December 19, 2016

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

Re: **Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, RIN 3038-AE54**

Dear Mr. Kirkpatrick:

The Institute of International Bankers ("**IIB**")[1] and the Securities Industry and Financial Markets Association ("**SIFMA**")[2] appreciate this opportunity to provide the Commodity Futures Trading Commission (the "**Commission**" or "**CFTC**") with comments on the Commission's proposed rules (the "**2016 Proposal**")[3] regarding the cross-border application of the registration thresholds and external business conduct standards applicable to swap dealers ("**SDs**") and major swap participants ("**MSPs**").

We welcome the Commission's decision to codify these elements of its cross-border framework, and we support the Commission's proposal to address some of the issues that have presented legal uncertainty under the Commission's July 2013 cross-border guidance (the "**2013 Guidance**").[4] We are concerned, however, that the 2016 Proposal would also greatly expand the extraterritorial application of U.S. regulation, in breach of statutory limitations on the Commission's authority. In so doing, the 2016 Proposal would repeal several key components of the 2013 Guidance, little more than three years after the 2013 Guidance took effect, without any new data or changed circumstances justifying the changes or underpinning an adequate cost-benefit analysis of them.

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[1] The IIB is the only national association devoted exclusively to representing and advancing the interests of the international banking community in the United States. Through its advocacy efforts the IIB seeks results that are consistent with the U.S. policy of national treatment and appropriately limit the extraterritorial application of U.S. laws to the global operations of its member institutions. Further information is available at www.iib.org.

[2] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 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] 81 Fed. Reg. 71946 (Oct. 18, 2016).

[4] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (Jul. 26, 2013).

I. INTRODUCTION

If adopted, the 2016 Proposal would expand Commission swaps regulation to cover, on a global basis, the activities of U.S. multinational parent companies, their foreign branches and subsidiaries, and their foreign counterparties.

The Commission does not appear to appreciate the great costs such expanded regulation would impose. In particular, the 2016 Proposal significantly underestimates the adverse impact such expanded U.S. regulation would have on market access and the competitiveness of U.S. companies—both financial and commercial—and the costs it would impose on the broader U.S. economy. The 2016 Proposal also does not account for the market disruption that will occur as firms are forced, for the second time in less than four years, to shift their trading and banking relationships and overhaul their documentation, policies, procedures, systems and controls.

Moreover, the 2016 Proposal's jurisdictional analysis is flawed. It overlooks meaningful differences among the corporate structures and contractual arrangements through which U.S. companies conduct business abroad, as well as how those companies are already regulated by U.S. and foreign authorities when they conduct that business. The 2016 Proposal also evinces no steps by the Commission to determine whether or under what circumstances extraterritorial activity might be significant to the U.S.

As a result, the 2016 Proposal does not appropriately consider the circumstances under which entities and structures present the "direct and significant" risk to the U.S. that is a prerequisite for extraterritorial regulation under Section 2(i) of the Commodity Exchange Act ("**Section 2(i)**"). Instead, the 2016 Proposal focuses on closing perceived regulatory loopholes. But not applying U.S. regulation to extraterritorial activity that does not present direct and significant risk to the U.S. does not constitute a loophole from U.S. regulation. Rather, it is a recognition of the express limit on extraterritorial regulation set forth in Section 2(i). The Commission cannot satisfy Section 2(i) by deciding, ex ante with only a token consideration of the extent and effects of extraterritorial activity, to regulate that activity.

Continually expanding extraterritorial regulation to cover any potential U.S. nexus, no matter how indirect and without any empirical evaluation of significance, will quickly stretch the Commission beyond its resources and expertise, with limited regulatory benefit and at potentially substantial cost. If other jurisdictions followed the Commission's lead, the resulting overlap in regulation would impose enormous costs, disruption and inefficiencies across the entire global marketplace. Direct foreign oversight of domestic U.S. market participants would also interfere with the Commission's core mission of regulating the domestic U.S. swap market.

In light of these considerations, and as discussed in greater detail below, we believe the Commission should focus on making incremental changes to its 2013 Guidance, so as to promote legal certainty and tailor its existing framework as necessary to further the objectives of Section 2(i). In particular, the Commission should focus on clarifying such matters as the "U.S. person" and "guarantee" definitions and the relevance of arranging, negotiating or executing activity by U.S. personnel to the cross-border scope of swaps regulation.

II. DISCUSSION

The 2013 Guidance currently applies CFTC swaps regulation extraterritorially in respects that outstrip all prior precedents for U.S. functional regulation. The approach taken in the 2013 Guidance was specifically designed by the Commission to address what it perceived to be direct and significant risks to the U.S. arising from the interconnectedness of global financial institutions and relationships within corporate consolidated groups. The 2013 Guidance was also intended to avoid undue disruption to international markets and account for international comity considerations.

Without identifying any evidence that the 2013 Guidance has failed to achieve these objectives, the 2016 Proposal would repeal fundamental aspects of the 2013 Guidance by:

- Creating a new test for a "direct and significant" connection or effect—accounting consolidation—that fails to take into account bona fide steps by U.S. parent companies to use limited liability structures to limit the risks they might face from their foreign operations and lacks any criteria for significance;
- Based on this new test, effectively establishing the Commission as another federal consolidated holding company group supervisor, despite the absence of statutory authority to do so or the regulatory tools to fulfill this role;
- Significantly expanding Commission supervision to encompass entity-wide prudential and functional oversight of wholly foreign institutions that have no business, operations, personnel, contractual relationships or controlling ownership interests directly involving the U.S.; and
- Ignoring fundamental principles of international comity that have enabled U.S. companies to participate, subject to local regulation, in international markets—and thereby creating incentives for foreign regulators to impose their own functional regulation on U.S. subsidiaries regulated by the Commission.

