February 3, 2011

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Ms. Elizabeth M. Murphy
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Mr. John Walsh
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Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
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Mr. Edward DeMarco
Acting Director
Federal Housing Finance Agency
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Washington, DC 20552

Mr. Gary Van Meter
Acting Director
Farm Credit Administration
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McLean, Virginia 22102—5090

Re: Registration of Swap Dealers and Major Swap Participants, RIN 3038-AC95;[1]

Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant," RIN 3235-AK65.[2]

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[1] 75 Fed. Reg. 71379 (Nov. 23, 2010) (hereinafter the "**Registration Proposed Rule**")

[2] 75 Fed. Reg. 80174 (Dec. 21, 2010) (hereinafter the "**Joint Definitions Proposed Rule**").

Dear Ms. Murphy, Mr. Stawick, Ms. Johnson, Mr. Walsh, Mr. Feldman, Mr. DeMarco and Mr. Van Meter:

The Securities Industry and Financial Markets Association ("**SIFMA**")[3] appreciates the opportunity to comment on the extraterritorial application of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act[4] and the rules proposed thereunder by the Commodity Futures Trading Commission (the "**CFTC**") and the Securities and Exchange Commission (the "**SEC**", and together with the CFTC, the "**Commissions**") that relate to the regulation of swap dealers.[5] We address this letter to the Commissions and the "prudential regulators," as such term is defined in Title VII, because the Commissions and the prudential regulators are responsible for adopting capital and margin requirements, which we discuss in this letter.

I. Introduction

The swaps[6] market is truly global: a single swap may be negotiated and executed between counterparties located in two different countries, booked in a third country and risk-managed in a fourth country, thereby triggering swaps regulation in multiple jurisdictions simultaneously. Many participants use a central booking entity to efficiently manage risks arising from swaps that they execute around the world through their subsidiaries, affiliates and branches.

These global arrangements emerged decades ago from the efforts of counterparties to maximize their credit protection and reduce their risks. The regulation of these swap arrangements is complicated by the nature of swaps, which are characterized by ongoing payments, deliveries or other obligations between the parties throughout their long duration. This may result in regulation of the swaps relationship over the course of many years, rather than primarily at the time of the execution of the transaction as with the purchase or sale of cash instruments.

An effective approach to U.S. swaps regulation must accommodate the global risk management and efficient operational structures currently in place. U.S.

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[4] *See* Public Law 111-203, 111th Cong., 2d sess. (July 21, 2010), §§ 726(b) and 765(b) (hereinafter "**Dodd-Frank**").

[5] The term "swap dealer" as used in this letter includes security-based swap dealers and refers to SEC or CFTC registrants.

[6] The term "swaps" as used in this letter refers generally to CFTC-regulated swaps and SEC-regulated security-based swaps.

regulators[7] should carefully draft the Title VII rules to avoid disrupting these international arrangements except where necessary to achieve an explicit legislative purpose. U.S. regulators should also give effect to the principles of international comity by refraining from unnecessarily regulating conduct outside national borders while appropriately allocating supervision of cross-border swaps activities in a way that protects U.S. markets and counterparties and avoids duplicative and inconsistent regulations.

The term "U.S. swap dealer" as used herein refers to a registered swap dealer that is incorporated, organized or established in the United States, while the terms "foreign swap dealer" and "non-U.S. swap dealer" refer to a registrant that is incorporated, organized or, in the case of a non-U.S. branch of a bank, established, outside of the United States, regardless of whether it has a U.S. parent company or U.S. affiliate, or is a non-U.S. branch of a U.S. bank. Such an approach is consistent with the SEC's Regulation S, which is discussed below.

We set forth below our proposed approach for how the U.S. regulators should exercise their jurisdiction over swap dealers and cross-border swaps activities. Specifically:

- A non-U.S. entity, including a non-U.S. affiliate or branch of a U.S. entity, should not be required to register as a swap dealer and comply with Title VII's swap dealer regulations if it conducts swaps transactions solely outside of the United States with non-U.S. persons.
- U.S. regulators should examine the entity-level regulations[8] applicable to a swap dealer and consider where it would be appropriate to rely on a non-U.S. swap dealer's home country entity-level regulation, for example when such regulation yields comparable results to U.S. regulation.
- U.S. regulators should examine the transaction-based regulations applicable to a swap dealer and consider whether such regulations should apply to swap dealers when a non-U.S. person is involved. The U.S. regulators should be sensitive to situations in which their transaction-based rules may conflict with non-U.S. transaction-based rules applicable to non-U.S. persons.
- The Commissions should permit multiple operating and risk-management models, including intermediary models, in which a non-U.S. swap dealer and its U.S. affiliate are responsible for fulfilling different responsibilities under Title VII, and inter-affiliate structures, in which Title VII's transaction-based

[7] The term "U.S. regulators" as used in this letter refers generally to the Commissions, the Board of Governors of the Federal Reserve System (the "**Federal Reserve**") and the other agencies to which this letter is addressed.

[8] Title VII's swap dealer requirements can be conceptually divided into requirements that apply on an entity-level, such as capital requirements, and requirements that apply on a transaction-by-transaction basis, such as mandatory clearing and business conduct requirements. These requirements are discussed in further detail below in section II.B.

regulations would not apply to transactions between affiliates entered into for risk hedging purposes.

