J.P.Morgan

Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, D.C. 20219
Attention: David A. Stawick, Secretary

Subject: *CFTC - RIN 3038–AD57 - Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act*

CFTC – RIN 3038–AD85 - Exemptive Order Regarding Compliance With Certain Swap Regulations

Ladies and gentlemen:

JPMorgan Chase & Co. ("***JPMorgan***") welcomes the opportunity to provide comments to the Commodity Futures Trading Commission (the "***Commission***") relating to the Commission's proposed guidance on the cross-border application of Title VII of the Dodd-Frank Act (the "***Extraterritoriality Proposal***")[1] and the corresponding exemptive order (the "***Proposed Exemptive Order***").[2] Any capitalized term not otherwise defined in this letter shall have the meaning assigned to such term in the Extraterritoriality Proposal.

Executive Summary

Section 722(d) of the Dodd-Frank Act states that the provisions of the Commodity Exchange Act added by the Dodd-Frank Act shall not apply to activities outside of the United States unless those activities, among other things, have a direct and significant connection with activities in, or effect on, commerce of the United States. The Commission has been actively engaged in rulemaking to implement the Dodd-Frank Act without addressing the very significant question of which activities, in a market that is global in scope, have such a "direct and significant connection." Although the Commission has taken the first steps toward clarifying this question with the Extraterritoriality Proposal, the deadline is rapidly approaching by which some market participants will have to register and begin to comply with the Commission's regulations as swap dealers, even while the application of the provisions to large portions of this international market remains unclear and uncertain.

We appreciate that the Commission has begun the process of clarifying the jurisdictional reach of its regulations. Nevertheless we have significant concerns with: (i) the form of the proposed clarifications (as guidance rather than a formal rule); (ii) the substance of the proposals (which we believe will create an unlevel regulatory playing field to the detriment of United States

[1] Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act; Proposed Rule, 77 Fed. Reg. 41214 (July 12, 2012).

[2] Exemptive Order Regarding Compliance With Certain Swap Regulations, 77 Fed. Reg. 41110 (July 12, 2012).

financial institutions); (iii) the process for clarifying the extraterritorial reach of these regulations (which will leave market participants, whether inside or outside the United States, with the challenge of implementing a compliance program of uncertain scope); and (iv) the lack of coordination of the proposals with other U.S. regulators as well as comparable regulators in Europe and other relevant jurisdictions. Therefore, we urge the Commission to issue a clear and comprehensive rule on the extraterritorial scope of its regulations, and to provide relief to *all* affected market participants with respect to the applicable regulations until such issues have been resolved.

We also believe that the comment period, which is effectively 30 days for both the Extraterritoriality Proposal and the Proposed Exemptive Order because they are so intertwined, is far too short given the complexity of these matters.

In this letter, we discuss the following specific concerns:

- The Commission's avoidance of the requirement to conduct a cost-benefit analysis under the Administrative Procedure Act by issuing proposed guidance rather than a proposed rule creates a gap in the regulatory analysis that may result in a substantial adverse effect on American businesses.

- The proposed process for establishing the comparability of other legal regimes would be burdensome for non-U.S. market participants and their regulators, and would lack the transparency that the Commission wants to bring to the swaps markets, create the possibility of regulatory arbitrage, create a patchwork of regulations that will leave market participants with a lack of certainty and a significant implementation burdens If the Commission does choose to adopt an approach based on substituted compliance, the determination should be made overall for a particular jurisdiction, in the way currently done under the Commission's rules relating to foreign boards of trade (***"FBOTs"***), rather than being made as an issue-by-issue determination.

- If the proposed methodology for determining the availability of substituted compliance for a particular jurisdiction is retained, foreign branches of U.S. persons should be allowed to petition for such a determination.

- The Commission should eliminate the concept of a "conduit" and instead rely on its approach to transactions with U.S. persons, which addresses the same concerns as the rules applicable to "conduits" without adding further complication.

- The *de minimis* exception for emerging markets branches should be explicitly be available to all branches as well as affiliates, as there is no basis in the statute for distinguishing between locations and entities in this manner, and activities below the *de minimis* threshold do not meet the significance standard set out in Section 722(d).

- Trade execution and real-time reporting obligations should be treated comparably to the external business conduct rules because they are intended to create market transparency for investor benefit rather than prudential risk management.

- The definition of "U.S. person" is overly broad and unnecessarily vague, and should be replaced with the Regulation S standard already familiar to market participants.

- U.S. guarantees of swaps positions of non-U.S. persons, outstanding at the commencement of the determination of the *de minimis* exception by the non-U.S. person, should not be included in the determination for the non-U.S. person (though they should be counted for the U.S. person) so long as such U.S. guarantees are eliminated for future transactions.

- The term "guarantee" should not include keepwells and liquidity puts because these agreements do not create the same types of third-party rights and address different risks than traditional guarantees.

- Non-U.S. affiliates of U.S. persons should not have to comply with any requirements earlier than non-U.S. entities that do not have U.S. affiliates. Requiring different compliance time frames for comparably situated entities formed in and operating under the laws of the same non-U.S. jurisdiction, solely on the basis of the existence of a U.S. affiliate, creates competitive disadvantages for one such entity over the other without any sound basis and fails to respect the corporate separateness of the entities and the entity formation laws of the other jurisdiction.

- The Proposed Exemptive Order should create clear timelines for compliance by explaining how it interacts with the complicated compliance timelines for the Commission's existing rules.

- The relief granted to non-U.S. swap dealers and non-U.S. major swap participants in the Proposed Exemptive Order should expire 12 months following publication of the final order, not the proposed order, in the Federal Register. Market participants require 12 months from the date of definitive regulation to take the action required by that regulation.

- We understand that the Commission is working on a proposed rulemaking regarding inter-affiliate transactions, which we believe will relate to the interpretations set forth in the Extraterritoriality Proposal in several important ways; market participants should have a meaningful opportunity to comment on these rules together.

In addition, we refer to the letter filed on our behalf by Sullivan & Cromwell on February 22, 2011 (the "S&C Letter"), a copy of which is attached to this letter, which contains more detailed comments on the threshold question of whether and in what circumstances the statutory requirements of Section 722(d) are met by the activities of foreign branches, subsidiaries and affiliates of U.S. banks. The Commission should not oversimplify and mischaracterize the legal status of the foreign branches of U.S. banks by declaring them, without further nuance, to be the same legal entity. Foreign branches of U.S. banks are hybrid entities with distinct regulatory status, in that they are subject to regulation by non-U.S. authorities, even though they are not separately incorporated. There is an existing and complex body of law relating to this area and the Commission's mischaracterization may have broader effects, including leading to unintended outcomes under the swaps push out rule.

Discussion

(1) Proposed Guidance Should be Promulgated as a Major Rule under the APA

The Extraterritoriality Proposal will impose significant costs on the swap market participants in the U.S. and abroad. It will require U.S. and non-U.S. entities to change the way they do business with each other, create compliance burdens for multiple affiliated parties with respect to a single transaction, create overlapping, and in some cases inconsistent, regulation with non-U.S. regulators, and impose competitive burdens on U.S. entities and their non-U.S. affiliates and branches. Moreover, it fails to address critical issues at a time when market participants are struggling to bring their operations into compliance with a massive and ever-shifting set of regulations, in the U.S. and overseas, that are changing core aspects of virtually every component of the swaps markets. Given its significance to the operations of the swaps market, this document, put forward as "guidance" is, in effect, a "major rule"[3], but as informal guidance, it lacks a cost-benefit analysis and the assessment of the effects on U.S. entities' competitiveness in the global economy. Therefore, we believe the extraterritorial reach of the Commission's regulations needs to be established through a thoughtful rulemaking in accordance with the Administrative Procedure Act (the "***APA***"),[4] with a meaningful cost-benefit analysis that supports the Commission's interpretations and with the requirement that the comments that the Commission has sought on the Extraterritoriality Proposal be taken into account and addressed in formulating the final rule.

Among the costs that the Commission has failed to consider are the following:

- Competitive disadvantages placed on U.S. firms by establishing an unlevel regulatory playing field for the branches and affiliates of U.S. entities in dealing with non-U.S. counterparties, compared to similarly situated non-U.S. entities transacting with the same non-U.S. counterparties.

- Costs associated with the treatment of guarantees and central booking arrangements that place duplicative and sometimes inconsistent compliance obligations on multiple entities in an affiliated group with respect to the same transaction.

- Costs of treating foreign branches of U.S. banks in a manner that is inconsistent with their treatment under U.S. and foreign banking laws.

- Costs associated with a process for establishing the ability to use "substituted compliance" that will lead to duplicative filings, potentially inconsistent treatment of entities in the same jurisdiction, the patchwork application of regulatory requirements in non-U.S. jurisdictions and burdens on foreign regulators as well as market participants.