If adopted, the 2016 Proposal would likely cause a dramatic reduction in the competitiveness of U.S.-headquartered companies, both financial and commercial, by creating significant disincentives for local foreign counterparties to enter into swap transactions that are critical to managing the risks of cross-border business. This movement of business away from U.S.-headquartered companies is not theoretical; for example, U.S.-headquartered companies previously saw foreign counterparties move their business away in response to the Commission's earlier decision to subject those counterparties—and not just their local U.S. branches—to SD or MSP registration when trading with U.S. persons.[5] Further reductions in access to foreign

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[5] Additionally, in October 2013, coinciding almost exactly with the effectiveness of the swap execution facility ("**SEF**") registration requirement in the U.S., the U.S. dealers' share of euro-denominated interest rate swap trading with European dealers fell from approximately 25% to less than 10%, as European platforms ceased offering services to U.S. persons in order to avoid the SEF registration requirement. A further loss of market share occurred early in 2014, when certain European dealers ceased trading with U.S. persons in order to avoid the newly-effective

counterparties would cause U.S.-headquartered companies to face increased costs and risks, as their trading partners are restricted to an increasingly concentrated U.S.-only market in which liquidity is more limited. The U.S. consumers who receive goods or services from these companies would face knock-on increases in their own costs.

The 2016 Proposal would also make it more difficult for foreign companies, particularly foreign financial institutions, to invest in and provide financing to U.S. companies without being required to register as an SD or MSP. These activities, which help promote U.S. economic growth, expose foreign companies to U.S. exchange rate and interest rate risk. Foreign companies often hedge that risk with the foreign branches and foreign consolidated subsidiaries ("**FCSs**") of U.S. financial institutions, or with foreign dealers that in turn hedge with those foreign branches and FCSs. The 2016 Proposal would subject these foreign companies, or the foreign dealers with whom they hedge their risk, to regulation by the Commission, in addition to regulation in their home country jurisdictions. This duplicative regulation creates a disincentive for U.S. investment and lending activities.

A. Registration of FCSs and Their Non-U.S. Counterparties

The 2016 Proposal would require FCSs[6] to register as SDs or MSPs solely based on their consolidation on the financial statements of a U.S. person. It also would require non-U.S. persons that are not FCSs or guaranteed by a U.S. person ("**Other Non-U.S. Persons**") to count swaps with FCSs toward their SD and MSP registration thresholds. Under the 2013 Guidance, in contrast, an FCS generally would not be subject to SD or MSP registration unless it traded with U.S. persons (other than foreign branches of U.S. SDs) or its swaps-related obligations were guaranteed by a U.S. person, nor would an Other Non-U.S. Person be subject to SD or MSP registration merely by virtue of trading with an FCS. The Commission should not adopt its proposed treatment of FCSs or their non-U.S. counterparties.

1. Consequences of Proposed Treatment of FCSs

The Commission estimates that subjecting FCSs to SD and MSP registration would result in approximately 14 new SD registrants.[7] SIFMA members have, however,

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U.S. trade execution requirement. See International Swaps and Derivatives Association, Inc., Cross-Border Fragmentation of Global Interest Rate Derivatives: Second Half 2015 Update (May 2016), available at: https://www2.isda.org/attachment/ODM4NQ==/Fragmentation%20FINAL1.pdf.

[6] The 2016 Proposal defines an FCS as a non-U.S. person in which an ultimate parent entity that is a U.S. person ("**U.S. ultimate parent**") has a controlling financial interest, in accordance with U.S. generally accepted accounting principles ("**GAAP**"), such that the U.S. ultimate parent includes the non-U.S. person's operating results, financial position and statement of cash flows in the U.S. ultimate parent's consolidated financial statements, in accordance with U.S. GAAP.

[7] 2016 Proposal, 81 Fed. Reg. at 71970.

estimated that more than 35 of their FCS affiliates might be required to register.[8] These FCSs are, in the vast majority of cases, already locally licensed and subject to local prudential and functional regulation; operating through such a locally licensed and regulated entity is not the result of an effort to evade or avoid Commission regulation, but rather reflects local regulatory, tax, insolvency or other legal considerations. These FCSs are able to transact in swaps with local foreign counterparties without the benefit of a U.S. guarantee because of their stand-alone creditworthiness. For example, often these FCSs, given their status as regulated entities in their local jurisdictions, have higher credit ratings than their U.S. ultimate parents.

Moreover, nearly all of the additional FCSs that were not required to register pursuant to the 2013 Guidance but would need to register under the 2016 Proposal are already subject to consolidated supervision and regulation by the Board of Governors of the Federal Reserve System ("**Federal Reserve**") as subsidiaries of U.S. bank holding companies. Even in the aggregate, the swap activity of these FCSs is typically modest relative to the overall swap activity of the consolidated holding company groups to which the FCSs belong, resulting in risk profiles that are similarly modest relative to group-wide capital.

Subjecting FCSs to registration would have several costs, including:

- the burdens of the registration process itself, particularly in jurisdictions where U.S. fingerprinting and background check procedures are unlawful;
- the application of U.S. transaction-level rules, particularly margin requirements, in jurisdictions where local competitors are not subject to similar requirements and/or the local laws or custodial infrastructure do not support netting or segregation consistent with U.S. rules;
- duplicative application of Commission entity-level regulations, particularly given the limited number of foreign jurisdictions (only six) that have received comparability determinations to-date and the challenges likely to be posed if the Commission was faced with over a dozen new applications for comparability; and
- inherent, ongoing challenges connected to the U.S. supervision of locally-managed foreign subsidiaries conducting business in faraway time zones and foreign languages, requiring costly translation of documents.