Our approach would not require the U.S. regulators to exempt entities from Title VII regulations. The legal authority to implement our proposed approach involves: (i) reliance on the jurisdiction provisions in Sections 722 and 772 to limit Title VII's requirements to U.S. transactions instead of granting exemptions from such requirements; (ii) the broad authority of the Commissions, in consultation with the Federal Reserve, under Section 712(d) of Dodd-Frank, to define "swap dealer" and to adopt such other rules regarding the definition of swap dealer as they deem necessary; (iii) the statutory mandate in Section 752 for the U.S. regulators to "coordinate and consult with foreign regulatory authorities on regulation" of swaps and swap dealers; and (iv) the authority of the Commissions in Sections 721 and 761 to designate an entity as a swap dealer with respect to certain activities and to limit the application of Title VII regulation to such activities.

II. Discussion: The Commissions Should Limit the Exercise of Their Jurisdiction over Cross-Border Swaps Activities

We acknowledge that U.S. regulators have jurisdiction over cross-border swaps activities where at least one counterparty to the swap is a U.S. person;[9] where an entity registers as a swap dealer; and where swap-dealing activities are conducted from within the United States. However, we believe that U.S. regulators should use discretion and limit the exercise of this jurisdiction with respect to cross-border swaps transactions where doing so would meet the policy objectives of Dodd-Frank and would preserve international comity.

A. A Foreign Entity's Swaps with Non-U.S. Persons Should Not Trigger Title VII's Registration Requirement

Consistent with the intent of Dodd-Frank, as well as the Commissions' current approach towards the extraterritorial application of U.S. regulation, we believe that a non-U.S. entity that conducts swaps transactions solely outside of the United States with non-U.S. persons should not fall within the definition of "swap dealer" and should not be subject to Title VII regulation. Registration requirements for non-U.S. entities should be based solely on whether the activity by such non-U.S. entity is with a U.S. person. The same treatment should apply to non-U.S. entities that are subsidiaries or affiliates of U.S. entities. The fact that such non-U.S. entity may be affiliated with a U.S. swap dealer should be irrelevant to determining whether such non-U.S. entity must register as a swap dealer.

As set out further below, we believe that there are good reasons for extending the same treatment to non-U.S. branches of U.S. banks that operate for valid business

[9] Below, we propose that U.S. regulators rely on existing SEC regulations to define a U.S. person.

reasons, engage in the business of banking and are subject to substantive banking regulation in the foreign location.

To determine whether a party to a swap is a "U.S. person," the Commissions should rely on the existing definition of that term contained in Rule 902(k) of the SEC's Regulation S.[10] This established, workable definition is familiar to regulators and market participants alike, and would provide legal certainty. It is noteworthy that the Regulation S definition of U.S. person does not include non-U.S. affiliates of U.S. persons[11] or non-U.S. branches of a U.S. bank[12] and generally excludes collective investment vehicles established outside the United States with U.S. investors. By contrast, any agency or branch of a foreign entity located in the United States, any partnership or corporation organized or incorporated under the laws of the United States and any natural person resident in the United States is within the definition of "U.S. person," as is any non-U.S. trust with a trustee that is a U.S. person.

Our proposed approach to defining "U.S. person" is consistent with the territorial scope of Title VII. Section 722 (CFTC) and Section 772 (SEC) limit the Commissions' jurisdiction to the United States, subject to specific exceptions for anti-evasion regulations and, in the case of Section 722 only, to offshore activities with a "direct *and* significant" U.S. nexus. In light of the recent Supreme Court decision in *Morrison v. National Australia Bank Ltd.*,[13] Sections 722 and 772 are presumed to be "primarily concerned with domestic conditions" and their extraterritorial scope will be narrowly construed.[14] Specifically, a transaction between two foreign entities that are affiliates of U.S. persons should be "without the jurisdiction of the United States" (for purposes of Section 772 regulating security-based swaps) or "outside the United States" (for purposes of Section 722 regulating

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[10] 17 C.F.R. § 230.902(k).

[11] Accordingly, a foreign affiliate of a U.S. bank falls outside Regulation S's definition of "U.S. person."

[12] *See* 17 CFR § 230.902(k)(2)(v) (excluding from "U.S. person" any agency or branch of a U.S. person located outside the United States that operates for valid business reasons, engages in the business of banking and is subject to substantive banking regulation in the foreign location).

[13] 130 S. Ct. 2869 (2010).

[14] *Id.* at 2877. In *Morrison*, the Supreme Court had occasion to remark on the meaning of Section 30(b) of the Securities Exchange Act of 1934 ("**Exchange Act**"), a jurisdiction provision that is substantively identical to Section 30(c) of the Exchange Act, as inserted by Section 772 of Dodd-Frank. The Supreme Court stated that "the exclusive focus on *domestic* purchases and sales is strongly confirmed by § 30(a) and (b) . . . . Under both provisions it is the foreign location of the *transaction* that establishes (or reflects the presumption of) the Act's inapplicability, absent [anti-evasion] regulations by the Commission." This statement suggests that absent the anti-evasion exception, Section 30(b) of the Exchange Act does not provide the SEC with jurisdiction over foreign transactions. A swap where neither counterparty is a "U.S. person" would clearly be a foreign transaction and would fall outside the scope of Section 30(c) of the Exchange Act.

swaps).[15] The mere fact that a U.S. entity directly or indirectly controls or is under common control with a foreign-incorporated entity generally is considered to be too tangential to constitute a sufficient U.S. nexus. Similarly, the exception in Section 722 for activities outside the United States that have a "direct and significant" effect on commerce of the United States does not warrant defining "U.S. person" to include foreign affiliates of U.S. persons because the effect on U.S. commerce will, in general, be tenuous, particularly in the context of the global economy.

