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Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
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Re: Project KISS

Secretary Kirkpatrick:

The Institute of International Bankers (the "Institute") appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission" or "CFTC") in response to Chairman Giancarlo's initiative ("Project KISS") to make the Commission's existing rules, regulations and practices simpler, less burdensome and applied in a less costly manner.[1]

Our comments focus on the Commission's rulemakings pursuant to Title VII of the Dodd-Frank Act and how they apply to foreign banks engaged in swap activities, both directly and through their affiliates located within and outside the United States. Now that the Commission has largely completed its Title VII rulemakings, Project KISS presents an opportunity for the Commission to clarify how Title VII applies to cross-border trading activity. Clarifying these matters will help to encourage trading and investment in the United States and promote U.S. access to integrated, global markets.

In particular, now more than four years after publishing its guidance regarding the cross-border application of Title VII (the "July 2013 Cross-Border Guidance"),[2] the Commission is well-positioned to evaluate which aspects of that guidance have worked well and which aspects need adjustments. The latter category includes the extent of reliance on comparable foreign regulation, which the Commission should expand now that other jurisdictions have increasingly caught up with the Commission in implementing G-20 derivatives reform mandates.

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1 82 Fed. Reg. 23765 (May 24, 2017).

2 78 Fed. Reg. 45292 (July 26, 2013).

The Commission can also address issues left open by the July 2013 Cross-Border Guidance, including issues that Commission staff have addressed through temporary no-action relief. As noted in our prior Project KISS submission,[3] the time has come to end the cycle of requesting, discussing and granting extensions of no-action letters. We support Commission staff's decision to remove time limitations in several recent extensions of no-action letters. In this letter, we identify other instances where this approach would be beneficial.

Finally, we cover certain issues raised by rules proposed or adopted by the Commission since the July 2013 Cross-Border Guidance, including most notably the Commission's capital requirements for swap dealers ("SDs") and major swap participants ("MSPs") and its margin requirements for uncleared swaps entered into by SDs and MSPs.

Our comments are organized as follows. First, we address the key scope and definitional matters covered by the July 2013 Cross-Border Guidance and subsequent related Commission rulemakings and guidance, such as the availability of substituted compliance and definitions of "U.S. person," "guaranteed affiliate," and "affiliate conduit." Next, we address issues relating to the registration and regulation of SDs and MSPs. We then address issues relating to the Commission's swap data reporting requirements and large trader reporting requirements. Finally, we address issues relating to the Commission's inter-affiliate exemption from mandatory clearing requirements and the application of mandatory trading requirements to inter-affiliate swaps.

I. Cross-Border Scope and Definitions

A. Adopt a Robust, Outcomes-Based Approach to Substituted Compliance

Relevant Rulemaking(s): July 2013 Cross-Border Guidance; Comparability Determinations; CFTC Rule 23.160

In recognition of international comity and to avoid the undue costs and complexity (for market participants and regulators alike) that arise from overlapping regulation, the July 2013 Cross-Border Guidance permits market participants to substitute compliance with comparable foreign rules for compliance with Commission rules. In evaluating the comparability of non-U.S. rules, the Commission indicated it would apply an "outcomes-based approach" to determine whether relevant foreign rules "achieve the same regulatory objectives of the Dodd-Frank Act," without requiring such foreign rules to be identical to Commission rules.[4]

In many instances, however, the Commission's approach to comparability determinations more closely resembles rule-by-rule comparisons instead of a holistic comparison of outcomes. For example, the Commission's comparability determination relating to Japanese margin rules for uncleared swaps[5] separately evaluated 11 discrete elements of margin rules,

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[3] See Letter From IIB, ISDA and SIFMA dated July 24, 2017.

[4] July 2013 Cross-Border Guidance, 78 Fed. Reg. at 45342.

[5] 81 Fed. Reg. 63376 (Sept. 15, 2016).

finding comparability for eight elements, expressly rejecting comparability for one element (treatment of inter-affiliate transactions), and implicitly rejecting comparability for two other elements (product and entity scopes). In so doing, the Commission effectively adopted a "strictest-rule-applies" approach by concluding that unless a particular transaction and pair of counterparties are covered by both CFTC and Japanese margin rules, substituted compliance will not be available. In July 2013, the Commission suggested it would take a similar approach to substituted compliance for clearing and trading requirements.[6]

By regulating cross-border transactions more strictly than domestic transactions, a strictest-rule-applies approach discourages cross-border trading activity and concomitantly diminishes market liquidity. The Japanese margin comparability determination again provides an example. Because the Commission's comparability determination did not cover transactions with smaller Japanese financial institutions subject to less stringent Japanese supervisory guidelines, those institutions were concerned that they could not effectively transact with liquidity providers dually regulated by the Commission as SDs and by Japanese authorities. To address this issue, Commission staff needed to provide supplemental no-action relief.[7] This issue would not have arisen in the first place had the Commission taken an outcomes-based approach to determining whether Japanese margin rules holistically achieve the same risk mitigation objectives as the Commission's margin rules.

The Commission should return to the outcomes-based approach it set forth in the July 2013 Cross-Border Guidance. An outcomes-based approach is consistent with the Commission's statutory mandate under Section 2(i) of the Commodity Exchange Act ("CEA") to apply Commission regulations extraterritorially only where necessary to mitigate "direct and significant" risk to the United States. Unless stricter-rule-applies conditions are necessary to mitigate a direct and significant risk, they should not apply.

In evaluating whether foreign rules holistically achieve the same regulatory objectives as the Commission's rules, such that permitting substituted compliance would be consistent with the Commission's Section 2(i) mandate, the Commission should look to whether the relevant foreign rules are consistent with international regulatory standards. For example, the Commission should consider foreign margin rules that are consistent with the framework published in September 2013 by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions ("BCBS-IOSCO") to be comparable to the Commission's margin rules. For other rulemaking areas (such as mandatory clearing, mandatory trading and reporting), the Commission should consider the evaluation of a jurisdiction's

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6 See Cross-Border Regulation of Swaps/Derivatives Discussions between the Commodity Futures Trading Commission and the European Union – A Path Forward (July 11, 2013), available at http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/jointdiscussionscftc_europeanu.pdf (Explaining that, for mandatory clearing obligations, the Commission and EU regulators have agreed to "a 'stricter-rule-applies' approach to cross-border transactions where exemptions from mandatory clearing would exist in one jurisdiction but not in the other.").

7 CFTC No-Action Letter 17-13 (Feb. 23, 2017).

progress in meeting its G-20 commitments by the Financial Stability Board's ("FSB") OTC Derivatives Working Group.

This approach will encourage international harmonization through key standard-setting bodies, in which the Commission frequently takes a leading role. Substituted compliance is also an appropriate approach for the Commission to take in light of the progress made by non-U.S. jurisdictions in adopting OTC derivatives reforms. In the four years since the Commission published the July 2013 Cross-Border Guidance, key jurisdictions have mostly caught up to the Commission's current state of regulations.[8] This further progress also makes substituted compliance necessary to avoid regulatory conflicts, duplication and ensuing market fragmentation.

B. Promote a Consistent, Harmonized Approach to Cross-Border Definitions in the Title VII Context

Relevant Rulemaking(s): July 2013 Cross-Border Guidance; CFTC Rule 23.160

Within the Commission's Title VII rules, there are now two different sets of "U.S. person" and "guarantee" definitions, one set contained in the July 2013 Cross-Border Guidance and another set applicable solely to the Commission's margin rules for uncleared swaps. The Securities and Exchange Commission ("SEC") has adopted slightly different definitions for purposes of its Title VII rules for security-based swaps, as have the Prudential Regulators for purposes of their Title VII margin rules for uncleared swaps and security-based swaps. These different definitions bring certain counterparties in-scope for purposes of some rules but not others, which increases the costs and risks of error in connection with market participants' systems, controls, and documentation. On the other hand, the policy objectives underlying the relevant rules do not vary in respects that justify these different definitions.[9]

Accordingly, the Commission should work with the SEC and the Prudential Regulators to adopt harmonized "U.S. person" and "guarantee" definitions for purposes of Title VII rules. In addition, to defray compliance costs, the Commission should allow market participants, on a grandfathered basis, to continue to rely on written representations they received regarding a counterparty's status under pre-existing definitions unless and until the counterparty

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[8] The FSB publishes reports tracking the progress of 24 jurisdictions implementing OTC derivatives markets reforms. In its latest report from June 2017, the FSB summarized the current state of implementation in key areas: (1) Trade Reporting: 19 out of 24 member jurisdictions have comprehensive trade reporting requirements in force (and the FSB expects that 23 member jurisdictions will have such requirements in force by the end of third quarter 2017); (2) Central Clearing: 17 member jurisdictions have in force comprehensive standards/criteria for determining when derivatives should be cleared and 11 jurisdictions have requirements in place for specific classes of derivatives; (3) Margin Requirements of Non-Cleared Derivatives: 14 member jurisdictions have requirements in force; (4) Platform Trading: 12 jurisdictions have legal frameworks and comprehensive standards/criteria in force, and six jurisdictions have determinations in force for specific derivatives products to be executed on organized trading platforms. See OTC Derivatives Market Reforms, Twelfth Progress Report on Implementation (29 June 2017), available at http://www.fsb.org/wp-content/uploads/P290617-2.pdf.

[9] In contrast, we believe it remains appropriate, as a policy and statutory matter, for the Commission not to apply its Title VII definitions to its futures-related rules.

provides notification to the contrary. Since those pre-existing definitions will in most instances be broader in scope, such grandfathering would at-worst result in more expansive application of Title VII abroad than is necessary.

C. Eliminate the "Affiliate Conduit" Category

Relevant Rulemaking(s): July 2013 Cross-Border Guidance

The July 2013 Cross-Border Guidance applies certain Commission rules to swaps between an "affiliate conduit" of a U.S. person and a non-U.S. SD, a guaranteed affiliate or another affiliate conduit. Specifically, in connection with such swaps, the parties are subject to real-time public reporting rules and, if the affiliate conduit has elected the inter-affiliate clearing exemption, the outward-facing swap condition to that exemption.[10] These rules correspond to areas where the Commission has provided exceptions or exemptions for inter-affiliate swaps and thus had concerns that a U.S. person could, through swaps with a non-U.S. affiliate that in turn trades with non-U.S. counterparties, avoid Commission regulation.

The affiliate conduit definition has been difficult for market participants to apply in practice because it is composed of a set of four overlapping, non-exclusive factors. Non-U.S. SDs cannot readily identify which of their non-U.S. counterparties are affiliate conduits, and non-U.S. counterparties frequently are not even sure whether they fall within the definition. The definition also is not tailored to cover structures designed to avoid or evade Commission regulation, but rather sweeps in bona fide centralized risk management programs.

This prophylactic approach has not been necessary to address risk to the U.S. financial system or prevent evasion. As discussed below, the alternative variation margin framework developed by the Commission in the inter-affiliate clearing exemption context has proven itself to be an effective means for mitigating risk to the U.S. financial system without necessitating extraterritorial regulation of swaps between non-U.S. persons. Also, inter-affiliate swaps undertaken to satisfy centralized risk management objectives involve a legitimate—and beneficial—business purpose, and thus do not constitute evasion.

In light of these considerations, the Commission should eliminate the "affiliate conduit" category and instead reiterate that structures involving inter-affiliate swaps with non-U.S. affiliates that do not fall within a centralized risk management program, but rather are designed solely to avoid Commission regulation, constitute impermissible evasion and an abuse of relevant inter-affiliate exceptions or exemptions.

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[10] See July 2013 Cross-Border Guidance, 78 Fed. Reg. at 45359 (swaps with non-U.S. SDs) and 45364 (swaps with guaranteed affiliates or affiliate conduits).

D. Eliminate Personnel-Based Tests for the Application of Title VII Requirements

Relevant Rulemaking(s): Staff Advisory 13-69; October 2016 Cross-Border Proposal

Non-U.S. SDs rely on U.S.-located personnel to effectively risk manage their U.S.-connected positions and provide front-office services to clients as part of their global business. U.S.-located personnel provide these services even in connection with swaps between non-U.S. persons ("non-U.S. swaps"), where the ultimate risk under the transactions is borne entirely by non-U.S. persons. By employing U.S.-located personnel, non-U.S. SDs also create financial sector jobs and expertise in the United States. Also, in many cases, the parties to non-U.S. swaps are already subject to home-country regulation in connection with their derivatives activities.

Past Commission actions would have applied U.S. rules to these non-U.S. swaps merely because of the involvement of U.S. personnel. In particular, Staff Advisory 13-69 would have required non-U.S. SDs to comply with the Commission's transaction-level rules with respect to non-U.S. swaps solely because U.S.-located personnel or agents are involved in arranging, negotiating or executing those swaps.[11] The Commission's October 2016 cross-border proposal (the "October 2016 Cross-Border Proposal") also would have codified Staff Advisory 13-69 in connection with certain external business conduct rules, while also presaging future consideration of whether to apply a U.S. personnel test to other transaction-level rules.[12]

Putting a U.S. personnel test into effect would likely cause non-U.S. clients to avoid interacting with U.S.-located personnel so that they can avoid the costs of complying with additional, and possibly conflicting, U.S. regulations, including amending their trading documentation, changing the speed and size of their trading to adjust for public disclosure impacts and potentially changing where and how they access execution platforms and clearinghouses. As noted by a group of commercial end-users of derivatives: "end-users, who are using swaps to hedge or mitigate commercial risks associated with operating their businesses, will generally seek not to trade with non-U.S. [SDs] when trading with such foreign entities will unnecessarily subject them to duplicative regulatory requirements, increase costs and place them at a disadvantage compared with competitors who do not trade with such non-U.S. [SDs] and therefore do not have to incur such costs."[13]

To remain competitive and accommodate these clients, non-U.S. SDs would likely need to implement compliance systems that eliminate U.S.-located personnel from arranging, negotiating and executing the clients' non-U.S. transactions. These systems will create barriers within entities and corporate groups based solely on the geographic location of

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11 Staff Advisory 13-69 (Nov. 14, 2013).