The full extent of these costs cannot be known because the Commission has not yet given the public a full indication of what regulations it would apply to FCSs. Even so, it seems quite likely that the costs associated with registration and ongoing compliance requirements would prove substantial relative to the potential benefits to FCSs of trading swaps in their local jurisdictions. U.S.-headquartered companies may accept incurring these substantial

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[8] The number of FCS affiliates that would be required to register under the 2016 Proposal would increase if the Commission allowed the SD de minimis threshold to decrease to $3 billion, as currently scheduled for December 31, 2018.

costs, but in many cases they are likely to cease swap dealing in jurisdictions where SD registration would make that activity unprofitable. The consequence would be decreased liquidity in these markets, and thus increased costs for managing risk for all market participants, including subsidiaries of U.S.-headquartered companies that use swaps to hedge in these markets.

2. Consequences of Proposed Treatment of FCSs' Non-U.S. Counterparties

The Commission was unable to estimate the number of new registrants it would face as a result of requiring Other Non-U.S. Persons to count their swaps with FCSs toward registration. Such number is, nonetheless, likely to be quite significant, given the extent to which U.S. parent companies, including commercial end users, operate abroad through FCSs.[9] This aspect of the 2016 Proposal would reach local banks and securities firms in nearly every market of the world, by virtue of them offering local currency, rates and commodities hedges to the local subsidiaries of U.S. financial institutions and U.S. multinational commercial companies. These local banks and securities firms may engage in swap dealing solely in their local marketplace, may not transact business in English, and may not be subject to any other U.S. laws. As such, they would be reluctant to continue trading with FCSs.[10]

These local banks and securities firms represent an important source of liquidity for U.S. companies operating in foreign markets. FCSs that are part of U.S. financial groups would be unable to access this liquidity, thus limiting their ability to compete in these local financial markets generally—not in just the swaps markets—as they would be unable to efficiently lay off risk associated with providing financial services in the local currency. FCSs that are part of U.S. commercial groups would not be able to face unregistered local counterparties to hedge local currency, interest rate and commodity risks arising out of their local business, thus making U.S.-headquartered companies uncompetitive when doing business abroad.

3. Absence of Direct and Significant Risk under Section 2(i)

Under Section 2(i), the Commission may not regulate extraterritorial swap activity unless such activity has "direct and significant" connection with activities in, or effect on, U.S. commerce. The 2016 Proposal's treatment of FCSs and their non-U.S. counterparties does not satisfy this test.

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[9] Though it is difficult to estimate the number of Other Non-U.S. Persons affiliates that would be required to register under the 2016 Proposal, that number would certainly increase if the Commission allowed the SD de minimis threshold to decrease to $3 billion, as currently scheduled for December 31, 2018.

[10] We also note that foreign-headquartered financial institutions operating through a subsidiarized structure would, under the 2016 Proposal, face a competitive disadvantage relative to institutions operating through branch networks, due to the greater number of locally-regulated legal entities they would be required to register in order to continue trading with FCSs.

a. Absence of "Direct" Risk

Many of the arrangements identified by the Commission as mechanisms for risks incurred by FCSs to be transmitted to the U.S. are already addressed by the 2013 Guidance. For example, the 2016 Proposal asserts that "affiliated entities within the corporate group provid[e] financial or credit support for each other, such as in the form of a guarantee or the ability to transfer risk through inter-affiliate trades."[11] In the 2013 Guidance, the Commission already subjected non-U.S. entities to U.S. regulation as a result of guarantees and inter-affiliate trades involving U.S. affiliates. While we do not necessarily agree with this aspect of the 2013 Guidance (and would encourage the Commission to evaluate whether it has proved beneficial), it begs the question why further expansion of extraterritorial regulation is necessary.

The 2016 Proposal also asserts that "reputational" considerations might lead a parent entity to assume its subsidiary's risks even in the absence of an explicit guarantee,[12] and that an "FCSs' counterparties generally look to both the FCS and its U.S. ultimate parent for fulfillment of the FCS's obligation under the swap even without any explicit guarantee."[13] These assertions sweep far too broadly. As a legal matter, parent companies that do not provide guarantees are not liable for their subsidiaries' obligations absent extraordinary circumstances in which doctrines such as "piercing the corporate veil" or "substantive consolidation" are applied in a tort litigation or bankruptcy. Courts are very unlikely to apply those doctrines to non-guaranteed subsidiaries that are separately regulated, well-capitalized, and have their own internal governance and records.

In addition, the 2016 Proposal overlooks key factors—such as whether a subsidiary is regulated, whether the subsidiary operates in a different jurisdiction from its parent, whether the subsidiary benefits from documented credit support, and whether the parent has a policy (such as in its resolution plan) of supporting its subsidiaries—that materially affect whether a counterparty will rely on parental support.[14] It is hard to see how the Commission can treat the swap activity of all FCSs as categorically exhibiting a "direct" U.S. connection or effect without considering these factors.

Moreover, the very voluntary nature of parental support absent a guarantee ensures that, as a logical matter, an FCS's extraterritorial swap activity should not pose a risk that is both direct and significant to the U.S. A rational parent company would not support its

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[11] 2016 Proposal, 81 Fed. Reg. at 71947.

[12] Id. at n. 13.

[13] Id. at 71950.

[14] These types of factors are expressly noted by the Moody's Ratings paper that the Commission cites as the basis for its assertion. See Moody's Investors Service, Proposed Bank Rating Methodology (Sept. 9, 2014) at p. 66-67, cited at 2016 Proposal, 81 Fed. Reg. at n. 39. That same paper also describes undocumented support measures, such as provision of liquidity from a parent beyond standard or contractual terms or provision of capital to prevent a regulatory shortfall or a crisis of market confidence, as so extraordinary as to fall outside Moody's baseline credit analysis. Id. at p. 65. It seems odd therefore for the Commission to assume that such measures will be taken in all circumstances.

non-guaranteed FCS, and accordingly would not bear direct risk to the FCS's swaps, if that risk was significant enough to endanger the viability of the parent company. Conversely, a rational parent company would only be willing to assume direct risk to its non-guaranteed FCS's swaps if such risk was not significant to the parent.