Furthermore, a foreign affiliate's swap transactions and dealings with other foreign entities should not generally trigger the Commissions' anti-evasion authority under Sections 722 and 772. Many U.S. companies have affiliates that are incorporated or organized outside the United States and conduct swaps activities overseas for legitimate business reasons, such as the need to build local relationships with customers. These well-established foreign affiliates of U.S. firms are clearly not seeking to evade Dodd-Frank.

B. Title VII's Entity-Level and Transaction-Based Swap Dealer Requirements

Title VII's requirements for swap dealers can be conceptually divided into requirements that apply individually to each swap transaction and those that apply to a registered swap dealer at the entity level. Entity-level requirements are those that apply to a swap dealer as a predicate to engaging in business as a swap dealer. Foremost among these requirements is capital. Transaction-based requirements are those that are triggered by and are tailored to a particular transaction and include counterparty business conduct standards, documentation requirements, collateral segregation, certain recordkeeping obligations as well as swap data reporting and mandatory clearing. We note that certain swap dealer regulations, such as margin, are difficult to categorize as strictly entity-level or transaction-based regulations, and that some regulations may be treated as transaction-based requirements for U.S. swap dealers but may be better treated as entity-level requirements for foreign swap dealers, depending on how the regulation interacts with other home country entity-level requirements. Therefore, the U.S. regulators should carefully analyze the nuances of the regulations, particularly as applied to different types of swap dealers, before applying them. We urge the U.S. regulators to examine all of their swap dealer rules on an individual basis and determine how to apply them to non-U.S. swap dealers on an entity-level, and in their transactions with U.S. persons and non-U.S. persons. In the following sections, we set forth our specific recommendations and the legal authority for the U.S. regulators to implement these recommendations.

[15] We note that the statutory formulations of the Commissions' jurisdiction differ and encourage the Commissions to interpret and exercise their jurisdiction consistently with each other.

1. Title VII's Entity-Level Requirements – U.S. Regulators Should Examine the Entity-Level Requirements and Consider Where It Would Be Appropriate to Rely on a Foreign Swap Dealer's Home Country Entity-Level Regulation

We propose that the U.S. regulators examine their entity-level requirements carefully and consider relying on a foreign swap dealer's home country entity-level regulation as long as such regulation yields comparable results to U.S. regulation. Although a foreign swap dealer is clearly subject to the Commissions' authority, application of U.S. entity-level requirements to foreign swap dealers may create conflicts with home country regulation. One example where this is particularly true is in the area of capital requirements. In addition, entity-level risk-management requirements are often mandated by supervisors in foreign jurisdictions since they must be designed and implemented in an integrated fashion with capital requirements. SIFMA proposes, therefore, that the U.S. regulators consider exercising their jurisdiction over non-U.S. swap dealers by relying on home country regulations that achieve objectives comparable to those of Title VII, and result in the foreign swap dealer being well-regulated in a manner comparable to the U.S. regulatory framework, even if the two regulatory schemes differ in the specific means of achieving these objectives.[16]

Entity-level rules apply not to individual transactions but to the core operations of the regulated entity. For this reason, where a legal entity that is incorporated or organized in one country (the home country) does business in various other countries (host countries), the home country supervisor typically is the one that establishes entity-level requirements, such as capital and risk-management requirements, and conducts examinations of the entity.[17] If a host country regulator also were to extend its entity-level regulations to the global entity, the entity would be subject to overlapping and potentially inconsistent regulation. In such event, the non-U.S. entity may decide that the easiest way to comply with each jurisdiction's requirements is to register separate entities in many more jurisdictions than it otherwise would. This fragmentation of global firms could lead to inefficient results. With respect to capital, for example, it would remove the benefits of netting, collateral management and centralized risk management, which are key components of systemic-risk mitigation. Fragmentation also would significantly increase the total amount of required capital relative to that which would be required if a central booking model could be maintained.

[16] As former CFTC Acting Chairman Walter Lukken stated: "principles provide valuable benchmarks as regulators look to the comparability of foreign jurisdictions. Rather than getting bogged down in a checklist of each nation's rules, principles keep the focus of regulators in the right spot: achieving regulatory outcomes." Walter Lukken, former Acting Chairman, CFTC, "Smart Regulation for the Global Marketplace," Remarks to the Federation of European Securities Commissions, (Jun. 26, 2007).

[17] The home country supervisor is often assisted by and cooperates with host country supervisors through memoranda of understanding and similar cooperative arrangements.

This result would be particularly harmful to the global swaps market. As noted earlier, financial institutions – U.S. or non-U.S.-banks and non-banks – operate and manage their swaps businesses globally and typically out of a central legal entity. This global approach allows counterparties to deal with the strongest entity from a financial and capital perspective, allows for efficient and holistic internal risk management, enables comprehensive supervision by the primary home country supervisor, significantly reduces systemic risk and lessens the complexity of orderly resolution procedures.

Our approach would preserve these benefits to the extent that U.S. regulators rely on home country entity-level regulation that meets their standards. Relying on home country entity-level regulation would also be efficient because the home country supervisor often is best positioned and has the greatest incentive to protect the financial health of swap dealers located in its jurisdiction.

