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Invested in America

November 18, 2019

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street N.W.
Washington, D.C. 20581

Re: Registration With Alternative Compliance for Non-U.S. Derivatives Clearing Organizations (RIN 3038-AE87); Exemption from Derivatives Clearing Organization Registration (RIN 3038-AE65)

Dear Mr. Kirkpatrick:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] welcomes the opportunity to provide the Commodity Futures Trading Commission (the "**Commission**") with comments on the above proposals to (a) allow certain non-U.S. clearing organizations that do not pose substantial risk to the U.S. financial system to register with the Commission as derivatives clearing organizations ("**DCOs**") and comply with certain provisions of the Commodity Exchange Act ("**CEA**") through compliance with their home-country regulatory regimes (such proposal, the "**Alternative Compliance Proposal**")[2] and (b) permit (i) a non-U.S. clearing organization that is exempt from DCO registration to clear swaps for U.S. customers under certain circumstances and (ii) a person located outside the United States that is a member of a non-U.S. clearing organization ("**non-U.S. clearing member**") to accept funds from U.S. persons to margin swaps it clears directly at an exempt DCO, without registering as a futures commission merchant ("**FCM**") (such proposal, the "**Exemption Proposal**"[3] and, together with the Alternative Compliance Proposal, the "**Proposals**").

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[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] 84 Fed. Reg. 34819 (proposed July 19, 2019) (to be codified at 17 C.F.R. §§ 39 and 140).

[3] 84 Fed. Reg. 35456 (proposed July 23, 2019) (to be codified at 17 C.F.R. §§ 3, 39 and 140).

INTRODUCTION

We generally support the steps taken by the Proposals to provide more robust deference to comparable foreign regulation of non-U.S. clearing organizations. We also support the use of risk-based measures of connections to the United States to calibrate the extent of extraterritorial U.S. regulation. These steps would help expand opportunities for U.S. customers, promote globally integrated swaps markets, reduce undue regulatory duplication and burdens, responsibly make more effective use of the Commission's resources and encourage reciprocal deference by foreign regulators. With respect to the specific changes the Proposals would make to accomplish these goals, we support the more detailed comments submitted by the Futures Industry Association ("**FIA**") and International Swaps and Derivatives Association.

We further believe that the Commission should use this opportunity to advance another important goal: promoting the competitiveness of U.S. FCMs and swap dealers by expanding their ability to access non-U.S. clearing organizations. The Commission's current approach to when and how U.S. FCMs and swap dealers can access non-U.S. clearing organizations has significantly impeded such access. To address this issue, the Commission should: (1) permit U.S. FCMs to use an omnibus clearing structure for foreign cleared swaps like they currently use for foreign futures and (2) allow a non-U.S. clearing organization to accept foreign branches of U.S. bank swap dealers as members without requiring the non-U.S. clearing organization to register with the Commission as a DCO or obtain an exemption from DCO registration.

These changes would, in addition to promoting the competitiveness of U.S. FCMs and swap dealers, help accomplish two more goals. First, they would promote customer choice. As sophisticated market participants, swaps customers should be permitted to weigh the pros and cons of different approaches to accessing foreign markets. Second, these changes would reduce market concentration, allowing a wider range of FCMs and swap dealers to access foreign markets efficiently. This second goal is especially important at this time given the increasingly concentrated market for swaps clearing services.

As we outline below, the Commission can make these changes while still retaining appropriate customer protections and systemic risk mitigants. The CEA also provides the Commission with ample legal authority to make these changes.

Now is the right time for the Commission to make these changes. Soon, a much larger number of market participants will be subject to initial margin requirements for their uncleared swaps. These requirements are specifically designed to increase demand for cleared swaps. Expanding clearing mandates in foreign jurisdictions will also increase demand for cleared swaps. Not all of the cleared swaps demanded by U.S. customers will be offered by U.S. DCOs. Even where they are, in many cases liquidity will instead be concentrated at non-U.S. clearing organizations (*e.g.*, for swaps denominated in foreign currencies or with foreign underliers). As things stand, U.S. customers would face a choice of clearing through U.S. DCOs or transacting in the less

liquid non-cleared swaps market, placing them at a disadvantage. The Commission should not let these developments lead to more fragmented and concentrated swap markets.