The 2016 Proposal further argues that, "by virtue of consolidated reporting under U.S. GAAP, the swap activity of an FCS creates a direct risk for the U.S. ultimate parent entity."[15] This argument runs at odds with clear precedent requiring more than a mere parent-subsidiary relationship to establish a "direct" link to the U.S., including a recent decision in the same circuit court (the Seventh Circuit) whose directness test the Commission itself has embraced.[16] In that decision, the Court found that foreign companies that allegedly fixed the prices of cell phone components they sold to the foreign subsidiaries of a U.S. parent company (Motorola) did not have a "direct" effect in the U.S. even though those foreign subsidiaries in turn incorporated the components into products that their U.S. parent resold in the U.S.[17] Writing for the Court, Judge Posner classified the effect on the U.S. parent and U.S. consumers as "remote" and "indirect."[18]

Moreover, the 2016 Proposal's accounting consolidation test ignores the fact that, when Congress wishes to impose U.S. regulation extraterritorially based on consolidation or control, it does so expressly, such as in the case of the Bank Holding Company Act of 1956.[19] Such expressly authorized group-wide regulation of parent company consolidated capital, risk management and corporate governance is already designed specifically to manage the shared incentives, risk management, information systems and trading personnel cited by the Commission as the basis for its FCS proposal.[20] The entity-level regulation of FCSs proposed by

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[15] 2016 Proposal, 81 Fed. Reg. at 71955.

[16] 2013 Guidance, 78 Fed. Reg. at 45300.

[17] Motorola Mobility LLC v. AU Optronics Corp,, et al, 746 F.3d 842, 844 (7th Cir. 2014).

[18] Id.

[19] We also note that Congress was required to amend Section 7 of the Securities Exchange Act of 1934 (the "**Exchange Act**") expressly to provide the Federal Reserve with authority to apply existing U.S. margin requirements to extensions of credit to foreign subsidiaries of U.S. companies before the Federal Reserve was permitted to do so. Specifically, in 1969, a U.S. District Court rejected the extraterritorial application of the Exchange Act's margin rules. See Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., 303 F.Supp. 1354 (S.D.N.Y. 1969). Following that decision, in 1970, Congress enacted Section 7(f) of the Exchange Act. Section 7(f) expressly provides the basis for the application of U.S. margin rules to a "foreign person controlled by a United States person."

[20] See SR 12-17 (Dec. 17, 2012) (setting forth the Federal Reserve's framework for the consolidated supervision of large financial institutions). The Securities and Exchange Commission ("**SEC**") has recognized this fact, explaining that a "focus on recourse guarantees appropriately targets the concerns raised by security-based swap activity that Title VII was intended to address, recognizing that Congress has established other regulatory tools that are specifically intended, and better suited, to address risks to bank holding companies and financial holding companies arising from the financial services activities of a foreign affiliate of those holding companies where the foreign affiliate does not engage in security-based swap activity in the United States." 79 Fed. Reg. 47278, 47319 (Aug. 12, 2014).

the Commission is a poor substitute for such group-wide regulation, since by definition it cannot address the management and resiliency of the group as a whole.

Indeed, the basis for the Commission's assertion of a jurisdictional interest, the consolidation of the subsidiary, in fact has precisely the opposite impact, as consolidation means that the activities and risks of the subsidiary are reflected (and, in the case of regulated parent companies, supervised) in financial statements at the parent level. If anything, consolidation mitigates the risk to the U.S. that the Commission identifies as the basis for extending the registration requirement to FCSs. Far greater risk to the U.S. exists when such group-wide consolidation and regulation do not apply, such as in cases where U.S. firms provide contractual support for off-balance sheet foreign entities through guarantees or inter-company transactions. These cases are already covered by the 2013 Guidance.

An Other Non-U.S. Person's effect on or connection to the U.S. is even less "direct" when all it is doing is trading with an FCS. In such a case, any U.S. effect or connection for the Other Non-U.S. Person occurs through the FCS and is thus, by definition, indirect. Moreover, Other Non-U.S. Persons that engage in swap dealing in local markets are typically subject to existing local regulation. The proposal to extend the registration requirement to an FCS's Other Non-U.S. Person counterparties thus plainly exceeds the reach of Section 2(i).

We also emphasize that, although the Commission decided to extend the application of its uncleared swaps margin requirements to all swaps of a registered SD that is an FCS, it does not follow that the swaps activity of a non-registrant FCS has a "direct" effect or connection under Section 2(i). Indeed, in the release accompanying the uncleared swaps margin cross-border rules, the Commission noted that, as a registered SD, an FCS's swap activities with U.S. persons were already sufficient to require its registration in the U.S.[21] A loss suffered by an FCS that is a registered SD with respect to its non-U.S.-facing swaps could weaken the financial condition of the FCS in a manner that threatens the FCS's U.S. counterparties or U.S. guarantor. Where an FCS does not have more than a de minimis level of transactions with U.S. counterparties or for which it has a U.S. guarantor, losses suffered by the FCS on its non-U.S.-facing swaps do not exhibit a direct and significant risk to the U.S.

b. Absence of "Significant" Risk

The 2016 Proposal does not include any analysis or set forth any standard for determining whether the activity of FCSs or their counterparties is "significant," as required by Section 2(i). It is not possible ex ante and without context to determine whether FCSs' activities, whether individually or in the aggregate, would be significant, either to a particular U.S. parent or to the U.S. financial system or market more generally. "Significance" can only be evaluated against some standard or metric, such as the level of risk to the U.S. parent, proportion of the U.S. corporate group's activity, or proportion to the U.S. market.

