December 19, 2016

Mr. Christopher Kirkpatrick
Commodity Futures Trading Commission
Three Lafayette Center
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 (CFTC RIN: 3038–AE54)

Dear Mr. Kirkpatrick:

Better Markets Inc.[1] appreciates the opportunity to comment on the above-captioned proposal on the "Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants" ("Proposal" or "Proposed Rule"), issued by the Commodity Futures Trading Commission ("CFTC" or "Commission").

INTRODUCTION

Counterparty credit risk in the derivatives markets knows no geographical or national boundaries. Consequently, a U.S. regime for regulating derivatives to protect the American taxpayer from having to foot the bill for another bailout of the global financial system will fail unless it is backstopped by robust international application. While it is clear that U.S. regulators may not exceed their jurisdiction as defined by Congress, it is equally clear that in the case of cross-border derivatives, this jurisdiction ranges far and wide. The Dodd-Frank Act established a broad legal foundation for the application of swaps regulation to conduct outside the U.S., conferring jurisdiction wherever those activities "have a direct and significant connection with activities in, or effect on, commerce of the United States," or wherever those activities violate rules prescribed to prevent evasion.[2] Thus, both the law and common sense dictate that if a derivatives transaction can directly and significantly

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

[2] 7 U.S.C. § 2(i).

impact commerce in the United States, it must be regulated in accordance with the standards of the Dodd-Frank Act.

The Proposal is designed to build upon the Commission's earlier attempts to delineate cases in which the CFTC will regulate cross-border swaps transactions and entities from those where the task will be left to foreign regulators under a principle of substituted compliance.[3] It also represents a further attempt to clarify what will be required of entities subject to CFTC oversight in a cross-border swaps context.

As was emphasized in the previous comment letters, the importance of these issues cannot be overstated. Without strong cross-border application of Title VII of the Dodd-Frank Act, domestic swaps business will move overseas to avoid regulation, yet the risks associated with that business will remain as a direct threat to the U.S. financial system and taxpayers. In light of the enormous and ongoing costs inflicted on the American people from the most recent financial collapse and economic crisis,[4] weak cross-border application would not only violate the letter and spirit of the Dodd-Frank Act but also set the stage for another financial crisis of historic proportions.

OVERVIEW OF PROPOSAL AND SUMMARY OF COMMENTS

The Proposal is an important step forward in reducing risks to the U.S. by clearly and broadly defining the trading relationships and entities whose cross-border swaps activity must be counted toward the de minimis thresholds for registration as a swap dealer ("SD") or major swap participant ("MSP"). The Proposal also addresses the cross-border application of external business conduct standards for SDs and MSPs. Establishing strong and clear definitions is especially important because, as noted in the Release, the Commission intends the proposed definitions to apply "not only within the context of the proposed rule, but for purposes of any subsequent rulemaking" addressing cross-border issues.[5] Additionally, this Proposal will establish a crucial U.S. benchmark for harmonizing cross-border OTC derivatives regulation with swaps trading rules in foreign jurisdictions. Therefore, we commend the Commission's effort in building upon its previous cross-border guidance and codifying its policy in a rule.

The Proposal has several components: (1) It defines key entities, including "U.S. person," "Foreign Consolidated Subsidiary," and "U.S. Guaranteed Entity;" (2) stipulates which swaps transaction between those entities must count toward the registration thresholds; (3) includes an important aggregation principal for affiliates bound together by "control" relationships; (4) defines a specific set of transactions that are arranged,

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3 *See* Better Markets Comment Letter, "Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act" (August 27, 2012) ("Better Markets Cross-Border Letter") (incorporated as though fully set forth herein), http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58706&SearchText=better%20markets.

4 Better Markets, THE COST OF THE WALL STREET-CAUSED FINANCIAL COLLAPSE AND ONGOING ECONOMIC CRISIS IS MORE THAN $12.8 TRILLION (Sept. 15, 2012), http://bettermarkets.com/sites/default/files/Cost%20Of%20The%20Crisis_0.pdf.

