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asset management group

August 21, 2013

Ms. Melissa D. Jurgens
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Comment Letter on the Exemptive Order Regarding Compliance with Certain Swap Regulations (RIN 3038-AE85) and Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations (RIN 3038-AD85)

Dear Ms. Jurgens:

The Asset Management Group (the "**AMG**")[1] of the Securities Industry and Financial Markets Association ("**SIFMA**") appreciates the opportunity to provide its views to the Commodity Futures Trading Commission (the "**Commission**") on the Exemptive Order Regarding Compliance with Certain Swap Regulations (the "**Exemptive Order**")[2] and Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations (the

[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds. In their role as asset managers, AMG member firms, on behalf of their clients, engage in transactions for hedging and risk management purposes that will be classified as "security-based swaps" and "swaps" under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

[2] Exemptive Order Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 43,785 (July 22, 2013).

"**Guidance**").[3] The AMG continues to have concerns with the Commission's approach to the cross-border application of its swap regulations, and in particular the U.S. person definition set out in the Guidance. The definition is overly broad and, in many cases, creates uncertainty in the application of the Commission's regulations. Moreover, the Exemptive Order provides far too little time for asset managers and their clients to assess their status under this complex and subjective definition and to come into compliance with the U.S. rules, exacerbating the difficulty of the interpretive questions and practical challenges arising from implementation of the Guidance's U.S. person definition. This letter provides our views, and recommendations for the Commission, on the Exemptive Order and the Guidance, which is integrated into and closely linked with the Exemptive Order.

The AMG also strongly supports the comments and recommendations provided to the Commission on August 12, 2013 by SIFMA, the Futures Industry Association, and the Financial Services Roundtable (the "**Joint Comment Letter**").[4] The AMG appreciates the Commission's consideration of the comments in this letter and those in the Joint Comment Letter as it considers modifications to the Exemptive Order and Guidance to address the concerns of AMG members and other market participants.

I. The Commission Must Provide for a Longer Compliance Period

Full compliance with the Commission's swap regulations, as interpreted under the Guidance, requires asset managers and their clients to engage in a two-stage process. First, asset managers will need to evaluate their clients to assess their status as U.S. persons and as guaranteed or conduit affiliates to determine whether, and which, U.S. regulatory requirements apply. This analysis includes the application of the new, complex and subjective definition of "U.S. person" to each individual client and fund entity for which an asset manager trades derivatives. As much of the information needed for such analyses is not available to or currently collected by asset managers, they will need to engage in significant outreach efforts to educate clients on the implications of the Guidance and to obtain the requisite information and representations from them. Some of these clients will themselves need to engage in an analysis of their regulatory status under the Guidance in order to provide the necessary feedback to their asset

[3] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).

[4] SIFMA, the Futures Industry Association, and the Financial Services Roundtable, Comment Letter on the Exemptive Order Regarding Compliance with Certain Swap Regulations (RIN 3038-AE85) and Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations (RIN 3038-AD85) (Aug. 12, 2013), *available at* http://www.sifma.org/comment-letters/2013/sifma,-fia-and-fsr-submit-comments-to-the-cftc-on-compliance-issues-relating-to-certain-swap-regulations/.

managers. For funds and other collective investment vehicles, asset managers may also require additional information from investors in order to assess their U.S. person status. Asset managers also will need to gather information about the scope of activities conducted for their collective investment vehicles in various jurisdictions and engage in a fact intensive analysis of those activities. Additionally, with respect to funds and other collective investment vehicles organized outside of the United States that may be U.S. persons and have not been afforded the ability to rely on substituted compliance under the Guidance, asset managers will need to consider how to address any of the new U.S. regulatory requirements that are duplicative of or conflict with, the rules promulgated or to be promulgated under the home jurisdiction of the fund or collective investment vehicle. Further, asset managers will need to identify whether their counterparties are *bona fide* foreign branches of U.S. swap dealers, U.S. branches of non-U.S. swap dealers, or entities that are newly required to register as swap dealers to ensure the appropriate treatment of their swap transactions and compliance with the relevant regulatory requirements. As certain non-U.S. swap dealers and foreign branches of U.S. swap dealers are permitted under the Guidance to rely on substituted compliance (once an applicable substituted compliance determination has been made) rather than comply with the Commission's requirements when trading with certain non-U.S. persons, asset managers also will have to confirm with such counterparties which rules would apply to their clients' and funds' transactions.