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[21] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818, 34834 (May 31, 2016).

For example, in the 2013 Guidance, the Commission established a so-called "emerging market" exception for swap activity by certain foreign branches that fell below 5% of the aggregate notional value of a parent bank's swap activity, on the basis that this foreign branch activity is "not significant in many cases."[22] Similarly, in applying its own version of Section 2(i), the European Commission does not treat a guaranteed foreign subsidiary's derivatives activity as "substantial" unless both (a) the aggregate notional amount of the guaranteed derivatives exceeds €8 billion and (b) the mark-to-market exposure arising from the guaranteed derivatives exceeds 5% of the aggregate mark-to-market exposure arising from derivatives entered into by the guarantor.[23] Viewed against similar metrics, the swap activity of most FCSs is not "significant."

A "significance" analysis also should account for circumstances where existing U.S. regulation already mitigates the potential for extraterritorial swap activities to pose significant risk to the U.S. For example, where an FCS is already required to register as an SD under the 2013 Guidance (e.g., because it trades with U.S. persons), Commission regulation already addresses the potential for a foreign counterparty to the FCS to pose a "significant" risk to the U.S.

4. **Absence of Evasion under Section 2(i)**

The Commission justifies its FCS proposal based on the need to close a "substantial regulatory loophole" that would "incentivize U.S. entities to conduct swap activities with non-U.S. counterparties through consolidated non-U.S. subsidiaries in order to avoid application of the Dodd-Frank Act SD requirements."[24] We do not believe, as policy or legal matter, that the FCS proposal is fairly targeted at any such loophole. Instead, it represents an ex ante, preemptive approach to regulation that does not satisfy applicable statutory standards.

Non-U.S. swap activities by FCSs are not in and of themselves evidence of a loophole or evasion. FCSs have long engaged in a range of derivatives and non-derivatives financial services activities for local and international clients and have separate strategic, business and legal reasons for their existence and organizational structure. For example, in many jurisdictions, FCSs have been established because certain activities may only be conducted by entities licensed or organized under local law. Such FCSs frequently use swaps to offer services to local customers or manage the risk from financial exposures incurred in such jurisdictions.

As a legal matter, given its most expansive construction, Section 2(i)'s prohibition on evasion prevents arrangements under which, as a minimum condition, firms structure their activities in such a manner that they continue to present direct and significant risks to the U.S.,

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[22] 2013 Guidance, 78 Fed. Reg. at 45351.

[23] 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.

[24] 2016 Proposal, 81 Fed. Reg. at 71955.

while remaining unregulated under the Dodd-Frank Act. When firms limit the application of the Dodd-Frank Act to their foreign swap activity by substantively structuring or restructuring those activities so they eliminate the direct and significant risk to the U.S. that Section 2(i) was intended to address, the very basis for regulation under the Dodd-Frank Act is eliminated. In such a case, there can, by definition, be no evasion of the Dodd-Frank Act. Nothing in the Dodd-Frank Act or any U.S. statute requires a person to structure its activities in a manner that presents direct and significant risk to the U.S. or attracts the most extensive scope of regulation under the Dodd-Frank Act or other U.S. laws.

5. International Comity Considerations

International comity, including avoiding duplication of or conflict with non-U.S. regulatory requirements, and the efficient use of U.S. supervisory resources should be key considerations for the Commission in considering registration requirements for non-U.S. persons. The potential availability of substituted compliance for certain aspects of SD/MSP regulation would not be sufficient to address these issues because it ignores the substantial burdens and conflicts of law resulting from registration itself. For example, the registration process, including fingerprinting and background check requirements, can conflict with local privacy laws. Direct, on-site examination of foreign locations where no U.S.-facing business occurs presents certain logistical challenges for the Commission and the National Futures Association (“**NFA**”), as well as challenges to territorial sovereignty.

The Commission also should consider the precedent it would set for other jurisdictions if it adopted the 2016 Proposal. Would the Commission consider it appropriate if foreign regulators imposed foreign functional regulation and conducted on-site examination in the U.S. of U.S.-organized SDs, futures commission merchants and other Commission registrants doing business solely with U.S. customers? How would the Commission’s ability to satisfy its regulatory mandate be affected if, particularly in a market crisis, foreign regulators took conflicting positions vis-à-vis the Commission as to the actions that such a U.S. registrant must take? What would be the effects on domestic market dynamics and liquidity if all other major jurisdictions took the approach the Commission proposes?

6. Absence of Adequate Cost-Benefit Analysis

The 2016 Proposal’s cost-benefit analysis is fundamentally flawed in that it either materially underestimates or fails to consider the negative consequences that would result from the proposed expansion of the SD and MSP registration requirements, and overestimates the potential benefits of requiring additional entities to register that have a limited connection to the U.S. It also is not possible for the public to provide meaningful cost-benefit feedback because the Commission has not yet explained how its clearing, trading, reporting, documentation or other rules would apply to FCSs or their Other Non-U.S. Person counterparties.

First, as noted above, the 2016 Proposal significantly underestimates the number of entities that would be required to register, and thus fails to account for the costs these entities would incur. These costs would include not only the cost of complying with U.S. regulation, but also the costs of reconciling U.S. regulation with home country regulation.

The 2016 Proposal also does not explain how the CFTC or NFA would effectively supervise registrants doing business abroad and in foreign languages, what additional costs would result from such supervision, and whether those costs would be imposed on the marketplace. The Commission should carefully weigh these costs against the limited value of expanding its regulatory coverage to entities that have such a minimal connection to the U.S.

The 2016 Proposal also underestimates the cost that firms would incur in overhauling the existing compliance systems and global booking models that they put in place in reliance on the 2013 Guidance.[25] The work necessary to rework firms' de minimis calculation monitoring and compliance systems and global booking models would go beyond the "marginal and incremental" assessment and monitoring costs identified by the Commission because it would likely involve the novation of positions and movement of banking and trading relationships.