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[3] The term "major rule" means any rule that the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget finds has resulted in or is likely to result in - (A) an annual effect on the economy of $100,000,000 or more; (B) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (C) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets. 5 U.S.C. § 804(2).

[4] See 5 U.S.C. §§ 551 *et seq.*

(2) Substituted Compliance and Comparability Determinations Should be Efficient and Transparent

The Extraterritoriality Proposal would permit certain non-U.S. entities that are subject to Dodd-Frank requirements to comply with the regulations of a primary local or domestic regulator instead of the Commission's regulations under certain circumstances.[5] As described in more detail in the S&C letter, we agree that non-U.S. entities should be able to comply with the swaps regulations of their primary regulators when such regulators have established robust oversight of swaps activities. In some cases, the Commission has also proposed to allow the foreign branches of U.S. banks to comply with the swaps regulations of their local regulators, which we also support. We are concerned that the Commission's proposed process for determining when to allow "substituted compliance" with a non-U.S. swaps regulatory regime will create unnecessary burdens and inconsistencies. Should the Commission decide to adopt the "substituted compliance" standard, we urge the Commission to take a more holistic approach to the recognition of foreign regulatory systems.

- **Overly Burdensome, Complicated and Unnecessary to Achieve Stated Policy Goal.** The proposal to make comparability determinations on an issue-by-issue basis, rather than for a legal regime as a whole, will create unnecessary burdens, impose unnecessary costs and potentially undermine the compliance efforts of affected participants. By approving only portions of a foreign regulatory regime as satisfying its "substituted compliance" standard, the Commission will place market participants in the relevant jurisdiction in the position of running two parallel (and potentially conflicting) compliance programs for the same activity for a subset of the swaps regulations. Moreover, as the Commission well knows, regulatory structures are more than the sum of their parts, and the effect of particular requirements when separated from the overall regulatory structure may be less clear, or even different, than the effect of such requirements as part of a comprehensive regulatory framework. The Commission has had a long history of making comparability determinations on a jurisdictional basis, and the Commission provides no persuasive reason to depart from that practice. Indeed, the Commission's recently-finalized rule regarding FBOTs continues to use such an approach to comparability determinations by looking at a jurisdiction's regulatory structure as a whole and utilizing a principles-based analysis.[6] This approach is fundamentally a more effective policy approach than requiring an issue-by-issue analysis.

- **Inconsistent Results.** The Extraterritoriality Proposal states that the Commission "*may* rely on prior comparability determinations with respect to a particular jurisdiction to facilitate its review of a subsequent applicant's request for recognition of substituted compliance."[7] The Commission is thus not binding itself to rely on such determinations, nor is it committing to reach the same conclusions for all participants in a jurisdiction. Throughout the Title VII rulemaking process, the Commission has expressed its commitment to principles of fairness and open access, and yet it is reserving to itself the right to make different determinations as to the sufficiency of the legal regime with

[5] *See generally*, Extraterritoriality Proposal, 77 Fed. Reg. at 41229-30.

[6] *See* Registration of Foreign Boards of Trade, 77 Fed. Reg. 80674, 80700 (17 C.F.R. § 48.5(d)) (Dec. 23, 2011).

[7] Extraterritoriality Proposal, 77 Fed. Reg. at 41233 (emphasis added).

respect to participants in a single jurisdiction. Absent a material change in the regulatory approach to swaps in an affected jurisdiction—which should be determined by the Commission rather than by market participants, as suggested—we believe that comparability determinations should have general applicability to market participants in the applicable jurisdiction, and persons seeking to avail themselves of substituted compliance for the first time should be able to rely on previous determinations. As proposed, they will likely have to engage in an expensive process of comparing the non-U.S. and U.S. regulatory regimes and will have the uncertainty of waiting for a determination while the Commission retreads covered ground. This is not a reasonable use of the Commission's or market participants' resources and would create a duplicative and wasteful approach that shows insufficient deference to non-U.S. regulators and imposes unnecessary burdens on the entities subject to their oversight.

- **Lack of Transparency**. In making comparability determinations, the Commission will have to engage in a complex analysis and comparison of legal regimes, and these determinations will have significant impacts on every market participant in that jurisdiction. As proposed, however, these determinations will be made unilaterally by the Commission without the transparency that public comments would provide and without any obligation on the Commission to explain its determinations. A more open process, including an opportunity for public comment, should be an essential aspect of the Commission's determinations as to the availability of substituted compliance.

- **Foreign Branches and Substituted Compliance.** The Extraterritoriality Proposal contemplates that foreign branches of U.S. banks may use substituted compliance in certain circumstances but does not provide these branches with the right to request a determination of the availability of substituted compliance.[8] This appears to be an oversight and accordingly should be clarified by the Commission.

(3) The Concept of a "Conduit" Should be Eliminated

The Extraterritoriality Proposal introduces the concept of a "conduit" and would apply Transaction-Level Requirements to any non-U.S. affiliate of a U.S. entity if the non-U.S. affiliate qualifies as a conduit.[9] We believe that these rules would unnecessarily complicate matters and therefore request that the Commission remove them from the Extraterritoriality Proposal. The concept of conduits is flawed and should take into account the fact that many swap dealers use internal transactions between affiliates as a means to aggregate and better manage market risk. The non-US client facing entity is not a "conduit" in that it acts as principal and assumes the counterparty credit risk of the party with which it transacts. Without the ability to offset the market risk with an affiliate without subjecting the non-US client facing entity to US regulation it would make it more difficult and more expensive to manage risks and thereby increase costs to the third party client entering into the transaction.

[8] The Extraterritoriality Proposal permits non-U.S. persons, a group of non-U.S. persons or a foreign regulator to request that the Commission permit substituted compliance from non-U.S. regulations. *See* Extraterritoriality Proposal, 77 Fed. Reg. at 41233. We note that non-U.S. branches of U.S. entities are permitted to utilize substituted compliance when transacting with non-U.S. persons, *see* 77 Fed. Reg. at 41230, so we believe that the non-U.S. branches of U.S. swap dealers should also be able to request permission to use substituted compliance.

[9] *See id.* at 41228-29.

The proposal states that swaps between non-U.S. persons and "conduits" of a U.S. person will be subject to Transaction-Level Requirements and that substituted compliance will be permitted,[10] but it is not clear how "conduits" of U.S. persons should be classified for purposes of certain other aspects of the Commission's interpretive guidance. This is important because exemptive relief will be available to entities to differing degrees based on their classification and because Category B requirements will or will not apply to certain transactions based on the specific classifications of the counterparties. It is therefore not clear what exemptive relief would be afforded to "conduits" under the Proposed Exemptive Order, and it is not clear whether Category B requirements would apply to transactions with "conduits."

These complications are unnecessary because all the concerns regarding "conduits" are addressed in connection with swaps entered into with a non-U.S. person where the swap is booked in the United States. These rules ensure that any swap entered into by a non-U.S. person (whether that person is a swap dealer/MSP or not) will be regulated under Dodd-Frank if the counterparty to that transaction, affiliate or not, is a U.S. person. We fail to see how the conduit rules will ensure that any swaps are regulated that will not already be covered by these rules. The Commission should therefore remove the provisions regarding "conduits."

In addition, we request that the Commission clarify that the physical location of the sales person does not factor into the analysis required under the Extraterritoriality Proposal. So long as the applicable regulations are complied with by the applicable entity with respect to the applicable counterparty, the physical location of those negotiating or documenting the transaction should be irrelevant.

(4) The Emerging Market Exemption Should be Clarified

The Extraterritoriality Proposal includes a proposed approach to "substituted compliance" with the transaction level requirements for certain branches of U.S. swap dealers in "emerging markets." In these emerging markets, even if the foreign regulations are not comparable to the Commission's regulations, foreign branches and agencies of U.S. banks would be permitted to comply with those foreign regulations with respect to the transaction-level requirements if the aggregate notional value of the swaps of all foreign branches and agencies in such countries does not exceed 5% of the aggregate notional value of all of the U.S. swap dealer's swaps.[11]

We support the Commission's inclusion of a modified standard for transactions that are less than the *de minimis* threshold. However, this exemption should be amended to reflect the intent of the statute. Section 722(d) requires that swap activity have a "direct and **significant** connection" (emphasis added) to or effect on commerce in the United States to be subject to regulation by the Commission. There is no distinction in the statute on the location of the activity, nor is there a limitation on what kinds of entities conduct the activity. If the Commission proposed this exemption to excuse branches of swap dealers with minimal swaps activities from compliance obligations (as appears to be the case due to the 5% threshold), we believe that the exemption should be available to all branches (*i.e.*, not just those in emerging markets), and to all affiliates and subsidiaries, since this activity will not lead to the importation of systemic risk, which

[10] *See id.*

[11] *See id.* at 41231.

underlies the Commission's proposal. The denominator for purposes of determining compliance with the 5% limit then would be the aggregate notional amount of the swaps booked by the parent entity plus all its affiliates, subsidiaries and/or branches.