Only after this first stage of critical analysis and due diligence has been completed will asset managers be able to begin implementing the requirements as they apply under the Guidance. Asset managers and their clients, particularly those who are newly subject to U.S. rules, will need to satisfy certain transaction-level requirements, such as executing new documentation with their counterparties and establishing new operational arrangements to meet the requirements, and will need to establish systems to monitor compliance for each client or fund for each type of counterparty. As evidenced by the Commission's phased-in compliance dates for the underlying regulations, such as for external business conduct, clearing, and swap trading relationship documentation, significant time is needed for such implementation. We believe that the basis for phased-in compliance timing applies equally in this context.

Under the Exemptive Order, these two stages must be completed in some cases by September 9, 2013, in most cases by October 10, 2013, and in all cases by December 22, 2013. The compliance period provided by the Exemptive Order is insufficient for asset managers and their clients to complete the first stage of the process, much less for them to complete both stages. Moreover, other Commission swap-related regulations, including the clearing deadline for Category 3 entities, the reporting requirements (including for historical swaps), the swap execution facility rules, harmonization rules for commodity pool operators of registered investment companies, and swap regulatory requirements

under the European Market Infrastructure Regulation ("**EMIR**") all take effect during this period, further stretching market participants' finite resources.

In order to allow sufficient time for asset managers to complete their review and come into compliance with applicable Commission rules for their funds and clients, the Commission should provide market participants until at least (i) the expiration of the Exemptive Order on December 21, 2013 to complete the first stage of the compliance process—evaluation and categorization of themselves and counterparties to determine which requirements apply under the Guidance—and (ii) March 31, 2014 to come into compliance with any newly applicable requirements as a result of a change in U.S. person or guaranteed or conduit affiliate status.

II. U.S. Person Definition

The U.S. person definition contained in the Guidance is of extreme importance to our members as, in many cases, it dictates whether market participants will be subject to regulation under the Commission's swap rules or will be wholly outside its swap regulatory regime. The Guidance's U.S. person definition is overly broad and complex, and may require market participants to engage in highly detailed facts-and-circumstances assessments to determine their U.S. person status. As a threshold matter, as discussed in the Joint Comment Letter, we are concerned about the catch-all provision in the definition of U.S. person that provides that the definition "generally includes, but is not limited to," the enumerated prongs of the U.S. person definition. This phrase adds unnecessary uncertainty to an already complicated definition and should be removed. We continue to believe that a properly formed, objective U.S. person definition would have been the best approach for the Commission to have taken. However, the Commission has elected instead to adopt a more subjective approach.

Particularly with respect to collective investment vehicles, the definition is highly dependent on the specific facts and circumstances of each vehicle. As a result, asset managers will be required to engage in an assessment of a collective investment vehicle's U.S. person status based on a weighing of the relevant facts and circumstances. We believe that it is critical that the Commission explicitly recognize that a good faith assessment of a collective investment vehicle's U.S. person status by an asset manager, based on a weighing of the facts and circumstances it deems most relevant to the analysis, would be consistent with Commission's expectations. Doing so would mitigate the risk and potentially severe ramifications of asset managers being second guessed and would alleviate market uncertainty based on the subjective nature of the test. We believe it is incumbent upon the Commission to clarify the Guidance's approach to the U.S. person definition in this respect and in several additional ways, as further detailed below.

1. Exclusion for public funds offered to non-U.S. persons and not offered to U.S. persons

The AMG appreciates the Commission's recognition in the Guidance that collective investment vehicles that are publicly offered outside the United States to non-U.S. persons, and that are not offered to U.S. persons, should not be viewed as U.S. persons. The text of the Guidance, and statements made by Commissioners at the July 12, 2013 open meeting at which the Guidance was adopted, clearly reflect the Commission's intent to exclude from the definition of U.S. person those funds that are publicly offered to non-U.S. persons, so long as the funds are not offered to U.S. persons. Specifically, the Guidance unambiguously states that "a collective investment vehicle that is publicly offered only to non-U.S. persons and not offered to U.S. persons generally *would not fall within any of the prongs of the interpretation of the term U.S. person.*"[5]

Notwithstanding this clear and specific statement in the main text of the Guidance, the summary of the U.S. person definition appears to contain an inadvertent error by including the public fund exception only in the text of prong (vi) of the definition, which relates to majority ownership by U.S. persons, but not in prong (iii), which relates to funds organized or having their principal place of business in the United States.[6] The Commission provides no further explanation for this oversight in prong (iii). The Commission should promptly provide clarification that a collective investment vehicle that is publicly offered only to non-U.S. persons and is not offered to U.S. persons is also carved-out of prong (iii) and all other prongs of the U.S. person definition to be consistent with its clear statement to this effect in the main text of the Guidance.

