August 24, 2012

Chairman Gary Gensler
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214

Dear Chairman Gensler:

The Committee on Capital Markets Regulation (Committee) appreciates the opportunity to comment on the Commodity Futures Trading Commission's (CFTC) proposed interpretive guidance regarding Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act[1] (Proposed Guidance) under § 722 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[2]

Since 2005, the Committee, composed of 33 members, has been dedicated to improving the regulation of U.S. capital markets. Our research has provided an independent and empirical foundation for public policy. In May 2009, the Committee released a comprehensive report entitled The Global Financial Crisis: A Plan for Regulatory Reform, which contains fifty-seven recommendations for making the U.S. financial regulatory structure more integrated, more effective, and more protective of investors in the wake of the financial crisis of 2008.[3] Since then, the Committee has continued to make recommendations for regulatory reform of major areas of the U.S. financial system.

On June 29, the CFTC released proposed interpretive guidance regarding the cross-border (extra-territorial) impact of the swap-related provisions of Title VII of the Dodd-Frank Act.[4] The Proposed Guidance divides Title VII's substantive requirements into entity and transaction requirements.[5] Entity requirements relate largely to matters that govern a swap dealer ("SD") or a major swaps participant ("MSP") and include: capital adequacy, chief compliance officers, risk management, swap data recordkeeping, swap data reporting, and physical commodity swaps

[1] Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41,214 (proposed July 12, 2012) [hereinafter Proposed Guidance].
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act § 722(d), Pub. L. No. 111-203 (2010) [hereinafter Dodd-Frank Act].
[3] COMM. ON CAPITAL MKTS. REG., THE GLOBAL FINANCIAL CRISIS: A PLAN FOR REGULATORY REFORM (May 2009), http://www.capmktsreg.org/research.html.

[4] Proposed Guidance, *supra* note 1, at 41,214
[5] *Id.* at 41,223-24.

reporting.[6] Transaction requirements relate largely to risk mitigation and market transparency, and include: clearing and swap processing, margining and segregation for uncleared swaps, trade execution, swap trading relationship documentation, portfolio reconciliation and compression, real-time public reporting, trade confirmation, daily trading records, and (in certain circumstances) external business conduct standards.[7]

The Proposed Guidance subjects any swap involving a "U.S. person" to all Title VII transaction requirements, regardless of the counterparty and execution location of the transaction.[8] For example, a swap between a U.S. person and a Hong Kong person executed in Hong Kong would be subject to Title VII transaction requirements.

The Proposed Guidance also determines whether a foreign person must register as an SD or MSP with the CFTC, based on the foreign person's level of swap dealing with U.S. persons under the same tests applicable to U.S. persons.[9] The SD *de minimis* test requires a U.S. Person to register as an SD if that person engages in swap dealing transactions over the prior 12 months at a level above an aggregate gross notional amount of $8 billion.[10] The MSP *de minimis* test requires the CFTC to assess a non-dealer's net positions in each major category of swaps, substantial net uncollateralized counterparty exposure and leverage to determine whether a non-dealer could pose systemic risk and requires regulation.[11]

If a foreign person is required to register as an SD or MSP, it is subject to Title VII's entity requirements. However, foreign SDs or MSPs may qualify for "substituted compliance" from Title VII's entity requirements if the CFTC determines that a foreign SD's or MSP's home country derivatives regime requirements are comparable to Title VII entity requirements.

The CFTC's guidance is inconsistent with the congressional intent of Section 722(d).

Section 722(d) of Dodd-Frank amended the CEA to include a new section 2(i), "Applicability," which provides that the provisions of Title VII do not apply to activities outside the United States *unless* those activities either: (1) have a direct and significant connection with activities in, or effect on, commerce of the United States (this applies to foreign entities); or (2) contravene such rules or regulations as the CFTC may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of Title VII.[12]

These jurisdictional limits must be interpreted in light of judicial precedent and the long-standing principle of American law that legislation of Congress, "'unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.'"[13] Thus, "'unless there is the affirmative intention of the Congress clearly expressed' to give a statute

