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September 20, 2011

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Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
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Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Office of the Comptroller of the Currency
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Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, N.W.
Washington, DC 20552

Gary K. Van Meter, Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102

Re: International Issues Relating to Title VII of Dodd-Frank

Ladies and Gentlemen:

This letter is submitted, on behalf of the undersigned U.S.- and internationally-based firms (the "Firms"), in response to the request for comments from the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission (the "SEC" and, together with the CFTC, the "Commissions") regarding international issues relating to the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection

Act ("Dodd-Frank")[1] and the Prudential Regulators' proposed rules on capital and margin requirements under Title VII.[2] The Firms welcome the attention of the Commissions and the Prudential Regulators (collectively, the "Agencies") to these important issues and appreciate the opportunity to provide these comments.

Swaps trade in a uniquely global market.[3] Therefore, it is essential that the Agencies provide clear and consistent guidance regarding the territorial application of Title VII well before its registration and other substantive requirements become effective. Many global institutions will find it challenging or impossible to design, test and implement the systems and other consequential changes necessary to comply with those requirements until there is clear and consistent guidance regarding Title VII's territorial application. Such guidance is, as a result, a prerequisite to prompt implementation of Title VII.

SUMMARY OF RECOMMENDATIONS

As discussed in further detail in this letter, we urge the Agencies to adopt a territorial approach to the implementation of Title VII that is consistent with the immediately following summary. This approach is based on the legal analysis, statutory provisions and precedents discussed in Part V of this letter.

- **Definition of U.S. Person.** The Agencies should adopt a consistent definition of "U.S. person" based on SEC Regulation S for purposes of analyzing whether a transaction involving one or more such persons may be subject to the provisions of Dodd-Frank. Under this definition, the non-U.S. branch or affiliate of a U.S. or non-U.S. person would not be a U.S. person; only affiliates or branches located in the U.S. would be covered. Adopting this definition also would provide important clarifications for arrangements involving asset managers and other agents.

- **Swap Dealer and Major Swap Participant ("MSP") Definitions.** The Commissions should make the following clarifications regarding the application of the swap dealer and MSP definitions to non-U.S. activities:

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[1] SEC Release No. 34-64939, File No. 4-636, 76 Fed. Reg. 44507.

[2] 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) (the "Prudential Regulator Capital and Margin Proposal"). In this letter, "Prudential Regulators" refers to the Board of Governors of the Federal Reserve System (the "FRB"), 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").

[3] References to "swaps" herein include "security-based swaps" unless otherwise specified or required by context.

- A non-U.S. person should not be deemed a U.S. swap dealer solely as a result of executing swaps with U.S.-registered swap dealers.

- Subject to the discussion below regarding swaps intermediated by a U.S.-registered swap dealer, the MSP definition for a non-U.S. person should generally be based on whether the credit exposures of unaffiliated U.S. persons (as defined under Regulation S) to it reach the thresholds specified by the Commissions as a result of swaps between the non-U.S. person and those unaffiliated U.S. persons.

- Inter-affiliate swaps should not cause either affiliated party to be deemed a swap dealer or MSP under Title VII.

- The issuance of a guarantee should not subject the guarantor to any registration requirement to which it would not otherwise be subject, and should not affect the applicability of Dodd-Frank to the guaranteed swap activity.

- The Commissions should utilize their limited designation authority under the swap dealer and MSP definitions to require registration of and regulate a financial institution <u>only</u> with respect to the branch(es) or separately identifiable department(s) or division(s) that are engaged in the swap activities that give rise to the U.S. registration requirement (recognizing that certain important regulatory requirements, such as capital adequacy, are entity-wide requirements).

- **Swap Dealer and MSP Registration and Regulation.** The Firms conduct their swap dealing businesses through a variety of structures, based on multiple and in many cases interdependent legal, strategic and business considerations that pre-date Dodd-Frank. In this connection, we urge the Agencies to address the following common cross-border transaction structures. We emphasize that no single one of these structural paradigms would suffice to meet the needs of all market participants. In many cases, individual financial institutions rely on two or more of these paradigms. None is a substitute for any other. Accordingly, it is important that the Agencies not regard these as alternative choices, but rather as alternative paradigms each of which must be addressed by the Agencies.

  - <u>*Non-Intermediated Swap Dealing with U.S. Persons*</u>. If a non-U.S. swap dealer (including a non-U.S. branch or affiliate of a U.S. person) transacts with U.S. persons without intermediation by a U.S.-registered swap dealer, then it should be required to register in the U.S. and Dodd-Frank should apply as follows:

    - The Agencies should permit the non-U.S. swap dealer registrant to comply with Title VII's entity-based rules, such as capital and risk management, through compliance with comparable home country requirements (with comparability determined based on whether the applicable home country entity-wide requirements are reasonably designed to achieve the same policy objectives as otherwise applicable U.S. requirements).

    - Transaction-level requirements should generally apply only to transactions with a U.S. person. References in this letter to "transaction-level requirements" are intended to encompass the margin collection and segregation, external business conduct, confirmation and documentation requirements applicable to swap dealers and MSPs.

  - *Use of U.S. Swap Dealer Intermediaries*. In circumstances where a non-U.S. swap dealer transacts in swaps with U.S. persons through an affiliated U.S.-registered swap dealer (including the U.S. branch or affiliate of the non-U.S. swap dealer) acting as agent, we urge the Agencies to adopt either (a) an approach modeled on the Commissions' existing approaches to the futures and securities markets, under which a non-U.S. swap dealer transacting with U.S. persons would not be subject to U.S. swap dealer or MSP registration if those transactions were intermediated by an affiliated U.S.-registered swap dealer or (b) a limited registration approach under which a non-U.S. swap dealer would be subject to U.S. swap dealer registration and regulation solely with respect to the capital and related prudential requirements relevant to its status as a swap counterparty, which requirements could be satisfied through compliance with comparable home country requirements.

  - *Swap Dealing with Non-U.S. Persons*. However the Agencies implement Dodd-Frank's limited designation provisions, the Agencies should not apply U.S. transaction-level requirements to transactions by a non-U.S. branch, division, department or affiliate with non-U.S. persons. Furthermore, consistent with the application of U.S. transaction-level requirements to swaps by a non-U.S. swap dealer with a U.S. person, as recommended above, a U.S. swap dealer (including the U.S. branch or affiliate of a non-U.S. person) that executes a swap with a non-U.S. person should be permitted, subject to appropriate disclosure, to comply with the transaction-level requirements of the jurisdiction in which its non-U.S. counterparty is domiciled. The U.S. swap dealer would remain subject to U.S. capital and other entity-level requirements, and exsiting and proposed capital requirements take into account discrepencies in the credit risk presented by outstanding swap transactions and the value of collateral held to secure those transactions.

- **Clearing, Trading and Reporting Requirements.** Dodd-Frank's clearing and trading requirements should apply to any swap designated for mandatory clearing by the relevant Commission if that swap has at least one U.S. person as a counterparty. Dodd-Frank's reporting requirements should apply to any transaction that has at least one counterparty that is a U.S. person or was cleared through a registered clearing organization having its principal place of business in the U.S. However, in each case, the Commissions should facilitate access to non-U.S. clearing organizations, swap execution facilities ("SEFs") and swap data repositories ("SDRs") by U.S. persons and access to U.S. clearing organizations, SEFs and SDRs by non-U.S. persons, as discussed in further detail below.

BACKGROUND

Non-U.S. firms have conducted swap activities with U.S. persons and U.S. firms have conducted swap activities with non-U.S. persons for many years, including through non-U.S. branches and affiliates. Although swap-specific regulation is largely new in the U.S. under Dodd-Frank, this is not the case for many non-U.S. jurisdictions. Many non-U.S. jurisdictions have regulated swap dealers, including non-U.S. branches and affiliates of U.S. and non-U.S. firms, for years under regimes governing market professionals. As the Agencies are aware, G-20 and other jurisdictions are also working to supplement their existing regulatory regimes to incorporate derivatives-related clearing and market transparency reforms to achieve regulatory objectives similar to those of Dodd-Frank.

To assist the Agencies in accomplishing Dodd-Frank's objectives in the context of a global market, Congress mandated that the Agencies seek international harmonization with their non-U.S. counterparts.[4] Congress also gave the Commissions, in consultation with the Department of the Treasury, broad authority to exclude from U.S. markets non-U.S. market professionals whose lax regulation is determined to undermine U.S. financial stability.[5]

At the same time, Congress expressly codified in Sections 722 and 772 of Dodd-Frank conventional territorial limitations to the scope of Title VII, consistent with the territorial scope of existing futures and securities regulations and, importantly, with well-established principles of international jurisprudence. Nothing in Dodd-Frank or the legislative record supports the conclusion that the conduct of otherwise *bona fide* derivatives activities by U.S. or non-U.S. persons (or their affiliates or branches) from outside, rather than from within, the U.S., would alone constitute the basis for the application of Title VII to those activities.

The Agencies should not adopt an extraterritorial regulatory framework premised on the assumption that activities conducted outside the U.S. will be undertaken abroad for the purpose of evasion. An attempt by the Agencies to anticipate and foreclose all possible forms of evasion through extraterritorial application of U.S. law will, in addition to the enormous costs it will impose on the Agencies and the affected firms, give rise to adverse, unintended, and in some cases, unpredictable consequences. Without understanding the specific circumstances that may be regarded as an evasion of Dodd-Frank, it is not possible for the Agencies to conduct the analysis they are statutorily required to undertake of the problems presented by the specific

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[4] Section 752 of Dodd-Frank.

[5] Section 715 of Dodd-Frank.

conduct and the costs and benefits of the imposition of a duplicative layer of U.S. law in an effort to address those problems. The Agencies should, accordingly, exercise their anti-evasion authority in response to evidence of evasion, and not in anticipation of evasion based on abstract conceptual concerns that lack empirical basis or definition.

A more complete discussion of the legal analysis, statutory provisions and precedents applicable is contained in Part V of this letter.

DISCUSSION

I. Definition of "U.S. Person"

A. *In General*

To facilitate compliance with and timely implementation of Dodd-Frank, we recommend that the Agencies codify a definition of "U.S. person." The "U.S. person" definition is necessary to analyze the extent to which Dodd-Frank is or is not applicable to a transaction involving one or more such persons. Significant dependencies, business decisions and operational processes hinge on this and related decisions. It is similarly important that the Agencies adopt a consistent definition of "U.S. person" across their implementation of Title VII.

Specifically, the definition is important in two respects – first, for determining those entities engaged in swap dealing that may fall within the jurisdiction of the Agencies; and, second, for determining the status of a swap dealer's or MSP's counterparty and the applicability of Agency transaction-level requirements to trades with such counterparties.

B. *Regulation S Definition*

We recommend that the Agencies adopt a definition of "U.S. person" that tracks the definition used in SEC Regulation S.[6] The Regulation S definition generally turns on whether a person is resident or domiciled in the U.S., but it contains important exceptions, discussed below, for non-U.S. branches and affiliates and for certain U.S. asset managers. This definition, including its exceptions, would codify the territorial scope intended by Sections 722 and 772. We believe a clear and consistent "U.S. person" definition along these lines would also be reassuring to non-U.S. regulators and foster deeper and more effective cooperation between the Agencies and non-U.S. regulators. Defining "U.S. person" along the lines of Regulation S would additionally help to establish a level playing field across Title VII, a very important objective that certain of the Agencies' proposals could otherwise undermine, if the Agencies were to adopt them as proposed.