Such reliance also would be consistent with the Federal Reserve's and the CFTC's current practice. In supervising foreign banks that are subject to its jurisdiction, the Federal Reserve takes the position that foreign banks are subject to primary supervision by their home country supervisors. In assessing the capital adequacy of a foreign bank seeking financial holding company status, if the foreign bank's home country supervisor has adopted risk-based capital standards that are comparable to the Capital Accord of the Basel Committee on Banking Supervision, the Federal Reserve relies on the bank's capital ratios calculated in accordance with home country standards, rather than requiring that the foreign bank recalculate its capital ratios using U.S. capital standards. For its part, the CFTC also has experience in relying on comparable foreign regulations. Since 1987, the CFTC has adopted an approach under its Part 30 rules for assessing whether certain foreign intermediaries' home country regulations for futures trading are comparable to those of the CFTC.[18] Under this approach, "[c]omparable does not mean identical: the CFTC may conclude that the regulatory program is comparable even though the offshore program does not contain elements precisely identical to that of the Commission's regulatory program."[19] The CFTC has determined the

[18] *See* 17 C.F.R. 30.10. The CFTC's Part 30 rules govern the offer and sale to U.S. persons of futures and options contracts listed for trading on foreign boards of trade. The rules generally provide that any person that solicits or accepts orders for or involving any foreign futures contract or foreign options transaction and, in connection therewith, accepts any money, securities or property to margin, guarantee or secure any trades or contracts that result or may result therefrom, must be registered with the CFTC as a futures commission merchant ("**FCM**"). Rule 30.10 authorizes the CFTC to exempt any person from the registration requirements of Part 30, if the CFTC finds that the person is subject to comparable regulation in its home country. Significantly, this exemption applies only with respect to the solicitation or acceptance of orders to be executed on a foreign board of trade.

[19] Joint Report of the SEC and the CFTC on Harmonization of Regulation, 82 (Oct. 16, 2009). Recently, the CFTC has proposed to continue to use this established comparability analysis to determine whether to register a foreign board of trade under Section 738 of Dodd-Frank. 75 Fed. Reg. 70,974, 70,977 (Nov. 19, 2010).

regulations in sixteen foreign countries, including major jurisdictions such as Canada, France, Germany, Japan, Singapore, Spain and the United Kingdom, to be comparable.[20] It is noteworthy that major jurisdictions such as the European Union are proposing similar mechanisms for relying on equivalent foreign regulations that would allow U.S. firms to have greater access to their markets.[21]

Furthermore, there is a strong basis for the Commissions and the Federal Reserve to conclude that certain non-U.S. swap dealers are subject to comparable entity-level regulation. Taking capital as one example, Sections 731 and 764 state that capital requirements should take into account the risks undertaken by the swap dealer in order to "ensure the safety and soundness of the swap dealer." For foreign banks, relying on home country supervisors that have implemented existing risk-based Basel standards would satisfy these statutory requirements. The future adoption of Basel III is likely to further the strength and uniformity of capital requirements across jurisdictions. In addition, many foreign, non-bank investment firms are subject to comprehensive capital regulation in their home countries that would likely satisfy the risk-based capital standards in Sections 731 and 764. In the European Union, the Capital Requirements Directive, comprising Directive 2006/48/EC[22] and Directive 2006/49/EC[23], establishes a prudential framework for non-bank investment firms based on the Basel Accords. Under this regulatory framework, the amount of capital that investment firms must have at their disposal is assessed depending on their risks, including credit risk, market risk and operational risk. Similar frameworks are being developed in other major financial markets.

Finally, approaching entity-level regulation of foreign swap dealers in this way would build on the experience of the Commissions and the Federal Reserve with closely cooperating with foreign regulators to establish tailored approaches to regulating cross-border activities. The Federal Reserve has a long history of working with their home country supervisors in regulating foreign banks.[24] The SEC has

[20] *Id.* at 83.

[21] The European Commission has suggested introducing an E.U.-level mechanism by which access to the European Union could be granted to foreign investment firms and markets subject to equivalent regulatory requirements. European Commission, "Public Consultation: Review of the Markets in Financial Instruments Directive (MiFID)" at 79-80 (Dec. 8, 2010), *available at* http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf. Currently, access by foreign intermediaries and markets to the European Union is not harmonized and is left to the discretion of individual European Union Member States. *Id.* at 78.

[22] Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.

[23] Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions.

[24] Over the years, the Federal Reserve has entered into memoranda of understanding with a number of foreign regulators, including the United Kingdom's Financial Services Authority (June 1, 1998), the European Commission (September 17, 1999), the Dutch Central Bank (January
(…continued)

entered into agreements with 55 foreign securities and derivatives regulators to cooperate in enforcement investigations and exchange surveillance information,[25] and the CFTC has entered into more than 30 bilateral information-sharing arrangements with foreign regulators that support surveillance, enforcement, and regulatory cooperation.[26] The Commissions and the Federal Reserve should leverage their knowledge of foreign financial regulation and experience with dealing with foreign regulators in assessing whether to rely on foreign country entity-level requirements.