[6] *Id.* at 41,224.
[7] *Id.* at 41,225.
[8] *Id.* at 41,228.
[9] *Id.* at 41,219-20.
[10] Further Definition of ''Swap Dealer,'' ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant'', 77 Fed. Reg. 30,634 (May 23, 2012)
[11] *Id.* at 30,661.
[12] Dodd-Frank Act § 722(d).
[13] EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991) (quoting Foley Bros., Inc. v. Filardo, 336 U.S. 281, 285 (1949)).

extraterritorial effect, 'we must presume it is primarily concerned with domestic conditions.' . . . When a statute gives no clear indication of an extraterritorial application, it has none."[14] The Dodd-Frank Act is clear in that it is intended to limit the CFTC's extra-territorial authority to activities that have a "direct and significant connection" to U.S. commerce or are specifically intended to evade Title VII.

By applying Title VII transaction requirements to any swaps transaction involving a U.S. person, regardless of execution location and without substituted compliance, the CFTC interprets its extraterritorial authority as broadly as possible and provides for no deference to other country's regulatory regimes. It does so without adequately establishing that such broad extraterritorial authority is justified in each instance by a "direct and significant" effect on U.S commerce or the need to prevent evasion of Title VII requirements. As a result, the CFTC has ignored judicial precedent and the restrictive intent of Section 722(d).

The CFTC does not need to impose Title VII transaction requirements to swaps executed in a foreign jurisdiction with a sufficiently similar derivatives regime. Under these circumstances, Section 722(d) requires that the CFTC allow for substituted compliance for transaction requirements. Section 722(d) also requires that the CFTC allow for substituted compliance for entity requirements for foreign persons with sufficiently similar home derivatives regimes. The CFTC should assess the adequacy of foreign derivatives regimes to determine whether the regimes requirements are sufficiently similar with Title VII requirements. Where swaps are executed in a foreign jurisdiction without any, or sufficiently similar, derivatives regulatory regime, the CFTC's approach of subjecting swaps where one of the counterparties is a US person to the transaction requirements is appropriate and consistent with Title VII.

The unilateral application of Title VII transaction requirements to any swaps transaction involving a U.S person is also inconsistent with section 752(a) of the Dodd-Frank Act.[15] Section 752(a) evidences Congressional intent that the Commission engage in a constructive dialogue with non-US regulators during the formulation of the global regulatory framework.

The CFTC should have issued a Notice of Proposed Rulemaking rather than Interpretive Guidance.

The Proposed Guidance is an "interpretive rule" and/or "general statement of policy" under the Administrative Procedure Act ("APA"), not subject to the standard APA requirements

[14] Morrison v. Nat'l Australia Bank, 130 S. Ct. 2869, 2882-83 (2010) (quoting EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991)).

[15] Section 752(a) of the Dodd-Frank Act provides:

In order to promote effective and consistent global regulation of swaps and security- based swaps, the Commission, the Securities and Exchange Commission, and the prudential regulators (as that term is defined in section 1a(39) of the [CEA]), as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps, security-based swaps, swap entities, and security-based swap entities and may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors, swap counterparties, and security-based swap counterparties.

for rulemaking. The Supreme Court has ruled that interpretive rules cannot be legally binding and do "not effect a substantive change in the regulations."[16] According to the Guide to the Rulemaking Process, prepared by the Office of the Federal Register, "There is a key distinction between an interpretive rule and a final 'legislative' or 'substantive' rule. The interpretive rule or policy statement must not set new legal standards or impose new requirements."[17]

The Proposed Guidance sets forth a novel view of extraterritorial jurisdiction and sets new legal standards. For example, for the purposes of Title VII, the Proposed Guidance defines the legal standard for qualification as a U.S. person and qualification as a foreign SD or MSP. The Proposed Guidance thereby subjects U.S. persons and foreign SDs and MSPs to certain requirements. This is not simply an interpretation of the meaning of a Title VII rule. Thus, the Proposed Guidance should have been issued as a 'legislative' or 'substantive' rule.