DISCUSSION

I. The Commission Should Permit U.S. FCMs to Use an Omnibus Clearing Structure for Foreign Cleared Swaps

In order for a U.S. FCM to clear swaps for its customers at a non-U.S. clearing organization, the Commission currently requires the U.S. FCM to be a member of the non-U.S. clearing organization (or clear through another FCM that is a member) and the non-U.S. clearing organization to be registered as a DCO. In the futures markets, in contrast, a U.S. FCM can carry a foreign futures and options customer's positions in an omnibus account of a non-U.S. clearing member,[4] without requiring the non-U.S. clearing member to register as an FCM[5] or the non-U.S. clearing organization to register as a DCO.[6] For the reasons described below, the Commission should amend its rules to permit U.S. FCMs to use a similar omnibus clearing structure for foreign cleared swaps.

A. Requiring U.S. FCMs to Be Members of Non-U.S. Clearing Organizations Creates Significant Problems

The Commission's current requirement that a U.S. FCM be a member of any non-U.S. clearing organization where it wants to clear swaps for customers is creating significant problems for U.S. FCMs.

First, this requirement subjects a U.S. FCM to the non-U.S. clearing organization's risk management obligations for clearing members. In particular, as a clearing member, the U.S. FCM must satisfy the non-U.S. clearing organization's minimum guarantee fund contribution requirement. The U.S. FCM also may become subject to the non-U.S. clearing organization's assessment rights or other extraordinary loss allocation measures. As Commissioner Stump noted in her statement, "[i]t is costly for an FCM to join any clearinghouse and may be especially uneconomic if the FCM only has a few customers who wish to access a particular non-U.S. DCO."[7]

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4 *See* 17 C.F.R. § 30.7 ("**Rule 30.7**").

5 *See* 17 C.F.R. § 30.4(a).

6 As noted in the Alternative Compliance Proposal, a non-U.S. clearing organization that is not registered as a DCO may still clear foreign futures if it observes the CPMI–IOSCO Principles for Financial Market Infrastructures and is in good regulatory standing in its home country jurisdiction. *See* Alternative Compliance Proposal, 84 Fed. Reg. at 34820.

7 Statement of Commissioner Dawn Stump, Alternative Registration Proposal, 84 Fed. Reg. at 34836.

If the U.S. FCM is part of a globally active firm, it will also typically have an affiliate that is already a member of a non-U.S. clearing organization in order to serve local customers. Having two affiliates both subject to a clearing organization's risk management obligations subjects the firm to heightened financial commitments, liquidity demands and risks. These additional costs and risks discourage U.S. FCMs from becoming clearing members in addition to their affiliates.[8]

In addition, requiring U.S. FCMs to become direct members of a non-U.S. clearing organization subjects them to overlapping regulation from the Commission and foreign regulators. For example, local regulators might seek to apply local licensing or segregation requirements. Frequently, these regulations conflict with the Commission's requirements or impose additional, unnecessary burdens on the FCM.[9]

These issues are especially acute for smaller FCMs, which do not have sufficiently large customer bases to justify the increased costs and risks of joining non-U.S. clearing organizations. As a result, typically only the largest FCMs can afford to provide their customers with access to foreign cleared swaps. And because customers generally prefer to use an FCM that can offer access to the full range of products, instead of using one FCM for one type of product and a different FCM for a different type of product, the inability of smaller FCMs to offer foreign cleared swaps reduces their overall competitiveness. In these ways, the Commission's current approach to foreign cleared swaps exacerbates concentration in the FCM market.