(5) Category B Transaction-Level Rules Should be Expanded to Include Real-Time Reporting and Trade Execution Because they do not Directly Relate to Risk Reduction

The Commission requested comment on whether real-time reporting and trade execution requirements should be included in Category B for Transaction-Level Requirements.[12] These requirements should be included in Category B.

Category B requirements—which, as proposed, would only include external business conduct requirements—will only apply to non-U.S. swap dealers or MSPs when they are transacting with U.S. persons.[13] The Commission reasoned that external business conduct standards should not apply to other transactions because such requirements largely prescribe sales practices, and foreign regulators have a greater supervisory interest in such matters than the Commission.

Another way of phrasing this is that external business conduct standards do not reduce market risk associated with swaps; they provide market participants with additional information in the nature of consumer protection. The same is true for real-time reporting and trade execution requirements. Both requirements are largely intended to provide additional information (both pre- and post-trade) in order to minimize possible information advantages and potentially increase competition.[14] Real-time reporting and trade execution are therefore unlike the requirements related to clearing, margining, confirmations, reconciliation and compression, all of which reduce some form of risk.

The Commission has indicated that concerns about risk are the basis for its conclusion that activities of swap market participants outside the U.S. "have a direct and significant connection with activities in, or effect on, commerce of the United States." Requirements for real-time reporting and trade execution, which involve issues of information flow to market participants but do not relate to risk management, do not have such an effect.

Therefore, real-time reporting and trade execution requirements should only apply to non-U.S. persons when they are transacting with U.S. persons.

(6) The Commission Should Adopt the Definition of a U.S. Person in SEC Regulation S

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[12] *See id.* at 41232.

[13] Category B requirements would not apply to a transaction between a non-U.S. branch of a U.S. swap dealer and a non-U.S. person even though the non-U.S. branch is considered to be a U.S. person. *See id.* at 41230 n.116.

[14] *See* Real-Time Public Reporting of Swap Transaction Data, 77 Fed. Reg. 1182, 1239 (Jan. 9, 2012) ("The Commission further believes that the reporting and public dissemination requirements of part 43, working in concert, promote the goal of swaps market price discovery enhancement."); Core Principles and Other Requirements for Swap Execution Facilities, 76 Fed. Reg. 1214, 1219 (stating that the Commission had considered "the core principles applicable to SEFs as well as the goals provided in Section 733 of the Dodd-Frank Act: (1) Bringing greater pre-trade price transparency to swap transactions; and (2) bringing more swaps trading onto regulated trading systems or platforms.").

The Extraterritoriality Proposal would employ a definition of a "U.S. person" that is different from the long-established definition in the SEC's Regulation S.[15] The Regulation S definition was designed to demarcate the extraterritorial reach of the U.S. securities laws and the limits on the SEC's investor protection responsibilities, and has functioned in this capacity for decades. The Commission stated that it did not rely on the Regulation S definition because it has a "different focus" than the definition in the Extraterritoriality Proposal, but the goals of these two regimes—customer protection—are in fact markedly similar. There are not distinctions between the global swap markets and the global securities markets that would justify a different scope for this term.

Adopting the Regulation S definition would facilitate compliance by non-U.S. market participants by providing them with an approach with which they are already familiar. For example, Regulation S would not consider a foreign agency or branch of a U.S. bank to be a U.S. person if: (i) the agency or branch operates for valid business reasons and (ii) the agency or branch is engaged in the business of banking and is subject to substantive banking regulation in the jurisdiction where located.[16] This makes practical sense. The Commission, however, is proposing to add a complex overlay to this approach that will create challenges for both foreign agencies/branches of U.S. banks and the persons with whom they transact. The Commission should take into account the compliance challenges that the proposed U.S. person definition will create for all market participants, and should be aware that heightened complexity in its rules is more likely to result in inadvertent compliance failures. Stated more simply, if the Commission is applying its rules outside the US, it should at least keep the rules the same as other U.S. regulators' when addressing the same subject (*e.g.*, whether an entity is a U.S. person), particularly when those rules are well-established. To do otherwise will make it harder and more expensive for all market participants to comply with all the rules.

(7) The Commission Should Clarify that Swaps Entered into Prior to the Effective Date of the Extraterritoriality Proposal Will Not be Included in a Non-U.S. Entity's *De Minimis* Calculation

The Extraterritoriality Proposal states that, "consistent with . . . the Commission's Final Entities Rulemaking," a non-U.S. person who engages in more than a *de minimis* amount of swap dealing activity must register as a swap dealer.[17] The Commission's entity definitions rule specifically states that, when determining whether a person exceeds the *de minimis* threshold, that person should only include swaps entered into following the effective date of the Commission's product definitions rule.[18] The Commission should clarify in its final cross-border interpretation that the *de minimis* calculation for non-U.S. entities will similarly only include swaps entered into on or after the effective date of the Commission's product definitions rule.

[15] *See* 17 C.F.R. § 230.902(k); SEC Release No. 33–6863, 55 Fed. Reg. 18306 (May 2, 1990).

[16] *See* 17 C.F.R. § 230.902(k)(2).

[17] *See* Extraterritoriality Proposal, 77 Fed. Reg. at 41219.

[18] *See* Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant, 77 Fed. Reg. 30596, 30744 (to be codified at 17 C.F.R. § 1.3(ggg)(4)) (May 23, 2012).

We are also concerned that swaps entered into prior to the effective date of the Extraterritoriality Proposal may be included in a non-U.S. entity's *de minimis* calculation if they are guaranteed by a U.S. person. If these historical or legacy swaps count toward the non-U.S. person's *de minimis* threshold merely because they are guaranteed, a non-U.S. person with U.S. guarantees for its historical or legacy swaps may have to register even if that person does not enter into any new swaps with a U.S. guarantee. This would have the odd, inefficient result of requiring that non-U.S. person to register as a swap dealer only to de-register once its swaps with U.S. guarantees expire. As a result, the Commission should clarify that U.S. guarantees of swaps entered into prior to the effective date of the Commission's Extraterritoriality Proposal will not count for purposes of a non-U.S. person's *de minimis* calculation.

(8) Regulations Applicable to Guarantees Should Not Apply to Keepwells and Liquidity Puts

The Extraterritoriality Proposal would apply certain regulations to a non-U.S. person if that person's swaps are guaranteed by a U.S. person[19] and states that the term "guarantee" includes several types of formal agreements for support such as keepwells and liquidity puts.[20] If the Commission determines to finalize the rule imposing these additional requirements on counterparties to U.S.-guaranteed swaps, we do not believe that these requirements should be triggered by keepwells, liquidity puts or other types of agreements to provide support (other than guarantees).

Keepwell agreements and liquidity puts may be entered into for a variety of reasons between a parent entity and its subsidiaries. They do not, however, carry the same rights as a guarantee and may be unenforceable by third parties except in limited circumstances, if at all. Liquidity puts, in particular, are designed not as a guarantee but as a way to allow the quick monetization of illiquid assets. We do not believe that treating them as equivalent to guarantees will properly identify risk taken on by a U.S. entity in connection with the swaps undertaken by its affiliates.

(9) The Proposed Exemptive Order Should Provide Much Clearer Guidance on Compliance Deadlines

The Proposed Exemptive Order would provide exemptive relief to non-U.S. persons until 12 months after the date on which the order was published in the Federal Register. There is not a rationale for the Commission to tie relief to the date of a proposed order, rather than a final order, especially given that the Extraterritoriality Proposal fails to address critical questions about the scope of application of the Title VII regulations outside the U.S. Moreover, the Commission's compliance deadlines under its regulations are a collection of interdependent time frames that adjust based on the nature of the entity, the nature of the counterparty, the nature of the product, various regulatory and market determinations (*e.g.*, subject to compliance mandate, made available to trade), the effective dates of other rules and the dates of expiration of other exemptive relief. The Commission should be very specific about how deadlines apply to non-U.S. persons following the end of the proposed exemptive relief. For example, the Commission should specify the date from which such entities will have to count their transactions with U.S.

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[19] See Extraterritoriality Proposal, 77 Fed. Reg. at 41220.

[20] *See id.* at 41221 & n.47.

persons for purposes of the *de minimis* exemption and should clearly indicate whether transition periods afforded under individual CFTC rules will run concurrently with the period of the exemption or whether those transition periods will be available beginning on the date that the exemptive relief ends. In addition, the Commission should consider a complete resequencing of all compliance dates once all of its rules are final to definitively take into account the interdependencies among them.

