rule and its application to the Proposed Margin Requirements will materially affect end users to the same extent as CSEs. Accordingly, MFA emphasizes that, in determining which cross-border approach is appropriate for the Proposed Margin Requirements, it is equally important for the Commission to evaluate and consider the aggregate effects of the Proposed Rule on end users.

We agree that utilizing the largely entity-level Proposed Approach would make sense if the Proposed Margin Requirements were essentially CSE internal compliance requirements, like the Commission's other entity-level requirements.[32] However, the Proposed Approach and its application to the Proposed Margin Requirements is so fundamentally tied to each individual uncleared swap transaction and the parties to that transaction that we feel strongly that it is appropriately a transaction-level requirement where the status of, and effect on, both parties receive equal consideration.

3. Application of the Proposed Approach to Non-CSE U.S. Persons

In MFA's view, the Proposed Approach does not strike the right balance between giving deference to the foreign regulatory regime to which a Foreign CSE is subject, and ensuring that U.S. persons are subject to U.S. rules, when a Foreign CSE is trading with a U.S. person (such as a U.S. Fund). Such imbalance could result in uncleared swaps with a substantial U.S. nexus being subject to a foreign jurisdiction's margin rules.

As the Commission knows, it regulates U.S. Funds as "U.S. persons" for purposes of its swap rules because the activities of these U.S. Funds have a substantial U.S. nexus. However, because the Proposed Rule allows substituted compliance where a Foreign CSE enters into an uncleared swap with a U.S. Fund,[33] even though the Commission regulates these U.S. Funds as "U.S.

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[31] *See id*. at 41381 ("The primary reason for collecting margin from counterparties is to protect an entity in the event of a counterparty default . . . In addition, margin functions as a risk management tool by limiting the amount of leverage that a CSE can incur . . . In this way, margin serves as a first line of defense to protect a CSE as a whole from risk arising from uncleared swaps.").

[32] See Final Cross Border Guidance at 45331 (Providing that the entity-level requirements include: (1) capital adequacy; (2) chief compliance officer; (3) risk management; (4) swap data recordkeeping; (5) swap data repository reporting; and (6) physical commodity large swaps trader reporting.

[33] *See* Proposed Release at 41381.

persons", these U.S. Funds will likely be required to margin their uncleared swaps in accordance with the foreign margin rules to which their Foreign CSE counterparty is subject.[34]

MFA does not believe any U.S. Fund should be required to comply with a foreign regulator's margin rules solely by virtue of the U.S. Fund trading with a Foreign CSE. In particular, MFA notes that, for purposes of the Commission's trading, clearing, and other swap rules already in effect, the Commission already regulates these U.S Funds as "U.S. persons".[35] These U.S. Funds have invested considerable resources establishing the infrastructure to allow them to transact as such. Therefore, MFA thinks it is burdensome for the Commission to change course and adopt the Proposed Approach, which would require these same U.S. Funds to alter their infrastructure to comply with the various third country margin rules of their Foreign CSE counterparties.

In addition, MFA understands that a fundamental issue related to the cross-border trading of swaps is that, where two parties from different jurisdictions enter into a swap, only the regulatory regime of one of the jurisdictions can ultimately govern the swap. As a result, for cross-border swaps, one party will necessarily have to navigate the rules and requirements of multiple jurisdictions (*i.e.*, the rules of its home jurisdiction as well as the rules of the home jurisdiction of its counterparty). However, as noted previously, few entities have provisionally registered with the Commission as SDs and MSPs, and thus, few entities would be CSEs under the Proposed Rule.[36] In contrast, potentially thousands of entities could be CSE counterparties. Therefore, MFA believes that CSEs are better positioned, and it is less onerous on the market for the Commission to require CSEs, to be responsible for analyzing and complying with the rules of multiple jurisdictions.

MFA understands that regulatory conflicts could result from adoption by the Commission of the Cross-Border Guidance Approach (even with MFA's recommended modifications) such that it made it palatable for the Commission to consider the Proposed Approach.[37] In particular, we recognize that there have been concerns that the Cross-Border Guidance Approach does not give sufficient deference to other jurisdiction's comparable regulatory regimes.[38] However, MFA does not believe that switching to the Proposed Approach is necessary to resolve these conflicts.

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[34] *See* Section III below for discussion of a key related issue arising from Article 13 of the European Market Infrastructure Regulation ("**EMIR**"). *See* Regulation (EU) 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories (Jul. 4, 2012), available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:201:0001:0059:EN:PDF.