12 81 Fed. Reg. 71946 (Oct. 18, 2016).

13 See Letter from the Coalition for Derivatives End-Users to the CFTC at p.3 (Mar. 10, 2014).

personnel, to the detriment of globalized risk management and at increased cost to clients.[14] Personnel-based tests are also cumbersome to administer, requiring entities to make seemingly arbitrary distinctions about permitted activities of personnel based on their geographic location at any time.[15]

The increased costs of compliance and changes to market behavior will impede the ability of non-U.S. SDs to invest and participate in U.S. markets and could lead to the elimination of a significant number of jobs for U.S.-located personnel. The costs of these rules far exceed any risk-mitigating benefit. For non-U.S. swaps, the presence of U.S.-located personnel in arranging, negotiating or executing does not result in risk flowing to the United States.

For these reasons, we support Commission staff's recent extension of no-action relief from Staff Advisory 13-69 until the effective date of Commission action addressing the relevance of a U.S. personnel test.[16] This extension provided much-needed clarity to the marketplace by eliminating the need for an annual extension of this relief.

Staff action is not, however, a substitute for formal Commission action. Accordingly, the Commission should now, in conjunction with finalizing the October 2016 Cross-Border Proposal, formally eliminate any U.S. personnel test for the application of Title VII to non-U.S. swaps.

E. Do Not Expand SD or MSP Registration Requirements as Contemplated by the October 2016 Cross-Border Proposal

Relevant Rulemaking(s): October 2016 Cross-Border Proposal

The October 2016 Cross-Border Proposal would expand the reach of SD and MSP registration to cover non-U.S. dealers providing liquidity to the non-U.S. branches of U.S. banks or the non-U.S. subsidiaries of U.S. parent companies (both banks and commercial firms). This proposal represents a significant expansion of SD and MSP registration relative to the July 2013 Cross-Border Guidance, which went into effect only three years earlier and under which Title VII rules do not apply to purely non-U.S. swaps.

Such an expansion would bring a large number of non-U.S. dealers with a very limited nexus to the United States within scope of comprehensive Commission regulation. These dealers' activities do not bear a "direct and significant" risk to the United States, which is a

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14 The risk management associated with a swap is inextricably linked to its price. Non-U.S. SDs offer liquidity and prices based on risk management considerations across the global enterprise. Barriers preventing coordination between risk management and trading personnel could lead to dealers mispricing transactions or taking on surplus risk.

15 For example, if a client in Europe places an order near the end of the day that a non-U.S. SD cannot finish executing until during U.S. market hours using U.S.-located personnel, a U.S. personnel test could subject that transaction to U.S. rules merely because of the time zone where it was executed.

16 No-Action Letter 17-36 (July 25, 2017).

prerequisite for the Commission to regulate them under Section 2(i) of the CEA. From a more practical perspective, the changes would limit the ability of American companies to hedge risks in non-U.S. markets by deterring non-U.S. dealers from trading with them, lest those non-U.S. dealers become subject to comprehensive Commission regulation due only to a very small part of their overall business.

Additionally, non-U.S. SDs have expended significant resources to comply with the July 2013 Cross-Border Guidance, which are reflected in their internal organization, documentation and compliance processes and procedures. In the October 2016 Cross-Border Proposal, Commission did not provide a sufficient basis to justify such a significant change in policy and the resultant costs to SDs.

The Commission therefore should not expand SD or MSP registration requirements as contemplated by the October 2016 Cross-Border Proposal. Rather, when finalizing that proposal, the Commission should codify the July 2013 Cross-Border Guidance's exceptions from SD and MSP registration for a non-U.S. person's swaps with non-U.S. branches of U.S. banks and non-U.S. subsidiaries and affiliates of U.S. firms.

F. Clarify When Title VII Rules Apply to Cross-Border, Post-Allocation Swaps

Relevant Rulemaking(s): July 2013 Cross-Border Guidance

The July 2013 Cross-Border Guidance recognized that, in certain instances where a non-U.S. person enters into a swap in circumstances where it does not know the identity of its counterparty, it is appropriate not to subject the non-U.S. person to regulation under Title VII. The specific instance addressed by the July 2013 Cross-Border Guidance involved swaps executed anonymously by a non-U.S. person on a designated contract market ("DCM"), swap execution facility ("SEF") or foreign board of trade ("FBOT") and cleared.[17] In this instance, the Commission recognized that the Commission's interest in regulating the swap was outweighed by the non-U.S. person's practical difficulties in determining whether the swap would be subject to Commission regulation, given that the non-U.S. person would have no information regarding its swap counterparty prior to execution of the swap.

A similar issue arises in connection with swaps subject to post-trade allocation. When a non-U.S. person enters a swap with a non-U.S. asset manager that is subject to post-trade allocation, the non-U.S. person does not know whether its counterparty(ies) is(are) a U.S. person, a non-U.S. person or some combination thereof, until after execution occurs. For cleared swaps or swaps executed under a prime brokerage arrangement, the non-U.S. person might never find out the ultimate beneficial owners of the swap because the non-U.S. person will, by the time allocation occurs, already face a clearing organization or prime broker as its counterparty.

For these post-allocation swaps, the non-U.S. person is not in a position to ascertain whether the Commission's rules apply. At the same time, it would not be reasonable for a U.S. beneficial owner to expect the protection of U.S. SD registration or external business conduct rules when it appoints a non-U.S. asset manager to trade with non-U.S. swap

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[17] See, e.g., July 2013 Cross-Border Guidance, 78 Fed. Reg. at 45325.

counterparties. It also should be the responsibility of any such U.S. beneficial owner to ensure that its non-U.S. asset manager satisfies Commission mandatory clearing, trading or real-time reporting requirements for its swaps.

To address this issue, the Commission should clarify that when a non-U.S. person enters into a swap with a non-U.S. asset manager that is subject to post-trade allocation, and the swap is submitted for clearing or given up to a non-U.S. prime broker before the asset manager allocates it, the non-U.S. person does not need to count the swap toward its SD de minimis threshold calculations or be responsible for compliance with the Commission's transaction-level rules unless the non-U.S. asset manager expressly indicates that the swap will be allocated to one or more U.S. persons.[18]

II. Registration and Regulation of SDs and MSPs

A. Make the Current $8 Billion SD De Minimis Threshold Permanent

Relevant Rulemaking(s): CFTC Rule 1.3(ggg)(4)(i)

The Commission's de minimis threshold below which a person can transact before registering as an SD is a central element of its Title VII framework. The calibration of the de minimis threshold defines, in many cases, whether a foreign entity is subject to wholesale Commission regulation as an SD or is exempt from most regulations.

By the end of 2018, the de minimis threshold is scheduled to decrease from $8 billion to $3 billion (calculated on a group-wide, rolling 12-month basis).[19] Commission staff have estimated that this decrease will cause an additional 84 firms to register as SDs.[20] Expanding the number of SD registrants so significantly would put strains on Commission and National Futures Association ("NFA") resources to supervise firms whose swap dealing activity does not pose a direct and significant risk to the U.S. financial system. As noted by Commission staff, covering these additional 84 firms would only expand coverage of notional swap activity by less than one percent.[21]

Moreover, the potential costs of submitting to SD registration and regulation would also lead many affected firms to curtail their swap dealing activity so as to remain below the de minimis threshold. The result would be decreased liquidity and increased market concentration. Due to the 12-month look-back within the de minimis threshold calculation, firms will likely begin to pull back from the market at the beginning of 2018.

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18 Notably, the SEC has adopted a similar clarification for purposes of its Title VII reporting rules. See 81 Fed. Reg. 53546, 53582 (Aug. 12, 2016).

19 81 Fed. Reg. 71605 (Oct. 18, 2016).

20 CFTC Staff, Swap Dealer De Minimis Exception Final Report (Aug. 15, 2016) at p.21 (counting solely swap dealers in interest rate swaps and credit default swaps).

21 Id.

To avoid these costs and issues, the Commission should make the current $8 billion de minimis threshold permanent.

B. Permit U.S. Branches of Foreign Banks to Rely on the Loan Origination Exception from the SD De Minimis Threshold

Relevant Rulemaking(s): CFTC Rule 1.3(ggg)(5)

Section 1a(49)(A) of the CEA provides that an insured depository institution ("IDI") shall not be considered to be an SD to the extent it offers to enter into a swap with a customer in connection with originating a loan with that customer. The Commission implemented this exception in its Rule 1.3(ggg)(5) (the "Loan Origination Exception"). As written, that exception is currently only available to U.S. IDIs.[22] It is common, however, for a foreign bank that makes a loan to a U.S. customer through the foreign bank's uninsured U.S. branch or agency to offer to enter into a swap in connection with that loan. Foreign banks are an important source of funding to U.S. companies,[23] and the current limited scope of the Loan Origination Exception impedes the range of funding services that foreign banks can provide.

It is not necessary to construe Section 1a(49)(A) so narrowly. As an initial matter, one could view Congress as expressing an interpretive view that swaps offered to customers by banks in connection with originating loans are not indicative of swap dealing activity. There is no reason to view uninsured U.S. branches and agencies of foreign banks any differently from U.S. IDIs for this purpose. Their corporate lending activities are substantially similar. Foreign banks' U.S. branches and agencies are subject to prudential regulation that is similar to the regulation of U.S. IDIs and are treated like U.S. IDIs for many purposes under U.S. law.[24] By statute, both uninsured and insured U.S. branches and agencies of foreign banks may

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22 Section 2 of the Dodd-Frank Act provides that "except as the context otherwise requires . . .," the definition of "insured depository institution" has the same meaning as in the Federal Deposit Insurance Act (18 U.S.C. §1813). "Insured depository institution'' is defined by section 3(c)(2) of the Federal Deposit Insurance Act to mean a bank or savings association the deposits of which are insured by the Federal Deposit Insurance Corporation, and, for some purposes under section 3(c)(3), an uninsured U.S. branch or agency. See 12 U.S.C. §§ 1813(c)(2) and (c)(3).

23 As of April 2017, collectively, our members' U.S. operations hold approximately $5 trillion in bank and nonbank assets, fund 27% of all commercial and industrial bank loans made in the United States, constitute three of the top ten U.S. agriculture lenders and funded 71% of U.S. infrastructure loan volume over the last five years. See U.S. Supervision and Regulation of International Banks: Recommendations for the Report of the Treasury Secretary, Institute, April 28, 2017, page 4.

24 See Cleary Gottlieb Steen & Hamilton LLP, Davis Polk & Wardwell LLP and Sullivan & Cromwell LLP, White Paper on the Separate Entity Doctrine as Applied to the U.S. Branches of Foreign Headquartered (Non-U.S.) Banks (Apr. 18, 2012), available at https://www.clearygottlieb.com/~/media/cgsh/files/publication-pdfs/white-paper-on-the-separate-entity-doctrine.pdf.

receive discount window advances on the same terms and conditions that apply to domestic insured state member banks.[25]

Additionally, the CEA does not define the term "insured depository institution," and Sections 712(d) and 721(b) of the Dodd-Frank Act granted the Commission further definitional authority in this context. It would be consistent with the policy objective of the Loan Origination Exception to promote lending and hedging activity to clarify that the term "insured depository institution" as used in the Loan Origination Exception includes the uninsured U.S. branch or agency of a foreign bank. We note that this clarification would be consistent with the decision by the Board of Governors of the Federal Reserve System (the "Federal Reserve"), in the context of Section 716 of Dodd-Frank (the so-called "Swaps Push-Out Rule"), to clarify that the definition of IDI in that parallel part of Title VII of the Dodd-Frank Act includes any uninsured U.S. branch or agency of a foreign bank.[26] After the Federal Reserve took that step, Congress codified the clarification.[27] As a result, we do not believe that it would be inconsistent with congressional intent for the Commission to adopt a similar clarification here.

C. Expand the Hedging Exception from the De Minimis Threshold to Cover Financial Hedging

Relevant Rulemaking(s): CFTC Rule 1.3(ggg)(6)(iii)

Although swaps entered into for the purpose of hedging are generally not indicative of dealing,[28] the facts-and-circumstances test for applying the "swap dealer" definition creates regulatory uncertainty that discourages some firms from using swaps to hedge. The existing exclusion from the de minimis threshold for swaps entered into for purposes of hedging physical positions (the "Hedging Exception")[29] helps to address this issue for firms that use swaps to hedge physical positions, but it does not help firms that use swaps to hedge financial risks, such as interest rate or foreign exchange risk associated with their liabilities. As a result, the existing Hedging Exception is not typically relied on by banking institutions, including foreign banks. Nor does it help commercial end users who use swaps for liability management purposes.

The Commission structured the bright-line test for the Hedging Exception based on its existing bona fide hedging exception from position limits.[30] We believe that a more appropriate basis for the exclusion would be CFTC Rule 1.3(kkk), which provides a bright-line

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25 Section 13(14) of the Federal Reserve Act; 12 U.S.C. § 347d.