(10) Market Participants Should be Permitted to Comment on the Extraterritoriality Proposal and the Upcoming Inter-Affiliate Transaction Rulemaking Simultaneously

It is our understanding that the Commission intends to publish in the near future a proposed rule identifying how its swaps regulations will apply to inter-affiliate transactions. We welcome this guidance and believe it will be an important piece to the swaps regulations. However, such rulemaking is likely to have important and significant connections to the Extraterritoriality Proposal that will make it difficult to formulate complete responses to either release individually. For example, market participants cannot formulate comprehensive comments on the rules in the Extraterritoriality Proposal regulating swaps entered into by non-U.S. persons where the swaps are booked in the U.S. if there is no clarity about which regulations will apply to the inter-affiliate swaps likely to be involved in that process. Therefore, it is important that the Commission leave the Extraterritoriality Proposal and inter-affiliate transaction rulemaking open for comment at the same time.

Conclusion

The Extraterritoriality Proposal and Proposed Exemptive Order are important and necessary components to swaps regulations because the swaps market is a truly global market and spans national borders to a very large extent. We commend the Commission for providing the guidance on this matter. However, we believe that the Commission should ensure that its interpretation meets the requirements imposed by law on major rulemakings of this sort, creates a level regulatory playing field, does not create unnecessary and burdensome regulations, and provides clarity regarding compliance obligations for the various market participants.

Thank you for the opportunity to comment publicly on these important matters.

Sincerely,

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February 22, 2011

VIA ONLINE SUBMISSION: http://comments.cftc.gov;
http://www.sec.gov/rules/proposed.shtml

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Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
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Ms. Jennifer J. Johnson, Secretary
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Re: Proposed Rule Relating to "Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant" and "Eligible Contract Participant."

Dear Ms. Murphy and Mr. Stawick:

We, on behalf of Bank of America Corporation, Citigroup Inc., and JPMorgan Chase & Co., are responding to Release No. 34-63452 (the "*Joint Definitions Proposing Release*"), in which the Commodity Futures Trading Commission (the "*CFTC*") and the Securities and Exchange Commission (the "*SEC*" and, together with the CFTC, the "*Commissions*") solicited comment on certain definitions contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("*Dodd-Frank*").[1] We appreciate the opportunity to comment on the definitions of "swap dealer,"

[1] *See* Public Law 111-203, 111th Cong., 2d sess. (July 21, 2010). Section 712(d)(1) of Dodd-Frank requires the Commissions to consult with the Board of Governors of the Federal Reserve System (the "*Federal Reserve Board*") when further defining such terms.

"security-based swap dealer," "major swap participant" and "major security-based swap participant"[2] and the registration requirements imposed by Dodd-Frank on such entities.[3]

Bank of America Corporation, Citigroup Inc. and JPMorgan Chase & Co. (collectively, the "*Companies*") all engage in swap activities in the United States and anticipate that certain of their U.S. subsidiaries will register as swaps entities on the basis of those activities. The Companies also engage in similar swap activities overseas through subsidiaries and branches of their U.S. banks as well as subsidiaries of the holding company ("*Non-U.S. Operations*"). To the extent that the activities of the Companies' Non-U.S. Operations take place with non-U.S. persons outside of the United States, we believe that those entities should not fall within the definition of "swap dealer," "security-based swap dealer," "major swap participant," or "major security-based swap participant" for purposes of Title VII of Dodd-Frank and the implementing regulations and, consequently, should not be subject to registration as such.

We fully support the Commissions' efforts to increase transparency in the swap markets, reduce systemic risk in the financial markets and promote market integrity and believe that these goals can be achieved in a manner that is consistent with the stated intent in Title VII that its provisions not be applied extraterritorially except in certain limited circumstances. Accordingly, the final regulations implementing the definitions of swaps entities and the associated registration requirements should not, in our view, cover the Non-U.S. Operations of U.S. banking organizations to the extent the Non-U.S. Operations engage in swaps activities outside the United States. Specifically, we submit that final regulations that reflect the following approach would be consistent with the language and the purposes of the statute:

- Non-U.S. Operations should not be considered swaps entities, or be required to register as such, solely on the basis that they are affiliated with, or, in the case of non-U.S. branches of U.S. banks, a part of, a U.S. bank.
- Non-U.S. Operations that engage in swaps activities should fall within the definition of swaps entity only if they engage in swap activities with U.S. persons, other than in any *de minimis* amount authorized by the final rules and in transactions with their U.S. affiliates for purposes of risk management.
- Engaging in transactions with non-U.S. counterparties whether or not the non-U.S. counterparties have a U.S. affiliate should not cause the Non-U.S. Operations to be swaps entities provided that the transactions are not

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[2] We will refer to swap dealers, security-based swap dealers, major swap participants and major security-based swap participants as "swaps entities" throughout this letter. We will refer to both swaps and security-based swaps as "swaps," unless we have noted otherwise.

[3] The CFTC solicited comment on registration requirements in its proposing release "Registration of Swap Dealers and Major Swap Participants," 75 Fed. Reg. 71379 (Nov. 23, 2010) ("*Registration Proposing Release*").

conducted out of the Non-U.S. Operations to evade the requirements of Title VII.

- The presence of a guarantee by one of the Companies or its U.S. subsidiaries of a swap transaction engaged in by a Non-U.S. Operation with a non-U.S. counterparty should not cause the Non-U.S. Operation to be considered a swaps entity.

This approach is supported by:

- The explicit limits on the extraterritorial application of Title VII in Dodd-Frank;
- The general presumption against extraterritorial application of Federal statutes;
- The Commissions' precedent regarding their respective jurisdictional limits; and
- Principles of international comity.

Following this approach would help U.S. banking organizations maintain their competitive position in overseas markets, which would be consistent with longstanding U.S. policy reflected in the Federal Reserve Act. It would also support the ability of U.S. banking organizations to provide services to their clients on a global basis.

I. Background

The Companies are financial holding companies as defined in the Bank Holding Company Act of 1956, as amended ("*BHC Act*").[4] They are incorporated and headquartered in the United States and provide banking, investing, asset management and financial and risk management products and services throughout U.S. and international markets. The Companies conduct swap activities, in addition to other financial services, overseas through their subsidiaries in addition to such activities in the United States.

The Companies have long-established Non-U.S. Operations that allow the Companies to participate in swap activities, among other financial activities, in foreign jurisdictions. In many cases, the Companies have had their Non-U.S. Operations for many decades. These Non-U.S. Operations already are regulated by their local foreign country regulators and generally will be subject to local regulation regarding swap activities. In fact, in some jurisdictions, such as China, Taiwan and India, only local banks and local branches of foreign banks may engage in swap activities. We also note that in the European Union, an E.U.-organized entity is given "preference" or "passport" authority to engage in swap transactions with customers (both companies and individuals) domiciled throughout the European Union, but such authority is not granted to entities outside the European Union. Non-E.U.-organized entities are required to

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[4] *See* 12 U.S.C. § 1841, *et seq.* A financial holding company is banking holding company that has elected to be treated as a financial holding company for purposes of the BHC Act. 12 U.S.C. § 1841(p).

obtain licenses in every individual jurisdiction, which is onerous and costly. Thus, to undertake E.U.-organized business transactions in the European Union in an efficient manner, the Companies must have E.U.-organized entities conducting the business.

The Companies conduct swaps activities through their Non-U.S. Operations, which include subsidiaries of the bank holding company, Edge corporation subsidiaries of their U.S. banks ("*Edges*") and non-U.S. branches of the bank. The non-U.S. subsidiaries of U.S. bank holding companies are subject to applicable law and regulation in the countries in which they are organized and, as subsidiaries of a bank holding company, are supervised by the Federal Reserve Board. Edges are corporations organized under the Edge Act (now Section 25A of the Federal Reserve Act) with the approval of Federal Reserve Board and are subject to supervision and regulation by the Federal Reserve Board.[5] Edges may be organized and established by member banks,[6] which are expressly permitted to hold their shares.[7] Edges were created to permit U.S. banking organizations to engage in international or foreign banking and other financial operations to promote the foreign trade of the United States and thus are authorized to exercise "sufficiently broad powers to enable them to compete effectively with similar foreign-owned institutions in the United States and abroad."[8] Edges may establish branches and subsidiaries in foreign countries in order to conduct their activities. Non-U.S. subsidiaries of Edges are subject to applicable law and regulation in the countries in which they are organized, in addition to being supervised by the Federal Reserve Board.

U.S. banks may establish branches in foreign jurisdictions with the prior approval of the Federal Reserve Board.[9] Similar to many other activities conducted through a foreign branch, the swap activities of foreign branches are focused overseas and generally conducted with non-U.S. persons. Like Edges, foreign branches permit U.S. banking organizations to compete with their foreign counterparts because such branches may exercise powers "as may be usual in connection with the transaction of the business of banking in the places where such foreign branch shall transact business."[10] As discussed further in Section III.E below, Edges and non-U.S. branches of U.S. banks have been authorized to engage in a wider range of activities than the U.S. parent bank to help promote the ability of U.S. banking organizations to compete in international markets.