[35] *See* Final Cross-Border Guidance *supra* note 6.

[36] *See supra* note 9.

[37] *See* Proposing Release at 41377-78 ("Conflicting and duplicative requirements between U.S. and foreign margin regimes could potentially lead to market inefficiencies competitive disparities that undermine the relative position of U.S. CSEs and their counterparties. Therefore, it is essential that a cross-border margin framework takes into account the global nature of the swaps market and the supervisory interests of foreign regulators with respect to entities and transactions covered by the Commission's margin regime.").

[38] *See id*. at 41380-81.

Rather, we are of the view that the Commission could resolve these same conflicts by retaining the Cross-Border Guidance Approach and modifying its "U.S. person" definition and substituted compliance approach as discussed herein. Thus, we would urge the Commission not to adopt either the Proposed Approach, but instead to revert to the Cross-Border Guidance Approach with our suggested modifications, which would allow the Proposed Margin Requirements to remain a transaction-level requirement and not require "U.S. persons" to alter their existing infrastructure.

D. International Harmonization and Modification of Existing Substituted Compliance Regime

MFA supports the Commission continuing to apply substituted compliance with respect to its swaps rules as set forth in the Final Cross-Border Guidance;[39] provided that, the Commission modifies its approach to allow substituted compliance for trades between "U.S. persons" and non-U.S. persons solely at such parties' mutual agreement. In addition, we emphasize that it is important that, prior to implementation of the final margin rules, the Commission coordinates with its U.S. and non-U.S. counterparts (in particular EU regulators) to ensure that that: (1) the details of how substituted compliance will work in practice are resolved; and (2) regulatory conflicts are resolved that substituted compliance alone will not address.

MFA strongly supports an internationally coordinated approach to derivatives regulation that ensures consistent regulation, reflects the global nature of the derivatives markets, and promotes competition and innovation. It is increasingly evident that the scope of various U.S. and international derivatives reforms will, to a certain extent, be duplicative and potentially conflicting. Therefore, we agree with the Commission's desire to "mitigate, to the extent possible and consistent with the Commission's regulatory interests, the potential for conflicts or duplication with other jurisdictions".[40]

MFA greatly supports the international framework provided by the Basel Committee for Banking Supervision and the International Organization of Securities Commissions on September 2, 2013 (the "**Basel-IOSCO Standards**"),[41] and the efforts of regulators to harmonize the substance of their respective margin rules at the international level. In addition, we appreciate that the Proposed Rule reflects the Commission's efforts to construct a thoughtful solution that would resolve potential regulatory conflicts, and thereby, prevent the derivatives markets from being impaired.[42] However, a significant number of questions remain, and conflicts exist, with respect to the cross-border intersection of derivatives rules adopted by U.S. and foreign regulators (*e.g.*, the EU derivatives rules under EMIR).[43]

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[39] *See supra* note 6.

[40] Proposing Release at 41381.

[41] Available at: http://www.bis.org/publ/bcbs261.pdf.

[42] *See supra* note 37.

[43] *See supra* note 34.

For example, in the case of U.S. Funds trading derivatives contracts with EU counterparties or non-U.S. Funds trading with U.S. counterparties, it appears that direct regulatory conflicts between U.S. and EU derivatives regulations will result. These types of cross-border transactions are a significant volume of business in both the cleared and uncleared derivatives markets. Therefore, it is critical that U.S. and EU regulators recognize the derivatives regulations of each other's jurisdictions as comparable and bilaterally allow substituted compliance solely at the parties mutual agreement for derivatives trades involving parties from each jurisdiction (where the parties mutually agree as to which regime is applicable) to prevent regulatory fragmentation within the global OTC derivatives markets

Specifically, because of the global nature of the derivatives market and the need to ensure that cross-border OTC derivatives transactions continue to take place, we strongly urge the Commission to use the Basel-IOSCO Standards as an example and promote a similarly harmonized and coordinated approach with respect to U.S. and non-U.S. substituted compliance regimes. In particular, we emphasize the need for the Commission to continue to maintain an open dialogue with their U.S. and non-U.S. counterparts, and work actively to develop harmonized and coordinated substituted compliance regimes to facilitate resolution of overlapping or intentionally divergent derivatives requirements as they arise.