2. Title VII's Transaction-Based Requirements -- U.S. Regulators Should Consider Whether Their Transaction-Based Rules Should Apply to Transactions Involving Non-U.S. Persons

While we recognize that registration with the Commissions as a swap dealer is a basis for U.S. jurisdiction, we believe that the Commissions should examine Title VII's transaction-based rules and consider whether swaps involving one or more non-U.S. persons (whether such non-U.S. person is a non-U.S. swap dealer or non-registered person) should be subject to the transaction-based rules. The U.S. regulators should be sensitive to the rules applicable to non-U.S. swap dealers and non-U.S. counterparties to avoid conflicts with local laws and to avoid putting swap dealers, and the U.S. swap market, at a competitive disadvantage. Conflicts of law exist in the following situations: (i) where a non-U.S. swap dealer is dealing with non-U.S. persons; (ii) where a U.S. swap dealer is dealing with non-U.S. persons; and (iii) where a non-U.S. swap dealer is dealing with U.S. persons. Similar conflicts between U.S. and foreign swap regulations apply to each of these swap permutations, as each permutation will trigger two or more jurisdictions' swap rules, some of which may be irreconcilable. These swaps present challenging regulatory questions that the U.S. regulators should analyze carefully before imposing their transaction-based rules. At a minimum, the Commissions should coordinate with foreign regulators to avoid conflicting rules pursuant to their statutory mandate in Section 752.

The U.S. regulators should not impose Title VII's transaction-based rules on a non-U.S. swap dealer when it deals with non-U.S. persons. This is important because of the high likelihood of conflicts of laws. A swap between a non-U.S. swap dealer and a non-U.S. counterparty located in a third country could lead to the application of three sets of transaction-based rules: Title VII rules, the non-U.S. swap dealer's home country rules and the home country rules of the non-U.S. counterparty. Such an approach to regulating non-U.S. swap dealers' swaps with non-U.S. persons is also

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2003), the Australian Prudential Regulation Authority (October 19, 2006), the British Virgin Islands Financial Services Commission (May 7, 2010) and the Cayman Islands Monetary Authority (August 6, 2010).

[25] Joint Report of the SEC and the CFTC on Harmonization of Regulation, 81 (Oct. 16, 2009), *available at* http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf.

[26] *Id.* at 85.

appropriate because applying U.S. transaction-based rules under these circumstances may not further the regulatory objectives of the particular rule considering the location of the parties involved in the swap. In addition, applying U.S. transaction-based rules to these cross-border swaps could put the non-U.S. swap dealer at a competitive disadvantage if the local jurisdictions do not have a comparable rule, or if the local jurisdictions are still developing their swaps rules (as will likely be the case in Europe until EMIR is implemented). For example, if the U.S. rules require a swap dealer to centrally clear a particular swap whereas the local rules do not, this could cause counterparties to prefer to enter into swaps with entities that are not registered as swap dealers, thereby significantly disadvantaging the non-U.S. swap dealer. For all of these reasons, the foreign entity's registration with the Commissions as a swap dealer should not result in the application of every Title VII swap dealer regulation to all of the registrant's swaps transactions.

This same reasoning may militate against the application of certain U.S. transaction-based rules to swaps between U.S. swap dealers and non-U.S. persons. For example, where a U.S. swap dealer engages in a swap with a foreign special entity, the foreign special entity typically would expect to be dealt with fairly, but may not expect swap dealer sales practices that are peculiar to the United States to apply. Instead, the foreign counterparty would rely on the protection afforded by the foreign counterparty's home country regulations. Applying U.S. special entity rules to such a transaction could conflict with local laws and create legal uncertainty and complicate the parties' commercial arrangement. In addition, U.S. swap dealers also may be at a competitive disadvantage relative to non-U.S. entities if U.S. swap dealers must comply with U.S. rules when dealing with a non-U.S. counterparty in a jurisdiction that does not have similar rules, for example, if the foreign rules do not mandate margin requirements for non-cleared swaps. For these reasons, SIFMA recommends that the U.S. regulators carefully consider the transaction-based rules on an individual basis to determine which of the transaction-based rules should apply to swaps between a U.S. swap dealer and a non-U.S. person to ensure that the benefit of doing so outweighs the cost of potential conflicts with local laws.

The need to avoid conflicting regulations for swaps involving a non-U.S. swap dealer, and swaps between a U.S. swap dealer and non-U.S. person, is particularly salient where both the United States and the relevant foreign jurisdiction require the swap to be cleared. Parallel foreign regulatory regimes may require swaps transacted by locally established swap dealers, residents and other locally regulated entities to be cleared at locally regulated clearinghouses.[27] This clearing requirement may conflict with Title VII's requirement that certain swaps be cleared through clearinghouses regulated by the Commissions if there is not a clearinghouse that is

[27] *See e.g.*, Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties and Trade Repositories ("**EMIR**") Art. 23 (A clearinghouse established in a third country may provide clearing services to entities established in the European Union only after that clearinghouse is recognised by the European Securities and Markets Authority ("**ESMA**") upon satisfaction of conditions such as the establishment of cooperation arrangements between ESMA and the third-country regulator.)

registered in both jurisdictions that can clear the swap. We recommend, therefore, that the Commissions work with foreign regulators to achieve a common approach that recognizes comparably regulated clearinghouses in other jurisdictions and exempts such clearinghouses from registration. We urge the Commissions to reconcile their clearing requirements with those of other jurisdictions so as to permit counterparties to satisfy the multijurisdictional clearing requirements imposed on their cross-border swaps and to avoid unnecessary duplication of regulation and supervision of clearinghouses.