5 Release at 71947.

negotiated, or executed in the U.S. by personnel of non-U.S. persons ("ANE transactions") and specifies the treatment of those transactions for purposes of the de minimis calculation and external business conduct standards; and (5) provides generally for the application of external business conduct standards to cross-border transactions.

The key elements of the Proposal are as follows.[6] Under the Proposed Rule, in making its de minimis calculation—

- A U.S. person would include all of its swap dealing transactions.
- A non-U.S. person would include all of its swap dealing transactions with respect to which it is a U.S. Guaranteed Entity.
- A Foreign Consolidated Subsidiary would include all of its swap dealing transactions.
- An Other Non-U.S. Person would include all of its swap dealing transactions with counterparties that are U.S. persons (including non-U.S. branches), U.S. Guaranteed Entities, or Foreign Consolidated Subsidiaries, unless the swap is executed anonymously on a registered SEF, DCM, or FBOT and cleared. Other Non-U.S. persons would not include any of their swap dealing transactions with Other Non-U.S. Persons.
- All potential SDs, whether U.S. or non-U.S. persons, would aggregate their swap dealing transactions with those of persons controlling, controlled by, or under common control with the potential SD to the extent that those affiliates are themselves required to include those swaps in their own de minimis thresholds, unless the affiliated person is already a registered SD.
- Non-U.S. persons engaged in ANE transactions would not have to count that activity toward their de minimis thresholds, although some of the external business conduct standards would apply.

Overall, the definitions, along with the rules summarized above, governing cross-border swaps transactions are sound. Nevertheless, the Proposal should be strengthened in several key respects, and some elements must be preserved against industry exhortations to weaken the Proposal:

- The cross-border rules should be finalized without delay.
- The definitions are strong but leave room for improvement.
    - The U.S. Person definition should include collective investment vehicles.
    - The definition and treatment of a U.S. Guaranteed Entity is sound and extremely important.

[6] The comments in our letter focus on the treatment of SDs under the Proposal, but they apply more generally to MSPs since the treatment of MSPs under the Proposal parallels the treatment of SDs.

  - The definition and treatment of a Foreign Consolidated Subsidiary is also sound, and it is necessary to help prevent evasion through de facto guarantees.

- The treatment of foreign branches of U.S. persons has been improved relative to the guidance, and that enhancement should be preserved in the final rule.

- The approach to ANE transactions should be strengthened or supported with a more clear and compelling justification.

- The aggregation provisions governing calculation of the registration thresholds for SDs and MSPs are appropriate and necessary.

- The cross-border application of External Business Conduct Standards should be strengthened.

DISCUSSION

The Cross-Border Rules Should Be Finalized Without Delay.

The majority of the commenters seeking to delay implementation of the Proposal cite the gap between U.S. and European regulations and the comparatively slow progress of reform overseas. However, this is not an appropriate consideration for several reasons. First, it is up to America's regulators to follow U.S. law and protect America's interests, and we cannot afford to wait for the rest of the world to catch up. Dodd-Frank Act implementation is already well behind schedule. We have been fortunate that no crisis-level events have befallen the U.S. financial sector during this regulatory lacuna so far. However, the Libor scandal and the losses incurred by JP Morgan through its "London Whale" operations prove beyond all doubt that unless meaningful cross-border enforcement of the Dodd-Frank Act provisions is implemented immediately, we are inviting catastrophe into our system.

Second, not only would a failure to act in a timely and thorough manner on cross-border implementation violate the financial reform law, it would also seriously injure American interests. If U.S. laws are not applied cross-border, then U.S. banks and dealers will move certain operations overseas into jurisdictions that reap the benefits of increased employment and revenue. However, when things go awry and those operations generate losses, then those losses will flow right back to the U.S., which will have to bail those firms out again if they are systemically significant. Thus, the upside is lost to foreign jurisdictions while the downside remains with the American taxpayer. This is a boon for banks and foreign countries, but it is foolhardy and unwise for the U.S. and U.S. taxpayers, and it must not be allowed. That is why the law mandates otherwise.