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[6] See Rule 902(k) under the Securities Act of 1933 (definition of "U.S. person"). See also SEC Final Rule, Offshore Offers and Sales, 55 Fed. Reg. 18306, 18308 (May 2, 1990). The CFTC has also adopted a similar, but not identical, definition in Rule 4.7 of its Regulations.

C. *Application to Non-U.S. Branches and Affiliates*

Regulation S does not include as a "U.S. person" the non-U.S. branch or affiliate of a U.S. or non-U.S. person; only affiliates or branches located in the U.S. are covered.

Non-U.S. swap activities of a non-U.S. branch or affiliate do not necessarily give rise to a "direct and significant" connection with or effects on U.S. commerce within the meaning of Section 722 of Dodd-Frank. The non-U.S. affiliate of a U.S. person is, in its own insolvency or that of its parent, typically subject to separate resolution from its parent and other affiliates. Although bank branches are not usually separately capitalized, their operations are generally subject to separate licensing and examination by local supervisors, they file separate financial reports with those supervisors and they maintain separate books and records in accordance with local requirements. In some jurisdictions, local bank branches are also subject to in-country capital or reserve maintenance requirements.

In the context of swap dealer and MSP registration and regulation, we note that the Agencies are expressly authorized to address separation between different branches, departments and divisions of U.S. and non-U.S. persons through the use of the limited designation provisions of the swap dealer and MSP definitions, as discussed in further detail below. In our view, this treatment of branches, departments and divisions is necessary to be consistent with the prohibition in Sections 722 and 772 of Dodd-Frank on the application of Agency rules to "activity" or "business" of a person outside the U.S., even if that person would otherwise be subject to the jurisdiction of the Agencies in connection with other activities conducted within the U.S. or with U.S. persons. Although certain requirements, such as minimum capital requirements, must by their nature be entity-wide, the Agencies should not apply U.S. transaction-level requirements to transactions by a non-U.S. branch, department, division or affiliate with non-U.S. persons.

Additionally, non-U.S. swap activities by a non-U.S. branch or affiliate are not in and of themselves evidence of evasion. Non-U.S. branches and affiliates have long engaged in a range of derivatives and non-derivatives financial services activities for local and international clients and have separate strategic, business and legal reasons for their existence and organizational structure. For example, in many jurisdictions, non-U.S. branches or affiliates have been established because certain activities may only be conducted by entities licensed or organized under local law. Such non-U.S. branches and affiliates typically manage the risk from financial exposures incurred in such jurisdictions in the local financial markets. Subjecting such non-U.S. branches and affiliates to U.S. requirements could effectively preclude them from, or significantly increase the cost of, managing their risk in the local financial markets, since local financial institutions may be required to comply with Dodd-Frank to provide those services.

Although Congress chose not to do so in Title VII, it has provided the Agencies with substantial authority outside of Title VII to address the risks to the U.S. that might be presented by swap and other activities conducted outside the U.S. Regulatory regimes specifically intended to apply on a consolidated basis, such as the Bank Holding Company Act and consolidated capital requirements for financial holding companies, assure that appropriate capital requirements and prudential supervision address the risks arising from activities undertaken by every entity within a regulated consolidated holding company group, whether that entity is operating inside or outside the U.S. In contrast, Title VII does not include any provision for the application of U.S. requirements abroad based on affiliation with, being a branch of or being guaranteed by, a U.S. person or for the consolidated regulation of swap activities.

D. Application to Transactions through Agents

Adopting the Regulation S definition would also provide needed clarification regarding the application of Title VII in the context of transactions by a putative registrant with a U.S. person acting as agent on behalf of a non-U.S. person and in the context of transactions with a non-U.S. person acting as agent on behalf of a U.S. person.

Under Regulation S, a "U.S. person" does not include a non-U.S. investment manager or other fiduciary acting on behalf of a U.S.-domiciled client on a discretionary basis. This outcome is based on the principle that, by hiring a non-U.S. manager, the U.S. client has made a voluntary and conscious determination to engage in transactions with a non-U.S. entity in a non-U.S. jurisdiction through individuals doing business outside the U.S., thereby electing to subject itself to non-U.S. legal requirements and protections. Accordingly, it would be natural for the client to expect to deal with non-U.S.-regulated, rather than U.S.-regulated, counterparties, and to benefit from the protections of non-U.S. law as a result.

In addition, the Regulation S "U.S. person" definition does not include a non-U.S.-domiciled client advised by a U.S. investment manager or other fiduciary. In this circumstance, the non-U.S. client is, in many respects, analogous to a non-U.S. resident that is only temporarily present (through its adviser) in the U.S., contacts with whom the SEC staff has not in the past viewed as requiring U.S. registration.[7] In addition to the relevant regulatory policy considerations, the imposition of U.S. requirements to these transactions, in addition to those of the jurisdiction in which the adviser's client is domiciled, raises commercial concerns regarding the impact that duplicative regulation could have on the competitiveness of U.S. advisers in global markets. We are not aware of problems that have arisen as a result of these policy judgments regarding the appropriate treatment of transactions involving advisers.

Accordingly, if a non-U.S. person transacts with an investment manager or other fiduciary falling within the above categories, the non-U.S. person should not become subject to Dodd-Frank's registration, margin, external business conduct, clearing, trading and reporting requirements in connection with that transaction.

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[7] See Cleary, Gottlieb, Steen & Hamilton, SEC No-Action Letter (Nov. 22, 1996, revised on Jan. 30, 1997).

E. <u>References to U.S./Non-U.S. Persons</u>

References in this letter to "U.S." or "non-U.S." swap dealers, MSPs, financial institutions, branches, divisions, persons or other entities are intended to encompass swap dealers, MSPs, financial institutions, branches, divisions, persons or entities that are "U.S." or "non-U.S." persons within the meaning of Regulation S.

II. <u>Swap Dealer and MSP Definitions</u>

A. <u>Swap Dealer Definition</u>

Consistent with existing territorial approaches to registration administered by the Agencies,[8] transactions by a non-U.S. person (including the non-U.S. branch or affiliate of a U.S. person) with a U.S.-registered swap dealer should not cause the non-U.S. person to be deemed a U.S. swap dealer. Among other considerations, this approach is necessary to permit U.S.-registered swap dealers to have ready access to non-U.S. swap dealers to engage in hedging and other trading activities in non-U.S. markets. This in turn enhances the ability of U.S.-registered swap dealers to provide liquidity in non-U.S. underliers to their U.S. customers.

B. <u>MSP Definition</u>

The MSP definition raises different jurisdictional issues than the swap dealer definition because, as the CFTC has noted, the MSP definition "specifically focuses on the degree of risk that an entity's swaps pose to U.S. counterparties and the U.S. market."[9] In light of this focus, we agree with the Commissions' proposal to determine MSP status for a non-U.S. person based on whether the credit exposures of unaffiliated U.S. swap counterparties to it reach the thresholds specified by the Commissions (subject to the discussion in Part III.B.2 below regarding transactions intermediated by a U.S.-registered swap dealer). For these purposes, U.S. swap counterparties should be defined by reference to the Regulation S definition of U.S. person. Exposures arising from swaps between non-U.S. persons should not be taken into account for such purposes, regardless of where or how those swaps are executed or whether they involve

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[8] <u>See</u> Rule 15a-6(a)(4)(i) under the Securities Exchange Act of 1934 (the "<u>Exchange Act</u>") (exempting a foreign broker-dealer that effects securities transactions with an SEC-registered broker-dealer).

[9] CFTC Proposed Rule, Registration of Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71379, 71382 (Nov. 23, 2010) ("<u>CFTC Registration Proposal</u>"). The MSP definition requires the Commissions to set thresholds for "substantial positions" at levels determined to be "prudent for the effective monitoring, management, and oversight of entities that are systemically significant or can significantly impact the financial system of the United States" and thresholds for "substantial counterparty exposures" that "could have serious adverse effects on the financial stability of the United States banking system or financial markets." <u>See</u> Section 1a(33) of the Commodity Exchange Act (the "<u>CEA</u>") and 3(a)(67) of the Exchange Act.

U.S. underliers, since the manner of execution or underlier for a swap is irrelevant to whether the swap poses a risk to U.S. counterparties or the U.S. market.

C. *Inter-Affiliate Swaps*

Swap transactions undertaken with an affiliate should not cause a person to become a swap dealer or MSP. Such transactions should not be deemed to constitute "swap dealing," since they are typically undertaken to allocate risk within a corporate group, not to supply liquidity to, or accommodate the independent trading objectives of, a third party.[10] Such inter-affiliate risk management transactions also do not, as the Commissions have acknowledged, pose the exceptional risks to the U.S. financial system that are the basis for the MSP definitions.[11] This is particularly the case where there are *bona fide* commercial reasons for a swap dealer to structure transactions with its affiliate through back-to-back or similar arrangements, such as when a counterparty prefers to face the swap dealer entity in the group due to commercial, tax, regulatory or market considerations, even though, from a risk management perspective, a different entity is better positioned to incur the exposure. Accordingly, we ask that the Commissions expressly confirm, in their final definitional rule release, that inter-affiliate transactions will not cause a person to fall within the swap dealer or MSP definitions.

D. *Guarantees*

It is also common for swap dealing subsidiaries, whether located in the U.S. or abroad, to have some or all of their swap-related obligations guaranteed by a parent. A U.S. holding company might, for example, provide a guarantee of its non-U.S. swap dealing subsidiary. Conversely, a non-U.S. holding company might provide a guarantee of its U.S. swap dealing subsidiary. This is done for a range of commercial reasons, such as in instances where the holding company, but not the subsidiary, has rated debt, or otherwise when counterparties are better able to assess the creditworthiness of the holding company than the subsidiary.

Such guarantees should not cause either the holding company guarantor or the subsidiary to become a swap dealer or MSP. Neither the swap dealer nor the MSP definitions give any indication that they encompass contingent credit support arrangements. Indeed, there has been no suggestion that supporting a subsidiary's swap dealing activities on a non-contingent basis by contributing capital to the subsidiary should trigger registration, and so *a fortiori* contingent credit support in the form of a guarantee should not trigger registration either. Credit exposures of counterparties to the subsidiary will be addressed through regulation of the

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[10] See CFTC and SEC Proposed Rule, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 Fed. Reg. 80174, 80183 (Dec. 21, 2010) ("Entity Definitions Proposal").

[11] See id. at 80202.

subsidiary itself and its capital adequacy, whether by the Agencies for a U.S. subsidiary or by the relevant non-U.S. regulator for a non-U.S. subsidiary. Any risk to the holding company under the guarantee is appropriately addressed through the consolidated prudential capital requirements and supervision applicable at the holding company level. As a result, Title VII registration in this context would be unnecessary and superfluous.