Because the CFTC did not follow the proper rulemaking process, the CFTC has unnecessarily exposed its actions pursuant to Section 722(d) to potential judicial challenge. Moreover, the public has been deprived of its statutory protections and market participants also lack regulatory certainty since interpretive rules cannot have legally binding effect. The Committee is concerned that other agencies may follow the CFTC's lead and issue interpretive rules in order to impose new legal standards or requirements on the public.

The Committee recommends that the Proposed Guidance be re-proposed as a Notice of Proposed Rulemaking subject to the standard APA and Commodities Exchange Act ("CEA") requirements. We also note that for the SEC's extra-territorial application of Title VII requirements to security-based swaps, the SEC staff has implied that the SEC will issue a Notice of Proposed Rulemaking not Interpretive Guidance.[18]

Most importantly, because the CFTC did not follow the proper rulemaking process it has also failed to comply with Section 15(a) of the CEA, which requires that the Commission evaluate the costs and benefits of its proposed actions "before promulgating a regulation . . . or issuing an order."[19] Issuing interpretive rules with broad economic effects without any cost-benefit analysis risks being arbitrary and is inconsistent with the current Administration's emphasis on the consideration of costs and benefits in connection with agency rulemaking.[20] The Committee requests that the Commission conduct a cost-benefit analysis of the Proposed Guidance.[21]

[16] Warder v. Shalala, 149 F.3d 73, 80 (1st Cir. 1998) (quoting Shalala v. Guernsey Mem'l Hosp., 514 US 87, 100 (1995)).

[17] OFFICE OF THE FEDERAL REGISTER, A GUIDE TO THE RULEMAKING PROCESS 11 (2011).

[18] *Hearing on Title VII Implementation Before the S. Comm. on Agriculture, Nutrition & Forestry*, 112th Cong. (2012) (statement of Robert Cook, Director, Division of Trading & Markets, U.S. Sec. & Exch. Comm'n), *available at* http://www.sec.gov/news/testimony/2012/ts071712rc.htm ("Additionally, we intend to propose rules and interpretive guidance to address the international implications of Title VII in the near term, reflecting the fact that the OTC derivatives market has grown to become a truly global market in the last three decades.").

[19] Commodity Exchange Act § 15(a) (2001).

[20] Exec. Order No. 13,563, 76 Fed. Reg. 3,821 (Jan. 21, 2011).

[21] Please note that as outlined in our March 7, 2012 letter on cost-benefit analyses, we nonetheless clarified that "To be clear, in calling for better cost-benefit analysis, we are not suggesting that rulemaking should be delayed. To the

Definition of U.S. Person

The CFTC's definition of a "U.S. person" in the Proposed Guidance fails to provide market participants with adequate regulatory certainty because the proposed definition is unnecessarily ambiguous.

For example, a U.S. person includes "any corporation, partnership, limited liability company, [or] business…in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. person."[22] The phrase "responsible for the liabilities of such entity," is open to interpretation. The Committee recommends that the CFTC specify the meaning of this phrase.

Additionally, in order for a foreign market participant to determine whether it must comply with Title VII transaction requirements or register as a SD or MSP with the CFTC, it must determine whether its counterparty is a U.S. person. This determination will typically require extensive knowledge of legal and ownership structure—information counterparties will not have. The Committee recommends that the CFTC revise the Proposed Guidance to permit reasonable reliance on counterparty representations regarding their status as a U.S. person.

Substituted Compliance

As mentioned earlier, any swap involving a U.S. person and a foreign market participant is subject to Title VII transaction requirements, regardless of the execution location of the transaction, with no exception for substituted compliance. Substituted compliance is effectively only applicable to foreign SDs and MSPs Title VII entity requirements. If other countries impose similar derivatives regimes then *all* cross-border swaps transactions will be subject to at least two derivatives regimes, including swaps between a U.S. person and a foreign counterparty executed in the U.S. At the very least this will result in unnecessary and costly regulatory overlap and, at worst, the overlapping derivatives regimes will be incompatible.