A similar accommodation is warranted with respect to reporting swap data to swap data repositories given their central role in the regulation of the global swaps markets. Swap data reporting is a main pillar of the Financial Stability Board's recommendations for over-the-counter derivatives reforms[28] recently endorsed by the G-20.[29] G-20 jurisdictions such as the European Union and Japan have adopted or are formulating swap reporting rules.[30] Like the United States, these jurisdictions are likely to require the reporting of all swaps executed in or by parties within their jurisdiction, including cross-border swaps. Therefore, the application of U.S. reporting rules to those transactions would subject swap dealers to two reporting regimes. The global effort to enhance swap data reporting reduces the need for each jurisdiction to mandate compliance with potentially differing requirements for reporting swaps to swap data repositories. Instead, the Commissions should work with foreign regulators to facilitate and encourage cross-registration of swap data repositories and to coordinate reporting requirements. The Commissions should consider the approach of the European Commission's proposed derivatives regulatory framework, which would permit the use of a foreign trade repository to satisfy trade reporting requirements if the ESMA finds that such trade repository is authorized in and subject to effective surveillance in the foreign country and if there is a memorandum of understanding or other cooperative arrangement to ensure that home country authorities have immediate and continuous access to all the necessary information for the exercise of their duties."[31]

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[28] Financial Stability Board, "Report on Improving OTC Derivatives Markets," 44-47 (Oct. 25, 2010), *available at* http://www.financialstabilityboard.org/publications/r_101025.pdf.

[29] G-20, "The G-20 Seoul Summit Leaders' Declaration," ¶ 37 (Nov. 11-12, 2010), *available at* http://www.g20.org/Documents2010/11/seoulsummit_declaration.pdf.

[30] *See* CFTC Staff, "Derivatives Reform: Comparison of Title VII of the Dodd-Frank Act to International Legislation" at 5 (Oct. 5, 2010), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/gmac_100510-cftc2.pdf.

[31] *See* European Commission, "Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, central counterparties and trade repositories" (Sept. 15, 2010), *available at* http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf. SIFMA notes that the ESMA has submitted letters dated January 17, 2011 to the Commissions recommending that the Commissions adopt a similar approach.

We urge the U.S. regulators to examine their transaction-based requirements carefully to consider how they should apply differently based on the location of the swap dealer's counterparty so as to avoid conflicts of laws. To the extent feasible, we urge the U.S. regulators to resolve the conflicts of multijurisdictional transaction-based rules for swaps between U.S. swap dealers and non-U.S. persons, and for swaps between non-U.S. swap dealers and non-U.S. persons, in a similar manner.[32] Otherwise, a U.S. swap dealer dealing with non-U.S. counterparties would be subject to U.S. transaction-based rules, whereas a foreign swap dealer with the same non-U.S. counterparties would be subject only to foreign transaction-based rules. A rigid application of Title VII's transaction-based rules could create a competitive disadvantage for the United States by causing U.S. swaps activities and U.S. swap dealers to move offshore to avoid the application of inconsistent or duplicative regulation.

3. Legal Authority To Implement Our Proposed Approach for Applying Title VII Regulation to Swap Dealers

Our proposed approach would not require the U.S. regulators to grant exemptions from Title VII's transaction-based requirements. Instead, the Commissions can rely on (i) their flexible and broad authority, in consultation with the Federal Reserve, under Section 712(d) of Dodd-Frank, to define "swap dealer" and to adopt such other rules regarding the definition of swap dealer as they deem necessary; and (ii) the statutory mandate in Section 752 for the U.S. regulators to "coordinate and consult with foreign regulatory authorities on regulation" of swaps and swap dealers.

With respect to entity-level regulation of foreign swap dealers, Sections 712(d), 731 and 764 provide the Commissions and Federal Reserve with ample flexibility to write rules that deem a foreign swap dealer to be in compliance with certain or all of Title VII's entity-level requirements if it is subject to comparable home country regulation.

The approach outlined above with respect to entity-level and transaction-based rules is also consistent with international comity, a principle regarded by the CFTC as relevant in "determining the proper scope of extraterritorial application of federal statutes."[33] Moreover, it is consistent with the objectives of Dodd-Frank and the Commissions' positions in other similar contexts. Under the comity principle, even where a nation has jurisdiction to legislate, it should not do so "with respect to a person or activity having connections with another state when the exercise of such jurisdiction is unreasonable."[34] Reasonableness, in turn, is determined by factors such as connections with the regulating nation, harm to that nation's interests, the

[32] The adoption of consistent transaction-based rules would in no way prevent the U.S. regulators from adopting differential standards for entity-based and registration purposes, which we strongly support.

[33] Swap Dealer Registration Proposed Rule at 71,379.

[34] Restatement (Third) of Foreign Relations Law of the United States (1986) § 403(1).

extent to which other nations regulate and the potential for conflict. The principle of international comity supports not applying certain U.S. transaction-based rules to cross-border swaps and to swaps between a non-U.S. swap dealer and U.S. persons.

Section 722 (CFTC) and Section 772 (SEC) provide strong support for limiting the application of Title VII's transaction-based rules to swaps between a foreign swap dealer and non-U.S. persons. These sections limit the Commissions' jurisdiction to the United States, subject to specific exceptions for evasion activities and, in the case of Section 722 only, to offshore activities with a "direct *and* significant" U.S. nexus. The fact that a non-U.S. entity is registered with the Commission should be considered too peripheral a connection to warrant the application of every Title VII transaction-based rule to otherwise offshore transactions.