Finally, we are not aware of any precedent or circumstance in which either Commission has adopted the position that an affiliate guarantee of the obligations of a registrant subjects the guarantor to the same registration requirement as the guaranteed registrant.

E. Global Branch Networks/Limited Designation

Many financial institutions engaged in swap dealing are organized through a global branch network. Requiring the entire institution to become subject to Dodd-Frank as a result of this organizational structure would result in several negative consequences. It would place U.S. institutions at a significant competitive disadvantage in operating outside the U.S., since their non-U.S. branches that do not conduct U.S. swap dealing activity would nevertheless have to comply with Dodd-Frank (in addition to local rules), potentially even when transacting with non-U.S. persons.[12] It would also cause non-U.S. institutions operating in the U.S. to accept U.S. supervision over their wholly non-U.S. activities. Such an outcome cannot be reconciled with Sections 722 and 772 of Dodd-Frank and is one that a number of non-U.S. regulators have indicated they would find unacceptable.

Historically, bank regulators have addressed these issues by establishing an allocation of home and host country jurisdiction. The Prudential Regulators have permitted U.S. banks to operate non-U.S. branches and non-U.S. "Edge Act" subsidiaries subject to non-U.S. regulation and permitted those non-U.S. branches and subsidiaries to engage in a wider range of activities than permitted to U.S. branches so that they may compete effectively with local institutions.[13] The Prudential Regulators have also permitted non-U.S. banks to establish U.S.

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[12] Regardless of the manner in which the Commissions implement Dodd-Frank's limited designation registration provisions, the Agencies should not apply U.S. transaction-level requirements to transactions by a non-U.S. branch, department, division or affiliate of a registrant with non-U.S. persons.

[13] In addition to their general powers under U.S. banking laws, under Regulation K (12 C.F.R. § 211.4) non-U.S. branches of U.S. banks may conduct insurance agency and brokerage activities and underwrite, distribute, purchase, sell and invest in obligations of foreign governments and their political subdivisions, agencies and instrumentalities. See also OCC Interpretive Letter No. 1102 (Nov. 2008) (national bank Mumbai branch may act as custodian clearing member of India's National Securities Clearing Corp.); 12 C.F.R. §§ 211.10(a)(14), (15) (permitting Edge Act corporations to underwrite and deal in equity securities outside of the U.S.).

branches and bank subsidiaries generally without directly supervising the activities of those banks outside the U.S.[14]

We strongly urge the Commissions to facilitate a similar approach for swap activities. Dodd-Frank contemplates designation of a person as a swap dealer for a "single type or single class or category of swap or activities."[15] Further, Sections 722 and 772 prohibit Agency rules from applying to "activity" or "business" of a person outside the U.S., even if that person would otherwise be subject to the jurisdiction of the Agencies for other activities with U.S. persons or within the U.S. Taking these provisions together, if a financial institution registers in the U.S. as a swap dealer or MSP, the Commissions should designate and regulate that institution only with respect to the branch(es) or separately identifiable department(s) or division(s) specifically engaged in the swap activity giving rise to the U.S. registration requirement.

Under the limited designation framework contemplated by Dodd-Frank, the branch, department or division of a registrant involved in the regulated swap activity should be responsible for compliance with Dodd-Frank's requirements, although outsourcing the performance (but not responsibility for due performance) of those requirements to a U.S. affiliate, acting as an agency intermediary, should be permissible, subject to registration of the affiliate as an introducing broker, futures commission merchant ("FCM") and/or securities broker-dealer, as appropriate.

In the context of designation at the branch, department or division level, Agency examinations to ensure compliance should occur at the branch, department, division or (if applicable) the U.S. affiliate of a registrant where the relevant U.S.-related activity occurs, with home or other host country regulators responsible for other branches, departments, divisions and affiliates. Requirements that typically apply to the board of directors or senior officers of a corporate legal entity, such as fingerprinting of directors for registration purposes, should apply to senior management or other individuals holding analogous positions within the designated branch, department or division (rather than at the legal entity level), since those individuals will be the ones directly responsible for the activity for which registration is required.[16] In addition,

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[14] U.S. branches of foreign banks are separately examined by U.S. banking authorities, assigned their own supervisory "ROCA" ratings (i.e., assessments of the branch's risk management, operations, compliance and asset quality), maintain separate books and records in accordance with U.S. regulatory requirements and file with U.S. regulators quaterly reports of the branch'es assets and liabilities (known as "Call Reports").

[15] See Section 1a(49) of the CEA and Section 3(a)(71) of the Exchange Act.

[16] Cf. FRB and FDIC Final Rule, Resolution Plans Required at p. 53 (Sept. 9, 2011), available at http://fdic.gov/news/board/Sept13no4.pdf (permitting a foreign-based company to have its resolution plan approved by a delegatee of its board of directors, instead of the board itself).

to promote cross-border regulatory cooperation and promote efficient use of supervisory resources, U.S. and relevant non-U.S. regulators should, 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.

This approach is necessary to preserve existing allocations of home and host country jurisdiction for U.S. and non-U.S. financial institutions operating on a global basis, and to establish a level playing field and address concerns that have been raised by non-U.S. regulators regarding the potential breadth of U.S. jurisdiction over and regulation of non-U.S. swap dealer and MSP registrants. Accordingly, we strongly urge the Agencies to clarify publicly the scope of jurisdiction they intend to exercise. Without assurances in this area, U.S. financial institutions could be placed at a significant competitive disadvantage in non-U.S. markets, and non-U.S. financial institutions will be reluctant to register, and their regulators will be reluctant to permit them to register, in the U.S. under Title VII.

III. Swap Dealer and MSP Registration and Regulation

The Firms, which include both U.S. and non-U.S. institutions, conduct their swap dealing businesses through a variety of structures, based on multiple and in many cases interdependent legal, strategic and business considerations that pre-date Dodd-Frank. These organizational structures, by their nature, tend to involve cross-border activities and arrangements. In light of these characteristics, it is critical that the Commissions clarify the territorial scope of swap dealer and MSP registration and other requirements. Unduly broad application of those requirements would be very disruptive to customers and markets, necessitating widespread business restructuring that is neither mandated by Dodd-Frank nor justified under Sections 722 and 772 or the Commissions' historically territorial approach to registration of market professionals.[17]

A. Non-Intermediated Swap Dealing with U.S. Persons

A common cross-border transaction paradigm involves a non-U.S. person (including the non-U.S. branch or affiliate of a U.S. person) that deals in swaps directly with

[17] See Statement of Policy Regarding Exercise of [CFTC] Jurisdiction Over Reparation Claims that Involve Extraterritorial Activities by Respondents, 49 Fed. Reg. 14721 (Apr. 13, 1984). See also CFTC Proposed Rule, Exemption from Registration for Certain Foreign Persons, 72 Fed. 15637 (Apr. 2, 2007) (noting that, in light of the CFTC's limited resources, it would be appropriate to focus CFTC customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic users and that the protection of foreign customers of firms confining their activities to areas outside this country, its territories and possessions may best be the responsibility of local authorities in such areas). See also SEC Proposed Rule, Exemption of Certain Foreign Brokers or Dealers, 73 Fed. Reg. 39182 (July 8, 2008); SEC Final Rule, Registration Requirements for Foreign Broker-Dealers, 54 Fed. Reg. 30013, 30016 (July 18, 1989) (discussion SEC's territorial approach to broker-dealer registration).

unaffiliated U.S. persons without intermediation by a U.S.-registered swap dealer. Consistent with principles of territoriality, comity and fair competition, such a non-U.S. person should be required to register as a swap dealer in the U.S., but should (a) be permitted to comply with Title VII's entity-based rules through compliance with comparable home country requirements and (b) only be subject to transaction-level requirements in the context of transactions with U.S. persons.

Below is a more detailed description of the application of Dodd-Frank to this paradigm. In particular, we discuss the application of (1) capital and related prudential requirements, (2) other entity-level requirements (such as conflicts of interest and chief compliance officer requirements) and (3) transaction-level requirements.

1. Capital and Related Prudential Requirements

Dodd-Frank requires a swap dealer or MSP to comply with minimum capital requirements.[18] The FRB has, consistent with its longstanding approach to the U.S. branches of non-U.S. banks, proposed that a non-U.S. bank registrant whose home country supervisor has adopted capital standards consistent with the Basel Accord would be required to comply with those home country requirements in satisfaction of U.S. swap dealer/MSP capital requirements.[19]

Under the current CFTC capital proposal, in contrast, the non-bank swap dealer and MSP subsidiaries of U.S. bank holding companies would be required to comply, at the level of the subsidiary, with FRB holding company requirements.[20] Many such subsidiaries outside the U.S. are currently, however, subject to capital regimes applied by regulators in the relevant non-U.S. jurisdiction, which would be inconsistent with the application of U.S. holding company capital requirements at the subsidiary level.

Moreover, under the CFTC proposal, the non-bank swap dealer subsidiaries of non-U.S. financial holding companies would be required to comply with proposed capital requirements designed to apply to U.S. nonfinancial companies.[21] This would unfairly disadvantage non-U.S. financial institutions, who would be required to apply standardized, rather than risk-based, capital charges to their swap dealer and MSP subsidiaries and to compute such subsidiaries' tangible net equity in accordance with U.S. GAAP, rather than IFRS, in

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[18] See Section 4s(e)(3)(A) of the CEA and Section 15F(e)(3)(A) of the Exchange Act.

[19] See Prudential Regulator Capital and Margin Proposal at 27852.

[20] See CFTC Proposed Rule, Capital Requirements of Swap Dealers and Major Swap Participants, 76 Fed. Reg. 27802, 27805-06 (May 12, 2011).

[21] See id. at 27806-07.

circumstances where such subsidiaries are already subject to comparable non-U.S. capital requirements on a consolidated basis, on an entity-level basis, or sometimes both. It is hard to see how such an inapposite approach can be justified, under a comity analysis or otherwise.

To address these issues, we urge the Commissions to adopt a similar approach to that of the FRB, recognizing compliance with comparable home country capital requirements for non-U.S. non-bank registrants (including non-U.S. affiliates of U.S. persons[22]) and for registrants that are U.S. non-bank subsidiaries of a non-U.S. person subject to comparable consolidated prudential supervision. The Commissions should make their comparability determinations based on existing standards, such as whether the FRB has determined that the home country supervisor administers a regime of comprehensive and consolidated supervision or whether the non-U.S. registrant is subject to a capital regime consistent with the Basel Accord.

Additionally, Dodd-Frank requires a swap dealer or MSP to maintain records and make reports regarding its financial condition[23] and to establish robust and professional risk management systems.[24] The CFTC has also proposed rules regarding portfolio reconciliation and compression requirements.[25] Such requirements are integrally related to capital adequacy and cannot be administered effectively in a manner inconsistent with a swap dealer or MSP's capital and risk management regime. Accordingly, the Commissions should recognize compliance with home country requirements for financial recordkeeping, risk management (including business continuity and disaster recovery) and portfolio reconciliation and compression for swap dealers and MSPs that are, either under Commission rules or the rules of the relevant Prudential Regulator, required to comply with home country capital requirements.[26]

In any case where the Commissions or the Prudential Regulators recognize compliance with home country requirements, a violation of those requirements should constitute a violation of Commission or Prudential Regulator rules, as applicable.