But even for some of the largest FCMs, these costs, risks and issues discourage participation in the foreign cleared swaps market. As a result, U.S. FCM clearing is limited at many non-U.S. clearing organizations.[10]

B. Unless the Commission Also Permits Omnibus Clearing, the Exemption Proposal Would Exacerbate These Problems

The Exemption Proposal would allow a non-U.S. clearing member to clear for U.S. customers at a non-U.S. clearing organization exempt from DCO registration, without requiring the non-U.S. clearing member to register as an FCM. As the

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[8] Statement of Commissioner Dawn Stump, Alternative Registration Proposal, 84 Fed. Reg. at 34836 ("[F]rankly it often makes very little economic sense for both the FCM and its affiliate to be capitalizing a clearinghouse simultaneously.").

[9] For example, if a U.S. FCM is a member of an EU clearing organization, it is subject to requirements under the European Market Infrastructure Regulation ("**EMIR**") to offer multiple types of client asset segregation, including segregation regimes that conflict with the Commission's FCM segregation requirements. As a result, currently a U.S. FCM offering its customers swaps at an EU clearing organization must offer these segregation regimes to those customers (to comply with EMIR), but any U.S. customers of the FCM must decline them (in order to satisfy the CEA).

[10] For example, Eurex Clearing AG, a leading European clearing organization, has 203 clearing members, only 5 of which are U.S. FCMs.

Commission acknowledges,[11] this proposal would place U.S. FCMs at a competitive disadvantage. Non-U.S. clearing members could offer U.S. customers swaps cleared at exempt DCOs, which U.S. FCMs could not offer, and in so doing non-U.S. clearing members would not suffer the increased costs, risks and issues noted above. Permitting U.S. FCMs to use an omnibus clearing structure would help offset these disadvantages, allowing U.S. FCMs to compete with non-U.S. clearing members on a more level playing field.

C. FCMs Have Successfully Used the Omnibus Clearing Structure for Foreign Futures for Over 30 Years

As noted by Commissioner Stump, the Commission has "extensive history in allowing [omnibus clearing] arrangements for U.S. futures clients of Commission-registered FCMs to access non-U.S. DCOs."[12] Specifically, in the listed futures markets, the Commission's Part 30 rules permit both a direct clearing structure—in which a U.S. customer clears swaps through a non-U.S. clearing member that is exempt from FCM registration on the basis of comparable foreign regulation—as well as an omnibus clearing structure—in which a U.S. customer clears swaps through a U.S. FCM that maintains the U.S. customer's positions and margin in a customer omnibus account with a non-U.S. clearing member that is not registered as an FCM.

Part 30 includes several requirements designed to ensure appropriate protection of customers clearing through FCMs using this omnibus structure. An FCM accepting U.S. customer funds for trading foreign futures or options must provide its customer with a disclosure statement addressing the risks of trading in foreign markets.[13] Such an FCM is subject to segregation requirements under Rule 30.7, which prohibit it from commingling or depositing the funds or other property it segregates to cover its obligations to its customers with respect to foreign futures and options ("**Rule 30.7 customer funds**") with the FCM's own assets or with domestic futures customer funds or cleared swaps customer collateral.[14] Foreign futures and options customers are treated in a separate

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[11] The Commission states that "FCMs may also face a competitive disadvantage as a result of [the Exemption Proposal], as they would not be permitted to clear customer trades at an exempt DCO. To the extent that their customers shift their clearing activity at registered DCOs to exempt DCOs, or otherwise reduce their clearing activity at registered DCOs as a result of this proposal, FCMs would lose business." Exemption Proposal, 84 Fed. Reg. at 35469.

[12] Statement of Commissioner Dawn Stump, Exemption Proposal, 84 Fed. Reg. at 35479.

[13] 17 C.F.R § 30.6(a).

[14] Rule 30.7(e). An FCM must maintain its Rule 30.7 customer funds with a bank or trust company located in the United States, a bank or trust company located outside the United States that meets certain capital requirements, another registered FCM, the clearing organization of a foreign board of trade ("**FBOT**"), a member of an FBOT or the designated depositaries of such clearing organization or member. Rule 30.7(b). An FCM must also obtain a written acknowledgement from each depositary as to the status of Rule 30.7 customer funds under the CEA. Rule 30.7(d). Like domestic futures customer funds and

"account class" from domestic futures customers and cleared swaps customers under the CFTC's bankruptcy regulations ("**Part 190**"),[15] meaning that domestic futures customers and cleared swaps customers do not share their property with foreign futures and options customers in the FCM's bankruptcy.

