bankenverband

Comments

Association of German Banks
Re: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD 57)

August 27th, 2012

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Secretary Stawick:

The Association of German Banks represents more than 200 privately-owned banks in Germany. Many of our internationally active banks have banking and securities operations in the U.S. as well as derivative business ties with U.S. persons and thus would be subject to the provisions of Title VII Dodd-Frank Act as implemented by the U.S. Commodity Futures Trading Commission ("the Commission" or "the CFTC") and other U.S. agencies.

A. Introduction and general comments

We commend the Commission for its efforts to provide direction on the cross-border aspects of Title VII DFA requirements through its proposed interpretive guidance and policy statement published in the Federal Register on July 12, 2012 ("the proposed guidance").[1] We understand that the CFTC as well as other relevant U.S. agencies are in close contact with the EU Commission and EU regulators with the aim of agreeing on consistent and strong standards to contain the risks of the derivatives market.

Nevertheless, we are concerned that such regulatory efforts may lead to unnecessary fragmentation of global derivative markets and to burdening internationally active banks and non-bank participants in derivatives markets with extraterritorial, duplicative or even contradictory regulations by different jurisdictions.

We urge the Commission to avoid such inconsistencies and frictions as far as possible. It is in this spirit that we would like to respectfully submit some comments and request some changes in the final Commission guidance to further this general aim.

In this connection, may we inform you that we support most of the comments in the August 13th, 2012 letter from the Global Financial Markets Association (GFMA, focusing on the substituted compliance approach proposed by the CFTC) and the August 27th, 2012 letter by the Institute of International Bankers to David Stawick, CFTC. Please note, however, that our following comments are not always identical with those made in these two letters by international associations.

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[1] Commodity Futures Trading Commission; 17 CFR Part 1; Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act; Proposed Rule; Federal Register Vol. 77, No. 134, Thursday, July 12, 2012; pp. 41214-41242.

B. Specific concerns and suggestions

1. Non-U.S. banks must be regulated less extraterritorially and be given more time to implement final U.S. rules

The CFTC should further take into account the considerable burden on non-U.S. banks in complying with the cross-border aspects of Title VII DFA. While it is true that both U.S. and non-U.S. banks were only recently informed, through the proposed guidance, on how the Commission proposed to apply swap rules to cross-border aspects of global derivative markets, the impact of this proposal would be felt much harder by non-U.S. banks.

This is so because, firstly, non-U.S. banks would be affected to a much larger extent than U.S.-headquartered banks by the adjustment of their global swap operations, also and in particular outside the U.S., as required under the proposed guidance for dealing with very broadly defined U.S. persons. Especially for those banks that book centrally, the question affects the very structure of their global operations, whereas in the case of a U.S. bank, the cross-border aspects are less profound in their potential implications.

Secondly, at the same time, non-U.S. banks would expect to be, first and foremost, subject to the home jurisdiction or non-U.S. host jurisdiction on their derivatives business in their home country and other countries outside the U.S. respectively. Whether these rules already exist or are still in the making, the proposed guidance would create considerable potential for duplicative and even conflicting regulation.[2]

In this connection, we note that Section 752(a) of the DFA itself mandates the Commission to seek consistent international standards for swaps and swaps entities. Such an international framework of consistent derivatives regulation is, however, still evolving. By unilaterally extending U.S. rules to non-U.S. banks and market participants, the proposed guidance effectively would endanger the orderly finalization of this international process, unless its final guidance and rules were to allow for appropriate international comity. One essential request would be to allow additional time for non-U.S. market participants to obtain the CFTC's recognition of comparable rulemaking by their home jurisdictions, even if the latter is still in the making (cf. section 4 below). Another conclusion would be to restrain the extraterritorial impact of the guidance, where such impact would not be clearly mandated by statutory requirements (cf. Section 722 of DFA), e.g., by providing a narrower and more workable definition of U.S. persons in the final guidance. In the latter respect, may we refer you to the suggestions by the Institute of International Bankers in its comment letters of August 9th and August 27th.

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[2] See, e.g., the August 24th, 2012 letter from Jonathan Faull, the European Commission, to David Stawick, the Commission. Similar concerns have been voiced by several national foreign regulators, both from within and outside the European Union.