Finally, promptly completing strong cross-border implementation of the new derivatives framework will set an appropriately high regulatory standard that can help shape the approach to derivatives regulation followed by our foreign counterparts. This in

turn will make the global regulatory framework governing the derivatives markets stronger and more consistent.

While Better Markets sympathizes with the Commission as it weighs the regulatory and political issues in deciding whether and how to finalize this rule, the CFTC should not countenance any further delays in finalizing this Proposal for the reasons set forth in this comment letter.

The definitions are strong but leave room for improvement.

The U.S. Person definition should include collective investment vehicles.

The definition of U.S. person is especially critical, since all swaps traded by U.S. persons count toward the registration thresholds, as do all trades by non-U.S. persons with U.S. persons. In general, Better Markets supports the Proposal's definition of U.S. person. It largely mirrors the guidance and includes the basic categories such as natural persons; corporate and other entities organized or with principal places of business in the U.S.; foreign entities that are owned by U.S. persons; and branch offices of U.S. persons.

However, we take issue with the Proposal's notable departure from the guidance in one important respect. Specifically, the Proposed Rule does not include a commodity pool, pooled account, investment fund, or other collective investment vehicle, **even if it is majority owned by one or more U.S. persons.**

We oppose this decision to exclude collective investment vehicles from the definition of U.S. person. The Commission concedes that "**U.S. owners of such funds may be adversely impacted in the event of a counterparty default**."[7] Thus, excluding such funds from the definition of U.S. person will undermine the protective purposes at the heart of the cross-border framework. What is more, the CFTC does not offer a persuasive rationale for its approach. More specifically, the agency merely notes, "[t]he Commission understands that identifying and tracking a fund's beneficial ownership may pose a significant challenge in certain circumstances. Although the U.S. owners of such funds may be adversely impacted in the event of a counterparty default, the Commission believes that, on balance, the majority ownership test should not be included in the definition of U.S. person."[8] But the Commission should not exclude commodity pools, pooled accounts, investment funds, or other collective investment vehicles simply because of unspecified practical concerns about the potential difficulty of determining a fund's beneficial ownership. Therefore, we urge the Commission to maintain the guidance's definition of U.S. persons with respect to collective investment vehicles.

The definition and treatment of a U.S. Guaranteed Entity is sound and extremely important.

The Proposal correctly treats non-U.S. persons whose swap obligations are guaranteed by U.S. persons as essentially identical to U.S. persons. As the Release explains, this approach is logical because "the U.S. guarantor bears risk arising out of the swap as if it

7 Release at 71949.
8 *Id.*

had entered into the swap directly."[9] Moreover, the guarantor's financial resources facilitate the dealing activity of the non-U.S. entity because absent the guarantee, counterparties may decline to enter into the transaction or do so only on less favorable terms. Furthermore, treating U.S. persons and U.S. Guaranteed Entities differently would open a huge loophole in the swaps regulatory framework, incentivizing U.S. persons to evade regulation of their swaps activity simply by trading through guaranteed non-U.S. entities while exposing the U.S. financial system to the huge risks associated with that activity.

The definition does resurrect a specific concern that surrounded the cross-border guidance. The guarantee in this context is defined to mean a right of recourse, or in other words, a conditional or unconditional legally enforceable right to receive payments from the guarantor.[10] This formalistic definition raised the specter of potential evasion in the affiliate context: U.S. affiliates might intentionally avoid issuing guarantees that fit this technical definition to fend off regulation, but still provide de facto guarantees to facilitate trading and promote counterparty confidence. This scenario raises a legitimate concern, since risk would still flow back to the U.S. de facto guarantor. However, the aggregation provision in the Proposal, coupled with the treatment of any Foreign Consolidated Subsidiary, both discussed below, address this concern.