Since this framework was initially adopted in 1987, it has been very successful. Cross-border trading is pervasive in the listed futures market, often comprising a majority of trading volume on leading exchanges.[16] The Commission has also enhanced the framework over time. In particular, in light of certain issues that arose in connection with the insolvency of MF Global, the Commission amended its rules in November 2013 to require an FCM to deposit a cushion of its own funds in its Rule 30.7 account,[17] limit the extent of Rule 30.7 customer funds held outside the United States[18] and require an FCM holding Rule 30.7 customer funds outside the United States to do so under the laws and regulations of the foreign jurisdiction that provide the greatest degree of protection to such funds.[19]

D. Swaps Customers, Not the Commission, Are Best-Positioned to Decide Which Clearing Structure Suits Them Best

Different clearing structures have different pros and cons. The existing direct FCM clearing structure for foreign cleared swaps, with imposition of the Commission's legal segregation with operational commingling ("**LSOC**") segregation rules, generally enhances the portability of cleared swaps and reduces foreign bankruptcy risk compared to an omnibus clearing structure. However, the direct clearing membership requirement, with its associated costs and risks to U.S. FCMs, significantly reduces the number of U.S. FCMs willing to provide clearing services for foreign cleared swaps and the number of non-U.S. clearing organizations with which U.S. FCMs are willing to provide clearing services. Allowing an alternative omnibus clearing model would expand the number of U.S. FCMs and non-U.S. clearing organizations through which U.S. customers can clear foreign cleared swaps and may allow such services to be provided to U.S. customers at a lower cost. In particular, since omnibus clearing allows a U.S. FCM to access non-U.S. clearing organizations where it is not feasible to become a direct member, permitting the structure would allow U.S. customers to clear their entire swaps portfolio through one

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cleared swaps customer collateral, an FCM may only invest its Rule 30.7 customer funds in certain specified assets. Rule 30.7(h).

15 17 C.F.R. § 190.01(a)(1).

16 *See* FIA, *Mitigating the Risk of Market Fragmentation* (Mar. 2019) (link) at p. 5.

17 *See* Rule 30.7(f).

18 *See* Rule 30.7(c); *see also* CFTC Letter No. 14-138 (Nov. 13, 2014).

19 Rule 30.7(c).

chosen FCM, rather than requiring such customers to use multiple FCMs depending on which FCM is a member of which non-U.S. clearing organization.

If the Commission permitted omnibus clearing for foreign cleared swaps, we would expect multiple clearing structures to be available to U.S. swaps customers. The largest non-U.S. clearing organizations, which are already registered as DCOs, have many FCM members and comply with LSOC, would likely continue to permit U.S. swaps customers to clear directly through an FCM. But some FCMs may instead offer clearing at these large non-U.S. clearing organizations (as well as smaller ones they do not currently access directly) through an omnibus structure instead. And, depending on the outcome of the Exemption Proposal, U.S. customers may also be able to clear through exempt non-U.S. clearing members in some cases.

U.S. futures customers—including retail customers—have long been given a choice regarding which clearing structure to use (direct clearing through an FCM, omnibus FCM clearing or direct clearing through a non-U.S. clearing member). Surely swaps customers, who by definition must be eligible contract participants, are sufficiently sophisticated to assess the relative risks and trade-offs of these different clearing structures. The Commission should not paternalistically make this assessment for them.

