



State Street Corporation

Stefan M. Gavell
Executive Vice President and Head of
Regulatory, Industry and Government Affairs

State Street Financial Center
One Lincoln Street
Boston, MA 02111-2900

Telephone: 617.664.8673
Facsimile: 617.664.9339
smgavell@statestreet.com
www.statestreet.com

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

Via CFTC Web site: <http://comments.cftc.gov>.

Proposed Rule – Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants (RIN Number 3038-AE54)

Dear Mr. Kirkpatrick:

State Street Corporation (“State Street”) appreciates the opportunity to provide comments on the proposed rule on the cross-border application of registration thresholds and external business conduct standards (“Proposed Rule”) issued by the Commodity Futures Trading Commission (“CFTC” or “Commission”).¹

Headquartered in Boston, Massachusetts, State Street specializes in the provision of financial services to institutional investor clients. This includes investment servicing, investment management, data and analytics, and investment research and trading. With \$29 trillion in assets under custody and administration and \$2 trillion in assets under management as of September 30, 2016, State Street operates in 30 countries and in more than 100 geographic markets. State Street’s primary banking subsidiary (State Street Bank and Trust Company) is registered with the Commission as a Swap Dealer (“SD”), and is a major global dealer in foreign exchange, operating overseas through multiple branches in foreign markets.

State Street strongly opposes the Commission’s Proposed Rule, which inappropriately captures entities beyond those that have a “direct and significant connection with activities in, or effect

¹ Commodity Futures Trading Commission. “Cross Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants.” FR Vol. 81, No. 201. October 18, 2016. (“CFTC 2016 Proposed Rule”).

on, commerce of the United States”.² We are very concerned that the Commission has greatly expanded the extraterritorial application of U.S. regulation, which may result in wide-ranging adverse market impacts, including increased liquidity issues for financial institutions.

Definition of Foreign Consolidated Subsidiary

State Street has strong concerns with subjecting new, non-U.S. entities to swap dealer registration requirements through the new definition of Foreign Consolidated Subsidiary (“FCS”) in the Proposed Rule.³ The Commission’s argument that the transactions of FCSs should be treated in the same manner as the swap dealing transactions of a U.S. person, inappropriately categorizes the nature of the relationship between the FCS and its U.S. ultimate parent entity. Furthermore, the Commission fails to address why the definition of FCS is required given the existing definition of “guaranteed or conduit affiliate” used in its 2013 Guidance. FCSs are often established because certain activities may only be conducted by entities licenses or organized under local law. These entities are not automatically “guaranteed” by their U.S. parents and thus do not pose any direct or significant risk to the U.S. financial markets that would warrant such an expansion of U.S. oversight. Any risks associated with an FCS’s swap positions have already been captured to the extent that the FCS trades with a U.S. person or is guaranteed by a U.S. person.

By expanding the definition to all subsidiaries that consolidate up to a U.S. parent, the Commission is using an inappropriate “one-size-fits-all” approach for foreign subsidiaries, and fails to recognize the differences that exist between foreign subsidiaries. In the Proposed Rule, the Commission notes that it believes FCSs require greater supervisory interest “...due to the nature and extent of the FCS’s relationship with its U.S. ultimate parent”.⁴ However, this “relationship” varies greatly between financial institutions, particularly in the case when these foreign subsidiaries only serve clients in foreign markets. The Commission also fails to recognize that the ultimate U.S. parent is not legally bound to fulfill the obligations of the FCS. The argument that, under this structure, the U.S. and non-U.S. derivatives trading functions “as a single enterprise”⁵ is inaccurate for foreign subsidiaries. These foreign subsidiaries focus their management structure on serving the needs of their clients in foreign jurisdictions. When these foreign subsidiaries operate abroad and are domiciled in foreign markets, the Commission’s approach should recognize the foreign jurisdictions’ strong supervisory interest in these swap transactions, as it does for swap transactions between “other non-U.S. persons”.⁶

For these reasons, State Street urges the Commission to abandon its approach to FCSs in the Proposed Rule, and instead only require FCSs to include relevant swaps for the SD registration calculation if the trade is with a U.S. person. We believe this appropriately reflects the necessary balance between capturing those entities with a nexus to the U.S. (through their trading with U.S. persons) and those foreign subsidiaries that choose to operate purely in foreign markets.

Treatment of non-U.S. Persons

² Commodity Exchange Act. See 7 U.S.C. 2(i).