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5 *See* 12 U.S.C. §§ 611; 614; *see also* 12 C.F.R. § 211.5.

6 Member banks are national banks or state banks that are members of the Federal Reserve System. *See* 12 U.S.C. § 221.

7 See 12 U.S.C. §§ 601, 24(7).

8 12 U.S.C. § 611a.

9 *See* 12 U.S.C. § 601.

10 12 U.S.C. § 604a.

II. Statutory Framework

A. Definitions

Section 721(a)(21) of Dodd-Frank amends Section 1a of the Commodity Exchange Act (as amended, the "*CEA*") to add a new paragraph (49) defining "swap dealer," and Section 761(a)(6) of Dodd-Frank amends Section 3(a) of the Securities Exchange Act of 1934 (as amended, the "*Exchange Act*") to add a new paragraph (71) defining "security-based swap dealer." Both definitions define a swap dealer as a person who (i) holds oneself out as a dealer in swaps, (ii) makes a market in swaps, (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account or (iv) engages in any activity causing oneself to be commonly known in the trade as a dealer or market maker in swaps.[11]

Section 721(a)(16) further amends Section 1a of the CEA to add a new paragraph (33) defining "major swap participant," and Section 761(a)(6) further amends the Exchange Act to add a new paragraph (67) defining "major security-based swap participant." Both definitions, as a general matter, would apply to a person (i) who maintains a substantial position in swaps; (ii) whose outstanding swaps create substantial counterparty exposure that could have destabilizing effects on the U.S. banking system or financial markets; or (iii) who is a financial entity that is highly leveraged relative to its capital, not subject to capital requirements, and maintains a substantial position in outstanding swaps.

Section 712(d)(1) of Dodd-Frank requires the Commissions, in consultation with the Federal Reserve Board, "[n]otwithstanding any other provision of this title," to further define "swap dealer," "security-based swap dealer," "major swap participant" and "major security-based swap participant," which the Commissions have proposed to do pursuant to the Joint Definitions Proposing Release. Neither the statutory definitions of swaps entities nor the Joint Definitions Proposing Release specifically address the jurisdictional limits on the definition of swaps entities.

The Commissions have broad discretion to adopt rules that exclude certain entities from the definition or that subject a specified subset of swaps entities to a more limited set of regulations. Not only does Section 712(d)(1) of Dodd-Frank require the Commissions to further define the definition of swaps entity, as discussed above, but Section 712(d)(2) of Dodd-Frank provides that the Commissions "shall jointly adopt such other rules regarding such definitions" as they "determine are necessary and appropriate, in the public interest, and for the protection of investors." There also is a statutory requirement in Section 752 of Dodd-Frank that U.S. regulators "coordinate and consult with foreign regulatory authorities on regulation" in the swaps area. Therefore, the Commissions could implement regulations excluding Non-U.S. Operations from the definition of swaps entity without the need to grant exemptions.

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[11] CEA § 1a(49)(A) and Exchange Act § 3(a)(71)(A).

B. Standards for Extraterritorial Application

The statutory text of Dodd-Frank reflects Congressional intent that Title VII generally should not apply to overseas swap activities. There are several provisions in Title VII of Dodd-Frank that make clear that there are limits to its extraterritorial reach, and the Commissions will need to account for these limits in their definition of swaps entity. Section 722(d)(i) of Dodd-Frank provides that "the provisions of [the CEA] relating to swaps that were enacted by [Title VII] (including any rule prescribed or regulation promulgated under [Title VII]), shall not apply to activities outside the United States unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States; or contravene such rules or regulations as the [CFTC] may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of [the CEA] that was enacted by [Title VII]." Section 772(c) of Dodd-Frank, amending the Exchange Act, provides that "[n]o provision of this title that was added by [Title VII], or any rule or regulation thereunder, shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of such rules and regulations as the [SEC] may prescribe as necessary or appropriate to prevent the evasion of any provision of this title that was added by [Title VII]."

III. Discussion

A. The Swap Activities of the Companies' Non-U.S. Operations Do Not Satisfy the Standard for Extraterritorial Application of the Definitions of the Swaps Entities in Title VII.

As noted, Sections 722 and 772 of Dodd-Frank establish narrow standards for the extraterritorial application of Title VII. Under the CEA, in order for Title VII to apply to swap activities outside the United States, the activities must have a "direct and significant" connection with activities taking place in the United States, a "direct and significant" effect on the commerce of the United States or the activities must contravene anti-evasion rules. The Exchange Act standard for extraterritorial application, as set forth under Section 772 of Dodd-Frank, is focused, by its terms, upon efforts to evade the applicable provisions of Title VII and permits extraterritorial application of Title VII only in those circumstances. Even though the standards for extraterritorial application under the CEA and the Exchange Act are different, the Commissions are directed in Section 712(d)(2) of Dodd-Frank to make their rules and regulations prescribed under Title VII comparable to the maximum extent possible, taking into consideration differences in instruments and in the applicable statutory requirements.

Sections 722 and 772 of Dodd-Frank evidence Congress' recognition that it and the Commissions' jurisdictions do not extend to the regulation of non-U.S. persons and non-U.S. markets. Title VII reflects a Congressional intent to strike a careful balance with respect to extraterritoriality by permitting the Commissions to reach entities or activities outside the United States only in order to prevent evasion of Title VII or in limited circumstances where there is a direct and significant connection with or effect on

U.S. commerce. We believe it would be inconsistent with this intent to apply the requirements of Title VII wholesale to the Companies' Non-U.S. Operations where those activities are with non-U.S. persons simply because the Companies have a U.S. parent or conduct business with non-U.S. affiliates of a U.S. firm. Such a determination would impose duplicative regulation and unnecessary cost on Non-U.S. Operations that already are subject to local foreign rules and regulations. Furthermore, this determination would only damage the Companies' positions in the overseas markets in which they compete by causing the swap business they presently conduct to migrate to non-U.S. firms. The appendix to this letter includes a chart that gives examples of the types of counterparties with which the Non-U.S. Operations and their non-U.S. competitors would enter into transactions and demonstrates where competitive issues could arise.

1. An Affiliation with a U.S. Banking Organization Alone Does Not Meet the Standards for Extraterritorial Application.

We do not believe that the Companies' Non-U.S. Operations have a "direct and significant connection with activities, or effect on, U.S. commerce" based solely on the existence of an affiliation with a U.S. banking organization.[12] The transactions that the Non-U.S. Operations will enter into will be with non-U.S. persons, with a non-U.S. business purpose, and thus, are likely to have a non-U.S. orientation. The connection with U.S. activities is therefore indirect, and the transactions would not have a significant effect on U.S. commerce because both counterparties are non-U.S. persons and the transactions are related to the activities of those non-U.S. persons. Furthermore, as discussed in Section III.C below, it would be inconsistent with the Commissions' jurisdictional precedent to require the Companies' Non-U.S. Operations to register as swaps entities solely because the U.S. parent bank must do so. Each entity's activities should be evaluated independently for determining whether the entity satisfies the definition of swaps entity and is required to register as such. This same approach has been used with a non-U.S. branch of a U.S. bank even though the branch is part of the bank.[13]

2. The Counterparties to the Swap Transactions in which the Non-U.S. Operations Engage Do Not Create a Jurisdictional Tie that Meets the Standards for Extraterritorial Application.

The Registration Proposing Release suggests that the CFTC does not intend that the proposed rules reach purely non-U.S. activities. Specifically, the CFTC stated that "a person whose swap dealing activity has no connection or effect of any kind, direct or indirect, whether through affiliates or otherwise, to U.S. commerce would not be

[12] The CFTC specifically has requested comment on when swap dealing activity with or by non-U.S. affiliates of U.S. persons (such as a non-U.S. subsidiary of a corporate parent headquartered in the U.S.) has a "direct and significant connection with activities in, or effect on," U.S. commerce. 75 Fed. Reg. at 71382.

[13] *See* Request for IB Registration No-Action Position, CFTC Staff Ltr. No. 00-44 (CCH) 28,095 (Mar. 31, 2000).

required to register as a swap dealer…[o]n the other hand, a person outside the U.S. who engages in swap dealing activities and regularly enters into swaps with U.S. persons would likely be required to register as a swap dealer."[14]

We acknowledge that if Non-U.S. Operations enter into swaps with U.S. persons in excess of any *de minimis* level set by the Commissions, they generally would meet the definition of swaps entity, if otherwise covered by the definitions, and be required to register as such. However, Non-U.S. Operations typically do not enter into transactions with U.S. persons as the activities of the Non-U.S. operations have a non-U.S. focus. All of the Companies have U.S. entities that will be registered as swaps entities and that are the vehicles of choice when facing U.S. customers on swap transactions.