E. Separate Treatment of Foreign Cleared Swaps Customers from LSOC Customers Would Appropriately Mitigate Any Uncertainty for LSOC Customers

The Commission asked how to mitigate concerns regarding potential uncertainty with respect to other U.S. customers (*i.e.*, customers who limit their activities to transactions cleared at registered DCOs) ("**LSOC Customers**") of an FCM that clears transactions for customers at an exempt DCO, considering in particular the potential of (1) a bankruptcy court in an FCM bankruptcy proceeding delaying the transfer of all swaps customer positions to another FCM to address potential legal challenges to the bankruptcy status of customer positions cleared at an exempt DCO, resulting in the need to close out customer positions or (2) a shortfall in swaps customer funds affecting all swaps customers of the FCM due to the bankruptcy of an affiliated foreign clearing member of the FCM through which the FCM clears customer transactions at the exempt DCO.[20]

As an initial matter, we note that the Commission has legal tools available to significantly reduce the risk of delay as described in (1) above.[21] In addition, replicating the Part 30 enhancements made in November 2013 would greatly reduce the risk of shortfall described in (2) above.

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[20] Exemption Proposal, 84 Fed. Reg. at 35464, Question 1.e.

[21] *See* Part II.F.2 below.

But moreover, these concerns would only arise in a scenario where a U.S. FCM commingled LSOC customer property with foreign cleared swap customer property. Where such commingling is prohibited, and the two classes of customers are treated separately in an FCM bankruptcy proceeding, LSOC customers would not be exposed to risks arising from the disposition of foreign cleared swaps customer positions or property. Indeed, precisely these considerations motivate the separate treatment of foreign futures and options customers in Part 30 and Part 190.

F. The Commission Has Ample Legal Authority to Permit an Omnibus Clearing Structure for Foreign Cleared Swaps

Although the Commission is not required to do so, the Commission still has ample legal authority to permit an omnibus clearing structure for foreign cleared swaps.

1. The Lack of a Legal Mandate to Establish a Separate Segregation Regime and Part 190 Account Class for Foreign Cleared Swaps Does Not Indicate a Lack of Legal Authority to Do So

Noting that the CEA and U.S. Bankruptcy Code (the "**Code**") have separate provisions addressing foreign futures, but not similar provisions for foreign cleared swaps, the Commission has requested comment on constructing a "Part 30-type" omnibus clearing structure for swaps.[22]

However, just because there is no CEA mandate that the Commission establish a special segregation regime governing foreign cleared swaps does not mean that the Commission lacks legal authority to do so. The plain text of CEA Section 4d(f)(2)'s segregation requirement clearly covers all cleared swaps customer property, regardless of whether the cleared swaps are cleared through a U.S. or non-U.S. clearing organization.[23] CEA Section 4d(f)(3), in turn, gives the Commission broad rulemaking authority to prescribe when commingling of cleared swaps customer collateral is permitted.[24] Currently, collateral for all types of cleared swaps may be commingled. But the

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22 Exemption Proposal, 84 Fed. Reg. at 35464, Question 2.

23 7 U.S.C. § 6d(f)(2)(A) ("A futures commission merchant shall treat and deal with all money, securities, and property of any swaps customer received to margin, guarantee, or secure a swap cleared by or through a derivatives clearing organization (including money, securities, or property accruing to the swaps customer as the result of such a swap) as belonging to the swaps customer."). The definition of "derivatives clearing organization" is not limited by jurisdiction or registration status. 7 U.S.C. § 1a(15).

24 7 U.S.C. § 6d(f)(3)(B).

Commission could just as easily prohibit the commingling of LSOC customer property with property deposited for foreign cleared swaps under an omnibus clearing structure.

Similarly, just because the Code does not separately identify foreign cleared swaps does not mean the Commission cannot create a separate account class for them under Part 190. Previously, in 2010, the Commission adopted a separate account class for cleared OTC derivatives, even though the Code did not separately address that type of contract.[25] It is not clear why the Commission should question its authority to take a similar approach now for foreign cleared swaps.