26 See 12 C.F.R. §237.21.

27 H.R. 83 (113th): Consolidated and Further Continuing Appropriations Act, January 3, 2015; 15 U.S.C. §8305(b)(3).

28 77 Fed. Reg. 30596, 30608 (May 23, 2012).

29 CFTC Rule 1.3(ggg)(6)(iii).

30 77 Fed. Reg. at 30612.

test for determining when a firm is using swaps for the purpose of hedging or mitigating commercial risk, including financial risk. Using Rule 1.3(kkk), instead of the bona fide hedging exception, would help to eliminate the undue disparity between physical and financial hedging, thus promoting beneficial hedging activity by firms who use swaps to hedge their liabilities or otherwise hedge using financial swaps that are not substitutes for transactions in physical marketing channels. Importantly, although it allows hedging of financial risks, Rule 1.3(kkk) does not cover positions held to hedge or mitigate the risk of another swap position unless that other position itself is held for the purpose of hedging or mitigating commercial risk.[31] Thus, expanding the Hedging Exception to cover swaps that fall within Rule 1.3(kkk) would not allow the exclusion to cover swaps that hedge swap dealing activity. Another advantage of the hedging test under Rule 1.3(kkk) is that, like the bona fide hedging exception, it is already well known and used by market participants for purposes of several Commission rules.[32] Expanding the Hedging Exception to cover swaps that fall within Rule 1.3(kkk) would thus involve minimal additional compliance costs while also promoting regulatory consistency.[33]

D. Reduce Conflicts and Inconsistencies Between the Commission's Margin Rules and Foreign Margin Rules

Relevant Rulemaking(s): CFTC Rules 23.150-161; CFTC Rule 23.701

The Commission's margin rules are part of the broader, international effort by BCBS-IOSCO to impose initial and variation margin requirements on uncleared swaps market participants. Non-U.S. SDs subject to the CFTC's margin rules are also typically subject to margin rules in their home jurisdiction, and U.S. SDs frequently trade with non-U.S. SDs subject to such foreign margin rules. Although the different rules implementing the BCBS-IOSCO framework are generally consistent, they are not identical, and non-U.S. SDs have identified challenges complying with multiple sets of rules. We recommend that the Commission take the following steps to address these challenges:

- Largely for historical and jurisdictional reasons, as opposed to product risk characteristics, the set of products covered by uncleared margin requirements is not identical across relevant rules. To comply with rules that cover different product sets, parties are required to create multiple netting portfolios, which increases settlement risk

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31 CFTC Rule 1.3(kkk)(2).

32 Initially, CFTC Rule 1.3(kkk) applied in connection with the major swap participant and eligible contract participant definitions. CFTC Rules 1.3(m)(7)(iii) and (kkk). Subsequently, the applicability of the test was expanded to the end-user exception from mandatory clearing. CFTC Rule 50.50(c).

33 Expanding the Hedging Exclusion in this way would also promote consistency with the Federal Reserve's rules pursuant to Section 165 of Dodd-Frank. Specifically, pursuant to that provision, the Federal Reserve has adopted rules that require foreign banking organizations that have U.S. non-branch assets of $50 billion or more to establish an intermediate holding company for those U.S. operations. See 79 Fed. Reg. 17240 (Mar. 27, 2014). These rules create incentives for foreign banks, including those that have registered their foreign parents as swap dealers, to manage the risks of their U.S. operations on a standalone basis, including through swaps. Without a clear safe harbor from swap dealer registration, however, it is costly for affected firms to engage in such hedging activities.

and margin obligations even where the products could be risk-reducing if margined on a portfolio basis. Commission staff addressed this issue in part when they issued No-Action Letter 16-71,[34] which permits SDs that do not have a Prudential Regulator to include security-based swaps in their product sets for initial margin, subject to certain conditions. However, that relief does not cover uncleared derivatives, such as securities options, that are not swaps or security-based swaps but are nonetheless covered by the foreign margin rules. The Commission should expand its relief to permit parties to portfolio margin using the broadest set of uncleared products covered by any margin rules applicable to either counterparty.

- The Commission's margin rules require SDs to post and collect margin on or before the business day after execution of a swap. Although the Commission modified its "day of execution" definition to address situations when counterparties are located in different time zones, these modifications did not address all the logistical issues presented by cross-border trading. For example, if a U.S. counterparty trades with a Japanese counterparty and the parties calculate margin requirements after the end of trading in New York (as is commonly the case, in order to take into account updated market data), there might not be enough time for the Japanese counterparty to act on the margin call it receives from the U.S. counterparty on the morning of the business day after execution of the parties' swap. In addition, some of the types of assets eligible as collateral do not settle on a same-day basis. To address these issues, the Commission should clarify that an SD satisfies its margin obligations so long as it calls for margin on or before the business day after execution of a swap and makes appropriate efforts to post or collect the margin if the counterparty does not promptly initiate a transfer of eligible collateral.

- Under the Commission's margin rules, fluctuations in foreign exchange rates could change how initial margin thresholds, minimum transfer amounts, the "material swaps exposure" definition or the initial margin compliance schedule applies to a non-U.S. market participant. In the preamble to its margin rules, the Commission acknowledged that "persistent and significant fluctuations in exchange rates could result in significant differences across jurisdictions that would complicate cross-border transactions and raise competitive inequities."[35] The Commission indicated it would periodically adjust the numerical levels in the rules, but this approach leaves periods of "significant differences" across different jurisdictions' rule sets unless the Commission adjusts numerical levels frequently. To address this issue without unnecessarily adding to the Commission's rulemaking obligations, the Commission should instead permit SDs to use non-U.S.

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[34] CFTC No-Action Letter 16-71 (Aug. 23, 2016).

[35] 81 Fed. Reg. 636, 677 (Jan. 2, 2016). When it adopted its margin rules, the Commission changed the minimum transfer amount and initial margin thresholds to match the BCBS-IOSCO international framework based on the exchange rate of the U.S. dollar to the Euro at that time: "In the final rule, the Commission is adjusting the numerical amounts described above in light of significant shifts in the Euro-U.S. Dollar exchange rates since the publication of the proposal. Specifically, the Commission is reducing the value of each numerical quantity expressed in dollars to be consistent with a one for one exchange rate with the Euro." Id.

currency equivalents when making required calculations under the margin rules with respect to non-U.S. counterparties.

- The Commission's exception from initial margin requirements for inter-affiliate swaps includes a prophylactic anti-evasion condition that prevents reliance on the exception in circumstances where one of the transacting affiliates trades with third parties and is located in a foreign jurisdiction that does not have comparable margin rules, unless that outward-facing foreign affiliate collects initial margin from those third parties as though it was subject to the Commission's margin rules.[36] This condition makes it more difficult for SDs to engage in beneficial, centralized risk management activities that involve foreign affiliates, especially since the CFTC has not yet made comparability determinations for most key foreign jurisdictions that have implemented margin rules. On the other hand, variation margin has proven to be an effective means for mitigating risk arising from inter-affiliate swaps without necessitating extraterritorial application of Commission rules to swaps between non-U.S. persons. Also, inter-affiliate swaps undertaken to satisfy centralized risk management objectives involve a legitimate—and beneficial—business purpose, and thus do not constitute evasion. Accordingly, the Commission should eliminate the outward-facing swap condition for the exception from initial margin requirements for inter-affiliate swaps.

- CFTC Rule 23.701 requires SDs to notify counterparties of their right to elect to segregate initial margin that the counterparty provides. The Commission amended this rule when it adopted its margin rules to clarify that it does not apply to initial margin that is required to be segregated under the Commission's margin rules. The Commission should also clarify that the notification requirement does not apply to initial margin required to be segregated under the Prudential Regulators' margin rules or a foreign jurisdiction's margin rules.[37]

E. Clarify and Streamline Proposed SD Capital Rules to Reduce Duplication and Overlap with Other Regulators' Capital Requirements

Relevant Rulemaking(s): Capital Requirements of SDs and MSPs, 81 Fed. Reg. 91,252 (Dec. 16, 2016).

In May 2017, we submitted a comment letter with recommendations for the Commission on its proposed capital requirements for SDs. In that letter, we recommended steps the Commission should take to enhance and clarify its substituted compliance regime, clarify and streamline its financial reporting requirements (particularly for non-U.S. SDs), clarify its treatment of foreign bank SDs that do not operate a U.S. branch and adopt an appropriate compliance schedule. We encourage the Commission to modify its proposal in accordance with

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36 See CFTC Rule 23.159(c).

37 Although we understand that CFTC Rule 23.701 is required by the CEA, we believe it is not necessary in light of the Commission's margin rules, which define the Commission's view about the margin that should be segregated. CFTC Rule 23.701 is operationally burdensome but rarely used and we would support a statutory amendment to the CEA repealing this requirement.

our suggestions and for your reference have attached our comment letter as Appendix A to this submission.

F. Tailor Risk Reporting Requirements for Non-U.S. SDs

Relevant Rulemaking(s): CFTC Rule 23.600(c)(2); NFA Financial Requirements Section 17; NFA Notice I-17-10

CFTC Rule 23.600 requires SDs and MSPs to implement a comprehensive risk management program, with numerous requirements for review and approval by the SD's "governing body" and "senior management," each as defined specifically in the rule. Although the Commission generally found home country requirements in Australia, Canada, the European Union ("EU"), Hong Kong, Japan and Switzerland to be comparable to Rule 23.600, including the rule's various governance-related requirement, it did not find comparability for the requirement in Rule 23.600(c)(2) that an SD produce quarterly risk exposure reports and provide such reports to its senior management, governing body and the Commission.[38] As a result, although non-U.S. SDs located in those jurisdictions can rely on substituted compliance for other aspects of Rule 23.600, they must still directly satisfy the Commission's quarterly risk exposure reporting requirement.

Rule 23.600(c)(2)'s risk exposure reporting requirement serve two independent functions: it helps ensure senior-level internal oversight of risk exposures, and it provides the Commission with risk exposure information for surveillance purposes. For non-U.S. SDs, the first function is already addressed by home country risk management requirements. Preventing non-U.S. SDs from relying on substituted compliance for Rule 23.600(c)(2) interferes with those requirements because it forces a non-U.S. SD to specify a swap dealer "governing body" and "senior management" to receive and review its risk exposure reports on a quarterly basis, regardless of the governance framework and risk reporting frequency required under home country rules. This effect does not seem consistent with the Commission's international comity objective.

Rule 23.600(c)(2) is also ill-suited to informing market-wide risk surveillance because SDs use heterogeneous, firm-specific risk metrics for their risk exposure reports. To help fill this gap, NFA recently adopted monthly risk metric reporting requirements for SDs, covering nine specified firm-wide market or credit risk metrics and one metric addressing credit exposure to specific counterparties. These requirements standardize the risk metrics reported by SDs, which aids in market-wide risk surveillance. Requiring non-U.S. SDs to satisfy

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[38] Comparability Determination for Australia: Certain Entity-Level Requirements, 78 Fed. Reg. 78864, 78871 (Dec. 27, 2013); Comparability Determination for Certain Requirements under the Laws of Canada, 78 Fed. Reg. 78839, 78845 (Dec. 27, 2013); Comparability Determination for the European Union: Certain Entity-Level Requirements ("EU Comparability Determination"), 78 Fed. Reg. 78923, 78930 (Dec. 27, 2013); Comparability Determination for Hong Kong: Certain Entity-Level Requirements, 78 Fed. Reg. 78852, 78858 (Dec. 27, 2013); Comparability Determination for Japan: Certain Entity-Level Requirements, 78 Fed. Reg. 78910, 78917 (Dec. 27, 2013); Comparability Determination for Switzerland: Certain Entity-Level Requirements, 78 Fed. Reg. 78899, 78904 (Dec. 27, 2013).

Rule 23.600(c)(2) in addition to NFA risk metric reporting requirements results in duplicative regulation with little benefit.

We are also concerned that NFA's risk metric reporting requirements do not account for the different practical and policy considerations presented in the case of non-U.S. SDs. Specifically, NFA's firm-wide market or credit risk metrics do not necessarily correspond to what non-U.S. SDs measure or prepare for their home country regulators, which will result in duplication and additional costs. Also, relative to home country regulators, NFA is not well-positioned to oversee the safety and soundness of non-U.S. SDs since it does not oversee their risk management frameworks, capital adequacy, or non-swaps businesses. These risk metrics accordingly have limited usefulness for NFA. It would be less costly and more consistent with allocation of prudential oversight responsibilities for NFA or the Commission to obtain firm-wide risk metrics regarding non-U.S. SDs through memoranda of understanding with home country regulators.

Also, requiring non-U.S. SDs to report metrics for credit exposures to specific non-U.S. counterparties has limited regulatory benefits. In particular, where a counterparty's uncleared swaps with a non-U.S. SD are not covered by U.S. margin rules because of the limited nexus those swaps have to the United States, requiring the non-U.S. SD to report its credit exposure to that counterparty is not necessary for NFA or the Commission to achieve U.S. risk surveillance objectives.

In light of these considerations, the Commission should expand its risk management comparability determinations to cover Rule 23.600(c)(2)'s risk exposure reporting requirement and work with NFA to tailor its monthly risk metric reporting requirements to non-U.S. SDs as described above.