In the case of Edges, their U.S. activities are explicitly limited by statute. An Edge is prohibited by the Edge Act from "carry[ing] on any part of its business in the United States except such as, in the judgment of the [Federal Reserve Board], shall be incidental to its international or foreign business."[15] The Federal Reserve Board has narrowly construed the ability of Edges to conduct activities in the United States. The Federal Reserve Board looks to "whether the activity has a direct or clearly identifiable connection to international transactions"[16] and has found that a sufficient international connection exists "where the activity relates to transactions performed or to property located abroad."[17]

In general, Non-U.S. Operations would enter into swaps with non-U.S. persons that are headquartered outside of the United States and with non-U.S. persons that are subsidiaries, branches of, or otherwise affiliated with a U.S. person. We believe that in both cases, the counterparty should be considered a non-U.S. person for purposes of the swaps entity definition and the registration requirements, provided that the transactions are not being conducted by the non-U.S. persons as an evasion.

In the first case, where the Non-U.S. Operations' counterparty to a transaction is a non-U.S. person that is based outside of the United States, the transaction would be unlikely to have a direct or significant connection with U.S. activities or effect on U.S. commerce. The only tie to the United States is the affiliation of the Non-U.S. Operations with the U.S. banking organization. As discussed above, we do not believe that tie alone is sufficient to meet the standard for extraterritorial application.

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14 75 Fed. Reg. at 71382.

15 12 U.S.C. § 616.

16 Order Issued under Section 25 of the Federal Reserve Act - Citibank International, 71 Fed. Res. Bull 265, 266 (1985).

17 *See id.* (citing to, as an example, 12 C.F.R. §§ 211.4(e)(4)(iv) and (xiv)).

Where the Non-U.S. Operations' counterparty to a transaction is a non-U.S. affiliate of a U.S. person, the connection to the United States is, at most, an indirect one, as both parties are located, and operate, overseas. The transactions between the two entities are themselves occurring outside the United States and are, therefore, removed from the U.S. stream of commerce. As a result, there is no "direct" effect on U.S. commerce and it is highly unlikely that the transactions would have any significant effect on U.S. commerce. The statutory standard is that the activities actually have a direct and significant connection with or effect on U.S. commerce. Including Non-U.S. Operations within the definition of swaps entity solely because they may enter into transactions with counterparties that have a legal affiliation with a U.S. person would result in an overly broad definition that is speculative with respect to a U.S. jurisdictional tie and, we submit, would be inconsistent with the careful balance Congress sought to achieve in Title VII with respect to its extraterritorial effect.

We note that the CFTC has recognized that the use of a U.S. execution facility or clearinghouse alone will not trigger registration for a swap dealer.[18] However, the Registration Proposing Release suggests that registration of major swap participants may raise different jurisdictional issues because the definition of major swap participant "specifically focuses on the degree of risk that an entity's swaps pose to U.S. counterparties and the U.S. market."[19] In particular, the CFTC provides that the analysis would need to take into account swap positions with U.S. counterparties (including the use of a U.S. clearing agency or swap execution facility) or that involve U.S. mails or any means or instrumentality of interstate commerce.[20] As discussed, the Non-U.S. Operations generally would not have swap positions with U.S. counterparties and, therefore, other than using a U.S. clearing agency or swap execution facility in certain circumstances, would be unlikely to use instrumentalities that would subject them to U.S. jurisdiction.

3. *The Risk of Evasion of Title VII Does Not Support Overly Broad Definitions of the Swaps Entities.*

The fact that one or both non-U.S. counterparties to a swap transaction may be affiliated with U.S. companies does not by itself indicate an intent to evade Title VII and its implementing regulations. The Companies have established their Non-U.S. Operations for legitimate business reasons, including because in some jurisdictions only local banks and local branches of foreign banks may engage in swap activities. In addition, as noted above, in the European Union, only entities organized in a jurisdiction belonging to the European Union. have "preference" or "passport" authority to engage in swap transactions with customers domiciled throughout the European Union. In addition,

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18 *See* 75 Fed. Reg. at 71382.

19 *Id.*

20 *Id.*

the Non-U.S. operations would still be subject to local foreign regulation. Duplicative regulation would only impose unnecessary burdens on Non-U.S. Operations.

We understand the concerns that the Commission may have that persons would seek to book transactions through non-U.S. branches or subsidiaries in order to evade the requirements of the CEA or Exchange Act. The Commissions should not, however, seek to address the potential for evasion through an overbroad definition of swaps entity. To do so would cause needless harm to the competitiveness of U.S. institutions in foreign markets whose activities do not have a direct and significant connection with or effect on U.S. activities or commerce and impose unnecessary regulatory burdens on such entities. Furthermore, as discussed in Section III.E below, the statutory restrictions on the U.S. activities of an Edge, through which the Companies conduct a significant amount of their overseas swap activities, provide a natural bulwark against evasion and evidence a valid reason for conducting the swap transactions with Non-U.S. persons through non-U.S. Operations.

Congress, in the language of Sections 722 and 772 of Dodd-Frank, specifically set forth the Commissions' authority to prevent such evasion through the promulgation of a set of rules and regulations independent from the Commissions' rules defining swaps entity and implementing registration requirements. With this authority, the Commissions are able to implement their authority to prevent the evasion of Title VII in a manner that addresses the specific circumstances in which persons seek to evade applicable U.S. regulations through overseas swap activities.

Our position is reinforced by the *Morrison* decision, where the Supreme Court stated that the "prevent evasion" language in Section 30(b) of the Exchange Act, which mirrors the language in Sections 722 and 772 of Dodd-Frank, was not sufficient to make that statute apply extraterritorially: "[t]he provision seems to us directed at actions abroad that might conceal a domestic violation, or might cause what would otherwise be a domestic violation to escape on a technicality."[21] Accordingly, the Commissions' authority to prevent evasion permits the Commissions to extend their traditional jurisdictional reach only in limited circumstances.

B. Judicial Precedent and Principles of Statutory Interpretation Do Not Support Extraterritorial Application of Title VII.

The jurisdictional limits of Title VII that are expressly stated in Sections 722 and 772 of Dodd-Frank 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.'"[22]

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21 *Morrison v. Nat'l Australia Bank*, 130 S. Ct. 2869, 2882-83 (2010).

22 *Id.* at 2877-78 (quoting *EEOC* v. *Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991)).

The Supreme Court has stated that the judicial presumption against the extraterritorial application of Federal statutes "rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign matters. Thus, 'unless there is the affirmative intention of the Congress clearly expressed' to give a statute 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."[23]

The jurisdictional limits in Section 722 and 772 of Dodd-Frank reflect this presumption and do not express a contrary intent to apply Title VII extraterritorially except for their specifically articulated exceptions. Furthermore, these exceptions must be read narrowly in light of the *Morrison* decision.

C. The Commissions' Precedent Supports the Conclusion that the Swap Activities of the Companies' Non-U.S. Operations Generally Should Be Beyond the Jurisdictional Reach of the Commissions.

The definition of swaps entity should be formulated in a manner consistent with the Commissions' long-established tradition of not asserting jurisdiction over transactions, or entities that engage in transactions, taking place or operating outside of the United States. This tradition reflects, among other things, the fact that such transactions and entities already are subject to local foreign regulation and that duplicative regulation will burden these entities with unnecessary cost and make them less competitive.

The SEC has, in the past, plainly stated that it uses a territorial approach in applying broker-dealer registration requirements to international operations. Only those broker-dealers who induce, or attempt to induce, securities transactions with persons in the United States would be required to register.[24] Similarly, the CFTC has recognized, as a principle of international law, that domestic regulations, such as the registration requirements under the CEA, apply only when either the conduct in question occurred within the United States, or conduct outside the United States has a significant impact within the United States. Foreign individuals or firms that deal solely with foreign customers and do not conduct business in or from the United States have not been required to register under the CEA.[25] For example, the CFTC generally does not require persons to register as an introducing broker when they are located outside the United States and transact business only with foreign customers. The CFTC has explicitly

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23 *Id.*

24 *See* Exemption of Certain Foreign Brokers or Dealers, SEC Release No. 34-58047 (June 27, 2008) and Rule 15a-6 Adopting Release, Exchange Act Release No. 27,017, Fed. Sec. L. Rep. (CCH) ¶ 84,428, at 80,237 (July 11, 1989).