The definition and treatment of a Foreign Consolidated Subsidiary is also sound, and it is necessary to help prevent evasion through de facto guarantees.

The Proposal defines "Foreign Consolidated Subsidiary" ("FCS") as a non-U.S. person whose operating results, financial position, and statement of cash flows are consolidated for accounting purposes, in accordance with U.S. GAAP, with an ultimate parent entity that is a U.S. person.[11] Better Markets supports this definition because it prevents evasion by a U.S. parent through the use of non-U.S. subsidiaries, regardless of whether explicit guarantee relationships exist. Additionally, we agree with the underlying rationale: "this definition would encompass those entities within this consolidated group that are subject to the financial control, and **directly impact the financials, of the U.S. ultimate parent entity**."[12] Moreover, the Proposal establishes a clear and commonsense, bright-line test for the agency to use when determining which non-U.S. person's swap activities pose a greater supervisory risk to the U.S. financial system and the broader economy.

Under the Proposal, FCSs are treated the same as U.S. persons and U.S. Guaranteed Entities. In other words, the Proposal requires FCSs to include relevant swaps towards their SD or MSP registration calculation in the same way as U.S. persons and U.S. Guaranteed Entities. This is notable because it helps close the de-guarantee loophole that triggered serious concerns among many proponents of strong cross-border regulation. In situations of market stress, and often even in normal market conditions, subsidiaries without an explicit guarantee pose just as much of a threat to the stability of the parent company, which may have to bail them out or risk losing all credibility in the marketplace. Even when a

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[9] *Id.* at 71955.
[10] *Id.* at 71955 n. 79.
[11] *Id.* at 71950.
[12] *Id.* (emphasis added).

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subsidiary lacks an explicit guarantee, it almost certainly possesses an implicit guarantee—not on a transaction-by-transaction basis (hence the reason that counterparties rightly regard a guaranteed subsidiary as a safer bet)—but certainly on a portfolio level. This is because reputationally, a dealer or large trader in the swaps market simply cannot afford to allow a supposedly non-guaranteed subsidiary to fail, except in very marginal cases.

As all swap market participants can confirm, a parent's or sponsoring company's "choice" to let a subsidiary fail will inevitably be interpreted as a sign of balance sheet weakness or as a breach of a claimed prior understanding, practice, or expectation. As a result, any substantial market participant making such a decision will inevitably see a decline in business and order flow, likely precipitously and in very large amounts. In the most extreme case, a failure to bail out a subsidiary can trigger a market crisis and counterparty confidence, causing a sudden liquidity squeeze, precisely the conditions that caused the near collapse of the financial system following the Lehman bankruptcy.

Indeed, the last financial crisis proved definitively that even non-guaranteed subsidiaries are bailed out when under stress, bringing the risks and liabilities back to the U.S. financial system and proving that cross-border regulation must be applied to them. All of these considerations highlight the need for the proposed FCS definition, to ensure that the dealing activity of consolidated subsidiaries, whether or not explicitly guaranteed, are appropriately counted toward the dealer registration threshold.

The treatment of foreign branches of U.S. persons has been improved relative to the guidance, and that enhancement should be preserved in the final rule.

Under the Proposal, an Other Non-U.S. Person must include in its de minimis threshold calculation all swap transactions with U.S. counterparties (U.S. persons and U.S. Guaranteed Entities) and with Foreign Consolidated Entities. The guidance contained an unwarranted carve-out for transactions between non-U.S. persons and **foreign branches** of U.S. swap dealers, which did not count toward the de minimis calculation. The Proposal thankfully closes this loophole: All transactions between an Other Non-U.S. person and a U.S. dealer, **including the foreign branches** of the dealer, must be taken into account when determining if the Other Non-U.S. Person must register as a dealer.