2. Principal place of business for collective investment vehicles

The Guidance provides that a collective investment vehicle will be a U.S. person if it has its principal place of business in the United States. The Guidance, despite the recognition that "the formation and structure of collective investment vehicles involve a great deal of variability," states that the Commission will:

> generally consider the principal place of business of a collective investment vehicle to be in the United States if the senior personnel responsible for either (1) the formation and promotion of the collective investment vehicle or (2) the implementation of the vehicle's investment strategy are located in the United States, depending on the facts and

[5] Guidance, 78 Fed. Reg. at 45,314 (emphasis added).

[6] Guidance, 78 Fed. Reg. at 45,316-17.

> circumstances that are relevant to determining the center of direction, control and coordination of the vehicle.[7]

The Guidance seeks to provide further clarity with respect to the application of these factors, including by providing examples of how the factors would apply to three hypothetical situations.

While the AMG appreciates the Commission's efforts to clarify the application of the principal place of business test of the U.S. person definition in the context of collective investment vehicles, we have several significant concerns with the Commission's approach. These concerns, and our recommendations for how they should be addressed, are discussed below.

As noted above, to determine whether its principal place of business is in the United States, under the Guidance, a collective investment vehicle must assess whether senior personnel responsible for either (1) the formation or promotion of the collective investment vehicle or (2) the implementation of the vehicle's investment strategy are located in the United States. The Guidance states that these factors are based on the principal place of business test developed by the U.S. Supreme Court in its 2010 decision in *Hertz Corp. v. Friend*,[8] which was designed by the Court to avoid unnecessary confusion in determining an entity's principal place of business.[9] However, particularly when read together with the examples in the Guidance, the factors result in significant questions for a collective investment vehicle in determining whether its principal place of business is in the United States. These questions, as described in more detail below, cast doubt on whether the Guidance, though it purports to follow *Hertz*, comports with its basic tenet that the test of an entity's principal place of business must yield one, and not more than one, location.[10]

The Guidance's principal place of business factors, and the examples applying those factors, do not directly address many common types of advisory arrangements. For instance, the examples set out in the Guidance applying the principal place of business factors do not address a situation in which the

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[7] Guidance, 78 Fed. Reg. at 45,310.

[8] Guidance, 78 Fed. Reg. at 45,309 ("Instead, as stated in the *Hertz* case cited above, the determination [of a collective investment vehicle's principal place of business] should generally depending on the location of the 'actual center of direction, control and coordinate' *i.e.*, the 'nerve center' of the collective investment vehicle.")

[9] *Hertz Corp. v. Friend*, 559 U.S. 77, 96 (2010) (discussing the "necessity of having a clearer rule" to determine an entity's principal place of business).

[10] *Id.* at 95 ("[A] corporation's 'nerve center,' usually its main headquarters, is a ***single place***" (emphasis added).

activities that fall within those factors are conducted by senior personnel in different locations. A collective investment vehicle may have senior personnel in multiple locations responsible for its formation, promotional activities, and implementation of its investment strategy. Indeed, it is not uncommon for the sponsor and promoter of a collective investment vehicle to be in a location different from that of the investment adviser responsible for implementing the vehicle's investment strategy.

The Guidance's factors and examples also do not sufficiently recognize the regulatory environment outside the United States in which collective investment vehicles operate. For example, under new requirements for asset managers under Europe's Alternative Investment Fund Management Directive ("**AIFMD**"), management companies operating in Europe must retain significant management functions for a collective investment vehicle, including risk management. The approach taken by the Guidance is at times inconsistent with how global asset managers of collective investment vehicles must operate to comply with multiple regulatory regimes, where these functions are more evenly divided across jurisdictions, with key functions being performed, and responsibility for those functions necessarily residing, in more than one jurisdiction.

The following examples highlight a few circumstances in which the Guidance's approach presents challenges in determining a collective investment vehicle's principal place of business.