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[22] Since capital and related prudential requirements necessarily apply on an entity-wide basis, non-U.S. branches of U.S. persons would continue to comply with their existing U.S. requirements.

[23] See Section 4s(f)(1)(A) of the CEA and Section 15F(f)(1)(A) of the Exchange Act.

[24] See Section 4s(j)(2) of the CEA and Section 15F(j)(2) of the Exchange Act.

[25] See CFTC Proposed Rule, Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 Fed. Reg. 81519 (Dec. 28, 2010) ("CFTC Confirmation, Reconciliation and Compression Proposal").

[26] We note that concerns have been raised with respect to imposition of specific Commission risk management and other requirements to U.S. entities subject to oversight by the Prudential Regulators. See Letter from John Walsh, Acting Comptroller of the Currency to Gary Gensler, Chairman, CFTC, dated June 30, 2011. We have similar concerns in relation to foreign registrants subject to prudential supervision by foreign regulators.

2. Other Entity-Wide Requirements

The Commissions have proposed several additional entity-wide requirements applicable to swap dealers or MSPs, such as the requirements for certain informational barriers and measures to address conflicts of interest,[27] diligent supervision,[28] and the designation and duties of a chief compliance officer.[29] In many cases, the proposed requirements are highly detailed and would conflict with group-structured systems, policies and procedures and different organizational structures designed to comport with pre-existing home country standards.

To avoid these conflicts, the Commissions should permit non-U.S. swap dealer and MSP registrants (including non-U.S. branches and affiliates of U.S. persons) to comply with home country requirements comparable to those adopted by the Commissions, with comparability determined based on whether the applicable home country entity-wide requirements are reasonably designed to achieve the same policy objectives as otherwise applicable U.S. requirements, viewed in the context of the particular, relevant requirements, not with respect to the regulatory regime as a whole. A violation of any such comparable home country requirements would, as in the case of violations of comparable capital and other prudential requirements, constitute a violation of U.S. requirements.

Alternatively, the Commissions should adopt requirements that are flexible enough so that compliance with comparable home country requirements would also satisfy relevant Commission rules. The SEC has, for example, proposed to require a registered security-based swap dealer or major security-based swap participant to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such registrant's business, to comply with the duties set forth in Section 15F(j) of the Exchange Act.[30] This requirement likely could, in many circumstances, be satisfied by policies and procedures designed to comport with home country standards.

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[27] See generally CFTC Proposed Rule, Implementation of Conflicts of Interest Policies and Procedures by Swap Dealers and Major Swap Participants, 75 Fed. Reg. 71391 (Nov. 23, 2010); SEC Proposed Rule, Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 42396 ("SEC Business Conduct Proposal").

[28] See generally CFTC Proposed Rule, Regulations Establishing the Duties of Swap Dealers and Major Swap Participants, 74 Fed. Reg. 71397 (Nov. 23, 2010); SEC Business Conduct Proposal.

[29] See generally CFTC Proposed Rule, Designation of a Chief Compliance Officer; Required Compliance Policies; and Annual Report of a Futures Commission Merchant, Swap Dealer, or Major Swap Participant, 75 Fed. Reg. 70881 (Nov. 19, 2010); SEC Business Conduct Proposal.

[30] See SEC Business Conduct Proposal at 42420.

In contrast, a requirement that the chief compliance officer of a swap dealer or MSP report to the chief executive officer or the board of directors of the legal entity comprising the swap dealer or MSP would usually not be consistent with the organizational structure adopted by non-U.S. swap dealers and MSPs that are large, globally active banks, which in some cases are also the listed parent company of the corporate group. Particularly in such large organizations, senior officers with responsibilities for managing branches, divisions or departments do not report directly to the registrant's chief executive officer, much less its board. Accordingly, any definition of senior officer should also include any officer having supervisory or management or senior compliance, legal or risk responsibilities who reports directly to the chief executive officer, and any other officer having such responsibility for the branch, division or department that has been designated as a swap dealer or MSP.

3. Transaction-Level Requirements

Several Dodd-Frank requirements applicable to swap dealers and MSPs apply at the level of the individual transaction or trading relationship. Consistent with Sections 722 and 772, those transaction-level requirements should apply only to transactions in which at least one counterparty is a U.S. person. However the Agencies implement the limited designation provisions of Dodd-Frank, U.S. transaction-level requirements should nonetheless not apply to transactions between a non-U.S. branch or affiliate and a non-U.S. person. As both Commissions have consistently recognized in the past, the non-U.S. counterparty in such transactions conducted abroad have no expectation of protection under U.S. law. As we discuss further below, U.S. swap dealers and MSPs involved in transactions with non-U.S. counterparties should also be permitted to conduct those transactions in accordance with the laws of the jurisdiction in which their counterparty is domiciled, subject to certain requirements.

i. Margin Requirements

Dodd-Frank requires the Agencies to adopt minimum initial and variation margin requirements for swap dealers and MSPs.[31] Margin requirements, of necessity, apply at the level of the particular transaction or trading relationship. These provisions must be read in a manner consistent with the territorial limitations set forth in Section 722(d) and 772(b) of Dodd-Frank.

The Prudential Regulators have proposed to apply U.S. margin requirements to transactions between a non-U.S. person counterparty and a non-U.S. registrant if the registrant is a branch or subsidiary of a U.S. person or if the counterparty has a guarantee from a U.S. affiliate.[32] These proposed requirements would, if adopted, be plainly inconsistent with Sections 722(d) and 772(b) because they would apply U.S. requirements to activities conducted outside

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[31] See Section 4s(e)(3)(A) of the CEA and Section 15F(e)(3)(A) of the Exchange Act.

[32] See Prudential Regulator Capital and Margin Proposal at 27850-52.

the U.S. between non-U.S. persons. In this regard, we note that Congress was required to amend Section 7 of the Exchange Act expressly to provide the FRB with authority to apply existing U.S. margin requirements to extensions of credit to non-U.S. borrowers before the FRB was permitted to do so.[33] In fact, the Prudential Regulators' proposal to apply margin requirements to such non-U.S. activities could only be justified if either (i) all transactions outside the U.S. are considered *per se* evasive, or (ii) the fact that a non-U.S. affiliate or branch has a U.S. parent or a guarantee from a U.S. affiliate automatically means that a transaction by the non-U.S. affiliate or branch has a "direct" and "significant" connection with, or effect on, commerce of the U.S., either of which would at the very least require a finding by the Agencies of such evasion, connection or effect.

We suspect, however, that a Court faced with the issue would likely be skeptical of such a finding under relevant precedent—which requires activities outside the U.S. either to be designed to conceal what is in fact a domestic violation or to be immediately consequential within the U.S. for U.S. jurisdiction to be supported[34]—and would likely presume that, because Congress did not codify the relevant margin provisions in a manner consistent with the extraterritorial approach it adopted under Section 7 of the Exchange Act, Congress could not have intended such an expansive territorial reach for Title VII's margin requirements.

At its most benign, the application of duplicative margin collection requirements to non-U.S. branches or subsidiaries of U.S. persons conducting business abroad would be potentially costly and burdensome to affected firms. If non-U.S. margin requirements are essentially the same, or are merely different, but not significantly different, it is not obvious how the Agencies could justify their proposal or *ex ante* cost-benefit analysis. At the other extreme, the proposed extraterritorial application of U.S. margin requirements, if materially different, could give rise to serious competitive disparities and harm the liquidity and efficiency of the global swap markets.

Some jurisdictions, particularly in Asia, simply do not have experienced custodians or the necessary legal regimes for segregation with a third-party custodian as required under the Prudential Regulators' proposal. In addition, subjecting non-U.S. branches and affiliates to U.S. margin requirements could limit their access to hedging and other risk

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[33] In 1969, a U.S. District Court rejected the extraterritorial application of the Exchange Act's margin rules. See Metro-Goldwyn-Mayer, Inc. v. Transamerica Corp., 303 F.Supp. 1354 (S.D.N.Y. 1969). Following that decision, in 1970, Congress enacted Section 7(f) of the Exchange Act. Section 7(f) expressly provides the basis for the application of U.S. margin rules to a "foreign person controlled by a United States person."

[34] See Part V of this letter for a discussion of this precedent.

management transactions with local market participants, since local financial institutions would be required to comply with Dodd-Frank for those transactions.[35]

The Prudential Regulators' proposal would also fragment global swap markets, since non-U.S. end users and swap dealers alike would be unlikely to transact with U.S.-controlled non-U.S. swap dealers and MSPs (including non-U.S. branches and affiliates of U.S. persons) or any non-U.S. person with a U.S. affiliate guarantee, lest they face higher U.S. margin requirements and U.S. segregation requirements. Non-U.S. regulators would also be more likely to require U.S. branches and affiliates of non-U.S. financial institutions to comply with non-U.S. margin and other requirements even when transacting with U.S. end users if this proposal were to be adopted.[36]

For these reasons, in setting margin requirements for a non-U.S. swap dealer or MSP registrant, the Agencies should not apply U.S. margin requirements to the non-U.S. registrant's transactions with non-U.S. persons, whether or not the non-U.S. registrant is a non-U.S. branch or affiliate of a U.S. person. Nor should they apply U.S. margin requirements to transactions with non-U.S. persons with guarantees from U.S. affiliates. Involvement of a U.S. agent in soliciting or negotiating the transaction similarly should not result in the application of U.S. margin requirements to a transaction between non-U.S. persons.

The CFTC and the Prudential Regulators have additionally proposed to treat non-U.S. sovereigns and their agencies and instrumentalities as "high risk" financial counterparties for purposes of Dodd-Frank's margin requirements, regardless of their individual credit rating.[37] We urge the Agencies to reconsider this approach and instead to exclude non-cleared swap transactions involving non-U.S. sovereign counterparties from U.S. margin requirements. Transactions with non-U.S. sovereigns do not inherently pose the type of risk to the safety and soundness of swap dealers and MSPs that would justify the categorical application of margin requirements to them. Rather, the risk profiles of sovereigns vary substantially, and, as a result, to be justifiable, margin levels should more properly be based on an individualized credit assessment.

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[35] That the Prudential Regulators would create such competitive disparities in the swap context is particularly surprising given that the FRB sought to establish a level playing field by adopting exemptions in Regulation U for credit extended outside the U.S. by a non-U.S. branch or non-U.S. subsidiary of a U.S. bank. See 12 C.F.R. § 221.6(c). See also Board Staff Opinion of Mar. 24, 1989, Federal Reserve Regulatory Service 5-884.67.

[36] 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 of "control."

[37] See Prudential Regulator Capital and Margin Proposal at 27571; CFTC Proposed Rule, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 23732, 23735 (April 28, 2011) ("CFTC Margin Proposal").

Moreover, credit exposures to non-U.S. sovereigns will be addressed adequately through appropriate credit risk deductions to capital: existing and proposed capital requirements take into account the nature and level of the credit risk posed by the counterparty to a bilateral swap transaction and the extent to which collateral taken by the swap dealer in connection with that transaction mitigates that risk.