In addition, our recommendation regarding recognition of foreign clearinghouses is expressly provided for in Sections 725 and Section 763, which state that the CFTC or SEC "may exempt, conditionally or unconditionally, a clearing agency from registration if the CFTC [or SEC] finds that it is subject to comparable, comprehensive supervision and regulation by the SEC [or CFTC] or the appropriate governmental authorities in its home country." With respect to swap data repositories, the Commissions could use their broad rulemaking authority to permit a foreign swap data repository to register with the Commissions if it is subject to comparable authority by its home country regulator.

C. The Commissions Should Consider Whether a Foreign Entity's Swaps with U.S. Swap Dealers Should Trigger Swap Dealer Registration

The Commissions should consider whether it is necessary to require a foreign entity to register with the Commissions as a swap dealer if the foreign entity's sole U.S. swaps activities are dealings with U.S.-registered swap dealers. As noted in the Joint Definitions Proposed Rule, swap dealers are often characterized by their transactions with non-dealers and the Commissions can most efficiently achieve the purposes of Dodd-Frank by focusing on swap dealers' functions as "points of connection" between non-dealers.[35] Furthermore, if interdealer trades between a foreign dealer and a U.S. dealer could *per se* trigger the foreign dealer's registration with the Commissions, then the foreign dealer would be less willing to enter into swaps with U.S. swap dealers. As a result, U.S. swap dealers would have reduced access to foreign markets; such access being important for liquidity and risk management purposes and the competitiveness of the U.S. market.[36]

[35] Joint Definitions Proposed Rule at 80,177.

[36] This position is consistent with the position that the CFTC has taken in connection with its Part 30 rules. CFTC Rule 30.4 provides that a foreign futures and options broker is not required to register as a FCM in order to accept orders from or to carry: (i) a U.S. FCM's foreign futures and options customer omnibus account; (ii) a U.S. FCM's proprietary account; or (iii) a U.S. affiliate account that is proprietary to the foreign futures and options broker.

Even if the Commissions decide to require such a foreign entity to register as a swap dealer on the basis of its dealings with U.S.-registered swap dealers, the Commissions should consider applying a limited set of the swap dealer regulations to the foreign swap dealer so as to avoid conflicts with foreign swaps regulatory regimes. As previously discussed, if the foreign entity is based in Canada, one of the European Economic Area member states, Japan or another country, such as a G-20 nation, that is in the process of developing a comprehensive swaps regulatory regime, the foreign entity will be subject to swap dealer regulations set by its home country.

D. The Commissions Should Permit a Branch to Register as a Swap Dealer and Should Permit Registrants to Comply with Title VII's Swap Dealer Rules through a Division or Office, Without Subjecting the Entire Bank or Entity to Swap Dealer Regulation

If a branch of a U.S. bank or a branch of a foreign bank engages in swap-dealing activities, the Commissions should permit the branch to register as a swap dealer, independently of the bank, so that Title VII regulations are imposed only on the branch and not on the bank as a whole.[37] The Commissions should also adopt rules that are flexible enough to apply only to a swap-dealing division or office of a bank or non-bank entity, even where the entire entity registers as a swap dealer.

Section 721(a)(17) of Dodd-Frank expressly contemplates branch registration by designating the Federal Reserve as the prudential regulator in "the case of a swap dealer . . . that is . . . a State-chartered <u>branch</u> or agency of a foreign bank [emphasis added]." In addition, the "prudential regulator" definition in Section 721 of Dodd-Frank distinguishes between the Office of the Comptroller of the Currency as the prudential regulator for a federally chartered branch or agency of a foreign bank and the Federal Reserve as the prudential regulator for a state-chartered branch or agency of a foreign bank, thereby determining the regulation of branches and agencies of foreign banks on an individual basis. These provisions of Dodd-Frank are consistent with the federal regulation of foreign banks' activities in the United States, which distinguishes between the separate branches and agencies of a foreign bank.[38]

Furthermore, even if the Commissions decide to treat a bank and its branches and agencies as one legal person for purposes of Title VII, Sections 721 and 761 give the Commissions authority to designate a person as a swap dealer only with respect to certain activities. A branch of a bank should be permitted to register as a swap dealer for the activities conducted by the branch. Finally, viewing the branches and agencies of a bank as separate legal persons from one another, and as separate from the bank itself, is consistent with the Regulation S

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[37] We acknowledge that Title VII capital requirements cannot be applied at the branch-level and, therefore, must be applied at the bank level.

[38] *See* the definitions in Section 1(b) of the International Banking Act of 1978 (12 U.S.C. § 3101(b)).

definition of U.S. person, which expressly differentiates between a U.S. bank and its non-U.S. branches.

With respect to regulation of a division of a registered entity, the CFTC specifically contemplated the approach of regulating a division of a registered entity in the Joint Definitions Proposed Rule. The CFTC "anticipate[d] that certain swap dealer requirements would apply to the swap dealing activities of the division, but not necessarily to the swaps activities of other parts of the entity [emphasis added]."[39] Such an approach would increase regulatory efficiency by focusing limited regulatory resources on that portion of a foreign swap dealer's business that involves swaps with U.S. customers.

E. Multiple Operating Models Should Be Accommodated

While SIFMA is not advocating any particular operating model for foreign entities dealing with U.S. persons or for how swap dealers should hedge their risk, we believe that the Commissions should apply the principles discussed in this letter to accommodate a variety of different operating and risk-management models consistent with a particular foreign entity's structure, including, as examples, intermediary and inter-affiliate structures.