25 *See* CFTC Statement of Policy, *Exercise of Commission Jurisdiction Over Reparation Claims That Involve Extraterritorial Activities by Respondents*, 49 Fed. Reg. 14721 (1984).

included foreign branches under this approach.[26] In addition, the CFTC does not require foreign brokers to register as futures commission merchants, or obtain an exemption from such registration, if the foreign brokers offer or sell foreign futures or options contracts to non-U.S. persons only.[27]

The Commissions' precedent also supports the conclusion that the Companies' Non-U.S. Operations should not be considered swaps entities and subject to registration as such solely because of their legal affiliations with U.S. parent banking entities that may be registered swaps entities. Under existing precedent, it is generally the case that subsidiaries of registered broker-dealers or futures commission merchants are not subject to the activity and prudential restrictions imposed on a registered entity, unless the subsidiary itself engages in activities that require registration. The SEC has previously indicated that, merely because a parent company is a registered broker-dealer, this does not mean that its subsidiary must also register and thereby subject itself to the Exchange Act's prudential restrictions.[28] Similarly, the CFTC has allowed a subsidiary of a registered foreign futures commission merchant to enter into options contracts without becoming subject to CFTC rules to the same degree as its parent.[29]

Finally, CFTC precedent supports a conclusion that the use by the Companies' Non-U.S. Operations of a swap execution facility, designated clearing organization, designated contract market or swap data repository that is registered and based in the United States should not establish the jurisdictional connection required by Title VII for the Commissions to deem such entities swap dealers and require their registration as such.[30] As discussed, above, we believe the same should be true for major swap participants. The CFTC has taken the position that a foreign broker trading solely for its own account or the accounts of its non-U.S. customers is not required to register with the CFTC, even if it executes transactions on a U.S. exchange or clears through a U.S. clearinghouse, provided that it limits its customers to those located outside the

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26 *See supra* note 13.

27 *See* 17 C.F.R. Part 30.

28 *See* Douglas Bremen & Co., Inc., SEC No-Action Letter (Dec. 19, 1988). *See also supra* note 24 and accompanying text.

29 *See* Authorizing Subsidiary of FCM to Enter Into Certain Contracts with a Federal Power Marketing Agency, CFTC Order (CCH) ¶ 24,297 (Aug. 2, 1988).

30 However, if a Non-U.S. Affiliate executes or clears a swap transaction on a U.S.-registered facility, the entity will be subject to the jurisdiction of the facility and will be subject to the respective Commission's jurisdiction for certain purposes, such as reporting and position limits. The CFTC takes the view that it will look across all positions held by a U.S. entity in the U.S. and non-U.S. markets when establishing position limits, and the CFTC may take this same view with respect to non-U.S. entities because the overall size of an entity's positions affects its ability to have an impact on prices.

United States.[31] Furthermore, the CFTC recently stated in the Registration Proposing Release that it "generally would not require a person to register as a swap dealer if their only connection to the U.S. was that the person uses a U.S.-registered swap execution facility, designated clearing organization or designated contract market in connection with their swap dealing activities, or reports swaps to a U.S.-registered swap data repository."[32] This statement is consistent with the CFTC's historical position with respect to futures commission merchant registration by foreign brokers described above.

We recognize that the SEC preliminarily believes that, for reporting purposes, it has jurisdiction over security-based swaps if they are executed in the United States or through any means of interstate commerce or are cleared through a U.S. clearing agency, even if the counterparties are both non-U.S. entities.[33] Although the transaction itself may be subject to certain requirements, we believe that Section 772 and Section 722 of Dodd-Frank should not be read to subject such entities to registration and other requirements under Title VII without additional connections to the United States. This conclusion is consistent with the long line of SEC precedent regarding the extraterritorial application of its regulatory authority, discussed above.

D. Principles of International Comity Do Not Support Subjecting the Swap Activities of the Companies' Non-U.S. Operations to Dual and Possibly Conflicting Regulation.

In the Registration Proposing Release, the CFTC recognized the importance of international comity in determining the extraterritorial application of Federal statutes.[34] The CFTC's recognition is consistent with Title VII, judicial precedent and the jurisdictional principles of the Commissions, as discussed above. It would not be in the interests of international comity for non-U.S. persons engaged in swap activities with non-U.S. customers to have to register with U.S. regulators. Such persons, including the Companies' Non-U.S. Operations, already will be subject to all foreign country requirements with respect to their swap activities.

In addition to the United States, other countries and the European Union are promulgating derivatives legislation that may apply to the same persons that would be regulated by the Commissions under Title VII, and duplicative regulation could result in inconsistencies and unnecessary cost. Dodd-Frank, through its Section 752, explicitly addresses the problem of duplicative regulation and requires the Commissions, when they

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[31] *See* 17 C.F.R. § 3.10 and Part 30.

[32] 75 Fed. Reg. at 71382.

[33] *See* Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 Fed. Reg. 75208, 75239-40 (Dec. 2, 2010).

[34] 75 Fed. Reg. at 71382 (citing *Hartford Fire Ins. Co.* v. *California*, 509 U.S. 764 (1993) and Restatement (Third) of Foreign Relations Law of the United States §§ 402-403 (1987)).

exercise jurisdiction over non-U.S. persons, to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulations of swaps and swap entities.[35] Such international harmonization of regulatory regimes would work to eliminate arbitrage and counteract the attempted evasion of regulatory oversight.

In cases where two regulators may exert jurisdiction over the same non-U.S. person, one regulator should defer to the regulator with the greater ability to effectively supervise and examine the particular banking organization and the presumption would be that this would be the local regulator. In the case of the Companies' Non-U.S. Operations, the foreign country supervisors should be presumed to be the relevant authority because the foreign supervisor would already be supervising the Non-U.S. Operations under various laws and regulations applicable to financial institutions and would be supervising and examining other persons active in the same market. Such an approach is consistent with international comity. At a practical level, their close geographical proximity, as well as broader knowledge of the Non-U.S. Operation's financial, capital and general supervisory condition, may allow for more frequent examination and effective imposition of any sanctions for breach.

E. Maintaining the Competitive Position of U.S. Banking Organizations Weighs in Favor of Limiting the Extraterritorial Application of Title VII.

The jurisdictional scope of the swaps entity definitions is critical to the ability of U.S. banking organizations to maintain their competitive position in foreign marketplaces. Imposing the regulatory regime of Title VII on their Non-U.S. Operations would place them at a disadvantage to their foreign bank competitors because the Non-U.S. Operations would be subject to an additional regulatory regime which their foreign competitors would not. Being subject to a U.S. regulatory regime as well as a non-U.S. regime would impose additional costs on Non-U.S. Operations and would require the devotion of additional resources to compliance measures, making them less competitive with other firms in those markets. It would also prevent U.S. banking organizations from providing services on a global basis to customers that have businesses with a global reach in the same manner as their non-U.S. competitors will be able to do. This will disadvantage not only the Non-U.S. Operations but the U.S. franchise as well. Furthermore, subjecting Non-U.S. Operations to any transaction level requirements on local transactions is a most direct disadvantage and is likely to lead either to directly conflicting requirements, *e.g.* the requirement to clear the same transaction in two different clearing houses, or to direct competitive disadvantage, *e.g.* clearing or margin

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35 *See* Dodd-Frank § 752. *See also* Dodd-Frank § 715 (permitting the Commissions to prohibit a foreign-domiciled entity from participating in swap activities in the United States if the regulation of swap markets in the foreign country undermines the stability of the U.S. financial system); Dodd-Frank §§ 113(f) and 175(c) (requiring the Financial Stability Oversight Council to consult with foreign regulatory authorities with respect to foreign entities).

requirements that are not standard for the local market and therefore not applicable to the same transaction as between the client and a local competitor.

Non-U.S. banking organizations that are not so burdened by such dual and potentially conflicting requirements would be able to provide a wider range of services to customers, and on a global basis, which may cause customers to migrate away from the Non-U.S. Operations. A reduction in the customer pool would limit the Non-U.S. Operations ability to manage and transfer risks. Such an effect is contrary to one of the purposes of Dodd-Frank, which is to reduce systemic risk in the financial system.

U.S. banking organizations already are subject to comprehensive supervision and prudential regulation by the Federal Reserve Board, and this oversight framework has been strengthened in Dodd-Frank. The Federal Reserve Board's supervisory powers extend to all the Companies' subsidiaries, including subsidiaries in non-U.S. jurisdictions, such as the Non-U.S. Operations. Part of the Federal Reserve Board's mandate under Dodd-Frank is to help prevent or mitigate risks to U.S. financial stability. Any effects on the U.S. operations of the Companies from the swaps activities of the Non-U.S. Operations are more appropriately monitored through this existing supervisory mandate – in contrast to the imposition of swap entity registration requirements which are designed for specific requirements on certain activities and that will likely conflict with, or be in addition to, local regulations on the same activities.