2. The Commission Can Interpret the Bankruptcy Code Definitions to Clarify Treatment of Foreign Cleared Swaps and Should at Least Permit an Omnibus Clearing Structure for Dually Registered DCOs

The Commission asked whether the Code can be read to permit swaps customer funds to be deposited at an exempt DCO through a foreign member of the DCO and still receive the same protections as swaps customer funds deposited at a registered DCO.[26]

The bankruptcy analysis requested by the Commission turns on whether the Code's definition of "commodity contract" covers swaps cleared at a non-U.S. clearing organization that is not registered as a DCO. Although there is some ambiguity on this matter, there are strong arguments that this definition should be interpreted to include swaps cleared at a non-U.S. clearing organization, regardless of whether the clearing organization is registered, not required to register or exempt from registration with the Commission as a DCO. The Commission also has additional authority under the CEA and Dodd-Frank Act to confirm this treatment. For an in-depth analysis of this issue, please see the SIFMA/FIA white paper titled "Promoting U.S. Access to non-U.S. Swaps Markets: A Roadmap to Reserve Fragmentation."[27]

In any event, the Commission does not need to address this issue to permit omnibus clearing for foreign cleared swaps. It would still be beneficial for the Commission to allow non-U.S. clearing organizations dually registered in their home countries and as DCOs with the Commission to clear swaps of U.S. customers using an

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[25] Indeed, at the time, the Commission viewed cleared OTC derivatives as a type of futures contract. *See* Account Class, 75 Fed. Reg. 17297 (Apr. 6, 2010).

[26] Exemption Proposal, 84 Fed. Reg. at 35464, Question 1.a.

[27] This white paper is available at https://www.sifma.org/resources/news/sifma-and-fia-release-white-paper-on-u-s-access-to-non-u-s-trading-venues-and-ccps/.

omnibus clearing structure. Whatever uncertainty exists under the Code for swaps cleared at exempt DCOs does not exist for swaps cleared at registered DCOs.

3. The Commission Has Authority to Provide FCM Registration Relief to Non-U.S. Clearing Members Carrying FCM Customer Omnibus Accounts

The Commission has authority under Section 4(c) of the CEA to grant relief from FCM registration for non-U.S. clearing members that limit their U.S. activities to carrying FCM omnibus accounts.[28] This is, in fact, the same authority the Commission proposed to utilize to grant relief from FCM registration for non-U.S. clearing members that cleared for U.S. customers on exempt DCOs.[29]

Further, the Commission has granted analogous relief from FCM registration in the past on a solely interpretive basis, without relying on Section 4(c). Specifically, under Commission Letter No. 87-7, Commission staff interpreted the FCM registration requirement that otherwise applies to foreign futures and options brokers not to apply to a broker that only carried the customer omnibus account of a U.S. FCM.[30] The staff reasoned that registration was not required in these circumstances because of the presence of an "intervening U.S. registrant," the U.S. FCM, which would be subject to Commission regulation.[31] This same rationale applies to an omnibus clearing structure for foreign cleared swaps, where a U.S. customer would interface with a Commission-regulated U.S. FCM and would not have direct contact with the non-U.S. clearing member.

II. The Commission Should Permit Non-U.S. Clearing Organizations to Accept Foreign Branches of U.S. Bank Swap Dealers

The Commission requested comment on whether the Commission should clarify that a non-U.S. clearing organization clearing swaps does not trigger registration as a DCO solely because it permits participation by foreign branches of U.S. bank swap

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[28] 7 U.S.C. § 6(c) (the public interest exemption to promote responsible economic or financial innovation and fair competition).

[29] *See* Exemption Proposal, 84 Fed. Reg. at 35457.

[30] CFTC Letter 87-7, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,972 (November 17, 1987).

[31] *Id.* ("[W]here an FCM transfers its customer omnibus account to an offshore firm which is either a member of a foreign exchange or is an offshore affiliate of a U.S. FCM licensed or authorized by the offshore jurisdiction where it is located, and such foreign exchange member's or affiliate's contact with foreign futures and options customers is limited to carrying the customer omnibus account of a U.S. FCM for execution on the foreign exchange, such activity should not bring it within the scope of the foreign futures and options rules.").

dealers.[32] As described below, providing this clarification is essential to remedying an undue competitive disadvantage faced by U.S. bank swap dealers that is not necessary to mitigate risk to the United States. Even if a non-U.S. clearing organization is not required to register with the Commission as a DCO or to obtain an exemption from registration, U.S. bank swap dealers could not, absent substituted compliance, use a non-U.S. clearing organization to satisfy the Dodd-Frank Act's mandatory clearing requirement unless it registered with the Commission as a DCO or obtained an exemption from such registration.