G. Clarify Chief Compliance Officer Requirements for Non-U.S. SDs

Relevant Rulemaking(s): CFTC Rule 3.3

The Commission permits a non-U.S. SD to rely on substituted compliance for its Chief Compliance Officer ("CCO") requirements under CFTC Rule 3.3. In its comparability determinations thus far, the Commission has found certain non-U.S. regulations to be comparable even if they do not require a non-U.S. SD to designate an individual as a CCO for its swap dealer business, but instead the non-U.S. SD can rely on its existing internal compliance governance.[39]

Because the Commission's comparability determinations so far have applied solely with respect to the requirements of CFTC Rule 3.3, there is a potential ambiguity about how CCO responsibilities located in other Commission rules are to be performed by a non-U.S. SD that is relying on substituted compliance for Rule 3.3. For example, the Commission's rules

[39] See, e.g., EU Comparability Determination, 78 Fed. Reg. at 78928 (finding MiFID requirements comparable to and as comprehensive as the requirements in CFTC Rule 3.3 (other than CFTC Rule 3.3(f)), even though MiFID does not require a non-U.S. SD to appoint a swap dealer CCO).

require a CCO to submit quarterly segregation notices[40] and to review the SD's determination that a special entity counterparty lacks an independent qualified representative,[41] but these rules are not covered by the Commission's comparability determination. For a non-U.S. SD that is relying on substituted compliance for the CCO rules, the Commission should clarify that the obligations of a CCO in other Commission rules can be satisfied by a senior compliance officer of the non-U.S. SD responsible for swaps compliance.

H. Eliminate Inconsistencies Between CFTC Swap Valuation Dispute Reporting Rules and Parallel European Rules

Relevant Rulemaking(s): CFTC Rule 23.502(c); NFA Interpretive Notice 9072

Even though the Commission found that the rest of its rules related to risk mitigation are "essentially identical" to rules under the European Market Infrastructure Regulation ("EMIR"), minor differences related to swap valuation dispute resolution and reporting requirements in CFTC Rule 23.502 and NFA Interpretive Notice 9072 create operational challenges for non-U.S. SDs subject to both sets of regimes.[42] We recommend that the Commission modify Rule 23.502 to eliminate the following inconsistencies with EMIR:

- The European Securities and Markets Authority ("ESMA") has stated that under EMIR, counterparties may agree upfront that discrepancies related to swaps that amount to a value below a pre-defined threshold do not count as disputes.[43] This approach eliminates the need for parties to expend resources to resolve disputes where the value at stake is de minimis relative to their internal risk limits and has not reached the thresholds established by ESMA for reporting. In contrast, Rule 23.502(a)(5) and (b)(4) treat all valuation differences greater than 10 percent as a "dispute" requiring resolution, regardless of the dollar amount at stake.

- Under Rule 23.502(c), an SD is required to report swap valuation disputes with a counterparty above a specified dollar threshold if the dispute is not resolved within three business days (with a counterparty that is an SD or MSP) or five business days (with a counterparty that is not an SD or MSP). In addition, NFA Interpretive Notice 9072 requires SDs to notify the NFA of changes to previously reported disputed amounts if the disputed amount increases or decreases in $20 mm increments as well as on the 15th (or the next following business day) and last business days of each month. These requirements are more strict than equivalent EMIR requirements. Under EMIR, a valuation dispute must be reported only if it is outstanding for at least 15 business days and parties are required to make at least monthly notifications of any disputes outstanding

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40 CFTC Rule 23.704(a).

41 CFTC Rule 23.450(f).

42 See CFTC No-Action Letter 13-45 (Jul. 11, 2013).

43 ESMA Questions and Answers; Implementation of the Regulation (EU) No 648/2012 on OTC Derivatives, central counterparties and trade repositories (EMIR) ("ESMA Q&A"), (Aug. 5, 2013), OTC Answer 15(a).

in the preceding month.[44] Nonetheless, the Commission found the EMIR requirements to be comparable to Rule 23.502(c).[45] For corporate groups that include U.S. and EU SDs, the discrepancies between the CFTC's and NFA's rules and the EMIR rules create operational burdens because they necessitate different dispute resolution procedures for different affiliates. On the other hand, now that uncleared swaps with SDs, MSPs and financial end users are subject to margin requirements that lead parties to exchange collateral for the undisputed amount of margin during this dispute period, providing market participants more time to resolve their disputes before notifying their regulators, and decreasing the frequency of notifications about changes should not pose undue risk.

I. Permit Substituted Compliance for SD Antitrust Requirements

Relevant Rulemaking(s): CFTC Rule 23.607

The July 2013 Cross-Border Guidance did not categorize CFTC Rule 23.607, which prohibits SDs and MSPs from engaging in certain anticompetitive conduct and requiring SDs and MSPs to adopt policies and procedures to prevent such conduct. Like the other duties applicable to SDs and MSPs under CEA Section 4s(j), Rule 23.607 most naturally applies to a firm's operations as a whole, not to particular transactions. In addition, most non-U.S. SDs are already subject to extensive requirements under U.S. and foreign laws prohibiting anticompetitive conduct. Accordingly, the Commission should treat Rule 23.607 as an "entity-level" rule eligible for substituted compliance.

J. Treat Customer Clearing Relationship Requirements as a Transaction-Level Rule

Relevant Rulemaking(s): CFTC Rule 23.608

The July 2013 Cross-Border Guidance also did not categorize CFTC Rule 23.608, which prohibits certain restrictions on customer clearing relationships. This rule is targeted at customers of U.S. futures commission merchants, which are typically U.S. persons. The rule also works in conjunction with the Commission's straight-through processing rules, which are transaction-level rules. Accordingly, the Commission should treat Rule 23.608 as a "transaction-level" rule.

K. Codify the Territorial Scope of SD Associated Person Requirements

Relevant Rulemaking(s): CFTC Rule 23.22; No-Action Letter 12-43

In December 2012, Commission staff issued No-Action Letter 12-43,[46] which permits an SD to employ an associated person subject to statutory disqualification so long as the

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[44] Commission Delegated Regulation (EU) No 149/2013, Article 15(2); ESMA Q&A, OTC Answer 15(d).

[45] Comparability Determination for European Union: Certain Transaction-Level Requirements, 78 Fed. Reg. 78878, 78884 (Dec. 27, 2013).

[46] CFTC No-Action Letter 12-43 (Dec. 7, 2012).

associated person is located outside of the United States and only conducts activities with non-U.S. counterparties. We agree with the staff's position in this letter, which accords with the treatment of associated persons for other Commission registrants under CFTC Rule 3.12(h)(1)(iv). In addition, the relief helps avoid potential conflicts with those foreign blocking, privacy and secrecy laws in certain jurisdictions that prohibit a non-U.S. SD from performing background checks regarding its non-U.S. associated persons. The Commission should codify the relief in No-Action Letter 12-43 in its regulations.

III. Reporting Requirements

A. Codify Existing No-Action Relief Regarding Swap Data Reporting

Relevant Rulemaking(s): CFTC Regulations Parts 45 and 46; No-Action Letter 16-79

The July 2013 Cross-Border Guidance applies the Commission's swap data reporting requirements to all of a non-U.S. SD's swaps, including swaps with non-U.S. persons. Reporting these non-U.S. swaps can cause the non-U.S. SD to violate local blocking, privacy or secrecy laws, as well as cause the non-U.S. SD to incur significant operational and compliance costs. Where a non-U.S. SD does not have a U.S. ultimate parent company, the swaps do not pose any material risk to the U.S. financial system.

In light of these considerations, Commission staff have issued a series of no-action letters providing time-limited relief from reporting these swaps.[47] The annual extension process, however, presents unnecessary uncertainty for non-U.S. SDs. We accordingly encourage the Commission to codify this relief in its regulations. In the interim, Commission staff should extend their no-action position indefinitely until the Commission takes final action on the matter.

We also encourage the steps that the Commission has already taken to review its reporting requirements, as outlined in its "Roadmap to Achieve High Quality Swaps Data." We

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47 The Commission has granted time-limited no-action relief from swap reporting requirements for non-U.S. swap dealers established in Australia, Canada, the European Union, Japan or Switzerland and that are not part of an affiliated group in which the ultimate parent entity is a U.S. SD, MSP, bank, financial holding company or BHC, and extended the relief several times. See CFTC No-Action Letter 13-75 (Dec. 20, 2013); CFTC No-Action Letter 14-141 (Nov. 24, 2014) (extending relief under no-action letter 13-75); CFTC No-Action Letter 15-61 (Nov. 9, 2015) (extending relief under no-action letter 14-141); CFTC No-Action Letter 16-79 (Nov. 21, 2016) (extending relief under no-action letter 15-61, such that the relief currently extends until the earlier of (a) 30 days following the issuance of a comparability determination with respect to the reporting rules in the relevant jurisdictions and (b) Dec. 1, 2017).

The CFTC has also provided masking relief for these swaps permitting reporting using "Privacy Law Identifiers" in lieu of counterparty-identifying information. See CFTC No-Action Letters 12-46 (Dec. 7, 2012) and 13-41 (June 28, 2013) (granting time-limited no-action relief permitting counterparties subject to CFTC reporting requirements under Parts 45 and 46 to mask legal entity identifiers, other enumerated identifiers and other identifying terms for swaps with counterparties located in enumerated jurisdictions where reporting such information is subject to statutory or regulatory prohibitions); CFTC No-Action Letter 17-16 (Mar. 10, 2017) (extending relief under no-action letters 12-46 and 13-41). We encourage the Commission to codify this masking relief.

support the Commission's efforts to standardize swap data reporting in the global derivatives markets.

B. Reduce the Extraterritorial Application of Large Trader Reporting Rules

Relevant Rulemaking(s): CFTC Regulations Part 20; No-Action Letter 17-16

The Commission's Part 20 large swap trader reporting rules require an SD to file certain reports and maintain books and records with respect to all of its physical commodity swaps, including reports about the positions of its counterparties. For non-U.S. SDs, these requirements apply to non-U.S. swaps as well. However, the non-U.S. counterparties to these swaps have not taken the steps normally necessary to subject a non-U.S. person to U.S. jurisdiction, such as transacting with a U.S. person or on a U.S. market. Non-U.S. SDs typically must obtain those counterparties' consent to disclose information about them to the Commission, which can be confusing to these counterparties because they lack any meaningful nexus to the United States. Also, in some instances local blocking, privacy or secrecy laws prohibit such disclosure even in the presence of consent.

To address these issues, the Commission should amend its Part 20 rules to permit non-U.S. SDs to exclude non-U.S. counterparties from counterparty-specific reporting requirements or, at a minimum, allow non-U.S. SDs to report "Privacy Law Identifiers" in lieu of counterparty-identifying information for all such counterparties.[48]

C. Clarify Reporting Requirements for Prime Brokerage Transactions

Relevant Rulemaking(s): CFTC Regulations Part 43; No-Action Letter 12-53

Prime brokerage arrangements permit a counterparty to diversify its liquidity sources by trading with multiple executing dealers on behalf of a single prime broker (subject to risk limits established by the prime broker), with that prime broker entering into a back-to-back swap (the "Counterparty Mirror Swap") with that counterparty if it gives up a swap it executed with an executing broker on behalf of the prime broker (the "ED-PB Swap"). These arrangements raised questions in connection with the Commission's reporting rules because the Counterparty Mirror Swap does not reflect current market prices at the time the PB enters into it with the counterparty, but rather is priced based on the price the counterparty previously negotiated with the executing dealer for the ED-PB Swap.

Commission staff previously clarified this issue through No-Action Letter 12-53,[49] which provided time-limited relief from Part 43 real-time public reporting requirements for the Counterparty Mirror Swap. That letter subsequently expired, however. The Commission should now clarify that Part 43 does not apply to Counterparty Mirror Swaps since they are not price-forming transactions. In conjunction with this clarification, the Commission

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[48] The Commission should also codify No-Action Letter 17-16's masking relief for counterparties subject to blocking, privacy or secrecy laws, including counterparties to U.S. SDs.

[49] CFTC No-Action Letter 12-53 (Dec. 17, 2012).

should also work with non-U.S. SDs taking part in prime brokerage arrangements to clarify how its reporting rules apply to cross-border prime brokerage transactions.

IV. Clearing and Trading Requirements

A. Codify Existing No-Action Relief Regarding the Inter-Affiliate Clearing Exemption

Relevant Rulemaking(s): CFTC Rule 50.52; No-Action Letters 16-81 and 16-84

The Commission has adopted a rule exempting inter-affiliate swaps from the Commission's mandatory clearing requirements, so long as certain conditions are met.[50] One of these conditions requires affiliates claiming the inter-affiliate clearing exemption to clear any swaps with unaffiliated third-parties or comply with an exemption from clearing with respect to that outward-facing swap (the "Outward-Facing Swaps Condition").[51] The Commission initially adopted the Outward-Facing Swaps Condition to address concerns that inter-affiliate swaps involving non-U.S. affiliates could be used to evade the Commission's clearing requirement.[52]

So far, however, the Commission has not applied the Outward-Facing Swaps Condition. Instead, Commission staff have issued a series of no-action letters permitting market participants to exchange variation margin for their inter-affiliate swaps in lieu of satisfying the Outward-Facing Swaps Condition.[53] This relief has been necessary because, even though several foreign jurisdictions have adopted their own clearing requirements, the Commission has not yet issued comparability determinations relating to mandatory clearing. For jurisdictions that have not yet adopted clearing requirements, the relief also permits a U.S. affiliate to rely on this variation margin alternative so long as its swaps with affiliates in those jurisdictions that are covered by the Commission's clearing requirement do not exceed five percent of all its swaps covered by the Commission's clearing requirement.[54]

This variation margin alternative has proven to be effective in mitigating the risks posed by inter-affiliate swaps to the U.S. In addition, the Outward-Facing Swaps Condition is

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50 CFTC Rule 50.52.

51 CFTC Rule 50.52(b)(4).

52 78 Fed. Reg. 21749, 21762 (Apr. 11, 2013).