Additionally, as a matter of international comity, the U.S. should not impose limits on the credit made available to non-U.S. sovereigns, particularly since any such requirement could well lead other jurisdictions to require the U.S. government, Federal Reserve Banks, and other U.S. agencies and instrumentalities to post unjustifiably high margin requirements in the case of transactions with non-U.S. persons. The competitive impacts of requiring non-U.S. sovereigns to post margin to U.S.-registered swap dealers and MSPs would also be severe, as locally regulated institutions will likely not be required to collect such margin from their own governments, and local agencies, municipalities and corporations often follow the lead of their sovereign, both for swaps and related businesses such as debt underwriting and payment services.

The CFTC and Prudential Regulators also have proposed to limit eligible collateral for purposes of Dodd-Frank's margin requirements to cash and U.S. government securities.[38] These limitations would adversely affect the efficiency of the global swap markets, since it is customary for transactions in other jurisdictions to be collateralized with securities of the local sovereign. Such limitations would also result in conflicts between U.S. and non-U.S. margin requirements if other regulators adopt similar limitations in non-U.S. jurisdictions. Accordingly, we recommend that the Agencies adopt nationality-neutral criteria for eligible collateral, subject to appropriate haircuts based on creditworthiness and tenor.

Finally, we urge the Agencies to clarify that Dodd-Frank's margin requirements do not apply to inter-affiliate transactions. As the Commissions have acknowledged, such transactions are, in most cases, entered into for the purpose of allocating risk within a corporate group,[39] an important objective that would be undermined, and made unjustifiably more costly, by application of margin requirements. Dodd-Frank's margin requirements are clearly intended to address the risk arising from non-cleared swap transactions with unaffiliated third parties, as such swap interconnectedness and counterparty risk were the key focuses of Title VII. Any credit risk concerns arising from inter-affiliate transactions will be adequately addressed through appropriate credit-risk based capital charges and internal risk management arrangements.

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[38] Prudential Regulator Capital and Margin Proposal at 27578; CFTC Margin Proposal at 23738-39.

[39] See notes 10-11, supra.

ii. Other Transaction-Level Requirements

Dodd-Frank mandates that swap dealers and MSPs comply with certain business conduct, margin segregation, confirmation and documentation requirements that also apply at the level of the particular transaction or trading relationship.[40] These requirements are intended to protect U.S. persons who transact with swap dealers and MSPs. As a result, consistent with Sections 722(d) and 772(b) of Dodd-Frank and existing Commission precedent regarding the application of customer protection requirements to non-U.S. registrants,[41] these requirements should only apply to a non-U.S. swap dealer or MSP registrant in connection with its transactions or relationships with unaffiliated U.S. persons.

B. *Use of U.S. Swap Dealer Intermediaries*

Another common cross-border transaction structure involves a U.S. intermediary, acting as agent for a non-U.S. principal, soliciting or negotiating transactions with U.S. counterparties, or in some cases committing its affiliated principal to transactions within parameters established by the principal.[42] In circumstances where the U.S. intermediary is registered in the U.S. as a swap dealer,[43] we believe there are two alternatives available for addressing the status of the non-U.S. swap dealer that is principal to the transactions intermediated by the U.S.-registered swap dealer: (1) a model based on existing futures and securities intermediation models and (2) a model based on limited registration of non-U.S. swap dealers in connection with their role as swap counterparties.

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[40] See, e.g., CFTC Proposed Rule, Protection of Collateral of Counterparties to Uncleared Swaps Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy, 75 Fed. Reg. 75432 (Dec. 3, 2010); CFTC Proposed Rule, Swap Trading Relationship Document Requirements for Swap Dealers and Major Swap Participants, 76 Fed. Reg. 6715 (Feb. 8, 2011); CFTC Confirmation, Reconciliation and Compression Proposal; CFTC Business Conduct Proposal; SEC Business Conduct Proposal; SEC Proposed Rule, Timely Acknowledgment and Verification of Security-Based Swaps, 76 Fed. Reg. 3859 (Jan. 21, 2011).

[41] See CFTC Regulations § 4.7(a)(2)(xi) (providing a registered commodity trading advisor with exemptions from certain CEA requirements with respect to its non-U.S. clients); Uniao de Bancos Brasileiros S.A., SEC No-Action Letter (July 28, 1992) (concluding that the registered foreign advisory subsidiary of a foreign bank need not comply with U.S. requirements with respect to its non-U.S. clients).

[42] Solicitation of or negotiation with non-U.S. person counterparties by a U.S. agent acting for a non-U.S. person (including a non-U.S. branch or affiliate of the agent) should not subject the non-U.S. person to swap dealer registration.

[43] The intermediary's activities as an agent should not, standing alone, require it to register as a swap dealer or MSP. However, in many situations the U.S. intermediary may wish to register in the U.S. as a swap dealer, based on its holding itself out as a swap dealer in the course of interactions with U.S. persons in the U.S. and assuming responsibility for the due performance of related swap dealer requirements applicable to those interactions, such as U.S external business conduct requirements.

1. Existing Intermediation Model

We think the Agencies would benefit from adopting an approach to swap dealer registration and regulation generally based on existing precedent. Accordingly, as one alternative, we suggest that the Commissions adopt an approach that is modeled on the Commissions' existing regimes, permitting non-U.S. swap dealers to transact with U.S. persons without registering in the U.S. if those transactions are intermediated by a U.S.-registered swap dealer. This would be consistent with the approach adopted by the SEC under Rule 15a-6 and prior interpretative precedents with respect to non-U.S. securities dealers. It would also be consistent with the approach adopted by the CFTC and non-U.S. futures regulators who have permitted futures brokers to carry the customer omnibus accounts of futures brokers in other jurisdictions without subjecting the carrying futures broker to registration as a futures broker in the jurisdiction(s) of the customers whose positions are so carried. These regimes essentially implement an interpretation of the appropriate territorial scope of registration requirements.[44]

Thus, we recommend an approach under which swap transactions by a non-U.S. swap dealer with U.S. counterparties that are intermediated by an affiliated U.S.-registered swap dealer (including the U.S. branch or affiliate of the non-U.S. swap dealer) would not require the non-U.S. swap dealer to become subject to U.S. swap dealer or MSP registration, if the non-U.S. person is regulated as a bank or broker-dealer or otherwise regulated as to its swap dealing activities outside the U.S.

This approach has the significant benefit of more than two decades of application by the Commissions. As a result, extending the same approach to swap dealers would avoid the need for difficult, *de novo* policy and practical judgments by the Agencies and market participants. This is particularly the case since, for more than two decades, the CFTC's regime for FCMs and non-U.S. futures brokers and the SEC's approach to U.S. and non-U.S. securities broker-dealers have effectively protected U.S. investors and markets while facilitating efficient U.S. investor access to non-U.S. markets.

An approach based on intermediation by a U.S. registrant would effectively address the policy objectives of Dodd-Frank. Under such an approach, a U.S.-registered swap

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[44] The CFTC staff adopted positions similar to Part 30.4 regarding the treatment of foreign brokers on an interpretive basis prior to the CFTC codification of those interpretations. See CFTC Interpretive Letter 87-7 (Nov. 17, 1987) (CFTC interpretive position that a foreign broker may, without registering, carry customer omnibus accounts in foreign futures for U.S. customers intermediated through a U.S.-registered FCM). SEC Rule 15a-6, in turn, was originally proposed as an SEC interpretive statement, not an exemption, and was adopted as an exemption based on a suggestion from members of the private securities bar that a "codification" would be more efficient and practical, not because of any suggestion that those positions could not have been adopted on an interpretive, rather than exemptive, basis. See SEC Proposed Rule, Registration Requirements for Foreign Broker-Dealers, 53 Fed. Reg. 38697 (Oct. 4, 1988) (publication of American Bar Association comment letter requesting codification of interpretive positions).

dealer, acting as agent for the non-U.S. person, would make or be involved in contacts with U.S. persons and take responsibility for ensuring that all U.S. external business conduct requirements are complied with, margin is collected and segregated in accordance with U.S. requirements and required trading records and maintained and made available to the Agencies.[45] Satisfaction of these requirements by the U.S.-registered swap dealer would largely obviate the basis for separate U.S. registration of the non-U.S. swap dealer. Further, U.S. clearing and trading requirements would remain applicable to the non-U.S. swap dealer, since it would be a "financial entity" whether or not registered as a swap dealer or MSP.

Under this approach, the Agencies would retain full authority, consistent with the their territorial jurisdiction under Sections 722 and 772, to address any potential issues that might arise, either over time or at the outset, through additional requirements applicable to the U.S.-registered swap dealer responsible for the transaction. If, for example, the Agencies were to develop concerns about the counterparty credit risk of U.S. persons to the non-U.S. swap dealer, the Agencies could require the U.S.-registered swap dealer to obtain and provide to the relevant Agencies evidence of a determination from the relevant Agency that the non-U.S. swap dealer is subject to comparable capital and prudential supervisory (including group-wide risk management) requirements in its home country and undertake to notify the relevant Agencies of any violations of or material changes to those requirements, which could constitute a basis for limiting the U.S.-registered swap dealer's ability to intermediate transactions with U.S. person counterparties involving that non-U.S. swap dealer.

As a legal matter, the Commissions have expansive definitional rulemaking authority under Section 712(d) of Dodd-Frank, and so it would be within that authority for them to further define the terms "swap dealer" and "security-based swap dealer" by codifying a territorial interpretation of those definitions. In addition, the Commissions have authority to exempt from designation as a swap dealer an entity that engages in a *de minimis* level of swap dealing,[46] which permits the Commissions to exempt the types of "unchaperoned" direct contacts by U.S. institutional investors with non-U.S. swap dealers that the CFTC has permitted with respect to foreign brokers[47] and the SEC has permitted with respect to foreign broker-dealers.[48]

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[45] Because the U.S. swap dealer would be acting as agent, it should not be required to hold capital against the resulting swap positions as though it were a principal counterparty to the transaction.

[46] Section 1a(49)(D) of the CEA and Section 3(a)(71)(D) of the Exchange Act.

[47] See CFTC Interpretive Letter No. 92-16 (Sept. 23, 1992) (CFTC staff interpretive position that a foreign broker affiliate of a CFTC-registered FCM may permit certain of its U.S. institutional customers in the customer omnibus account of its FCM affiliate to transmit trading orders directly to the foreign broker, rather than through the FCM, subject to compliance with internal controls relating to the authorization, identification and supervision of those orders).

[48] See SEC Rule 15a-6(a)(3)(i). See also Cleary Gottlieb Steen & Hamilton, SEC No-Action Letter (April 9, 1997).