- The principal place of business test looks to the location of the "senior personnel" of a collective investment vehicle responsible for specified key functions. However, a collective investment vehicle may have many personnel with different responsibilities that all may be viewed as functions that determine the collective investment vehicle's principal place of business under the Guidance. For example, one of the specified key functions is "the implementation of the collective investment vehicle's investment strategy." Depending on how this phrase is interpreted, it may include functions performed by the chief operating or risk officer, who is responsible, in different ways, for ensuring orderly and efficient operations of the collective investment vehicle and that the collective investment vehicle's risks are appropriately addressed based on its investment strategy. It may also include portfolio managers and heads of trading desks or businesses lines who are responsible for the collective investment vehicle's investment strategy and its investment performance. All of these personnel may each be viewed as "senior personnel" of the fund that "implement the investment strategy" of the fund. If some of these personnel are in the United States and others abroad, it is not

immediately clear if the collective investment vehicle's principal place of business is in the United States.

- A collective investment vehicle may engage in swap and non-swap investment activities. In this case, certain senior personnel may be responsible for the swap activities of the collective investment vehicle, while others in other jurisdictions are responsible for the collective investment vehicle's non-swap investments. It is unclear whether the Guidance, which defines U.S. person only for the Commission's swaps regulations, would require a collective investment vehicle to look to the location where its overall investment strategy (as opposed to only its swaps activities) is implemented.

- The second example in the Guidance indicates that having personnel in supervisory positions in one location that are responsible for traders or other investment advisory personnel in another particular location may cause the location of the supervisory personnel to be a collective investment vehicle's principal place of business, although the determination may vary based on the relevant facts and circumstances. The Guidance provides no discussion of the treatment under the principal place of business test where supervisory personnel are located both inside and outside the United States and does not specify the types of supervisory activities that, if conducted in the United States, would cause an otherwise non-U.S. collective investment vehicle to be deemed to be a U.S. person.

While the Commission acknowledges that market participants may seek further guidance from the Commission's staff under the existing process set out in regulation 140.99, we believe that seeking such guidance on an ongoing basis for even the most typical circumstances that arise in the context of collective investment vehicle structures and operations is overly burdensome and impracticable for both market participants and the Commission, especially, in light of the aggressive compliance deadline for the new U.S. person definition.

The Commission has declined in the Guidance to establish bright-line rules defining whether a market participant is a U.S. person. The uncertainty that results from the Guidance's approach must be addressed by market participants as they seek to implement the Guidance. We believe the Commission, to avoid a result that is inconsistent with the basic premise of *Hertz*, should clarify that a collective investment vehicle, or an asset manager acting on its behalf, may assess and determine in good faith, based on the facts and circumstances it deems most relevant to the analysis, whether the collective investment vehicle's "center of direction, control and coordination" is in the United States. Such a clarification is

consistent with the approach taken by the Guidance, and we believe that it would better align the Commission's principal place of business test with that of *Hertz*.

3. The Guidance should exclude from the U.S. person definition collective investment vehicles that are privately offered to non-U.S. persons and not offered to U.S. persons

The Commission appropriately takes the view that a collective investment vehicle that is *publicly* offered to non-U.S. persons and that is not offered to U.S. persons is not a U.S. person. We believe that a collective investment vehicle that is *privately* offered to non-U.S. persons and is not offered to U.S. persons should also categorically be excluded from the U.S. person definition. A vehicle that is not offered to U.S. investors does not have enough of a connection to or effect on United States commerce to be considered a U.S. person. The Commission should explicitly provide that any collective investment vehicle that is not offered to U.S. persons is not a U.S. person.

4. ***Determination of U.S. person status of beneficial owners***

The AMG strongly supports the elimination of the requirement, as included in the Commission's proposed cross-border guidance, for a collective investment vehicle to look to the U.S. person status of both its direct and indirect owners to determine its U.S. person status under the majority-ownership prong of the U.S. person definition. The Guidance does not, however, address some of the concerns raised in connection with the proposed cross-border guidance relating to the impracticably in some circumstances of assessing the U.S. person status of direct beneficial owners. For example, investors may hold interests in a collective investment vehicle through intermediaries in omnibus, nominee or street name accounts, such that the manager or operator of the collective investment vehicle does not have access to information to identify that investor's U.S. person status. As the Commission acknowledged in footnote 139 of the Guidance, certain jurisdictions may prohibit disclosure by intermediaries of beneficial owner information.

Accordingly, in these circumstances, it would not be practicable for the manager or operator of the collective investment vehicle to assess the U.S. person status of the ultimate investors holding through intermediaries in omnibus, nominee or street name accounts. To address such circumstances, the Commission should expressly clarify that a collective investment vehicle may treat interests held in omnibus, nominee or street name accounts by intermediaries located in the United States as attributable to U.S. person beneficial owners and, conversely, may treat interests held in such accounts by intermediaries located outside the United States as attributable to non-U.S. person beneficial owners.