³ CFTC 2016 Proposed Rule, 81 Fed. Reg. at 71955.

⁴ CFTC 2016 Proposed Rule, 81 Fed. Reg. at 71950.

⁵ CFTC 2016 Proposed Rule, 81 Fed. Reg. at *Id.*.

⁶ CFTC 2016 Proposed Rule, 81 Fed. Reg. at 71956.

Similar to the definition of FCS, State Street strongly opposes provisions of the Proposed Rule that inappropriately capture “other non-U.S. persons” that have no direct trading relationship with the U.S. The Proposed Rule notes that “other non-U.S. persons” will need to count not only their swaps with U.S. persons and U.S. guaranteed entities towards the SD registration threshold, but also any swaps with a foreign branch of a U.S. swap dealer or a non-U.S. person that is a FCS.

By expanding the covered swaps transactions of a non-U.S. person, the Proposed Rule fails to recognize the potential wide-ranging market impacts that this change will have if implemented. In many cases, these foreign counterparties trade swaps entirely in local, non-U.S. markets, and subjecting them to U.S. swaps regulation could create a significant disincentive for them to continue trading with FCSs or foreign branches of a U.S. swap dealer. Such a situation will only serve to further decrease market liquidity, harming price discovery through a decrease in the number of counterparties that market participants are willing trade with.

As “other non-U.S. persons” seek to avoid any connection with the U.S. market and only trade with “other non-U.S. persons”, this market development will severely disadvantage not only foreign branches of U.S. banks, but also FCSs, many of whom maintain a trading portfolio consisting entirely of foreign counterparties. In addition, there could be increases in market concentration in particular jurisdictions, increasing liquidity issues for firms, particularly end-users in the U.S. Given that the derivatives markets can be considered as having higher concentration risks than is desirable, the Proposed Rule could actually have the unintended consequence of increasing this risk.

More broadly, these changes appear to be a drastic reversal in policy by the Commission, which previously articulated the concerns noted above in its 2013 Guidance:

“The Commission understands that commenters are concerned that foreign entities, in order to avoid swap dealer status, may decrease their swap dealing business with foreign branches of U.S. registered swap dealers and guaranteed affiliates that are swap dealers. Therefore, the Commission’s policy, based on its interpretation of section 2(i) of the CEA, will be that swap dealing transactions with a foreign branch of a U.S. swap dealer or with guaranteed affiliates that are swap dealers would generally be excluded from the de minimis calculations of non-U.S. persons that are not guaranteed or conduct affiliates.”⁷

The Commission does not articulate the changes in the swaps market that would require the inclusion of “other non-U.S. persons” or why it has changed its interpretation of section 2(i) of the CEA, nor does the Commission provide studies or data to evidence the need for the proposed changes. Foreign branches and guaranteed affiliates are already under Commission oversight by virtue of the fact that they are connected to a U.S. swap dealer. Previously, the Commission recognized this, and thus it did not make sense to have a non-U.S. person count swap transactions with such entities given one counterparty is subject to comprehensive oversight and regulation by the Commission.⁸ Under the current framework, foreign branches of U.S.-based swap dealers and FCSs are not treated as U.S. persons by non-U.S. person counterparties. This allows Commission regulations to apply to the extent they are protective of the U.S.-based swap dealer (e.g. entity-level requirements), but the non-U.S. counterparty

⁷ CFTC 2013 Guidance, 78 Fed Reg. at 45324.

⁸ CFTC 2013 Guidance, 78 Fed. Reg. at 45324.

would be subject to local regulations, allowing equal treatment of the foreign branch and FCS in the local marketplace.

Given these potential adverse market affects, State Street opposes the provisions of the Proposed Rule that capture “other non-U.S. persons” with no direct trading relationship to the U.S., and, suggests the Commission instead maintain its current approach for “other non-U.S. persons”.

Conclusion

Once again, State Street appreciates the opportunity to comment on the Proposed Rule. As noted above, we strongly disagree with the Commission’s treatment of FCSs and non-U.S. persons. We believe that the Commission should instead focus on promoting legal certainty around its existing framework, by further tailoring future rulemakings to recognize the importance of avoiding duplication or conflict with non-U.S. regulatory requirements.

Please do not hesitate to contact me with any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Stefan M. Gavell". The signature is fluid and cursive, with a prominent initial "S" and "G".

Stefan M. Gavell