With respect to MSP designation, in the case of a non-U.S. swap dealer that (1) is regulated as a bank or broker-dealer or otherwise regulated as to its swap dealing activities in its home country, (2) is subject to comparable home country capital and prudential supervision, (3) engages in swap transactions with U.S. (non-swap dealer) counterparties through an affiliated U.S.-registered swap dealer, (4) as a financial entity, is subject to the same clearing and trading requirements as an MSP and (5) as a financial entity, is obliged to post margin to swap dealers and MSPs to the same extent as an MSP, we see no incremental benefit from an extraterritorial application of U.S. MSP registration requirements. In addition, the statute provides a definitional basis for excluding non-U.S. swap dealers that are regulated in that capacity in the relevant non-U.S. jurisdiction, including with respect to their capital. Specifically, the MSP definitions only encompass "any person who is not a swap dealer." They do not provide that an excluded person be registered in the U.S. as a swap dealer.[49]

Accordingly, we believe the Commissions have all the authority they require, definitionally, to exclude such non-U.S. swap dealers from the MSP definition and that it would be entirely consistent with legislative intent for them to do so. The purpose of the MSP category was to address otherwise unregulated swap market participants whose activities give rise to credit exposures in the U.S. that are systemically significant. Congress did <u>not</u> intend to impose unnecessary restrictions on non-U.S. persons whose regulated status in their home jurisdiction already mitigated risks that their activities might pose to the U.S. financial system.[50] In contrast, MSP registration of non-U.S. swap dealers under the circumstances summarized immediately above would merely result in unnecessary and costly U.S. supervisory responsibilities.

2. <u>Limited Registration Model</u>

As noted above, Dodd-Frank's swap dealer definitions authorize limited swap dealer designation.[51] As an alternative to the above approach, we note that the Commissions

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[49] This omission of the word "registered" can be distinguished from the likely unintentional omission of that word in certain parts of Section 4s of the CEA and Section 15F of the Exchange Act. Those Sections expressly address the registration of swap dealers and the requirements applicable to registered swap dealers. They make inconsistent references, with respect to the same requirements, to "registered swap dealers" and "swap dealers." Compare the reference in Section 4s(h)(1) of the CEA to "registered swap dealers and major swap participants," with the reference to "swap dealers and major swap participants" in Section 4s(h)(3), which specifies the business conduct rules to be adopted by the CFTC and to be adhered to by "registered swap dealers and major swap participants." In contrast, the reference to "swap dealer" in the MSP definitions does not relate to the requirements applicable to registrants but is rather, of course, definitional in nature, and so should be regarded as expressing Congress' intent that, as a definitional matter, swap dealers are not MSPs.

[50] Senator Lincoln, for example, observed that "it may be appropriate for the CFTC and the SEC to consider the nature and current regulation of the entity when designating an entity a major swap participant or a major security-based swap participant." (Congressional Record, July 15, 2010, S5907).

[51] <u>See</u> note 15, <u>supra</u>.

have the authority, pursuant to these limited designation provisions, to register and regulate a non-U.S. person as a swap dealer solely with respect to its activities as a swap counterparty. Under this approach, the Commissions would allow a non-U.S. person to register as a limited purpose swap dealer.[52] The non-U.S. person would act as a contractual counterparty only and thus the scope of the Agencies' regulation would be addressed to those swap dealer obligations that are intrinsic to the creditworthiness of the non-U.S. person. As these obligations are addressed by compliance with comparable home country capital and related prudential (including risk management) requirements, the Agencies would be able to defer to home country prudential regulation but still have regulatory jurisdiction over a non-U.S. person that violated the requirements administered by its home country prudential supervisor. A violation of those requirements would constitute a violation of Agency rules. Such a limited swap dealer registration would significantly reduce the extraterritorial examination that the Agencies would otherwise be required to undertake without posing undue risk.

Concomitant with the limited swap dealer registration, the non-U.S. person would be required to have an affiliated U.S.-registered swap dealer that would be obligated to comply with other aspects of Agency regulation. As noted above, the non-U.S. swap counterparty registrant would be responsible only for compliance with capital and related prudential requirements, since those are the only requirements relevant to the swap dealer's creditworthiness. The intermediating U.S.-registered swap dealer would be directly responsible for due performance of other Dodd-Frank requirements.

The Agencies' examinations should therefore extend solely to the U.S.-registered swap dealer intermediating transactions with U.S. persons. This approach would achieve compliance with all the relevant Dodd-Frank rules and provide a scalable and manageable registration model that makes the most efficient use of Agency and other regulators' resources, while simultaneously rationalizing compliance costs for affected firms. For this approach to succeed, however, the Agencies will need to delineate clearly the obligations of the limited non-U.S. swap dealer and those of the U.S.-based swap dealer. Without clear delineation, some non-U.S. regulators might not be comfortable with the submission to U.S. jurisdiction of entities subject to their supervision.

In contrast to either of these two approaches, subjecting all non-U.S. swap dealers to full registration and regulation in the U.S. even when intermediated by a U.S.-registered swap dealer would not provide any significant additional protections to U.S. counterparties or U.S. markets, but would require the Agencies to undertake substantial additional supervisory responsibilities that would be difficult and costly to discharge, and that would be unwarranted in

[52] In circumstances where a non-U.S. swap dealer, acting through a Commission-registered affiliated swap dealer, enters solely into cleared swaps with U.S. counterparties there should be no need even for limited registration of the non-U.S. swap dealer as a swap counterparty. In those circumstances, the U.S. counterparties have exposure to their U.S. clearing members and the relevant clearing organization(s), not the non-U.S. swap dealer.

light of the ability of non-U.S. regulators to regulate the local activities of non-U.S. persons more efficiently and effectively. Because these approaches would apply equally to the non-U.S. dealer subsidiaries of U.S. and non-U.S. institutions, they would assure a level playing field.

C. Swap Dealing with Non-U.S. Persons.

To be consistent with the statutory limitations on extraterritorial application of the Agencies' rules, we reiterate that non-U.S. branches and affiliates of U.S. persons should be deemed separate persons and not subject to registration or other requirements of the Agencies in their transactions with non-U.S. persons. In any event, we believe it would be plainly inconsistent with Sections 722 and 772 for the Agencies to exert jurisdiction over transactions that originate outside the U.S. in non-U.S. branches or affiliates of U.S.-registered swap dealers (whether the swap dealer is a U.S. person or not) and in which the counterparty is a non-U.S. person.

Furthermore, for U.S.-originated transactions, we note that many U.S.-based swap dealers, including the U.S. branches and affiliates of non-U.S. persons, enter into swaps with non-U.S. persons. We have recommended above that a swap between a non-U.S. swap dealer and a U.S. counterparty be executed in compliance with U.S. transaction-level requirements. Consistent with this approach, we believe that, in the context of a swap between a U.S. swap dealer (including the U.S. branch or affiliate of a non-U.S. person) and a non-U.S. counterparty, the Commissions should permit the U.S. swap dealer to comply with the transaction-level requirements of the non-U.S. jurisdiction in which its counterparty is domiciled, in lieu of complying with otherwise applicable U.S. transaction-level requirements.

In order to ensure that this approach to U.S.-originated transactions does not prevent the achievement of Dodd-Frank's objectives or defeat the expectations of non-U.S. counterparties, we suggest certain conditions. First, the U.S. swap dealer or MSP should be required to disclose clearly that the transaction is being conducted in accordance with the non-U.S. person's local transaction-level requirements rather than U.S. transaction-level requirements. Second, the failure of the U.S. swap dealer or MSP to comply with applicable non-U.S. requirements would be deemed a failure to comply with U.S. requirements. We believe that this approach strikes an appropriate balance in regulatory interests and that deference to the counterparty's home country investor protection regime would be appropriate, both as a practical matter and as a matter of comity.

To be clear, however, all U.S. swap dealers (including U.S. branches and affiliates of non-U.S. persons) will remain subject to capital and all other entity-level regulatory requirements. Just as in the case of a corporate end user who qualifies for exclusion from margin collection requirements, the level of margin collected by a swap dealer or MSP from a non-U.S. counterparty will (and appropriately should) be taken into account in the computation of deductions to capital for credit risk. We believe that firms engaged in swap activities with counterparties domiciled abroad should be permitted to make these credit judgments in accordance with local requirements. As in the case of other transaction-level requirements, the failure of the U.S. swap dealer to comply with applicable non-U.S. margin requirements would be deemed a failure to comply with U.S. margin requirements.

We believe the approaches recommended in this sub-section are important in averting potentially significant adverse impacts on the ability of U.S. firms to compete for business with counterparties domiciled outside the U.S. We believe these approaches will also promote robust, competitive and liquid U.S. markets, without compromising in any material respect the policy objectives of Dodd-Frank. They would also mitigate incentives for firms to conduct swap activities from outside the U.S.

IV. Clearing, Trading and Reporting

A. *Scope of U.S. Clearing, Trading and Reporting Requirements*

1. Clearing and Trading Requirements

Dodd-Frank's clearing and trading requirements should apply to any swap designated for mandatory clearing if that swap has at least one U.S. person as a counterparty (subject to the discussion below regarding the use of non-U.S. clearing organizations and SEFs).

The Commissions should not apply Dodd-Frank's clearing and trading requirements to swaps between non-U.S. persons, whether or not executed by personnel located outside the U.S., including through use of a U.S. SEF. Such transactions are, in many cases, likely to be subject to local clearing requirements (which may (practically or legally) require use of a local clearing organization and so, in some cases, could conflict with Dodd-Frank's clearing requirement). Application of Dodd-Frank's clearing requirement could also deter the use of U.S. SEFs by non-U.S. persons, which would conflict with Dodd-Frank's objective of promoting the trading of swaps on SEFs[53] and could lead to market fragmentation and concomitant restrictions in liquidity and higher costs of execution.

In addition, it is common for non-U.S. persons to utilize U.S. agents for swaps because of those agents' expertise in the relevant market (such as in the case of a swap with a U.S. underlier) or because of logistical matters, such as the time zones in which the parties conduct business. The challenges that would result from application of U.S. clearing and trading requirements solely because of the involvement of a U.S. agent could significantly curtail the use of U.S. agents and encourage personnel based in the U.S. to relocate elsewhere. It could also result in an inefficient and undue concentration of open interest in U.S. clearing organizations during that period as non-U.S. persons are forced to clear their transactions in the U.S.

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[53] See Section 733 of Dodd-Frank.

Accordingly, we recommend that the Commissions not apply U.S. clearing and trading requirements to transactions between non-U.S. persons, recognizing that they may choose to re-evaluate this position for transactions negotiated by U.S. agents if, following the agreed December 2012 G-20 deadline, other major jurisdictions have not moved to implement parallel clearing and trading requirements.

2. Reporting Requirements

The SEC has proposed to require reporting to a U.S.-registered SDR for any security-based swap that (1) has at least one counterparty that is a U.S. person; (2) was executed in the U.S. or through any means of interstate commerce; or (3) was cleared through a registered clearing agency having its principal place of business in the U.S.[54] We generally support this territorial approach to the scope of U.S. reporting requirements, but we believe that requiring transactions between non-U.S. persons that are executed (but not cleared) in the U.S. to be reported in the U.S. is unnecessary and unworkable. Such transactions will in most cases be subject to reporting requirements in the relevant non-U.S. jurisdiction(s) of the parties. Any information necessary to collect for risk monitoring purposes is better collected in the parties' jurisdiction(s). Information necessary to collect for market surveillance purposes will be available from the U.S. SEF or introducing broker, FCM or broker-dealer that executed the transaction. Requiring additional information also to be transmitted to a U.S. SDR would merely impose additional costs. These costs would be significant because they would involve market participants building their trade capture systems to track both parties' execution method(s) in addition to their domicile(s) and the transaction's clearing status. Such a build-out would doubtlessly delay reporting implementation, perhaps materially so.