The Release amply justifies this approach. A foreign branch is an integral part of a U.S. person, and therefore, transactions with that branch clearly and unquestionably pose risk to the U.S. person itself.[13] Allowing a potentially unlimited amount of swap dealing to take place between unregistered Other Non-U.S. Persons and foreign branches of U.S. dealers would place a substantial amount of dealing activity with U.S. counterparties outside the comprehensive Dodd-Frank swap regime.

[13] Release at 71956.

The approach to ANE transactions should be strengthened or supported with a more clear and compelling justification.

Under the Proposal, swap transactions arranged, negotiated, or executed between Other Non-U.S. Persons acting through personnel in the U.S. are subjected to some of the external business conduct standards, but they do not count toward the registration thresholds. This approach is only half right.

As a general matter, subjecting ANE transactions to swaps regulation is fundamentally sound and represents the only reasonable interpretation of Congress's mandate: The new framework clearly applies to all activities **inside** the U.S. so it is not even necessary to consult the standard applicable to activities **outside** the U.S.[14]

The Commission correctly decided that ANE transactions warranted application of the external business conduct standards. In reaching this conclusion, the Commission was appropriately guided by the definition of a dealer. Arranging, negotiating, and executing transactions on U.S. soil clearly amounts to conducting dealing activity in the U.S. Importantly, the terms "arrange, execute, or negotiate" are the precise functions performed by brokers, structurers, traders, and salesmen, who collectively comprise what is understood to be the core front office involved in "market-facing activity." Put another way, regardless of where a trade is ultimately booked, the dealing business is conducted at least in part wherever these front office personnel sit. Therefore, there is no dispute that transactions arranged, executed, or negotiated in the U.S. have indeed occurred in the U.S.

Moreover, the Commission was correct in concluding that such dealing activity raises "regulatory concerns of the type that the Dodd-Frank Act is intended to address."[15] Among those concerns are improving market transparency and promoting market integrity.[16] Applying at least the antifraud and fair dealing external business conduct standards to ANE transactions helps address those concerns and promotes the objectives of the law. Accordingly, foreign branches of a U.S. SD and a non-U.S. SD that use personnel for "market-facing activities" must comply with CFTC Regulation 23.410, which prohibits fraud, manipulation, and other abusive practices, and 23.433, which sets fair dealing standards.

However, the Commission's decision not to count ANE transactions toward the de minimis threshold calculation is not well-justified and even appears to be internally inconsistent. The decision seems to rest on the premise that ANE transactions do not pose sufficient risks to U.S. entities or the U.S. financial system, since both parties to the transactions are Other Non-U.S. Persons. But the Release fails to adequately justify this premise or the consequences that follow.

As a threshold legal matter, the Commission's conclusion that ANE transactions undoubtedly entail dealing activity within the U.S. would seem to be sufficient grounds not only for applying the external business conduct standards but also for considering such

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14 *See* 7 U.S.C. § 2(i) (extending cross-border reach to foreign activities with a "direct and significant connection with activities in, or effect on, commerce of the United States.").

15 Release at 71952.

16 *Id.* at 71953.

transactions when deciding whether those non-U.S. persons should be required to register as dealers. A systemic risk assessment is not a legal pre-requisite.

But even if it **were** necessary to identify a specific threat or risk of contagion from ANE trading before counting that activity toward the registration thresholds, it appears that the Commission made just such a finding. The Release indicates that ANE activity does in fact raise the risk of contagion:

> Even if the financial risks [of ANE trades] are borne by entities residing outside the United States, this activity indicates a level of involvement, and intention to participate, in the U.S. swap market that may raise concerns regarding customer protection, market transparency and financial **contagion** intended to be addressed by the Dodd-Frank Act.[17]