For example, the U.S. and E.U. regimes only permit their home-country institutions to participate in a foreign clearinghouse if the regulation of a foreign clearinghouse is equivalent to that of the regulation of clearinghouses in the home country. Although both regimes favor central clearing of standardized and liquid derivatives contracts, the regulation of clearinghouses may differ on important specifics, including capital requirements and ownership restrictions. Thus, we urge the U.S. and E.U. regulators to cooperate and ensure the mutual recognition of clearinghouses such that market participants can satisfy their clearing obligations at a recognized DCO / CCP in either location, and avoid the impossible situation where a U.S. person transacting in swaps in Europe would have to clear swaps with both a U.S. clearinghouse and an EU clearinghouse.

contrary, we firmly believe that certain changes mandated by Dodd-Frank are crucial to the functioning of the financial markets and should thus be put into effect as soon as possible. For example, we strongly support central clearing of derivatives and hope that in the interest of reducing risk and increasing transparency, the agencies will expeditiously promulgate rules in this area."

[22] Proposed Guidance, *supra* note 1, at 41,218.

Additionally, the Proposed Guidance imposes a significant burden on foreign SDs and MSPs seeking substituted compliance for entity requirements. Typically, foreign SDs or MSPs must apply for such an exemption when registering as an SD or MSP. In order to determine whether a foreign derivative regime may be substituted for Title VII entity requirements, the Commission will use a too vaguely described "outcomes based approach" in assessing whether the foreign requirements "are designed to meet the same regulatory objectives of the Dodd-Frank Act."[23]

Consistent with the stated G-20 goals, it is expected that G-20 market participants will be subject to home country regulation that seeks to achieve the same regulatory objectives as Title VII entity requirements. Thus, the Committee urges the Commission to make a substituted compliance determination for each G-20 derivatives regime—including entity and transaction requirements—after they are each finalized.

If the CFTC determines that a foreign regime qualifies for substituted compliance then all swaps transactions that are executed in that foreign jurisdiction, whether they involve U.S. or foreign persons, would be subject to the foreign derivatives regime, not Title VII requirements. Thus, foreign persons would only be subject to Title VII transaction requirements for swaps executed in the U.S. The Committee recommends that substituted compliance be conditioned on a reciprocal arrangement with other G-20 country regulators to the effect that U.S. persons will not be subject to regulation by that jurisdiction, unless a swap is executed in the foreign jurisdiction. Thus, if a U.S. person and a Japanese person execute a swap in the UK then the UK derivatives regime would be applicable to the transaction, so long as both countries have determined that the UK derivatives regime qualifies for substituted compliance.

It is the Committee's position that such a substituted compliance regime would ensure that cross-border swaps transactions are not subject to multiple derivatives regimes. Such a regime would be consistent with principles of international comity and would substantially reduce unnecessary costs and potential conflicts between overlapping derivatives regimes. Moreover, the regulatory protections provided by Title VII to U.S. market participants and the U.S. financial system would not be affected.

International Coordination

Although all G-20 countries are expected to implement comparable regimes, it will be some time before non-U.S. countries implement their derivatives regimes. For example, although it is expected that the EMIR will be implemented by January 1, 2013, and this will include the core clearing and reporting obligations, other important provisions will follow later in the MiFID II or amendment of the Capital Requirements Directive.[24] MiFID II is not expected to be in effect until 2015, and will require nation-by-nation implementation. Thus, a comprehensive substituted compliance determination with respect to Europe will not be possible in the year planned by the Commission. Other countries including Japan, Singapore, and Hong Kong are further behind the EU in implementing the core clearing and reporting obligations.

[23] *Id.* at 41,232.

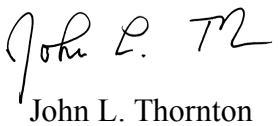
[24] These provisions may deal with risk management and chief compliance officer matters, trade execution venue requirements, expansion of commodity derivatives regulation and wider applicability of capital requirements.

The Committee recommends that the Commission not issue final guidance until an understanding in principle as to overlapping jurisdiction and comparable regulatory content is reached among the Commission, the SEC, and important foreign regulators.

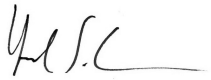
Thank you for considering our comments. Please do not hesitate to contact us at (617) 384-5364 if we can be of any further assistance.

Respectfully submitted,

R. Glenn Hubbard
CO-CHAIR



John L. Thornton
CO-CHAIR



Hal S. Scott
DIRECTOR