1. Intermediary Structures

The Commissions should permit intermediary structures whereby a foreign entity and its U.S. affiliate engage in different functional activities regarding a swap and are responsible for fulfilling different obligations under Title VII. The foreign and U.S. entities should be permitted to register for the limited activity regarding a swap they are engaged in and to comply with the particular Title VII rules that correspond to those activities.

Sections 721(a)(21) and 761(a)(6) provide the Commissions with legal authority to implement our proposed approach. These sections expressly authorize the Commissions to designate a person as a swap dealer for "a single type or single class or category of . . . activities and considered not to be a swap dealer for other types, classes, or categories of . . . activities [emphasis added]." The definitions of swap dealer in Section 721 and 761 of Dodd-Frank set forth a non-exhaustive list of activities for which one could register as a swap dealer, including: holding oneself out as a dealer in swaps, making a market in swaps, regularly entering into swaps with counterparties as an ordinary course of business for one's own account and engaging in any activity causing one to be commonly known as a dealer or market maker in swaps. If an entity engages in one type of swap-dealing activity only, it should be able to register as a swap dealer with respect to that activity and only the Title VII regulations that are designed to regulate that activity should apply to that entity.

[39] Joint Definitions Proposed Rule at 80,182 (emphasis added).

For example, a foreign principal that relies on a U.S. intermediary to conduct all swaps activities and make direct contacts with U.S. counterparties should be able to register as a swap dealer for the limited activity of acting as a foreign booking entity for swaps with U.S. persons (and so would be subject to U.S. prudential regulation and would need to demonstrate to the Commissions or the Federal Reserve, as appropriate, that it is subject to comparable home country capital and risk-management requirements).[40] For its part, the U.S. intermediary should be able to register for the activity of holding itself out as a dealer (and so would be subject to U.S. counterparty business conduct and other transaction-based requirements). This approach would tailor the application of Title VII to the functions conducted by each swap-dealing entity. This authority could also be used to permit a foreign entity to register as a swap dealer only with respect to its swaps activities with U.S. persons and be subject to Title VII's requirements only with respect to such activities.

2. Inter-Affiliate Structure

The Commissions should permit a structure in which affiliates (one or both of which are swap dealers) engage in swap transactions with each other for risk-hedging purposes. In this structure, the U.S. transaction-based rules should not apply. In the Joint Definitions Proposed Rule, the Commissions noted that in determining whether a person is a swap dealer, it is important to consider whether the swaps simply represent an "allocation of risk within a corporate group" and whether they "involve the interaction of unaffiliated persons" that is the "hallmark" of certain elements of the definition of a swap dealer.[41] Furthermore, because these inter-affiliate transactions would involve a registered swap dealer, there should not be a concern that the transactions are designed for the purpose of evading the Commissions' swap dealer regulations. The Joint Definitions Proposed Rule similarly provides support for not requiring an entity to register as a swap dealer on the basis of its inter-affiliate swaps that are executed for risk-management purposes and for not applying Title VII's swap dealer requirements to these inter-affiliate swaps.

Carrying this logic forward, if a U.S. swap dealer enters into swaps with customers and then back-to-backs these swaps with a foreign affiliate, these swaps should not trigger a registration requirement for the foreign affiliate. In addition, if a foreign entity enters into transactions as a principal with a foreign customer and then enters into back-to-back transactions with an affiliated U.S. swap dealer for risk-hedging purposes, the Commissions should not subject the back-to-back transactions between the foreign entity and the affiliated U.S. swap dealer to U.S. transaction-based rules. Where the U.S. swap dealer is dealing only with a foreign affiliate, application of U.S. transaction-based rules is not necessary.

[40] As noted above, the CFTC's Part 30 rules exempt from registration as a FCM a foreign futures and options broker that has no direct relationship with U.S. customers but carries a U.S. FCM's foreign futures and options customer omnibus account.

[41] Joint Definitions Proposed Rule at 80,183.

III. Conclusion

SIFMA strongly encourages the Commissions to carefully consider the extraterritorial application of their swap dealer regulations. We believe that our recommended approach to regulating foreign swap dealers and cross-border swaps activities is consistent with the legal authority provided by Dodd-Frank as well as the Commissions' current approach towards extraterritorial application of U.S. regulation, would achieve the statute's objectives, give effect to the principles of comity by appropriately allocating supervisory responsibilities between the U.S. and home country supervisors and facilitate an efficient, effectively regulated and competitive global swaps market.

Respectfully yours,

Kenneth E. Bentsen, Jr.
Executive Vice President
Public Policy and Advocacy
SIFMA

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Michael Dunn, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Jill E. Sommers, Commissioner
Commodity Futures Trading Commission

Honorable Mary L. Schapiro, Chairman
Honorable Luis A. Aguilar, Commissioner
Honorable Kathleen L. Casey, Commissioner
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Board of Governors of the Federal Reserve System

February 3, 2011

John Walsh, Acting Comptroller
Office of the Comptroller of the Currency

Sheila Bair, Chairman
Federal Deposit Insurance Corporation

Timothy Geithner, Secretary and Chair of the Financial Stability Oversight Council
Lael Brainard, Under Secretary for International Affairs
Marisa Lago, Assistant Secretary for International Markets and Development
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