In light of this acknowledgement, it is unclear why the Commission decided it was unnecessary or inappropriate to take ANE transactions into account when deciding who must register as a dealer. The principal justifications proffered in the Release are strikingly weak and speculative. For example, the Release notes that "the level of ANE transactions engaged in by Other Non-U.S. Persons **may** be comparatively insignificant," since the Foreign Consolidated Subsidiary provisions may capture a substantial portion of the transactions conducted by Non-U.S. persons.[18] The Release similarly notes that Other Non-U.S. persons that engage in ANE transactions "**could**" be already registered as dealers or required to register under other provisions if the rule is adopted.[19]

The decision to ignore ANE dealing activity in the U.S. for the purpose of calculating dealer registration thresholds should not rest on such tenuous grounds. Accordingly, the Commission should either include ANE transactions in calculating the de minimis thresholds, or provide a clear and compelling justification, on legal and policy grounds, for not doing so.[20]

The aggregation provisions governing calculation of the registration thresholds for SDs and MSPs are appropriate and necessary.

The Proposal represents an improvement from the Guidance with respect to the aggregation of swaps for the purpose of determining who must register as a SD. This issue is of central importance to the entire cross-border swaps regulatory program. Weaknesses in the domestic SD and related entity definitions rule has already created a risky environment in which **not a single entity** is classed as a Major Swap Participant.[21] There is no reason to believe that foreign firms will be more likely to fall under the excessively high MSP threshold

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17 *Id.* at 71953 (emphasis added).
18 *Id.* at 71956 (emphasis added).
19 *Id.* (emphasis added).
20 We commend the Commission for not excluding trades via algorithmic or automated trading for execution from the scope of Dodd-Frank requirements. The agency's rational and interpretation is straightforward and should be practical for market participants.
21 National Futures Association, SD/MSP Registry, https://www.nfa.futures.org/NFA-swaps-information/SD_MSP_Registry.xml (last visited Dec. 19, 2016).

than domestic firms. Therefore, if large overseas entities heavily active in the swaps markets are to be subjected to proper oversight, it is only under the mantle of SDs that they will become so.

Under the old proposals, foreign firms would not need to include any of the swap dealing activities of their U.S. affiliates when determining whether they meet the SD threshold. Additionally, the 2013 guidance did not include the category of FCSs. The CFTC has wisely reconsidered these approaches. Under the Proposal, all firms, both U.S. and foreign, would be required to count all swap dealing activities entered into by any affiliates bound by control relationships, except in cases where the relevant affiliate is independently registered as an SD. This is a far better approach, as it prevents firms from simply evading the registration requirements through the simple expedient of fragmenting trading volume among various affiliates. In particular, it avoids the absurd scenario of the original proposal in which derivatives transacted on U.S. soil, potentially on U.S. platforms, would simply disappear from the regulatory purview for the purpose of determining SD status. Therefore, the Commission is rightly concerned that a failure to properly aggregate appropriately could result in a "substantial regulatory loophole" through which trades would be routed to avoid the swaps data aggregation and reporting requirements.

Slightly more intricate is the question of whether non-U.S. affiliates of non-U.S. Persons registered as SDs should themselves be required to register as SDs if they engage in any amount of swap dealing. The Commission's affirmative answer is correct and it draws on the basic rationale for the aggregation rule: A failure to follow this approach would open an unacceptable loophole that would incentivize non-U.S. SDs to propagate numerous non-U.S. affiliates simply to avoid regulatory oversight.

The need for a strong aggregation approach is reinforced by the extremely high de minimis threshold established by the SD definitions rule. An $8 billion threshold is—as has been argued in our letter on the relevant rule[22]—too high in any context. In the specific scenario envisaged in the Proposal, this is especially true. Allowing a subsidiary of an already large and highly active firm (i.e. an SD) to trade billions of dollars of swaps annually without the enhanced protections required of SDs would be a huge gamble.