Recognizing the need for U.S. banking organizations to be competitive in international markets would be consistent with the intent expressed in the Federal Reserve Act regarding the establishment of Edges and the broader scope of activities permissible for Edges and non-U.S. branches than for the U.S. bank itself. Edges are meant to permit U.S. banking organizations to engage in international or foreign banking and other financial operations to promote the foreign trade of the United States, and thus they are authorized to exercise "sufficiently broad powers to enable them to compete effectively with similar foreign-owned institutions in the United States and abroad."[36] Section 25A of the Federal Reserve Act enumerates specific powers of Edges (including their branches and subsidiaries) and authorizes the Federal Reserve Board to add such powers "as may be usual…in connection with the transaction of the business of banking or other financial operations in the countries…in which [the Edge] shall transact business…"[37] Importantly, the only activities of an Edge permitted in the United States are those that are incidental to its international or foreign business.[38]

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36 12 U.S.C. § 611a.

37 12 U.S.C. § 615(a). The Federal Reserve Board has previously determined, in Regulation K, that swaps activity is "usual . . . in connection with the transaction of the business of banking or other financial operations" in other countries. *See* 12 C.F.R. § 211.10(a)(19) (commodity swaps); § 211.10(b) (incorporating all of the activities permitted under Regulation Y, including § 225.28(b)(8)(ii) of Regulation Y which permits broad swaps activities). The "usual in connection with" provisions of the statute still retain independent significance, as the Federal Reserve Board is permitted to approve, and has approved, activities that may not be listed in Regulation K or Regulation Y. Some

Although foreign branches of U.S. banks are not corporate entities separate and apart from their bank parents, foreign branches have long been allowed to engage in a wider range of activities than are their U.S. head offices and have benefitted from the presumption against applying U.S. law extraterritorially.[39] Under Section 25 of the Federal Reserve Act, Congress granted the Federal Reserve Board authority to permit foreign branches of U.S. banks to exercise such further powers "as may be usual in connection with the transaction of the business of banking in the places where such foreign branch shall transact business,"[40] even if those activities were not permissible for a U.S. bank domestically, and the Federal Reserve Board has exercised this authority in certain circumstances.[41]

We make these points not because we are arguing for greater powers of Non-U.S. Operations, but because there is significant Federal statutory evidence of a policy decision by Congress to foster and encourage the competitive position of Non-U.S. Operations vis-à-vis their local counterparts and to allow such entities to be subject to the same rules as local entities.

IV. Inter-Affiliate Swap Transactions and Guarantees

The Commissions should permit Non-U.S. Operations to engage in back-to-back swap transactions with their U.S. affiliates pursuant to risk management and risk-allocation strategies. In so doing, the Non-U.S. Operations should not fall within the definition of a swaps entity, or otherwise be required to register as such. Therefore, if a U.S. swaps entity enters into swaps with customers, and, in seeking to allocate risk, back-to-backs these swaps with Non-U.S. Operations, such swaps should not trigger a registration requirement for the Non-U.S. Operations. Similarly, if the Non-U.S.

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activities have been approved notwithstanding the fact that they are impermissible for depository institutions under U.S. regulations and impermissible under Regulation Y. *See, e.g.,* Citibank Overseas Inv. Corp., 1985 Fed. Res. Interpretive Ltr. (Dec. 9, 1985) (approving an Edge's application to conduct real estate brokerage activities through a subsidiary); 67 Fed. Res. Bull. 269, 366 (April 1981) (approving an Edge's application to engage in the underwriting of credit life, credit accident and credit health insurance regardless of whether the insurance is directly related to the extension of credit by the Edge or its affiliates); and 12 C.F.R. §§ 211.10(a)(14), (15) (permitting Edges to underwrite and deal in equity securities outside of the U.S.).

38 *See* 12 U.S.C. § 616.

39 *See generally* 12 C.F.R. § 211.4 (foreign branches may *inter alia* act as insurance agents or brokers, and may underwrite, distribute, deal, and invest in the obligations of foreign governments, agencies, instrumentalities and political subdivisions, all powers that would generally not be permissible for U.S. branches of the banks).

40 *See* 12 U.S.C. § 604a.

41 *See supra* note 39.

Operations seek to allocate risk by back-to-back transactions with a U.S. swaps entity, registration also should not be triggered.

This approach would be consistent with the Commissions' recognition that a person may not need to be considered a swaps entity when swaps simply represent an "allocation of risk within a corporate group" because "[s]waps and security-based swaps between persons under common control may not involve the interaction with unaffiliated persons that [the CFTC] believes is the hallmark of the elements of the definitions that refer to holding oneself out as a dealer or being commonly known as a dealer."[42] In this case, the transaction with the unaffiliated counterparty would be outside the United States and relate to the counterparty's non-U.S. activities and, absent evasion, in our view should not be subject to the Commissions' jurisdiction. The corresponding inter-affiliate transaction would not involve interaction with an unaffiliated person and should not on its own trigger a registration requirement if the transaction is entered into for risk mitigation purposes. If neither of the transactions independently would require registration as a swap dealer, the two together similarly should not. This position is also consistent with the CFTC's historical practice, pursuant to which non-U.S. entities may hedge in the United States through their U.S. affiliates without being subject to the jurisdictions of the CEA and the CFTC.[43] Furthermore, in both cases, the U.S. affiliate itself would be a registered swaps entity, which means that those activities would already be subject to oversight in the United States.

In some cases, the U.S. parent or other affiliate of the Non-U.S. Operations guarantee the swap transactions entered into by the Non-U.S. Operations with third parties. To the extent that there are concerns about a guarantee by a U.S. affiliate, those can be addressed as a safety and soundness matter as part of the supervisory process. The Companies and their respective subsidiaries are all subject to the Federal Reserve Board's ongoing supervision and prudential regulation, which has been further strengthened under Dodd-Frank. For a U.S. affiliate providing a guarantee that is itself a swaps entity, such as we anticipate certain of our subsidiaries will be, the affiliate will also be subject to the applicable requirements in Title VII. Consequently, there is no need to subject the Non-U.S. Operations to registration as swaps entities to capture risks associated with guarantees by U.S. affiliates.

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42 *See* "Further Definition of 'Swap Dealer,' 'Security-Based Swap Dealer,' 'Major Swap Participant,' 'Major Security-Based Swap Participant' and 'Eligible Contract Participant,'" 75 Fed. Reg. 80174 (Dec. 21, 2010).

43 *See, e.g.*, CFTC-OGC Interp. Ltr. No. 86-2 ¶ 22,943 (May 22, 1985) (recognizing that a non-U.S. subsidiary may cover or hedge transactions through its U.S. parent without necessarily being subject to the CEA).

* * * *

We appreciate the opportunity to comment to the Commissions on the definitions of "swap dealer," "security-based swap dealer," "major swap participant" and "major security-based swap participant," and would be pleased to discuss any questions either Commission may have with respect to this letter. Any questions about this letter may be directed to Sarah Lee, Associate General Counsel, Bank of America Corporation, at 646-855-0837; Carl V. Howard, Deputy General Counsel, Citigroup Inc., at 212-559-2938; Diane Genova, Managing Director, JPMorgan Chase & Co., at 212-648-0268; and Kenneth Raisler, Sullivan & Cromwell LLP, at 212-558-4675.

Sincerely,

Sullivan & Cromwell LLP

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
Honorable Troy A. Paredes, Commissioner
Honorable Elisse B. Walter, Commissioner
Securities and Exchange Commission

Honorable Ben S. Bernanke, Chairman
Honorable Janet L. Yellen, Vice Chair
Honorable Elizabeth A. Duke, Governor
Honorable Sarah Bloom Raskin, Governor
Honorable Daniel K. Tarullo, Governor
Honorable Kevin M. Warsh, Governor
Board of Governors of the Federal Reserve System

John Walsh, Acting Comptroller
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Sheila Bair, Chairman
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Timothy Geithner, Secretary and Chair of the Financial Stability Oversight Council
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Appendix: Examples of Non-U.S. Entities and Their Swap Transaction Counterparties

Potential Non-U.S. Swaps Entity	Counterparty	Implication of Title VII Coverage
Taiwanese Bank	Taiwan-based company	No Title VII coverage.
Non-U.S. branch of U.S. bank in Taiwan	Taiwan-based company	No link to United States other than U.S. parent bank. Under local regulations, a non-Taiwanese bank may engage in swap activities only through a branch of the bank. Taiwan branch must compete with Taiwan Bank for local business but, if required to register as a swaps entity, would be subject to additional regulation.
German Bank	French subsidiary of a U.S. hedge fund	No Title VII coverage of German Bank.
Non-U.S. subsidiary of a U.S. bank holding company in Germany	French subsidiary of a U.S. hedge fund	Only links to United States are the parent bank holding company and the U.S. hedge fund. Under E.U. "passport" authority, a U.S. bank holding company needs an E.U.-organized entity to avoid separate license requirements in each E.U. country. German subsidiary of U.S. bank holding company must compete with German Bank for local business but, if required to register as a swaps entity, would be subject to additional regulation.