III. Equivalence Issue Related to Article 13 of EMIR[44]

MFA notes that certain regulatory conflicts between U.S. and EU derivatives requirements exist that allowing substituted compliance solely at the parties mutual agreement alone would not resolve.[45] In particular, below we summarize a key regulatory conflict that would arise for U.S. Funds related to Article 13 of EMIR that the Commission must work with U.S. and EU authorities to address.[46]

In broad terms, Article 13 of EMIR allows the European Commission ("**EC**") to declare margin (and certain other) rules of a third country relating to OTC derivative contracts to be "equivalent" to the relevant provisions of EMIR.[47] Similar to substituted compliance regimes in the U.S., following an EC equivalence declaration with respect to a jurisdiction's derivatives rules, where an EU counterparty enters into a derivatives contract with a counterparty that is

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[44] MFA notes that a similar issue exists under Article 33 of the Markets in Financial Instruments Regulation ("**MiFIR**") with respect to the MiFIR trading obligation. MFA has have raised this issue in its response to the recent consultation papers issued by the European Securities and Markets Authority on MiFIR.

[45] MFA emphasizes that the below regulatory conflict is one of many that arise due to the interaction and overlap of the U.S. and EU derivatives rules. We could provide examples of a number of other conflicts that arise depending of the specific rule at issue and the jurisdiction of organization of the counterparties to the trade. Therefore, MFA emphasizes that it is important that the Commission identify and resolve all conflicts related to the cross-border application of the Proposed Rule prior to implementation.

[46] *See* MFA Discussion Paper on Equivalence Issues under Article 13(3) of the European Market Infrastructure Regulation, dated June 3, 2014, available at: https://www.managedfunds.org/wp-content/uploads/2014/06/MFA-Discussion-Paper-on-Article-13-EMIR-Equivalence-Final-6-3-14.pdf (Summarizing this issue is greater detail).

[47] *See* Article 13(2) of EMIR.

"established" in that equivalent jurisdiction, the EU counterparty will be deemed to be in compliance with EMIR if it is complying with the equivalent jurisdiction's derivatives regulations.[48]

While it is broadly expected that the EC will declare U.S. derivatives rules, including the Proposed Rule, to be equivalent to EMIR, the notion of being "established" in the U.S. presents difficulties for Funds that fall under the Commission "U.S. person" definition.

As mentioned, many U.S. Funds are organized outside the U.S. as a legal matter (*e.g.*, their place of incorporation is the Cayman Islands). Because these U.S. Funds are managed by U.S.-based managers, these Funds are "U.S. persons" when trading swaps and are appropriately subject to U.S. derivatives regulations.[49] However, notwithstanding the Final Cross-Border Guidance and the "U.S. person" definition in the Proposed Rule, the EC has indicated that for purposes of EMIR it does not view these U.S. Funds as being "established" in the U.S. because their legal place of incorporation is outside of the U.S. Instead, the EC would require the U.S. Fund and its EU counterparty to comply with the EMIR margin rules with respect to their uncleared swap (without allowing compliance with U.S. rules to satisfy the parties' obligations under EMIR).

The result of the U.S. and EU each asserting jurisdiction over the uncleared swap would be that the Fund and its EU counterparty would be subject to both the Proposed Rule and the similar margin requirements under EMIR with respect to their uncleared swap, which will almost certainly conflict with each other once final. Therefore, in practice, the Fund and EU counterparty might no longer be able to enter into uncleared swaps with each other.

MFA emphasizes that this fact pattern is reflective of a significant volume of business in the uncleared OTC derivatives market. Therefore, we emphasize that it is important that the Commission work on resolving this issue and other derivatives regulatory conflicts that arise from the cross-border application of the Proposed Rule and the Final Cross-Border Guidance to allow counterparties to continue to trade derivatives contracts on a cross-border basis.

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[48] *See* Article 13(3) of EMIR.

[49] *See supra* note 6. MFA notes that the applicable U.S. derivatives regulations include, among other things, rules regarding mandatory clearing, mandatory trade reporting, segregation of collateral, required trading on swap execution facilities or derivatives contract markets, other risk mitigation requirements, and ultimately margin requirements for uncleared derivatives contracts.

MFA appreciates the opportunity to comment on the Proposed Rule. We would welcome the opportunity to discuss our views with you in greater detail. Please do not hesitate to contact Carlotta King or the undersigned at (202) 730-2600 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director & General Counsel

cc:

The Hon. Timothy G. Massad, Chairman
The Hon. Sharon Y. Bowen, Commissioner
The Hon. J. Christopher Giancarlo, Commissioner