In addition, as described in more detail below, the Commissions should adopt accommodations for the use of non-U.S. SDRs in appropriate cases. The Commissions also should reconsider their proposal to require reporting of swap data by U.S. persons who transact with non-U.S. swap dealer registrants,[55] which is unduly burdensome for end users and could negatively impact competitiveness in the affected U.S. markets. These changes will help to establish a more efficient and effective reporting regime with globally active repositories. Such a regime is necessary to facilitate development of more uniform reporting standards, minimize duplicate reporting, and provide more accurate and comprehensive information to regulators.

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[54] See SEC Proposed Rule, Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75208, 75329 (Dec. 2, 2010) ("SEC Reporting Proposal"). The CFTC has similarly proposed to require reporting to a U.S.-registered SDR for any swap with a U.S. person counterparty, that is executed in the U.S. or is cleared by a derivatives clearing organization. CFTC Proposed Rule, Swap Data Recordkeeping and Reporting Requirements, 75 Fed. Reg. 76573, 76604 (Dec. 8, 2010) ("CFTC Reporting Proposal")

[55] SEC Reporting Proposal at 75211; CFTC Reporting Proposal at 76593.

B. *Use of Non-U.S. Clearing Organizations, SEFs and SDRs*

Many non-U.S. jurisdictions are planning to adopt clearing, trading and reporting requirements similar to those contained in Dodd-Frank, as well as requirements regarding the regulation of clearing organizations, execution facilities and data repositories. Accordingly, to prevent conflicts with non-U.S. laws for cross-border transactions, the Commissions will need to accommodate the use of non-U.S. clearing organizations, SEFs and SDRs.

1. Use of Non-U.S. Clearing Organizations and SEFs

Dodd-Frank permits market participants to comply with its mandatory clearing and trading requirements by using a non-U.S. clearing organization and SEF, respectively, if the clearing organization or SEF is subject to comparable regulation and has been exempted from registration by the Commissions.[56] In applying this exemption, we request that the Commissions adopt a flexible standard for comparability determinations. As in the case of the standard used by the CFTC in making Part 30 determinations, this standard should be based on whether the relevant non-U.S. jurisdiction applies requirements reasonably designed to address the key objectives of analogous U.S. regulatory requirements.[57]

U.S. customers should be able to access non-U.S. clearing organizations and SEFs in a manner similar to the manner in which they currently access non-U.S. futures and securities exchanges. With respect to security-based swaps, we believe that SEC Rule 15a-6 already provides a means for U.S. customers to access non-U.S. clearing organizations and SEFs, subject to intermediation by a U.S. broker-dealer. We understand that the CFTC, in contrast, has recently indicated its intentions to disallow omnibus clearing structures currently permissible in the futures markets and instead to require any direct clearing member who provides access at a non-U.S. clearing organization to U.S. customers to register with the CFTC as an FCM. We

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[56] See Sections 2(h)(1)(A), 2(h)(8)(A)(ii), 5b(h) and 5h(h) of the CEA and Sections 3C(a)(1) and 17A(k) of the Exchange Act. Although Dodd-Frank does not expressly grant the SEC the same exemptive authority with respect to comparably regulated non-U.S. security-based SEFs as it grants to the CFTC with respect to comparably regulated non-U.S. SEFs, we note that the SEC's plenary exemptive authority under Section 36 of the Exchange Act extends to the mandatory execution requirement in Section 3C and the SEF registration requirement in Section 3D.

[57] By way of example, in the case of a clearing organization, the non-U.S. jurisdiction should have requirements regarding risk management and default rules, financial resources, protection of customer collateral and conflicts of interest. If the non-U.S. jurisdiction addresses these objectives in a manner that is different than U.S. requirements but that is reasonably designed to accomplish the same objectives as the U.S. requirements, they should be deemed to satisfy the comparability standard. Examples of differences in approach that nonetheless should be deemed comparable include: the requirement of notification and approval for concentrated ownership of a clearing organization (as opposed to *per se* limits on ownership); the use of a principal-to-principal clearing model (as opposed to an agency model) but with robust requirements for the protection of customer collateral; and the requirement that a customer be permitted to choose between omnibus or individual segregation of collateral (as opposed to imposing individual segregation).

urge the CFTC to reconsider this approach and to permit a U.S. customer to (a) use a comparably-regulated Part 30.10-exempt foreign FCM or (b) have its account carried by a U.S. FCM that in turn has an omnibus account carried at a non-U.S. member of the clearing organization/SEF, without giving rise to registration for the non-U.S. member.[58] Direct membership in a multiplicity of non-U.S. clearing organizations will impose significant costs on U.S. FCMs due to the requisite minimum default fund contributions and the likely imposition of non-U.S. licensing requirements. These costs could limit the number of U.S. FCMs willing to provide these services at non-U.S. clearing organizations, resulting in less competition, less access, and higher clearing fees for U.S. customers.

In addition, consistent with the territorial limitations on Title VII and the considerations noted above, we ask the Commissions to confirm that, if a non-U.S. clearing organization or SEF registers in the U.S., its members conducting swap activities outside the U.S. for non-U.S. customers will not become subject to registration in the U.S. unless they also carry accounts directly for U.S. customers (and do not qualify for exemption).[59] Similarly, under Section 722 and 772 of Dodd-Frank, a non-U.S. clearing organization or SEF should not itself become subject to registration (or mandatory exemption) under Title VII in the U.S. unless it permits U.S. persons to become direct members and utilizes instrumentalities of U.S. commerce to facilitate membership or participation by U.S. persons.

We see no basis in Dodd-Frank for the Commissions to adopt a different approach to non-U.S. clearing and trading of swaps than they have adopted for futures and securities.

2. Use of Non-U.S. SDRs

Dodd-Frank may be read not to authorize the Commissions to exempt comparably regulated non-U.S. SDRs from Commission registration. Dodd-Frank also separately requires that each non-cleared swap transaction be reported to an SDR or the relevant Commission.[60] In addition, for a non-U.S. regulator to access information from a U.S.-registered SDR, the regulator will be required to indemnify the SDR and the relevant Commission for any expenses

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[58] Although a U.S. customer accessing a non-U.S. clearing organization through an omnibus account structure may not receive the protections from fellow customer risk contemplated by the CFTC's "legal segregation" proposal, in our view the customer should be permitted to make the choice to forego those protections when accessing a non-U.S. clearing organization.

[59] In this regard, we note that "carrying" an account for a person is distinct from the requirement in some non-U.S. jurisdictions that an account be named under the beneficial owner, since in such arrangements the intermediating agent is still responsible to the beneficial owner for the activity in the account.

[60] See Section 4r(a)(1) of the CEA and Section 13A(a)(1) of the Exchange Act.

arising from litigation relating to the information provided by the SDR.[61] Because, among other considerations, non-U.S. regulators will be unlikely to provide such an indemnification agreement, it would be problematic for the Commissions to require non-U.S. SDRs to register with the Commissions.[62] In addition, the indemnification requirement could be a significant impediment to effective regulatory coordination, since non-U.S. regulators may establish parallel requirements for U.S. regulators to access swap data reported in their jurisdictions.

To address these issues, we recommend that a non-U.S. SDR should not be subject to U.S. registration so long as it collects and maintains information from outside the U.S., even if such information is collected from non-U.S. swap dealer or MSP registrants. In addition, so long as the Commissions have access to the information at the non-U.S. SDR, such as through an agreement with the SDR's regulator, a transaction reported to such SDR should be deemed to have been reported to the relevant Commission in accordance with Dodd-Frank's requirements. In such a case, a swap dealer or MSP registrant reporting a swap to such a non-U.S. SDR would have discharged its responsibility for reporting under Dodd-Frank.

In this regard, we recommend that the Commissions retain Dodd-Frank's allocation of reporting responsibility among swap dealers, MSPs and end users for cross-border transactions. We are concerned that requiring any U.S. person transacting with a non-U.S. person to have the obligation to report swap transaction data without regard to the types of entities involved, as has been proposed by the Commissions,[63] would unnecessarily burden U.S. end users (which generally will not have the infrastructure in place to transmit data electronically to an SDR). It also would disadvantage non-U.S. swap dealers and MSPs because U.S. end users would face the additional costs of acting as the reporting party, thereby negatively affecting competition. Retaining Dodd-Frank's reporting allocation for cross-border transactions is thus necessary to establish a level playing field.

Additionally, in cases where a non-U.S. SDR does register with the Commissions but is also subject to regulatory oversight by an appropriate non-U.S. regulator, we agree with

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[61] See, e.g., Section 21(d) of the CEA ("each entity [includes "foreign financial supervisors," "foreign central banks," and "foreign ministries"] shall agree to indemnify the swap data repository and the Commission for any expenses arising from litigation relating to the information provided under section 8.").

[62] See Letter from Carlos Tavares, Vice-Chairman, European Securities and Markets Authority, to Gary Gensler, Chairman, the CFTC, dated Jan. 17, 2011 (discussing issues raised by requiring foreign SDRs to register in the U.S.).

[63] See note 55, supra.

the CFTC's interpretation that the non-U.S. regulator is not as a result subject to Dodd-Frank's notice and indemnification provisions.[64] We recommend that the SEC adopt this interpretation.

C. *Access by Non-U.S. Market Participants to U.S. Clearing Organizations, SEFs and SDRs*

The CFTC has noted that it would not require a non-U.S. person to register as a swap dealer if its only connection to the U.S. is that the person uses a U.S.-registered clearing organization, SEF or exchange in connection with its swap dealing activities or reports swaps to a U.S.-registered SDR.[65] It is important that both Commissions confirm this interpretation. Confirmation of this interpretation will help promote clearing and trading on U.S. clearing organizations and SEFs, increasing open interest and liquidity in U.S. markets.

In addition, the CFTC has proposed to expand its "foreign broker" provisions to permit non-U.S. brokers to access U.S. designated contract markets and SEFs on behalf of non-U.S. swaps customers without registering as an FCM, provided that they do so through an omnibus account carried by a U.S. FCM.[66] We recommend that the CFTC expand the foreign broker provisions also to cover swaps executed bilaterally and cleared in the U.S. We also recommend that the CFTC confirm that, as in the futures context, a U.S. FCM should treat the foreign broker and the foreign broker's omnibus customer account as its customer.[67]

Finally, when a non-U.S. person either reports data for its transaction to a U.S. SDR or has that data reported to a U.S. SDR by its counterparty, there will be circumstances in which that non-U.S. person's regulator wishes to access that data. As noted above, Dodd-Frank would in such a case generally require the non-U.S. regulator to indemnify the SDR and the relevant Commission. In this regard, we support the CFTC's interpretation that the Commission may provide non-U.S. regulators with access to confidential information obtained from an SDR

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[64] See CFTC Final Rules, Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 Fed. Reg. 54538, 54554 (Sept. 1, 2011).

[65] See CFTC Registration Proposal at 71382.