III. Minimizing Unnecessary Regulatory Overlap by Allowing Substituted Compliance for All Counterparties

Asset managers and their clients that operate both inside and outside the United States may be subject to swap regulatory requirements under the Commission's regulations and the regulations of the other jurisdictions in which they operate. For example, a collective investment vehicle that is organized in the European Union and is not a U.S. person, when transacting with a U.S. swap dealer may be subject to requirements, such as swap reporting, clearing, trade execution, and portfolio reconciliation under both EMIR and Commission regulations. If the Commission has determined that the relevant EMIR rule is "comparable," to Commission rules, the Commission will have acknowledged that the EMIR rule generally achieves the same goals as the Commission regulation, thereby making the overlap in requirements unnecessary. However, substituted compliance would not be available to the collective investment vehicle when trading with a U.S. swap dealer.

The AMG believes that where the Commission has determined that a foreign jurisdiction's requirement is comparable to that of the Commission, both counterparties should be allowed to comply with the applicable comparable requirements. This would avoid the counterparties being subject to potentially conflicting or duplicative regulatory requirements.

IV. Treatment of Swaps under Limited-Recourse Separate Account Arrangements as Swaps with Affiliate Conduits

Asset managers commonly provide investment advisory services to corporate entities and other institutional clients through separate account arrangements. In such cases, an asset manager is given investment authority over a specific pool of funds and assets owned by the institutional client (and typically held at its custodian). While the investments are held directly by the client, the trading arrangements governing the separate account set up by an asset manager may limit the recourse of a swap counterparty to only those assets under management by the asset manager and held in the separate account arrangement. For such a limited-recourse separate account, the risks associated with a swap entered for the separate account are not borne by the institutional client as a whole, but rather the potential exposure under the swap is limited to the funds and assets held in the separate account.

The types of clients for which some asset managers may establish limited-recourse separate account arrangements may include non-U.S. person institutional clients that may qualify as "affiliate conduits" under the Guidance.[11] Generally,

[11] An affiliate conduit generally includes an entity that, although it is a non-U.S. person, is a majority-owned affiliate of a U.S. person; is controlled, controlling, or controlled by the U.S. (…continued)

the activities that would cause an entity to qualify as an affiliate conduit are unrelated to the asset manager's services under the limited-recourse separate account arrangement. Under the Guidance, transactions with affiliate conduits are subject in some circumstances to requirements not otherwise applicable to transactions with non-U.S. persons. For example, a swap between an affiliate conduit and a foreign branch of a U.S. swap dealer or major swap participant or with a non-U.S. swap dealer or major swap participant would be subject to Transaction-Level Requirements (as defined under the Guidance).

The application of U.S. requirements to such a transaction is based on the view that "given the nature of the relationship between the [affiliate conduit] and the U.S. person [owner of the affiliate conduit], the U.S. person is directly exposed to risks from and incurred by the affiliate conduit."[12] This risk is not present for a swap entered into under a limited-recourse separate account arrangement, even where the client is otherwise an affiliate conduit, as the swap counterparty's recourse is limited to the assets in the separate account. On that basis, the AMG requests that the Commission clarify that a swap transacted through a limited-recourse separate account arrangement would not be viewed as a transaction with an affiliate conduit, regardless of whether the owner of the separate account would otherwise qualify as an affiliate conduit.

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(continued…)

person; its financial results are included in the consolidated financial statements of the U.S. person; engages, in the regular course of its business, in swaps with non-U.S. third parties for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliates; and enters into offsetting swaps or other arrangements with its U.S. affiliates to transfer the risks and benefits of the swaps with third-parties to its U.S. affiliates. Guidance, 78 Fed. Reg. at 45,359.

[12] Guidance, 78 Fed. Reg. at 45,358.

The AMG appreciates the Commission's consideration of these comments and stands ready to provide any additional information or assistance concerning these topics that the Commission may find useful. Should you have any questions, please do not hesitate to call Tim Cameron at 212-313-1389 or Matt Nevins at 212-313-1176.

Sincerely,

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Managing Director, Asset Management Group
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Matthew J. Nevins, Esq.
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cc: Hon. Gary Gensler, Chairman, Commodity Futures Trading Commission
Hon. Bart Chilton, Commissioner, Commodity Futures Trading Commission
Hon. Scott O'Malia, Commissioner, Commodity Futures Trading Commission
Hon. Mark Wetjen, Commissioner, Commodity Futures Trading Commission