53 See CFTC No-Action Letter 14-25 (Mar. 6, 2014); CFTC No-Action Letter 14-135 (Nov. 7, 2014) (extending relief under no-action letter 14-25); CFTC No-Action Letter 15-63 (Nov. 17, 2015) (extending relief under no-action letter 14-135); CFTC No-Action Letter 16-81 (Nov. 28, 2016) (extending relief under no-action letter 15-63, such that the relief currently extends until the earlier of (i) December 31, 2017; and (ii) with respect to a particular jurisdiction, 60 days after the date on which the Commission announces that it has made a comparability determination described in CFTC Rule 50.52(b)(4)(i)); CFTC No-Action Letter 16-84 (Dec. 15, 2016) (extending the relief in no-action letter 16-81 to eligible affiliate counterparties located in Australia and Mexico).

54 Currently, this five percent limit applies to foreign affiliates located outside Australia, the EU, Japan, Mexico and Singapore.

not necessary to address the Commission's anti-evasion concerns. The vast majority of inter-affiliate swaps activity is done for legitimate risk management purposes, and the inter-affiliate clearing exemption already requires that exempt swaps be subject to a centralized risk management program. The Commission has broad anti-evasion powers and should target specific troubling trading patterns it identifies in the market rather than curb inter-affiliate swaps in general. The Commission's concerns should also be mitigated by the increasing number of jurisdictions implementing clearing requirements.

The Commission's current approach of extending the variation margin alternative to the Outward-Facing Swaps Condition through no-action letters creates uncertainty for market participants. In addition, affiliates located in jurisdictions that have already implemented clearing requirements remain subject to the five-percent limit until the Commission staff issues a no-action position stating that the five-percent limit does not apply. For example, certain foreign jurisdictions, such as Canada, have now adopted clearing requirements and thus, swaps with affiliates located in those jurisdictions should not be subject to the five-percent limit.

To address these concerns, the Commission should codify existing relief from the Outward-Facing Swaps Condition to the inter-affiliate clearing exemption without a time-limit. The Commission should also provide that if a jurisdiction adopts a clearing requirement, market participants can presume that the five-percent limit does not apply to swaps with affiliates located in that jurisdiction unless the Commission specifically determines otherwise. In the interim, Commission staff should extend their current no-action position indefinitely until the Commission takes final action on the matter.

B. Codify Existing No-Action Relief from Mandatory Trading for Inter-Affiliate Swaps

Relevant Rulemaking(s): CEA Section 2(h)(8); No-Action Letter 16-80

CFTC Rule 50.52 provides that if an inter-affiliate swap satisfies the conditions to be excluded from the mandatory clearing requirement, the swap is also exempt from the mandatory trading requirement, but inter-affiliate swaps that do not satisfy the conditions remain subject to the mandatory trading requirement. Commission staff have, however, issued a series of time-limited no-action letters excluding all inter-affiliate swaps from the mandatory trading requirement, recognizing that that requirement is not appropriate for inter-affiliate swaps, which are entered into to manage internal risk.[55] The Commission should codify this relief and, in the interim, Commission should extend their no-action position indefinitely until the Commission takes final action on the matter.

[55] See CFTC No-Action Letter 14-26 (Mar. 6, 2014); CFTC No-Action Letter 14-136 (Nov. 7, 2014) (extending relief under no-action letter 14-26); CFTC No-Action Letter 15-62 (Nov. 17, 2015) (extending relief under no-action letter 14-136) CFTC No-Action Letter 16-80 (Nov. 28, 2016) (extending relief under no-action letter 15-62, such that the relief currently extends until December 31, 2017).

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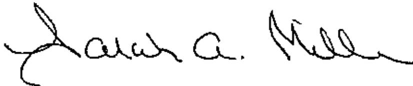
The Institute appreciates the consideration of these matters by the Commission. Please do not hesitate to contact the undersigned at (212) 421-1611 with any questions regarding this letter.

Respectfully submitted,



Sarah A. Miller
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Appendix A

INSTITUTE MAY 15, 2017 COMMENT LETTER ON
CAPITAL REQUIREMENTS OF SWAP DEALERS

INSTITUTE OF INTERNATIONAL BANKERS

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May 15, 2017

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

Re: Capital Requirements of Swap Dealers and Major Swap Participants, RIN 3038-AD54

Secretary Kirkpatrick:

The Institute of International Bankers (the "Institute") welcomes the opportunity to provide comments to the Commodity Futures Trading Commission (the "Commission") in response to the above-captioned proposal (the "Proposed Rule")[1] regarding (i) capital and liquidity requirements for swap dealers ("SDs") and major swap participants ("MSPs" and together with SDs, "Swap Entities") that are not subject to capital rules of a Prudential Regulator[2] ("nonbank Swap Entities") and (ii) financial recordkeeping and reporting requirements for (a) nonbank Swap Entities and (b) Swap Entities that are subject to capital rules of a Prudential Regulator ("bank Swap Entities").

We appreciate the Commission's efforts to leverage parallel requirements from other regulators in developing the Proposed Rule. Given the extent to which Swap Entities are, or will be, subject to overlapping oversight by multiple regulators, this approach will help reduce unnecessary regulatory burdens. We are particularly supportive of the Commission's decision to permit an SD organized and domiciled outside the U.S. (a "non-U.S. SD") to substitute compliance with comparable home country requirements.

In our comments below, we recommend additional steps the Commission should take to enhance and clarify the Proposed Rule's substituted compliance regime. We also recommend steps the Commission should take to clarify and streamline the Proposed Rule's

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1 81 Fed. Reg. 91,252 (Dec. 16, 2016).

2 The Prudential Regulators are the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency and the Farm Credit Administration.

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

financial reporting requirements, particularly for non-U.S. SDs. We further recommend that the Commission clarify the overall treatment of foreign bank SDs that do not operate a U.S. branch. Finally, we set forth a compliance schedule designed to address the considerations described in this letter.

I. Substituted Compliance

A. Capital and Liquidity Requirements

The Proposed Rule would permit a non-U.S. SD to substitute compliance with comparable home country capital requirements for compliance with the Commission's capital and liquidity requirements.[3] To qualify for substituted compliance, a non-U.S. SD's home country jurisdiction would need to receive a Comparability Determination from the Commission, based on consistency with Basel capital standards for banking institutions, among other factors.[4]

As noted above, we support the Commission's proposal to permit substituted compliance with comparable home country capital requirements. We recommend that the Commission enhance and clarify this substituted compliance regime as follows:

- A non-U.S. SD should automatically qualify for substituted compliance if it is subject to Basel-compliant home country capital requirements administered by a regulatory authority that is either: (1) in a G20 jurisdiction; or (2) a member of the Basel Committee on Banking Supervision ("BCBS") or the Board of the International Organization of Securities Commissions ("IOSCO"). This approach would be consistent with the approach taken by the Federal Reserve in applying capital requirements to foreign bank Swap Entities.[5] Also, any such Basel-compliant capital requirement would necessarily be comparable in scope, objectives and outcomes to the Commission's capital requirements, since the Commission's requirements incorporate the Federal Reserve's own Basel-compliant capital requirements. Regulators who are located in G20 jurisdictions or who are members of the BCBS or the Board of IOSCO also generally have comparable supervisory and enforcement authority. Finally, this approach would reduce the strain on Commission resources associated with reviewing Comparability Determination requests, which will be particularly helpful in light of the resources that will be necessary to coordinate with the National Futures Association ("NFA") in reviewing and approving U.S. SDs' internal capital models.

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3 *See* Proposed Rule, § 23.101(a)(5).

4 *See* Proposed Rule, § 23.106(a)(3).

5 *See* 12 C.F.R. § 237.12(c) (requiring a Swap Entity that is a foreign banking organization to comply with the Federal Reserve's Regulation Y (12 C.F.R. § 225.2(r)(3)), under which a foreign banking organization whose home country supervisor has adopted Basel-compliant capital standards may calculate its capital ratios under the home country standard).

- To further reduce the burden on the Commission, the NFA and SDs, the Commission should automatically approve an SD's internal capital models if those models have already been approved by another appropriate regulator, including the consolidated supervisor of the SD's ultimate parent holding company.[6] For example, the Commission should automatically approve the internal capital models of a U.S. SD that is part of a foreign holding company group subject to consolidated supervision by a non-U.S. regulator meeting the criteria described above if that regulator has already approved use of those models by the U.S. SD's foreign parent.

- In recognition of the fact that international Basel III capital standards incorporate a liquidity coverage ratio requirement,[7] a non-U.S. SD that qualifies for substituted compliance with the Commission's capital requirements should also qualify for substituted compliance with the Commission's liquidity requirements and equity withdrawal restrictions. Such an approach would avoid application of duplicative liquidity requirements to non-U.S. SDs. This approach would also be consistent with the fact that these requirements and restrictions are intended to work in tandem with capital requirements as part of a holistic approach to managing the risks and financial resources of an SD.

B. Financial Recordkeeping and Reporting Requirements

The Proposed Rule would permit a non-U.S., nonbank Swap Entity subject to comparable home country financial reporting requirements to file with the Commission monthly financial reports and/or annual financial reports prepared in accordance with home country rules in lieu of the reports required under the Commission's rules.[8] To qualify for such substituted compliance, a non-U.S. Swap Entity's home country jurisdiction would need to receive a Comparability Determination from the Commission, as described above.[9]

We also support this aspect of the Proposed Rule, but we believe the following additional clarifications and conforming changes are necessary to establish an effective substituted compliance regime for Swap Entity financial reporting:

- Non-U.S., bank Swap Entities should likewise be permitted to qualify for substituted compliance with the quarterly financial reporting requirements applicable to them.[10] This is particularly important because bank financial reporting requirements in foreign

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[6] More detail on this approach is contained in the Institute's July 1, 2011 comment letter to the Commission, which is attached as Appendix A.

[7] *See* Basel Committee on Banking Supervision, *Basel III: The Liquidity Coverage Ratio and liquidity monitoring tools* (Jan. 2013), *available at* http://www.bis.org/publ/bcbs238.pdf.

[8] *See* Proposed Rule, § 23.105(o).

[9] *See* Proposed Rule, § 23.106.

[10] *See* Proposed Rule, § 23.105(p)(2).

jurisdictions may not necessarily be the same as the U.S. "call reports" that served as the basis for the Commission's financial reporting requirements for bank Swap Entities, even if they convey similar information. Requiring non-U.S. bank Swap Entities to fulfill U.S. financial reporting requirements would accordingly impose significant additional costs, with little to no regulatory benefit.[11]

- Other aspects of the Commission's financial reporting requirements, including requirements relating to financial books and records,[12] a change in a Swap Entity's fiscal year-end,[13] extensions of time to file financial reports[14] and public disclosures of financial information,[15] should also be eligible for substituted compliance. Otherwise, non-U.S. Swap Entities could not effectively rely on the internal systems, processes and procedures that underlie home country financial reports, even though they qualify for substituted compliance in connection with the content of the reports they file with the Commission.

- The Commission should clarify that a non-U.S., nonbank SD that qualifies for substituted compliance with capital and liquidity requirements can, in connection with notice requirements referencing Commission minimum capital or liquidity requirements,[16] instead refer to its home country capital or liquidity requirements.[17]

II. Additional Comments on Financial Reporting Requirements

A. Position and Margin Reports

In addition to the monthly, quarterly and annual financial reports discussed above, the Proposed Rule would require Swap Entities to file certain reports regarding their positions and margin. Specifically, a nonbank SD would be required to file monthly reports regarding its

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11 Given the burdens of complying with U.S. financial reporting requirements for non-U.S., bank Swap Entities, we encourage the Commission to facilitate substituted compliance in a timely manner. If a non-U.S., bank Swap Entity is not eligible for substituted compliance for these requirements or is unable to obtain a Comparability Determination prior to the rule's compliance date, the Commission should discuss with the Institute and its members how to tailor any ensuing U.S. financial reporting requirements so they appropriately take into account the different circumstances faced by foreign banks as distinct from domestic banks.

12 Proposed Rule, § 23.105(b).

13 Proposed Rule, § 23.105(g).

14 Proposed Rule, § 23.105(j).

15 Proposed Rules, §§ 23.105(i) and (p)(7).

16 *See* Proposed Rule, § 23.105(c).

17 Similarly, if a non-U.S., nonbank SD qualifies for substituted compliance with margin requirements, it should be permitted to refer to its home country margin requirements in lieu of Commission margin requirements for purposes of Commission notice requirements that reference compliance with margin requirements.

swap and security-based swap positions,[18] a bank SD would be required to file quarterly reports regarding its swap and security-based swap positions,[19] and both bank and nonbank SDs alike would be required to file weekly position and margin reports.[20]

Certain of these requirements are duplicative of the Commission's existing reporting requirements for SDs under Part 45. In particular, SDs are already required to report each uncleared swap that they enter into to a swap data repository[21] and keep position information current at all times.[22] Because this information is already available to the Commission, it should eliminate the independent requirement for SDs to file weekly position reports.

If the Commission retains position and margin reporting requirements, we recommend that the Commission clarify and modify these requirements as follows:

- A non-U.S. SD should, when subject to comparable home country financial reporting requirements, be eligible for substituted compliance for these position and margin reporting requirements, just as it would be for other financial reporting requirements. When making a comparability determination for financial reporting requirements, the Commission should use a holistic, outcomes-based approach that takes into account all financial reporting requirements applicable to an SD under home country rules.