[66] See CFTC Proposed Rules, Registration of Intermediaries, 76 Fed. Reg. 12888 (Mar. 9, 2011); Adaptation of Regulations to Incorporate Swaps, 76 Fed. Reg. 33066 (June 7, 2011).

[67] If an individual legal segregation approach, such as the one proposed by the CFTC, is adopted in the U.S. for cleared swaps, then the Commissions could address positions held by non-U.S. clients of foreign brokers through an omnibus account of a U.S. FCM by requiring such positions and the value of collateral associated with them to be reported to the U.S. clearing organization in a manner similar to the mnemonic-based reporting framework for special calls currently required of foreign brokers under CFTC rules.

without the non-U.S. regulator becoming subject to Dodd-Frank's indemnification requirement.[68] We recommend that the SEC also adopt this interpretation.

V. Analysis of Title VII's Territorial Scope and Related Legal Precedents

The jurisdictionally-based regulatory framework summarized above is based on the territorial scope of Title VII and related precedents, as described immediately below.

A. Territorial Scope of U.S. Jurisdiction Generally

"[T]he general and almost universal rule is that the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done."[69] Under this long-standing principle of sovereignty, territoriality is the normal basis for a state's jurisdiction.[70] Moreover, even when a basis for jurisdiction is present, a state may not exercise jurisdiction with respect to a person or activity having connections with another state when the exercise of such jurisdiction is "unreasonable."[71] The exercise of jurisdiction may be unreasonable where, for example, the regulation might conflict with justified expectations or the interests of another state in regulating the relevant activity.[72]

B. Sections 722(d) and 772(b) of Dodd-Frank

It is a "long-standing principle of American law" that legislation of Congress, "unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States."[73] In this regard Congress added Sections 722(d) and 772(b) of Dodd-Frank to codify conventional territorial limitations to the scope of Title VII, consistent with the territorial scope of existing futures and securities regulations, and, importantly, with well-established principles of international jurisprudence.

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[68] See note 64, supra.

[69] American Banana Co. v. United Fruit Co., 213 U.S. 347, 357 (1909) (Holmes, J.).

[70] See Restatement (Third) of Foreign Relations §402 (1987). The other generally accepted basis for jurisdiction is nationality, *i.e.*, states have jurisdiction over their nationals both within and outside their territory. See id. Nationality jurisdiction over a domestic corporation's own activities abroad is, however, distinct from jurisdiction over the non-U.S. branch or affiliate of a domestic corporation, which is to be limited to "exceptional cases." See id. at § 414.

[71] See id. at § 403.

[72] See id.

[73] Morrison v. NAB, 130 S. Ct. 2869, 2877-78 (quoting EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991)) (internal quotations omitted).

Sections 722(d) and 772(b) are expressed as prohibitions on extraterritorial application of the Agencies' rules, subject to narrow exceptions. These provisions evidence Congress' intent to adopt conventional territorial boundaries to the application of Title VII. Section 722(d) provides that the provisions of the CEA relating to swaps that were enacted by Title VII of Dodd-Frank "shall not apply to activities outside the United States unless those activities . . . have a direct and significant connection with activities in, or effect on, commerce of the United States [or] contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of [the CEA] that was enacted by [Title VII]." Section 772(b), in turn, provides that "[n]o provision" of the Exchange Act added by Title VII of Dodd-Frank "shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of any provision of [the Exchange Act] that was added by [Title VII]."

Sections 722(d) and 772(b) do include certain limited exceptions. The language in the exceptions in Sections 722(d) and 772(b) closely tracks language that Congress has used in other contexts to limit U.S. jurisdiction. Section 722(d)'s exception for "direct and significant" connections with or effects on commerce of the U.S. is strikingly similar to exceptions contained in other statutes, which U.S. courts have interpreted narrowly to apply only in cases where conduct abroad has "an immediate consequence" within the U.S., as opposed to a consequence the occurrence of which is subject to uncertain intervening developments.[74]

The classic example of conduct subject to effects jurisdiction is the proverbial gun that is shot across a border. In the context of financial market regulation, U.S. effects jurisdiction over conduct outside the U.S. has typically been limited to cases involving fraud and manipulation.[75] Courts have generally rejected application of substantive U.S. requirements to activities conducted abroad.[76] As the Second Circuit has observed, "[t]he problem of conflict

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[74] See Republic of Argentina v. Weltover, 112 S.Ct. 2160 (1992), U.S. v. LSL Biotechnologies, 379 F.3d 672 (9th Cir. 2004); United Phosphorus, Ltd. v. Angus Chem. Co, 131 F.Supp.2d 1003 (N.D. Ill. 2001); In re Intel Corp. Microprocessor Antitrust Litig. (Intel II), 476 F.Supp.2d 452 (D.Del. 2007). See also F. Hoffman-La Roche Ltd. et al. v. Empagran S.A. et al., 124 S.Ct. 2359, 2361 and 2369 (2004) (rejecting the notion that the Foreign Trade Antitrust Improvements Act exception for "direct" effects expanded U.S. antitrust jurisdiction, noting that "if America's antitrust policies could not win their own way in the international market place for such ideas, Congress, we must assume, would not have tried to impose them, in an act of legal imperialism, through legislative fiat.").

[75] See, e.g., In the Matter of Sumitomo Corporation, Comm. Fut. L. Rep. ¶27, 327 (May 11, 1998) (CFTC enforcement action for manipulative copper trading outside the U.S. that directly affected U.S. prices).

[76] For example, in Plessey Co. PLC v. General Electric Co. PLC, a U.S. District Court refused to apply the disclosure and filing requirements of Section 14(d) of the Exchange Act to a tender offer launched in Britain by one

(footnote continued on next page . . .)

between our laws and that of a foreign government is much less when the issue is the enforcement of the anti-fraud sections of the securities laws than with such provisions as those requiring registration of persons or securities."[77]

In this regard, the argument that merely operating a non-U.S. swap dealing affiliate or choosing to conduct swap activities in non-U.S. markets has a sufficiently "direct and significant" effect on U.S. commerce to merit application of U.S. requirements extraterritorially would clearly go too far—since it would justify extraterritorial application of U.S. requirements always and in every case—and surely would not pass the "immediate consequence" test for direct effects that U.S. courts have applied in the past. The U.S. Supreme Court has expressly noted that diminution of New York's status as a world financial center as a result of conduct outside the U.S. was too remote and attenuated to qualify as a "direct" effect.[78]

In addition, both Section 722(d) and Section 772(b) contain "anti-evasion" language that is almost identical to language that the Supreme Court construed in Morrison v. NAB.[79] The Morrison Court specifically concluded that that language was not sufficient to evidence extraterritorial intent of Congress, but rather was intended to address actions abroad that might conceal a domestic violation of U.S. law or that might cause what would otherwise be a domestic violation to escape on a technicality.[80]

This jurisprudence is consistent with long-standing canons of statutory construction that exceptions to a general rule—in this case, the general rule being a prohibition on extraterritorial application of the Agencies' rules—must be construed narrowly,[81] primarily because the general rule

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British company for another where there were no allegations of fraud, the tender offer did not involve the U.S. market and only a small percentage of the target's voting shares were held in the U.S. 628 F. Supp. 477 (D. Del. 1986).

[77] International Investment Trust v. Cornfeld, 619 F.2d 909, 921 (2d Cir. 1980).

[78] See Weltover, 112 S.Ct. at 2168.

[79] The Morrison Court interpreted Section 30(b) of the Exchange Act, which, like Sections 722(d) and 772(b) of Dodd-Frank, confers Commission jurisdiction over non-U.S. business that contravenes "such rules and regulations as the Commission may prescribe as necessary or appropriate to prevent the evasion of" the Exchange Act.

[80] See Morrison, 130 S.Ct. at 2882-83. Although Congress did respond to Morrison in Section 929P of Dodd-Frank by providing extraterritorial enforcement jurisdiction to the SEC and the Department of Justice, it did so solely in the context of the anti-fraud provisions of the federal securities laws.

[81] See Sutherland Statutes and Statutory Construction (7th ed. 2011), §47:11 ("Where a general provision in a statute has certain limited exceptions, all doubts should be resolved in favor of the general provision rather than the exceptions.").

states the primary policy objective of Congress. Put differently, exceptions should not be permitted to swallow the rule.

C. Cost-Benefit Analysis

The Commissions are required under Section 15(a) of the CEA and Section 3(f) of the Exchange Act, respectively, to take into account cost-benefit and related economic analyses in their rulemakings.[82] Consistent with these statutory requirements, the benefits of any extraterritorial application of U.S. law must outweigh the costs. Such costs would be significant. Administering a regime of extraterritorial regulation would burden U.S. regulators with unrealistic supervisory responsibilities, would burden regulated persons and, potentially, could burden unregulated counterparties who have no expectation of protection under U.S. law. (By way of a simple example, non-U.S. counterparties might be required to engage U.S. counsel for advice as to whether they satisfy a certain standard within the meaning of a Commission regulation or Dodd-Frank with which they are not familiar.) Competitive disparities, fragmentation of global markets and reciprocal application of non-U.S. law to U.S. activities also would likely result. At the same time, the benefit of extraterritorial application of U.S. law cannot be known *ex ante* without knowing how markets and market participants implement Dodd-Frank and respond to its implementation, as well as the extent and effects of any differences between Dodd-Frank and the reforms being adopted in other jurisdictions.

As a corollary, preemptive exercise of the Agencies' anti-evasion authority cannot be justified *ex ante* under a cost-benefit analysis because the extent and effects of evasive activity cannot be known *ex ante*. Nor can a determination of evasion be made without analysis of the motivation and intent of the parties—certainly the mere conduct of swap activity from validly existing non-U.S. locations does not, by itself, support a conclusion of evasive activity.

Cost-benefit analysis additionally requires that the Agencies take into account considerations of comity and competition. In particular, comity, including avoiding duplication of or conflict with non-U.S. regulatory requirements, and the efficient use of U.S. supervisory resources should be key considerations for the Agencies in considering registration and regulatory requirements for non-U.S. persons. The Agencies must also be mindful of assuring a level playing field between U.S. and non-U.S. market participants, and so should refrain from

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[82] See Report of Investigation Regarding Cost-Benefit Analysis Performed by the CFTC in Connection with Rulemakings Undertaken Pursuant to the Dodd-Frank Act, Office of the Inspector General, CFTC (Apr. 15, 2011) (noting that a more robust approach to cost-benefit analysis, with greater input from the Office of the Chief Economist, would be desirable in the context of CFTC rulemakings under Dodd-Frank); Business Roundtable and Chamber of Commerce v. SEC, No. 10-1305 (D.C. Cir. July 22, 2011) (vacating SEC proxy access rule because the SEC "inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters").

distinguishing between market participants on the basis of their nationality, as opposed to the location in which they conduct their activities.

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We would be pleased to provide further information or assistance at the request of the Agencies or their staffs. Please do not hesitate to contact Edward J. Rosen (212 225 2820) or Colin D. Lloyd (202 974 1908) of Cleary Gottlieb Steen & Hamilton LLP, outside counsel to the Firms, if you should have any questions with regard to the foregoing.

Respectfully submitted,

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