The Commission acknowledges that the full market impact of the 2016 Proposal "cannot be determined at this time in the absence of further rulemakings addressing the cross-border application of substantive requirements under the Dodd-Frank Act." We agree, and recommend that the Commission take a comprehensive approach, like it took in the 2013 Guidance, with respect to the newly proposed registration requirements and involvement of U.S. personnel in arranging, negotiating or executing swaps. Only by considering the regulation of the swaps markets holistically can the Commission ensure that the costs of the extraterritorial application of that regulation do not outweigh the perceived benefits. The Commission cannot satisfy its public rulemaking responsibilities without giving the commenters sufficient information to formulate their views.

The 2016 Proposal's cost-benefit analysis also fails to adequately consider the negative consequences to the competitiveness of U.S.-headquartered companies and market efficiency more generally. The Commission notes that foreign market participants may react to the 2016 Proposal by refusing to trade with FCSs, but fails to consider the consequences to the marketplace if that were to occur, including competitive disparities, increased costs, and bifurcated liquidity. Instead, the Commission notes that competitive disparities would be mitigated to the extent that foreign jurisdictions impose comparable requirements—but rather than mitigating costs, this would result in even more significant costs to the marketplace as market participants would have to comply with a complex web of overlapping regulations.

Finally, the Commission fails to consider factors that might reduce the incremental benefits of the proposal, including existing regulation of FCSs and their U.S. ultimate parents, or the absence of significant swaps activity by FCSs or their non-U.S. counterparties, as further described above.

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[25] As a result of the 2013 Guidance, compliance systems were developed, global booking models were re-aligned, new counterparty activity was moved between entities, and in some instances existing positions were novated to make sure that globally active financial institutions did not needlessly allow multiple entities within their groups to trigger a registration obligation. From a governance, business and compliance perspective, it was (and still is) critical to rationalize global booking models and compliance systems so the activity that will subject an entity to CFTC registration is conducted within an entity(ies) well-positioned from a governance, business, and compliance perspective to undertake such a significant regulatory burden.

B. Registration of Non-U.S. Counterparties to Foreign Branches and Guaranteed Affiliates

Under the 2013 Guidance, the Commission provided certain targeted exceptions from the general requirement that a non-U.S. person (that is not a conduit affiliate or guaranteed by a U.S. person) count towards the SD or MSP registration thresholds all swaps with a foreign branch of a U.S. person, a non-U.S. SD that is guaranteed by a U.S. person, or a non-U.S. person guaranteed by a non-financial U.S. entity.[26] In most cases, these exceptions were adopted because one counterparty to the swap is, or is part of an affiliated group containing an entity that is, registered with the Commission and subject to comprehensive regulation of its swaps activities—and thus any risk imported into the U.S. is already subject to Commission regulation.

The circumstances that led the Commission to adopt these exceptions have not changed. These exceptions allow Commission-regulated foreign branches and guaranteed affiliates to trade with foreign counterparties without subjecting those foreign counterparties to registration with the Commission. These foreign counterparties often have little expertise with U.S. regulation and trade swaps entirely in local, non-U.S. markets. At the same time, they rely heavily on foreign branches and guaranteed affiliates to provide liquidity in U.S.-dollar-denominated swaps, very often to hedge exposure incurred in connection with investments or loans in the U.S. Subjecting those foreign counterparties to direct U.S. swaps regulation would create a significant disincentive to engaging in this beneficial activity.

In addition, fostering reluctance by foreign counterparties to trade with foreign branches and guaranteed affiliates would diminish the ability of U.S.-headquartered firms to compete or access liquidity in foreign marketplaces, not just in connection with swaps but also in connection with the local lending and securities activity that swaps often accompany. Of particular concern would be obstacles to U.S. banks' ability to manage exposures denominated in foreign currencies or relating to local foreign commodities. It seems counterintuitive to apply U.S. regulation extraterritorially in ways that would make it more challenging for U.S.-headquartered firms to manage the risks they incur abroad.

For these reasons, we recommend that the Commission retain these targeted exceptions for non-U.S. persons that are not conduit affiliates and not guaranteed by a U.S. person when they do business with regulated foreign branches and guaranteed affiliates.

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[26] Under the 2013 Guidance, a non-U.S. person would not have to count a swap towards (I) the swap dealer de minimis threshold if its counterparty is (1) a bona fide foreign branch of a U.S. swap dealer, (2) a non-U.S. person swap dealer that is guaranteed by a U.S. person, (3) a non-U.S. person that is (a) guaranteed by a U.S. person, (b) affiliated with a registered swap dealer, and (c) engages in a de minimis amount of swap dealing activity, or (4) a non-U.S. person that is guaranteed by a U.S.-person non-financial entity, or (II) the MSP threshold if (1) its counterparty is a bona fide foreign branch of a U.S. swap dealer or (2) a non-U.S. person swap dealer that is guaranteed by a U.S. person; provided that, if it is a financial entity, its counterparty collects daily variation margin. 2013 Guidance, 78 Fed. Reg. at 45326-27.