- To the extent it does not qualify for substituted compliance with position or margin reporting requirements, a non-U.S. SD that is either a bank SD or qualifies for substituted compliance with capital requirements should not be required to file position or margin information regarding (i) cleared transactions with a non-U.S. clearing organization that is not registered with the Commission or the Securities and Exchange Commission ("SEC") or (ii) uncleared transactions with counterparties that are not subject to U.S. margin requirements.[23] In light of the limited nexus that these transactions have to the U.S., requiring non-U.S. SDs to report this information would likely impose costs that exceed their regulatory benefits. Tailoring these reports to exclude these transactions would help align the scope of position and margin reports with the scope of other risk-based regulations adopted by the Commission under Title VII of the Dodd-Frank Act.

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18 *See* Proposed Rule, § 23.105(l).

19 *See* Schedule 1 to Appendix B to Proposed Rule, § 23.105.

20 *See* Proposed Rule, § 23.105(q).

21 17 C.F.R. § 45.3(c).

22 17 C.F.R. § 45.4.

23 For example, a non-U.S., nonbank SD that qualifies for substituted compliance with capital requirements and that is neither a Foreign Consolidated Subsidiary nor guaranteed by a U.S. person should not be required to file position or margin reports relating to its uncleared swaps with a non-U.S. counterparty that is not a Foreign Consolidated Subsidiary or guaranteed by a U.S. person.

- Where margin reporting requirements do apply, the Commission should confirm that the reports are to reflect the extent to which a Swap Entity margins its uncleared swaps on a portfolio basis with uncleared security-based swaps and any other uncleared derivatives, whether in accordance with Commission no-action relief,[24] the Prudential Regulators' margin rules, or home country margin requirements that the Commission or the Prudential Regulators have determined to be comparable.

- The Commission should incorporate any position and margin reporting requirements into its existing regulatory reporting regime under Part 45, instead of as new requirements under Part 23. These reports, like the requirements of Part 45, are intended to facilitate market monitoring and market risk mitigation.[25] Because SDs would be required to report on a position-by-position basis, they will also need to inform their counterparties of the new requirements and obtain their consent to report information. By including similar reporting obligations in a single rule, the Commission will facilitate this aspect of compliance. We also note that existing industry-wide efforts to notify counterparties about the Commission's reporting requirements direct counterparties to Part 45.[26]

B. Public Disclosures

The Proposed Rule would require a Swap Entity to publish information regarding its financial condition, level of regulatory capital and minimum capital requirements, on a quarterly and annual basis.[27] As noted above, these requirements should potentially be eligible for substituted compliance.

In addition, we recommend that the Commission solely require annual reporting requirements for Swap Entities that are not otherwise required by a Prudential Regulator, home country regulator, or for securities law disclosure purposes to make quarterly public financial disclosures. Relying on annual public financial disclosures would be consistent with the approach currently taken by the Commission for futures commission merchants, as well as the approach currently taken by the SEC for foreign private issuers that have registered their securities under the Securities Exchange Act of 1934 (the "Exchange Act") or are subject to Exchange Act reporting requirements. Relatedly, to avoid conflicts with the U.S. securities laws, the Commission should permit a Swap Entity that is subject to such SEC annual financial reporting and disclosure requirements to comply with those requirements in lieu of the Commission's public financial disclosure requirements for Swap Entities.

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24 *See* Letter No. 16-71 (Aug. 23, 2016).

25 *See* 77 Fed. Reg. 2136, 2138 (Jan. 13, 2012).

26 *See* ISDA August 2012 DF Supplement, Schedule 2.

27 *See* Proposed Rules, §§ 23.105(i) and (p)(7).

III. Treatment of Foreign Bank SDs that Do Not Operate a U.S. Branch

We note that the Federal Reserve declined to adopt minimum capital requirements for a Swap Entity that is a foreign bank that does not operate an insured branch but is not otherwise a "foreign banking organization" as defined in the Federal Reserve's regulations. Currently, these Swap Entities are all located in Basel-compliant jurisdictions. Nonetheless, the Federal Reserve remains the Prudential Regulator for these Swap Entities, and the Federal Reserve's capital and margin regulations apply to them.[28] As drafted, the Proposed Rule could be read to suggest that these Swap Entities are instead subject to the Commission's capital rules because they are not "subject to minimum capital requirements established by the rules or regulations of a [Prudential Regulator]."[29] We do not believe that the Commission intended the Proposed Rule to be read this way because the Federal Reserve retains sole authority to adopt minimum capital rules for such entities. This same ambiguity applies to the proposed financial recordkeeping and reporting requirements applicable to nonbank Swap Entities.[30] Accordingly, the Commission should revise its capital, liquidity, and financial recordkeeping and reporting requirements for nonbank Swap Entities so that they do not apply to a Swap Entity that has a Prudential Regulator.

IV. Compliance Timeline

Significant time and effort will be necessary for the Commission, NFA and SDs to implement the proposed capital framework. SDs will need time to comply with the administrative requirements of the Proposed Rule, such as applying for Commission or NFA approval of their internal capital models (or developing such models if the SDs do not already have them) and applying for a Comparability Determination in the case of non-U.S. SDs seeking to rely on substituted compliance. The Commission and the NFA will likewise need time to review internal capital models and make Comparability Determinations. Even if the Commission adopts the streamlined approach to internal capital model approval and substituted compliance that we recommend in this letter, many SDs will still need time to raise additional capital or change the allocation of capital within their corporate groups and to develop and implement robust compliance and reporting programs. The Commission's proposal would also impose additional capital requirements for uncollected initial margin on uncleared swaps, even with respect to counterparties that are not yet required to post initial margin under the Commission's margin rules. To ensure that parties retain the benefit of the Commission's margin implementation schedule, the Commission should only impose capital requirements once its margin rules are fully phased in.

In light of these considerations, the Commission's capital rules should not become effective until the latest of: (1) the date after which all initial margin requirements have become

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[28] *See* Commodity Exchange Act § 1a(39)(A)(iii), 12 C.F.R. § 237.2 (definition of "covered swap entity").

[29] Proposed Rule, § 23.101(a)(3).

[30] *See* Proposed Rule, § 23.105(a)(2).

fully effective; (2) three years from the date that the Commission adopts final capital requirements; and (3) three months from the date that the Commission or the NFA has certified that all provisionally approved SDs have been given a reasonable opportunity for model approval.

* * *

The Institute appreciates the consideration of these matters by the Commission. Please do not hesitate to contact the undersigned at (212) 421-1611 with any questions regarding this letter.

Respectfully submitted,

Sarah A. Miller
Chief Executive Officer
Institute of International Bankers

INSTITUTE OF INTERNATIONAL BANKERS

APPENDIX A

INSTITUTE JULY 1, 2011 COMMENT LETTER ON
TITLE VII CAPITAL AND MARGIN PROPOSALS

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July 1, 2011

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Re: Title VII Capital and Margin Proposals

Ladies and Gentlemen:

The Institute of International Bankers appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**") and the Prudential Regulators[1] on their proposals (the "**Proposed Rules**") regarding capital requirements for swap dealers ("**SDs**") and major swap participants ("**MSPs**") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") and margin requirements for uncleared swaps.[2] We support the steps that the Commission and the Prudential Regulators have taken to implement a risk-based approach to capital and margin requirements that makes appropriate use of supervisory resources by leveraging existing regulatory regimes.

[1] In this letter, "Prudential Regulators" refers to the Board of Governors of the Federal Reserve System (the "**Board**"), the Office of the Comptroller of the Currency (the "**OCC**"), the Federal Deposit Insurance Corporation (the "**FDIC**"), the Federal Housing Finance Agency (the "**FHFA**") and the Farm Credit Administration (the "**FCA**").

[2] When used in this letter in the context of the Prudential Regulators' proposal, "swaps" refers to swaps and security-based swaps.

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

In this letter, we respectfully suggest certain modifications to the Proposed Rules designed to further achieve that objective in the cross-border context.[3]

I. Executive Summary

As the Commission and the Prudential Regulators are aware, there are many circumstances under which an entity subject to oversight by a foreign regulator, either directly or on a consolidated basis, might register as an SD or MSP. For instance, many foreign banks conduct swap activities through their U.S. branches or agencies, which under Dodd-Frank will be subject to capital and margin requirements established by the Board (for a state branch or agency) or the OCC (for a Federal branch or agency). Some foreign banks conduct swap activity with U.S. counterparties from branches and offices located outside the U.S.; under Dodd-Frank, those foreign banks will be subject to capital and margin requirements established by the Board. Finally, swap activity is also conducted by (i) foreign non-bank entities subject to direct supervision by a foreign regulator and (ii) U.S. and foreign non-bank subsidiaries of either foreign financial holding companies or foreign banks subject to consolidated prudential supervision (together, "**Foreign-Supervised Non-Bank SDs and MSPs**"). Foreign-Supervised Non-Bank SDs and MSPs, like other non-bank SDs and MSPs, will be subject to capital and margin requirements established by the Commission.

Each of these circumstances presents opportunities for the Commission and the Prudential Regulators to achieve Dodd-Frank's objectives of ensuring the safety and soundness of SDs and MSPs while also leveraging existing regulatory regimes. In this regard, the Institute and its members support the proposal to permit the use of approved models for computing capital and margin requirements and the proposal by the Board to continue its longstanding approach of deference to home country capital standards for SDs and MSPs that are foreign banks subject to comparable prudential supervision and oversight. Consistent with this approach, the international harmonization mandate of Section 752 of Dodd-Frank and the coordination efforts of the G-20 and the Basel Committee, we respectfully suggest the following modifications to the Proposed Rules:[4]

- **Capital**. As noted above, the Commission is responsible under Dodd-Frank for setting capital requirements for non-bank SDs and MSPs. For a Foreign-Supervised Non-Bank

[3] This letter does not address other issues raised by the Proposed Rules, such as those relating to calibration of initial margin levels, netting and risk offsets, segregation requirements, application of margin requirements to end users and foreign sovereigns and documentation requirements for uncleared swaps.

[4] Although the Securities and Exchange Commission ("**SEC**") has not yet proposed capital and margin rules under Title VII of Dodd-Frank, we recommend that the SEC also adopt a similar approach to the one we suggest for the Commission in this letter.

SD or MSP, the Commission should, consistent with the Board's proposal for foreign bank SDs and MSPs, defer to comparable home country capital and related requirements. As part of its comparability determination, the Commission should look to established benchmarks, such as pre-existing evaluations of the foreign regulator's supervisory framework by the Board or whether the foreign regulator administers a capital regime consistent with the Basel Accord.

- *Minimum Capital Requirement*. The Commission should permit a Foreign-Supervised Non-Bank SD or MSP (other than a registered futures commission merchant ("**FCM**")) that is subject to comparable minimum capital requirements in its home country (or whose parent is subject to such requirements) to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission requirements.

- *Market and Credit Risk Charges*. The Commission should permit Foreign-Supervised Non-Bank SDs and MSPs to use internal models for computing market and credit risk charges if those models are subject to approval and assessment by a foreign regulator (including a consolidated holding company group supervisor) whose approval and assessment standards are comparable to U.S. standards (any model subject to such approval and assessment is referred to as a "**Comparable Foreign-Supervised Model**").

- *Financial Recordkeeping and Reporting*. The Commission should permit a Foreign-Supervised Non-Bank SD or MSP subject to comparable financial recordkeeping and reporting requirements in its home country to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission requirements. The Commission and relevant foreign regulator should also, to the extent they have not already done so, establish an appropriate allocation of responsibility for the exercise of examination authority and access to financial, operational, and other supervisory information.

- **Margin**.

    - *Initial Margin Models*. The Commission should permit the use of Comparable Foreign-Supervised Models for computing initial margin requirements for uncleared swaps. Additionally, in approving the use of an internal model for computing initial margin requirements for uncleared swaps by an SD or MSP that is a foreign bank or a state or Federal branch or agency of a foreign bank, the

Prudential Regulators should recognize the supervisory approval of Comparable Foreign-Supervised Models by home country regulators.[5]

- *Extraterritorial Scope*. The Commission should, like the Prudential Regulators, clarify that an uncleared swap between foreign counterparties will not be subject to U.S. margin requirements.[6]
- *Inter-affiliate Swaps*. The Commission and the Prudential Regulators should confirm that uncleared swaps between persons under common ownership will not be subject to margin requirements.
- *Custodial Arrangements*. The Commission and the Prudential Regulators should take a more flexible approach toward the risk of a custodian's insolvency, consistent with the Commission's earlier proposal for addressing legal risk more generally.

II. Discussion

A. Capital Requirements

1. Prudential Regulators' Proposal

As part of the Prudential Regulators' proposal on capital and margin requirements for SDs and MSPs (the "**PR Proposal**"),[7] the Board has proposed to require that an SD or MSP that is a foreign banking organization (as defined in 12 C.F.R. § 211.21(o))[8] or state branch or agency

[5] If, in the future, a foreign regulator adopts margin requirements for uncleared swaps that are comparable to U.S. requirements, then the Commission and the Prudential Regulators should permit a foreign SD or MSP subject to those requirements to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission or Prudential Regulator requirements.

[6] As discussed further below, we believe that this approach should apply to all swaps between foreign counterparties, whether the SD or MSP or its counterparty is ultimately U.S.- or foreign-owned.

[7] Margin and Capital Requirements for Covered Swap Entities, Board Docket No. R-1415, Docket No. OCC-2011-0008, FDIC RIN 3064-AD79, FHFA RIN 2590-AA45, FCA RIN 3052-AC69, 76 Fed. Reg. 27654 (May 11, 2011).