A. U.S. Bank Swap Dealers Need Access to Non-U.S. Clearing Organizations That Cannot Register as DCOs or Obtain DCO Exemptions

Since the Commission originally developed its approach to regulating non-U.S. clearing organizations under the Dodd-Frank Act, the number of foreign jurisdictions with swaps clearing mandates has expanded significantly. U.S. bank swap dealers that operate through global branch networks have become subject to these clearing mandates. In addition, U.S. bank swap dealers are subject, on a global basis, to the U.S. Prudential Regulators' margin rules for non-cleared swaps. Under these rules, U.S. bank swap dealers trading uncleared swaps in a foreign jurisdiction where netting is not enforceable and local law does not recognize segregation arrangements must collect initial margin on a gross, un-segregated basis. When initial margin requirements expand in 2020 to cover a larger number of counterparties in these foreign jurisdictions, collecting initial margin on this basis will make U.S. banks uncompetitive when trading uncleared swaps with those counterparties.

Both of these developments increase the need for U.S. bank swap dealers to trade cleared swaps in foreign jurisdictions. However, not all non-U.S. clearing organizations are able or willing to register as DCOs or obtain exemptions from DCO registration. In particular, non-U.S. clearing organizations may face conflicts with local data protection laws in their home countries. These conflicts prevent them from satisfying the conditions the Commission has imposed on exempt DCOs.

B. Requiring Subsidiarization of U.S. Bank Swap Dealers Prevents Access to Foreign Swaps Markets

If the main clearing organization in a foreign jurisdiction is unwilling or unable to register as a DCO or obtain an exemption from DCO registration, a U.S. bank is required to create a local subsidiary in order to access such non-U.S. clearing organization as a clearing member. Requiring U.S. bank swap dealers to clear with non-U.S. clearing organizations through local subsidiaries rather than branches results in competitive disparities that are not necessary to mitigate risk to the United States. Establishing a local subsidiary is an onerous undertaking that typically requires U.S. bank swap dealers to

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[32] Exemption Proposal, 84 Fed. Reg. at 35465, Question 12.

obtain regulatory approval from both U.S. and local regulators. Subsidiarization also results in a more complex bank organizational structure, which is in direct contrast to the goals of reforms introduced after the financial crisis to streamline and rationalize legal entity structures.[33]

Altogether, it can be unreasonable for a U.S. bank swap dealer to incur the costs of creating a subsidiary for the sole purpose of accessing a non-U.S. clearing organization. U.S. bank swap dealers may also be unable to do so for regulatory reasons. As a result, U.S. bank swap dealers may be foreclosed from accessing foreign markets that require clearing if there is no non-U.S. clearing organization that is either registered as a DCO or exempt from DCO registration in such market. This decreases competition in the cleared swaps markets and makes it more difficult for U.S. bank swap dealers to centrally clear their swaps, in contrast to the Dodd-Frank Act's objectives.

C. Admitting Foreign Branches of U.S. Bank Swap Dealers as Clearing Members Should Not Cause a Non-U.S. Clearing Organization To Trigger the Commission's Cross-Border Jurisdiction

Section 2(i) of the CEA states that the jurisdiction of the Commission shall not extend to swap activities outside of 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 anti-evasion regulations.[34] Based on how it has previously construed Section 2(i), the Commission should permit a non-U.S. clearing organization to admit the foreign branch of a U.S. bank swap dealer as a clearing member without registering as a DCO or obtaining an exemption from DCO registration.