C. Conduit Affiliates

The 2016 Proposal would not apply SD or MSP registration requirements to a non-U.S. person based on whether that person acts as a "conduit affiliate" for a U.S. person. The Commission requests comment, however, as to whether an Other Non-U.S. Person that is consolidated with an affiliated U.S. SD for financial reporting purposes and that transfers some or all of the risk of a swap with an Other Non-U.S. Person counterparty, directly or indirectly, to an affiliated U.S. SD (an "**SD Conduit**") should be required to count its outward-facing swaps as to which it acts as a conduit toward its SD or MSP registration threshold.[27]

The potential for risk to the U.S. or evasion of the Dodd-Frank Act to manifest or occur is far more limited in circumstances where a non-U.S. entity engaged in inter-affiliate transactions with a U.S. person is affiliated with a registered SD. In those circumstances, the Commission already can exercise appropriate regulatory oversight through its regulation of the registered SD. This consideration underlies the Commission's decision to exclude affiliates of a registered SD from the "conduit affiliate" definition in the 2013 Guidance,[28] as well as the similar approach taken by the SEC in its implementation of the Dodd-Frank Act.[29] We are not aware of any new data or changed circumstances that would merit a change in this policy by the Commission, such as the SD Conduit proposal described above.

Also, it would be very difficult to establish an SD Conduit definition or approach to registration calculations for SD Conduits that is both clear and reasonably targeted at the potential for risk or evasion animating the SD Conduit concept. Adopting that concept would thus undermine the legal certainty objective underlying the Commission's decision to codify its cross-border framework for SD and MSP registration. The concept stands likely to inhibit bona fide centralized risk management programs that the Commission has elsewhere mandated through its SD risk management requirements[30] and as conditions to relief from clearing and margin requirements for certain inter-affiliate transactions.[31]

Accordingly, we recommend that the Commission refrain from adopting a new registration requirement for SD Conduits (or conduit affiliates more generally).

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[27] 2016 Proposal, 81 Fed. Reg. at 71958.

[28] 2013 Guidance, 78 Fed. Reg. at 45359.

[29] See 17 C.F.R. 240.3a71-3(a)(1) (defining "conduit affiliate" to exclude non-U.S. entities that transfer risk to a U.S. person registered as a security-based swap dealer).

[30] See Commission Regulations § 23.600(c)(1)(ii) (requiring an SD's risk management program to be integrated into risk management at the consolidated entity level).

[31] See Commission Regulations §§ 23.159(a)(1)(i) and 50.52(b)(3) (limiting such relief to inter-affiliate swaps subject to a centralized risk management program).

D. Proposed Definitions

1. "U.S. Person"

The 2016 Proposal would adopt the same "U.S. person" definition for purposes of the cross-border application of the swaps provisions of the Commodity Exchange Act and Commission regulations generally as it recently adopted for purposes of its uncleared swap margin requirements. We support this aspect of the 2016 Proposal.

First, we agree with the Commission that expanding the use of this definition would enhance legal certainty by eliminating both (i) the prong for a collective investment vehicle that is organized and has its principal place of business outside the U.S. but is majority-owned by U.S. persons and (ii) the prefatory phrase "includes, but is not limited to." These two aspects of the 2013 Guidance's "U.S. person" definition have proved difficult to apply in practice.[32]

We also note that eliminating the U.S. majority ownership prong for collective investment vehicles is consistent with a careful reading of Section 2(i). As noted above in the discussion regarding FCSs, U.S. ownership does not, by itself, create a direct relationship between a non-U.S. entity's swaps activity and commerce in the U.S. Such swaps are not the direct obligation of any of the owners of the non-U.S. entity, whether it is an operating company or a collective investment vehicle, and the risk to the owners of any related losses is limited to the extent of their investment in the entity.

In addition, we believe it is important for consistent definitions to apply across the Commission's swaps regulations. Not only does consistency foster legal certainty, but it also supports the comprehensive, holistic approach to interpreting Section 2(i) and conducting cost-benefit analysis that we believe the Commission should take.

2. "Guarantee"

The 2016 Proposal would use the same "guarantee" definition for purposes of SD and MSP registration as the Commission adopted in its cross-border margin rule, such that a "guarantee" would mean an arrangement pursuant to which a party to a swap with a non-U.S. person has a legally enforceable right of recourse against a U.S. person for such non-U.S. person's obligations under that swap.

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[32] There are significant practical impediments to the identification and tracking of U.S. beneficial ownership in foreign collective investment vehicles, including by the vehicle itself (and its management). Particularly in the case of collective investment vehicles formed before the adoption of the Commission's U.S. person definition in the 2013 Guidance, subscription documents did not capture the requisite information or include a framework to track it. And, as a result, in the case of new collective investment vehicles, many non-U.S. asset managers have taken more blunt steps to restrict investments by U.S. persons. The resulting limits on investment options for U.S. persons impose costs when the competing benefits could be better addressed in other, less costly ways. In particular, concerns regarding U.S. ownership of foreign collective investment vehicles that engage in swaps activity are instead more appropriately addressed by applying the Commission's existing comprehensive investor protection requirements to investment by U.S. persons in collective investment vehicles, which does have a direct nexus to the United States.

This definition, like the proposed "U.S. person" definition, would promote legal certainty by establishing a clearer test for when a non-U.S. person is considered to have financial support from a U.S. person. It also would be more consistent with Section 2(i) for the Commission to limit the concept of a "guarantee" for purposes of the swaps rules to arrangements that involve legally enforceable recourse by a non-U.S. counterparty against a U.S. person. Only in these cases is there direct privity between a non-U.S. counterparty and a U.S. guarantor, which should be a necessary (although not sufficient) condition for satisfying Section 2(i).

E. "ANE" Proposal

As described in our prior comment letters on the topic,[33] we generally believe that the policy objectives of the Dodd-Frank Act and the risk-based standard set forth in Section 2(i) do not support application of Commission regulation to a non-U.S. SD that is not guaranteed by a U.S. person nor trading with a U.S. person merely because the non-U.S. SD is using personnel located in the U.S. to arrange, negotiate or execute its swaps. At the most, Commission jurisdiction over such activity extends to the U.S. personnel in question, not the non-U.S. legal entities that bear the risks of the swaps executed by those personnel.