[8] We note that, as a technical matter, the "foreign banking organization" definition would not encompass a foreign bank that does not have U.S. operations. Dodd-Frank's "prudential regulator" definition, however, designates the Board as the Prudential Regulator for both a foreign bank with U.S. operations (under prong (A)(v) of definition, which covers a foreign bank that is treated as a bank holding company under section 8(a) of the International Banking Act of 1978) and a foreign bank not having any U.S. operations (under prong (A)(iii) of the definition, which covers a foreign bank which does not operate an insured branch). Moreover, the Board is best-situated to set and enforce capital and margin requirements for a foreign bank without U.S. operations because of its long experience with foreign banking supervision generally. Accordingly, we recommend that Board also include a

(footnote continued on next page . . .)

of a foreign bank (as defined in 12 U.S.C. §§ 3101(11) and (12)) comply with the capital requirements contained in § 225.2(r)(3) of the Board's Regulation Y.[9] Under § 225.2(r)(3), a foreign bank whose home country supervisor has adopted capital standards consistent with the Basel Accord is required to comply with those home country standards.[10]

We strongly support this proposal, which is consistent with the Board's longstanding framework for supervising the cross-border banking operations of a foreign bank. That framework is based on an understanding that the foreign bank is subject to primary supervision by its home country authority, with the Board, as a host country supervisor, exercising appropriate oversight of the bank's U.S. operations.[11] We believe that the policies underlying this framework, including international comity and the effective and efficient allocation of supervisory responsibilities, are equally applicable to prudential supervision under Title VII as they are to prudential supervision under the U.S. banking laws.

2. CFTC Proposal

The Commission's proposal on capital requirements for non-bank SDs and MSPs (the "**CFTC Capital Proposal**")[12] would require a non-bank SD or MSP that is a subsidiary of a U.S. bank holding company (other than a registered FCM or a U.S. nonbank financial company that has been designated a systemically important financial institution by the Financial Stability Oversight Council) to comply with minimum capital requirements consistent with those that apply to its holding company under Board regulations. The Commission has also proposed to permit such a non-bank SD or MSP that is a subsidiary of a U.S. bank holding company to utilize

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(. . . footnote continued from previous page)

foreign bank (as defined in 12 C.F.R. § 211.21(n)) as a covered swap entity subject to § 237.10(c) of its proposed rules.

[9] Similarly, the OCC has proposed to require an SD or MSP that is a Federal branch or agency of a foreign bank to comply with the capital adequacy guidelines that are applicable as generally provided under 12 C.F.R. § 28.14. Under those standards, the OCC looks to the capital of the foreign bank itself. See 12 C.F.R. § 28.14(a).

[10] If the foreign bank's home country supervisor has not adopted capital standards consistent with the Basel Accord, it must obtain a determination from the Board that its capital is equivalent to the capital that would be required of a U.S. banking organization.

[11] See Federal Reserve Board, "Policy Statement on the Supervision and Regulation of Foreign Banking Organizations" (Feb 23, 1979), Federal Reserve Regulatory Service 4-835; Federal Reserve Board Supervisory Letter SR 08-09 re Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 16, 2008).

[12] Capital Requirements of Swap Dealers and Major Swap Participants, CFTC RIN 3038-AD54, 76 Fed. Reg. 27802 (May 12, 2011).

internal models that have been reviewed and are subject to regular assessment by the Board to compute market and credit risk charges for its swap and related hedging positions. These proposals would apply to both U.S. and foreign subsidiaries of U.S. bank holding companies.

Under the CFTC Capital Proposal, however, a Foreign-Supervised Non-Bank SD or MSP that is not a subsidiary of a U.S. bank holding company would not be permitted to utilize an approach to capital that is equivalent to that proposed to be permitted for subsidiaries of U.S. bank holding companies. In this regard, the Commission has requested comment regarding whether it should permit an SD or MSP to compute market and credit risk charges using internal models subject to approval and assessment by a foreign regulator.[13]

The CFTC Capital Proposal explains that the Commission has determined to defer to the Board's existing capital requirements for subsidiaries of U.S. bank holding companies because doing so would remove incentives for regulatory arbitrage.[14] The Commission also notes that the Board's capital requirements address the full range of swap activity regulated under Dodd-Frank, sufficiently account for credit and market risk exposures, ensure the safety and soundness of the SD or MSP and are appropriate for the risk associated with the uncleared swaps positions of the SD or MSP.[15] The Commission also identifies the current and prospective levels of Commission resources as a factor in its decision to look to model approvals by the Board and the SEC.[16]

Many Foreign-Supervised Non-Bank SDs and MSPs are subject to extensive capital requirements and related supervision by their home country regulator. Foreign financial holding companies, foreign banks, and their respective U.S. and foreign subsidiaries are, in turn, often subject to consolidated capital requirements and related supervision by the consolidated prudential supervisor of the holding company group, as are U.S. bank holding companies. In many cases, both foreign and U.S. financial and bank holding companies use approved internal models for computing capital requirements for multiple trading entities.

We emphasize that the capital requirements for Foreign-Supervised Non-Bank SDs and MSPs and foreign financial holding companies are in many cases the same as for foreign banks. Additionally, in many cases those entities are supervised by the same supervisor that will be responsible for the capital oversight of foreign banks under the PR Proposal.

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[13] Id. at 27818.

[14] Id. at 27806.

[15] Id.

[16] Id. at 27808.

We strongly encourage the Commission to defer to home country capital and related requirements for Foreign-Supervised Non-Bank SDs and MSPs where those requirements are comparable to U.S. requirements. Such deference would have the same benefits as the Commission's proposed approach for subsidiaries of U.S. bank holding companies: avoiding regulatory arbitrage, applying comprehensive requirements that account for risk exposures and meet Dodd-Frank's safety and soundness standard, and making efficient use of Commission resources. It is also necessary to prevent Foreign-Supervised Non-Bank SDs and MSPs (including subsidiaries of both U.S. and foreign financial holding companies) that are already subject to capital requirements in their home countries from becoming subject to duplicative and inconsistent capital requirements under Commission requirements. Moreover, unless the Commission permits Foreign-Supervised Non-Bank SDs and MSPs that are not subsidiaries of U.S. bank holding companies to use Comparable Foreign-Supervised Models, its rules could violate principles of national treatment by providing significant advantages to U.S.-controlled SDs and MSPs based solely on the nationality of their parent entity.

Accordingly, we urge the Commission to permit a Foreign-Supervised Non-Bank SD or MSP (other than a registered FCM) that is directly subject to comparable minimum capital requirements in its home country to comply with those requirements in lieu of U.S. requirements. Additionally, consistent with the Commission's proposal for subsidiaries of U.S. bank holding companies, the Commission should permit a Foreign-Supervised Non-Bank SD or MSP (other than a registered FCM) that is a subsidiary of either a foreign financial holding company or a foreign bank subject to comparable consolidated prudential supervision to comply with the minimum capital requirements of its holding company as though it were the holding company. In either case, a violation of home country requirements should be enforceable by the Commission as a violation of Commission requirements.

The Commission should also permit the use of Comparable Foreign-Supervised Models to compute market and credit risk capital charges. Those models may be approved and assessed by the foreign regulator that directly oversees the Foreign-Supervised Non-Bank SD or MSP, the consolidated prudential supervisor of the foreign financial holding company group, or a regulator that oversees an affiliate of the Foreign-Supervised Non-Bank SD or MSP.

We understand that the Commission may, in light of its current resource constraints, have limited capability to conduct detailed comparability assessments for foreign jurisdictions, at least in the near-term. There are, however, several established benchmarks that the Commission should leverage to make such determinations without overburdening its limited resources.

In reviewing applications by a foreign bank to establish a branch or agency or acquire a commercial lending company or a U.S. bank, the Board, consistent with its overall framework for supervising the U.S. operations of foreign banks, evaluates whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country

supervisor ("**comprehensive consolidated supervision**").[17] We recommend that the Commission regard a Foreign-Supervised Non-Bank SD or MSP's home country capital requirements and model reviews and assessment to be comparable to U.S. requirements if the Foreign-Supervised Non-Bank SD or MSP, or its parent,[18] is subject to supervision or regulation by a foreign regulator that the Board has determined subjects the Foreign-Supervised Non-Bank SD or MSP or its parent to comprehensive consolidated supervision.[19] By taking this approach, the Commission would be leveraging the Board's existing supervisory framework much as it is currently proposing to do for non-bank subsidiaries of U.S. bank holding companies.

Additionally, as the Commission is aware, many foreign securities regulators, like their banking counterparts, apply Basel capital requirements. Those regulators are not, however, subject to assessment by the Board unless they also oversee banks. For Foreign-Supervised Non-Bank SDs and MSPs subject to capital oversight by such non-banking regulators, we urge the Commission, like the Board, to defer to home country minimum capital requirements and model reviews and assessments if the relevant foreign regulator applies capital requirements consistent with the Basel Accord.

Finally, the Commission should permit a Foreign-Supervised Non-Bank SD or MSP subject to comparable financial recordkeeping and reporting in its home country to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements

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[17] See 12 C.F.R. § 211.24(c). In the event that the Board is unable to find that a foreign bank meets this standard, the Board nevertheless may permit the bank to establish a U.S. branch if it determines that "the appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank." See 12 U.S.C. § 3105(d)(6)(A)(i). We recommend that the Commission similarly treat a foreign regulator that the Board has determined satisfies this "working toward" standard as one that the Board has determined administers a regime of comprehensive consolidated supervision.

[18] In cases where the parent of a Foreign-Supervised Non-Bank SD or MSP, but not the Foreign-Supervised Non-Bank SD or MSP itself, is subject to comprehensive consolidated supervision, then we suggest that the Commission take the same approach to the Foreign-Supervised Non-Bank SD or MSP as it is proposing to take for a non-bank subsidiary of a U.S. bank holding company, *i.e.*, the Foreign-Supervised Non-Bank SD or MSP would be (i) subject to the minimum capital requirement applicable to its holding company as though it were the holding company and (ii) permitted to use internal models for computing market and credit risk charges if those models are subject to review and regular assessment by the home country supervisor of the Foreign-Supervised Non-Bank SD's or MSP's holding company.

[19] While the Board's determination under 12 C.F.R. § 211.24(c) is, as a technical matter, made on an institution-by-institution basis, its evaluation of a foreign supervisor's regime is generally consistent across different institutions within a particular jurisdiction regulated by the same supervisor. Accordingly, we believe that the Commission should similarly regard a Foreign-Supervised Non-Bank SD's or MSP's home country capital requirements and model reviews and assessment to be comparable to U.S. requirements if (i) the Board has determined that another entity organized in the same jurisdiction as the Foreign-Supervised Non-Bank SD or MSP or its parent, as applicable, is subject to comprehensive consolidated supervision and (ii) that entity is under substantially the same supervision or regulation as the Foreign-Supervised Non-Bank SD or MSP or its parent.

would be treated as a violation of Commission requirements. This is necessary in order to prevent duplicative and inconsistent requirements, such as requiring a Foreign-Supervised Non-Bank SD or MSP to conduct its accounting under both U.S. GAAP and IFRS.[20]

The Commission and relevant foreign regulator (in coordination with the Board and the OCC, as applicable) should also, to the extent they have not already done so, establish an appropriate allocation of responsibility for the exercise of examination authority and access to financial, operational, and other supervisory information. We note that the Commission has proposed to require that a registered SD or MSP subject to prudential regulation be required, upon request, to provide the Commission with copies of its capital computations and all supporting schedules and other documentation. For a foreign bank SD or MSP, we urge the Commission to obtain this information in coordination with the Board, which has established protocols with foreign regulators for sharing information relating to capital and prudential supervision.

B. Margin Requirements for Uncleared Swaps

1. Calculation of Initial Margin Requirements

The PR Proposal would permit an SD or MSP that is a foreign bank or state or Federal branch or agency of a foreign bank to use internal models for calculating initial margin requirements for uncleared swaps if those models comply with certain requirements and are approved by the Board. The Commission's proposal on margin requirements for uncleared swaps (the "**CFTC Margin Proposal**")[21] would also permit the use of models, but only those models that are (i) currently used by a derivatives clearing organization for margining cleared swaps, (ii) currently used by an entity subject to regular review and assessment by a Prudential Regulator for margining uncleared swaps or (iii) made available for licensing to any market participant by a vendor. Neither proposal addresses models that have been approved by a foreign regulator.

Initial margin is related to capital. Models used to compute the potential market, and resulting credit, risks associated with swap positions must model these risks in a manner that is consistent with the modeling of these risks for capital computation purposes. As a result, it is critical that initial margin and capital requirements be administered within a consistent supervisory framework. This is particularly the case where the same modeling techniques or the same models are used for computing both capital charges and initial margin amounts. In those

[20] As and to the extent necessary, the Commission could require certain accommodations to be made, such as permitting the preparation of English translations and reconciliation from IFRS to U.S. GAAP.

[21] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, CFTC RIN3038-AC97, 76 Fed. Reg. 23732 (April 28, 2011).

circumstances, the same regulator should be responsible for the requirements applicable to, and the review and assessment of, those models for purposes of both capital and margin requirements. The use of different, and separately supervised, models for capital and margin purposes could give rise to unidentified risks or capital inefficiencies.