The Commission has previously recognized that applying registration requirements to parties transacting with the foreign branches of a U.S. bank swap dealer is not required by Section 2(i). Specifically, in 2013, the Commission interpreted Section 2(i) to not require a non-U.S. person that transacted with a foreign branch of a U.S. bank swap dealer to register with the Commission as a swap dealer, noting that applying registration requirements would result in competitive disparities that are not necessary to mitigate risk to the United States.[35]

Like when they trade with non-U.S. dealers, comprehensive regulation of U.S. bank swap dealers by the Commission and U.S. banking regulators similarly addresses

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[33] Federal Reserve and FDIC, Guidance for 2018 §165(d) Annual Resolution Plan Submissions by Domestic Covered Companies that Submitted Resolution Plans in July 2015 at 23–24, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20170324a21.pdf; *see also* U.S. Dep't of the Treasury, Orderly Liquidation Authority and Bankruptcy Reform at 13–14 (Feb. 21, 2018).

[34] 7 U.S.C. § 2(i).

[35] *See* Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292, 45324 (July 26, 2013) ("The Commission understands that commenters are concerned that foreign entities, in order to avoid swap dealer status, may decrease their swap dealing

the risks faced by the foreign branches of U.S. bank swap dealers clearing through non-U.S. clearing organizations. The Commission's existing swap dealer risk management regulation specifically addresses these risks by requiring, among other measures, diligent investigation of a non-clearing organization's financial resources and risk management procedures,[36] risk limits[37] and stress tests.[38] In addition, prudential capital standards require U.S. bank swap dealers to assess the regulatory status of all non-U.S. clearing organizations in which they participate if they wish to receive favorable capital treatment.[39]

Also, U.S. bank swap dealers are required to report all of their swap transactions in accordance with Part 45 of the Commission's Regulations, including swaps cleared by their foreign branches through non-U.S. clearing organizations. The Commission and the U.S. banking regulators can also obtain additional information directly from U.S. bank swap dealers regarding their clearing activity without seeking such information from non-U.S. clearing organizations. Through these measures, existing regulation already provides the tools for the Commission and the U.S. bank regulators to replicate most of the conditions the Commission has applied when exempting non-U.S. clearing organizations from DCO registration.[40]

In light of these considerations, the Commission should apply the same standard to DCO registration as it did for swap dealer registration and recognize that applying the Dodd-Frank Act's DCO registration requirements extraterritorially to such non-U.S. clearing organizations is not required by Section 2(i).

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business with foreign branches of U.S. registered swap dealers and guaranteed affiliates that are swap dealers. Therefore, the Commission's policy, based on its interpretation of Section 2(i) of the CEA, will be that swap dealing transactions with a foreign branch of a U.S. swap dealer or with guaranteed affiliates that are swap dealers should generally be excluded from the *de minimis* calculations of non-U.S. persons that are not guaranteed or conduit affiliates").

[36] 17 C.F.R. § 23.600(c)(5)(iii).

[37] 17 C.F.R. § 23.609(a)(1), (2) and (3).

[38] 17 C.F.R § 23.609(a)(4).

[39] *See, e.g.*, 12 C.F.R. § 217.2 (definition of qualifying central counterparty); 12 C.F.R. § 217.35 (Cleared transactions); 12 C.F.R. § 217.133 (Cleared transactions).

[40] *See, e.g.*, Amended Order of Exemption from Registration (Jan. 28, 2016) (ASX Clear (Futures) Pty Limited); Amended Order of Exemption from DCO Registration (May 15, 2017) (Japan Securities Clearing Corporation); Order of Exemption from DCO Registration (Oct. 26, 2015) (Korea Exchange, Inc.) and Order of Exemption from DCO Registration (Dec. 21, 2015) (OTC Clearing Hong Kong Limited).

If you have any questions concerning our comments, please feel free to contact the undersigned. SIFMA welcomes the opportunity to discuss these issues further with the Commission and its staff.

Sincerely,

Kyle Brandon
Managing Director
SIFMA

cc: Honorable Heath P. Tarbert, Chairman
Honorable Rostin Behnam, Commissioner
Honorable Dan M. Berkovitz, Commissioner
Honorable Brian D. Quintenz, Commissioner
Honorable Dawn DeBerry Stump, Commissioner
Malcolm C. Hutchinson III, Director, Division of Clearing and Risk
Joshua B. Sterling, Director, Director of Swap Dealer and Intermediary Oversight