In most instances, the costs associated with such an "arrange, negotiate or execute" ("**ANE**") test, both with respect to implementing the test and managing ensuing conflicts with foreign laws, are likely to be significant, with minimal countervailing U.S. policy benefit.[34] Furthermore, an ANE test could have significant negative consequences for U.S. jobs, as non-U.S. SDs would need to move personnel offshore to accommodate increasing pressure from foreign counterparties to ensure that their trades are not subject to complex U.S. regulation.

For these reasons, we generally do not support the adoption of any ANE test. If the Commission decides, nonetheless, that U.S. market integrity considerations favor adoption of an ANE test, the Commission should not apply the test beyond market-facing activity by U.S. sales and trading personnel, consistent with the way the SEC has interpreted its parallel test.[35] It

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[33] See Letters from Sarah Miller, CEO, IIB, to Melissa Jurgens, Secretary, the Commission, dated March 10, 2014, and from Kenneth Bentsen, President and CEO, SIFMA, Walt Lukken, President and CEO, Futures Industry Association, and K. Richard Foster, Vice President and Senior Counsel, Financial Services Roundtable, to Melissa Jurgens, Secretary, the Commission, dated March 10, 2014.

[34] See Letter from Sarah Miller, CEO, IIB, to Christopher Kirkpatrick, Secretary, the Commission, dated May 11, 2015 (performing a cost-benefit analysis for an ANE test).

[35] Although we support a consistent interpretation of which transactions are covered by an ANE test, we would not support the Commission harmonizing with the SEC by applying an ANE test to SD registration. We do not believe that SEC's decision to apply an ANE test to security-based swap dealer registration was warranted based on the policy objectives of the Dodd-Frank Act, as we note below. We also note that the relationship of the security-based swap market to the cash securities markets, and Congress's decision to define security-based swaps as "securities," raise certain policy and legal considerations relating to existing, pre-Dodd-Frank securities regulation that are not raised in the context of swaps regulation by the Commission, and thus justify the Commission's proposed departure from the SEC's approach to dealer registration. These considerations would also tend to support the Commission declining to apply any ANE test at all, notwithstanding the SEC's position.

also would be essential to limit the regulations triggered by the ANE test so as reduce interference with non-U.S. supervisory interests and the costs of implementing the ANE test.

Accordingly, we strongly support the Commission's decision not to adopt an ANE test for application of the SD or MSP registration requirements. Although the definition of "swap dealer" could be read to focus on activities, not risks, the regulation of SDs and MSPs is focused primarily on the risks associated with swap activities. Thus the application of the SD and MSP registration requirements to non-U.S. entities should continue to be based on whether the swaps entered into by those entities present a direct and significant risk to the U.S. under Section 2(i). SD and MSP registration is not necessary to address market integrity considerations, since Commission anti-fraud and anti-manipulation regulations apply to all market participants, regardless of their registration status.

For similar reasons, it generally is not necessary for the Commission to apply transaction-level rules based on an ANE test. Based on the Commission's analysis in the 2013 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.[36] The Commission also took the view in the 2013 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.[37] Consistent with this logic, these rules should not be covered by an ANE test, as that test captures transactions that pose no direct and significant risk to the U.S.[38]

Finally, applying external business conduct standards (other than fair dealing and anti-fraud and anti-manipulation rules) to swaps covered by an ANE test would impose documentation burdens on non-U.S. counterparties that discourage them from interacting with U.S. personnel, without furthering any U.S. counterparty protection objectives.

F. Transition Period

Any changes to the Commission's cross-border framework must be accompanied by an adequate transition period. Changes to defined terms affecting the classification of market participants will, at a minimum, require market participants to exchange new representation letters and update their internal systems and controls accordingly. Any expansion of the transactions subject to U.S. regulation will, moreover, likely require more fundamental changes to how and with whom market participants transact in swaps. Also, given the 12-month look-back period associated with the SD de minimis threshold and the application of the MSP

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36 2013 Guidance, 78 Fed. Reg. at 45366-68.

37 See id.

38 Excluding risk-based rules from coverage by an ANE test would also be consistent with the decision by the Prudential Regulators to apply their margin rules for non-cleared swaps based on the statuses of the entities to which a swap is booked. See Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840, 74883, n. 183 (Nov. 30, 2015).

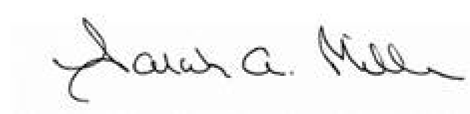
calculation to outstanding positions, it will be necessary to clarify that changes to those registration requirements solely apply prospectively following a transition period sufficient for market participants to take the steps described above.

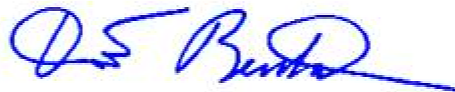
Finally, as noted above, the Commission should take a comprehensive, holistic approach to making any changes to the cross-border application of swaps regulation, and the related transition period should begin only after the Commission has fully adopted any changes. Market participants will not be able to determine how to implement changes to the Commission's cross-border framework unless they know the full extent and nature of the changes. Similarly, the necessary duration of the transition period will also depend on the cumulative impact of any changes. The Commission should not take a piecemeal approach that would exacerbate costs and disruption by requiring multiple rounds of changes to firms' compliance infrastructures and booking models.

* * *

We would be pleased to provide further information or assistance at the request of the Commission or its staff. Please do not hesitate to contact the undersigned, or Colin D. Lloyd (+1 212 225 2809) or Scott M. Reinhart (+1 212 225 2933) of Cleary Gottlieb Steen & Hamilton LLP, outside counsel to IIB and SIFMA, if you should have any questions with regard to the foregoing.

Respectfully submitted,





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cc: Honorable Timothy G. Massad, Chairman
Honorable Sharon Y. Bowen, Commissioner
Honorable J. Christopher Giancarlo, Commissioner