As a result, while we believe it is appropriate for a U.S. SD or MSP that is a subsidiary of either a foreign financial holding company or a foreign bank to comply with U.S. margin requirements, and for a foreign SD or MSP to do so with respect to its U.S.-facing transactions, we do not believe that either such SD or MSP should be required to use different, separately supervised models for purposes of those requirements than the models it uses for purposes of capital requirements.[22]

Additionally, the review and assessment of initial margin models will undoubtedly present substantial logistical challenges for the Prudential Regulators, the Commission, the SEC and SDs and MSPS generally. In particular, within roughly the same period prior to effectiveness of the Proposed Rules, a large number of SDs and MSPs will seek to obtain approval of their internal models. Recognition of Comparable Foreign-Supervised Models would significantly increase the efficiency of that process.

Accordingly, we recommend that the Board and the OCC, in approving an initial margin model for an SD or MSP that is (i) a foreign bank or state or Federal branch or agency of a foreign bank and (ii) permitted to compute its capital in accordance with home country capital requirements, give recognition to the approval of that model by the home country regulator. Similarly, for a Foreign-Supervised Non-Bank SD or MSP permitted to comply with its home country capital requirements (or those of its consolidated holding company group) under the proposal described in Part II.A.2 above, the Commission should give recognition to the home country regulator's or consolidated prudential supervisor's approval of an initial margin model. In cases where an SD or MSP seeks to use a Comparable Foreign-Supervised Model that has been approved by the regulator of an affiliate of the SD or MSP, the Board, the OCC or the Commission (as applicable) should also give recognition to that regulator's approval.

There may also be circumstances, at least initially, where foreign regulators are not yet in a position to approve initial margin models for uncleared swaps because, for instance, margin requirements are not yet in effect in the relevant jurisdiction. In those cases, we would expect the Board and the OCC to assess and approve the initial margin model directly (and for the Commission to do the same for non-bank SDs and MSPs once it has the resources to do so). At the same time, we recognize that the Board's and the OCC's resources for reviewing and

[22] As noted above, if a foreign regulator adopts margin requirements for uncleared swaps that are comparable to U.S. requirements, then the Commission and the Prudential Regulators should permit a foreign SD or MSP subject to such requirements to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission or Prudential Regulator rules.

approving models will be limited, and that their review and approval process may take longer than the proposed 180-day pre-effective period for those SDs and MSPs with which the Board and the OCC are less familiar or to which the Board and the OCC currently devote less examination resources. As a result, we are concerned about the possibility that the margin requirements will become effective for some SDs and MSPs while the Board's and the OCC's model reviews are still pending, thereby imposing significant competitive disadvantages on those SDs and MSPs by subjecting them to standardized margin requirements that do not take into account portfolio offsets. Accordingly, we urge the Board and the OCC to set the effective date for the margin requirements based on the time that will be needed for the model approval process to be completed for all SDs and MSPs who initially apply, not just those to which the Prudential Regulators already devote significant examination resources.

2. Territorial Scope of Margin Requirements

a. PR Proposal

Under the PR Proposal, all swaps with U.S. counterparties would be subject to U.S. margin rules, but swaps between a foreign SD or MSP and a foreign counterparty would instead be subject to the margin requirements, if any, of the relevant foreign jurisdiction(s).[23] We strongly support this proposal. We also ask that the Prudential Regulators further confirm that this distinction will also apply in cases where U.S.-based personnel employed by a U.S. affiliate separate from the foreign SD or MSP (or the foreign counterparty) are involved, as agents of the foreign SD or MSP (or the foreign counterparty), in soliciting or negotiating with the foreign counterparty (or the foreign SD or MSP), although those personnel would need to comply with U.S. requirements applicable to introducing brokers or securities broker-dealers to the extent that the U.S. affiliate is so registered and those personnel are acting as employees or associated persons of the registered affiliate. We believe that this interpretation is consistent with the safety and soundness objectives of margin requirements under Dodd-Frank, since the location(s) of agent(s) involved in negotiating a transaction is wholly irrelevant to the transaction's effect on the SD or MSP's safety and soundness.

Additionally, we note that the PR Proposal would distinguish between U.S. and foreign-controlled firms – with U.S. firms' non-U.S. operations subject to U.S. margin rules and foreign-controlled firms subject to rules of the applicable foreign jurisdiction. We believe, however,

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[23] We also note that many global banks conduct their trading activities through multi-branch master netting agreements. In such cases, we believe that netting effects from foreign transactions not subject to U.S. rules should be recognized when computing margin requirements for U.S.-covered transactions so long as those netting effects are legally enforceable. So, when a foreign SD or MSP has a swap with the U.S. branch of a global bank, on the one hand, and also an offsetting swap with a foreign branch of that bank, on the other hand, the foreign SD or MSP should be permitted to recognize that offset for purposes of calculating the amount of initial margin required for the swap with the U.S. branch, so long as both swaps are subject to the same enforceable netting agreement.

that all transactions entered into between foreign counterparties, regardless of whether conducted by a U.S. firm's foreign operation or by a foreign-controlled firm, should be subject to primary supervision by foreign regulators, not U.S. regulators. This approach is consistent with the territorial application of law (as embodied in Sections 722(d) and 772(b) of Dodd-Frank),[24] and expectations of market participants. Both foreign-controlled firms and the foreign operations of U.S. firms currently conduct business abroad subject to foreign regulation; such activity is due to the global character of financial markets and is not inherently evasive. The application of Dodd-Frank to any such foreign activity could lead to reciprocal extraterritorial application of financial regulation by foreign regulators to U.S. activities.[25]

b. CFTC Margin Proposal

Unlike the Prudential Regulators, the Commission has not proposed a distinction in the CFTC Margin Proposal between foreign and U.S. transactions, just as it has not generally addressed the extraterritorial application of its rules. In this regard, we very strongly urge the Commission also to distinguish, for a foreign SD or MSP (whether ultimately U.S. or non-U.S. owned), between swaps with U.S. versus foreign counterparties. Without clarity on the boundaries of the Commission's margin proposal, it will be impossible for SDs and MSPs to implement the proposal.

Distinguishing between transactions by a foreign SD based on the nationality of its counterparty would be consistent with Congress' intent to authorize the Commission and the SEC to designate and regulate persons as SDs for limited purposes. Specifically, Dodd-Frank's SD definition provides that a "person may be designated as a swap dealer for a single type or single class or category of . . . activities and considered not to be a swap dealer for other types, classes, or categories of . . . activities" (emphases added).[26] Accordingly, in circumstances where it is appropriate to require SD registration, the Commission should designate and regulate a foreign person as an SD only with respect to its execution of swaps from within the U.S. or

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[24] We note that the Supreme Court has recently interpreted language very similar to 722(d) (in the 2004 Empagran decision) and 772(b) (in the 2010 Morrison decision) and affirmed that, under long-established canons against the extraterritorial application of U.S. law, the relevant language should be interpreted generally to limit U.S. jurisdiction, with language that would apply U.S. law extraterritorially interpreted narrowly. See F. Hoffman-La Roche Ltd v. Empagran S.A., 524 U.S. 155 (2004) and Morrison v. National Australia Bank, 130 S. Ct. 2869 (2010); see also United States v. Philip Morris USA Inc., 2011 U.S. Dist. LEXIS 32053 (D.D.C., Mar. 28, 2011) (noting that the Supreme Court in Morrison "intended the presumption against extraterritoriality to apply to all statutes, not simple the Exchange Act").

[25] Additionally, distinguishing between counterparties based on whether they are controlled by a U.S. person poses significant practical difficulties, since margin requirements must largely be implemented in real time through automated systems that are not conducive to facts-and-circumstances determinations and the PR Proposal does not contain a clear, bright-line test (or any test) for "control."

[26] See § 1a(49)(B) of the CEA, as amended by Dodd-Frank.

with U.S. counterparties. This would be consistent with principles of international comity, with the *bona fide* expectations of foreign counterparties, and with the objectives of international regulatory cooperation underpinning Section 752 of Dodd-Frank.

In contrast, applying U.S. margin rules (or other transaction-specific rules) to swaps between foreign counterparties merely because one of those parties is registered in the U.S. as an SD or MSP would strongly discourage participation in the U.S. market by foreign market participants. This is because, under such an approach, any participation in the U.S. market that resulted in a U.S. SD or MSP registration requirement would also result in extraterritorial application of U.S. margin rules or would require U.S. swap activities to be conducted through a separately incorporated U.S. subsidiary. We emphasize that the significant negative impacts on capital, netting and risk management resulting from conducting derivatives trading through multiple U.S. and non-U.S. legal entities would impose significant costs on U.S. customers and foreign SDs and MSPs alike and reduce liquidity available to U.S. market participants generally.

3. Inter-Affiliate Transactions

Neither the PR Proposal nor the CFTC Margin Proposal addresses the application, or non-application, of margin requirements to transactions between entities under common ownership. In this regard, we note that, to centralize risk management, a U.S.-based SD or MSP may use swap transactions to allocate the market risk arising from its swap activities to a foreign affiliate through back-to-back transactions or other similar arrangements. Similarly, a foreign SD or MSP may use swap transactions to allocate the market risk arising from its swap activities to a U.S. affiliate so that personnel employed by that U.S. affiliate can manage that risk. Such arrangements can be used, for instance, so that a global organization's U.S. dollar interest rate portfolio is managed centrally by expert personnel in the U.S. where the greatest liquidity for such product exists, and similarly its non-U.S. dollar interest rate portfolio can be managed centrally by expert personnel of a relevant non-U.S. affiliate.

Application of margin requirements to such transactions would in some instances completely prevent, and in others seriously reduce the efficiency of, those transactions – thereby undermining Dodd-Frank's objective of mitigating systemic risk. It is also unnecessary so long as a U.S.-registered SD or MSP is involved in the transaction, since in such case any outward, U.S.-facing swaps would be subject to U.S. margin requirements. To the extent that the Prudential Regulators or the Commission are concerned about inter-affiliate credit risk, that risk is better addressed through applicable capital rules. Furthermore, Dodd-Frank's expansion of Section 23A of the Federal Reserve Act, which will subject some (but not all) inter-affiliate derivatives transactions to collateralization requirements, strongly suggests that Congress did not intend for Title VII's more generally applicable margin requirements to apply to inter-affiliate transactions, since otherwise Dodd-Frank's amendments to Section 23A would be superfluous.

4. **Custodial Arrangements**

The PR Proposal would require that, for swaps between a bank SD or MSP and another SD or MSP, initial margin be segregated at an independent custodian located in a jurisdiction that applies the "same insolvency regime" to the custodian as would apply to the *posting* bank SD or MSP. The CFTC Margin Proposal would require that, for swaps between a non-bank SD or MSP and another SD or MSP, *both* the initial margin *posted* by that non-bank SD or MSP and the initial margin *received* by that non-bank SD or MSP be segregated at an independent custodian located in a jurisdiction that applies the "same insolvency regime" to the custodian as would apply to the non-bank SD or MSP.

These proposals would result in several significant practical costs and complications. For a swap between a bank SD or MSP and a non-bank SD or MSP, the parties would be faced with inconsistent custodial requirements: the bank SD or MSP would be required to have the collateral it posts held at a bank custodian, and the non-bank SD or MSP would be required to hold that same collateral at a non-bank custodian. Similarly, the CFTC Margin Proposal seems to require that, for a swap between two non-bank SDs or MSPs located in separate jurisdictions, each non-bank SD or MSP would be required to hold the collateral it receives at an independent custodian located in its own jurisdiction, while at the same time the counterparty non-bank SD or MSP posting that same collateral would be required to have that collateral held by an independent custodian located in its own, different jurisdiction. Of course, the same custodian cannot simultaneously be a bank and a non-bank or simultaneously be located in two different jurisdictions.

Moreover, even if these inconsistencies were resolved, any requirement for the use of two different custodians by the parties to the same transaction would result in unnecessary increased costs and operational complexities and risks. In many cases, such a requirement would also disrupt existing swap trading relationships with different custodial arrangements. The further requirement for the use of unaffiliated custodians would, in turn, result in increased concentration of custodial assets at a handful of institutions – thereby further increasing risks – and reduced competition among custodians – thereby further increasing costs.

While we agree that SDs and MSPs should take steps to mitigate legal risks associated with the insolvency regime of their custodians, we believe that a more flexible approach can address this objective without giving rise to the unintended consequences noted above. In this regard, we note that the Commission has already proposed to require SDs and MSPs, as part of their risk management program, to adopt policies and procedures to mitigate legal risk.[27] We recommend that the Prudential Regulators and the Commission adopt a similar requirement that SDs and MSPs establish, maintain, and enforce policies and procedures reasonably designed to

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[27] See Regulation Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, CFTC RIN 3038-AC96, 75 Fed. Reg. 71397 (Nov. 23, 2010).

assess the legal risks associated with their custodial relationships. This requirement would address the legal risks identified by the Prudential Regulators and the Commission while also recognizing that the nature of that legal risk, and the trade-offs with reputational, credit and other risks, can vary depending on specific facts and circumstances. It also would not raise the unintended consequences of the more rigid requirements contained in the Proposed Rules.[28]

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The Institute appreciates the opportunity to submit these comments in connection with the Proposed Rules. Please do not hesitate to contact the undersigned at (212) 421-1611 with any questions or if we can be of assistance to the Commissions.

Sincerely,

Sarah A. Miller
Chief Executive Officer

cc: Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

[28] If, however, the Prudential Regulators and the Commission believe it to be necessary to place more prescriptive requirements on the identities of custodians used by SDs and MSPs, then we urge the Prudential Regulators and the Commission to adopt the following recommendations: (i) an unaffiliated custodian should not be required, (ii) the custodian should not be required to be in the same insolvency jurisdiction as the SD or MSP and (iii) if a specific insolvency jurisdiction is required, then it should be the insolvency jurisdiction of the SD or MSP receiving the collateral.