It is true that some firms might suffer unnecessarily if they were forced to register as SDs despite the fact that they only engage in a de minimis amount of swap dealing. A de minimis allowance for subsidiaries of SDs closer to the $100 million level originally proposed by the Commission[23] would address this concern and indeed achieve the best of both worlds. It would enable subsidiaries of non-U.S. SDs to deal a genuinely de minimis quantity of swaps without thereby being required to register as an SD, while at the same time preventing a

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[22] Better Markets comment letter, "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant,' and 'Eligible Contract Participant'" (April 6, 2012), http://www.bettermarkets.com/sites/default/files/CFTC-%20Supp%20CL%20SD,%20MSP%20Def%20w%20attachment-%204-6-12_0.pdf.

[23] 75 Fed. Reg. 244 (Dec. 21, 2010). *See also* Better Markets comment letter "Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"" (February 22, 2011), http://www.sec.gov/comments/s7-39-10/s73910-68.pdf; and note 15 *supra*.

proliferation of large, under-regulated, opaque, and interconnected derivatives desks that all ultimately feed back into systemically important financial institutions.

The cross-border application of External Business Conduct Standards should be strengthened.

The Proposal requires a U.S. SD or MSP to comply with the external business conduct standards in Part 23 of the CFTC Regulations for all swaps, without substituted compliance, and regardless of counterparty, except with respect to swaps conducted through its foreign branches. The cross-border application of business conduct standards is necessary as the Dodd-Frank Act established them to protect market participants from fraud, abuse, and a lack of transparency in the derivatives markets. They greatly reduce the potential that customers will enter into arrangements without a full appreciation of the extraordinary risks associated with derivatives. Furthermore, the conduct of registered U.S. SDs and MSPs will obviously affect the integrity—both actual and perceived—of the U.S. derivatives markets and give rise to potential concerns about the protection of participants in U.S. markets. Therefore, we support the cross-border application of external business conduct standards to all U.S. SDs and MSPs.

The Proposal contains an important gap, however. Under the Proposal, a non-U.S. SD or MSP (including an FCS and a U.S. Guaranteed Entity) and foreign branches of U.S. SDs and MSPs would only need to comply with the external business conduct standards (without regard to substituted compliance) to the extent the counterparty is a U.S. person. In this context, foreign branches of a U.S. person would **not** be considered a U.S. person and would not receive the protections of the external business conduct standards.

This approach should be strengthened in two respects, one which expands the class of entities that receive the protections of the external business conduct standards and one which expands those obligated to abide by them. First, with respect to protections, when foreign branches of a U.S. person serve as the counterparty to a transaction with a non-U.S. person or with another foreign branch of a U.S. person, the external business conduct standards should apply for the benefit of that foreign branch counterparty. As observed in the Release, foreign branches of U.S. persons "are part of the same legal entity as their U.S. principal," and "from the standpoint of risk, there is no difference between a swap with a U.S. SD/MSP and a swap with its foreign branch."[24] We submit that the relevant risk in this context includes not just the risk of counterparty default but also the risk of damages sustained as a result of fraud or abuse.

Second, with respect to the duty to comply, all entities with a significant nexus to the U.S. should be subject to the external business conduct standards. That would include FCSs and U.S. Guaranteed Entities, as well as foreign branches of U.S. persons. Their connections to the U.S. arise from their corporate structures (foreign branches and FCSs) or their guarantees (U.S. Guaranteed Entities). Applying the external business conduct standards to these entities will help ensure that they adhere to high standards of conduct, thus protecting not only their counterparties but also the reputations of the U.S. firms that control or stand

[24] Release at 71961 n. 122.

behind them as home offices, parents, or guarantors. Moreover, to the extent legal or de facto liabilities flow back to those U.S. entities by virtue of these structures and guarantees, fraud, abuse, or other misconduct on the part of these entities will ultimately affect the U.S. In short, only Other Non-U.S. Persons transacting with Other Non-U.S. Person counterparties should be exempt from the external business conduct standards. With this approach, the Commission can more effectively balance the need for counterparty protections, reputational safeguards, principles of international comity, and the supervisory interests of foreign jurisdictions.

CONCLUSION

We hope these comments are helpful in your consideration of the final rule.

Sincerely,

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