As a result of the CFTC rulemaking so far, the tight compliance timeframes, especially for registration and reporting, will be more difficult for non-U.S. banks to meet, all the more so as

(i) significant technology investments must be made to comply with reporting requirements, and

(ii) a thorough review of the bank's counterparties must be undertaken to determine which entities are "U.S. persons", a uniquely and broad term defined in the proposed guidance.

A more workable definition of U.S. persons would also reasonably limit the resources required to review a bank's counterparties, especially if such definition corresponded to established categories of information that market participants are required to collect in most jurisdictions. In this connection, we also note that the proposed guidance does not contain a cost-benefit analysis, which we would regard as a very helpful tool for finalizing the guidance.

Thus, the aim of regulating the U.S. derivatives market should be balanced against the aim of avoiding unnecessary burden for non-U.S. banks and other non-U.S. participants in global derivatives markets, particularly in jurisdictions other than the U.S. In addition, we urge the Commission to provide sufficient time for the above-mentioned preparations to be made by non-U.S. banks and delay its registration and compliance dates accordingly, also allowing for the finalization of the guidance before these dates.

2. The aggregation rule for determining swap dealer registration must be corrected

Under the proposed guidance, any non-U.S. affiliate of a German bank that registers as a swap dealer must itself register as a swap dealer if it maintains any dealing activities with U.S. persons. This is so because of the aggregation requirement for the purposes of registration as a swap dealer.

We respectfully request that this requirement be modified to exclude the swaps of an affiliated registered swap dealer. In addition, sufficient transition time should be provided for efficient adaptation and reorganization in a group's U.S. persons facing swap business (cf. point 3 below).

3. Sufficient transition time needs to be provided to allow for efficient adaptation of a group's U.S. persons facing swap business

Difficulties and unnecessary cost in connection with implementing internal procedures to comply with proposed regulations will arise although they may still be changed either through US rules and regulations becoming final in a different form or substitute European or Asian rules coming into effect. These difficulties and costs are substantial.

Registration and compliance timeframes set by the Commission should allow for this.

4. The "substituted compliance" approach must be made more flexible, as regards both its timing and content, in order to work

The Commission should recognize the difficulty of submitting a compliance plan 60 days after registration identifying to the CFTC how a non-U.S. bank registrant plans to comply with rules where substituted compliance is allowed. For a European bank, many of the comparable regulations are currently not final.

Thus, the Commission should accommodate for such adaptation periods. For example, it could grant provisional substituted compliance status also to EU institutions as Europe is in the process of working towards such standards. The Federal Reserve Board's "actively working to establish" standard (referring to comprehensive consolidated supervision by the bank's home jurisdiction) for branch applications by non-U.S. banks is a precedent for this. Alternatively, the CFTC could extend its proposed exemption[3] for the relevant jurisdiction.

Moreover, while we commend the Commission on allowing "substituted compliance", we are concerned that the approach chosen in the proposed guidance would create an overly bureaucratic and burdensome structure for recognizing home-jurisdiction standards of non-U.S. banks. For EU banks substituted compliance should not have to be applied for and granted on the level of individual institutions but by a memorandum of understanding between the Commission and EU authorities. In addition, we are concerned that the non-applicability of substituted compliance for individual US requirements would create insurmountable practical problems for centralized swap operations of EU institutions. This would be even more so if other international regulators followed suit. We would, therefore, respectfully request that consideration be given to a more workable principles-based approach to the Commission's concept of substituted compliance. This would entail much-needed relief for EU institution and ESMA, and not least the CFTC itself, in making its comparability determinations.

For EU institutions having to expressly apply for substituted compliance when registering as a Swap Dealer also does not seem feasible as currently the EU regulations and parts of the Dodd Frank implementation are not yet in place and questions of comparability fall within the realm of, and should be dealt with by, EU and U.S. authorities rather than an individual institution vis-à-vis the Commission.

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[3] Exemptive Order Regarding Compliance with Certain Swap Regulations, 77 Fed. Reg. 41110 (proposed by Jul. 12, 2012).

Finally, we urge the Commission to apply its concept of substituted compliance also to Transaction Level Requirements in connection with a non-U.S. person's trades with a U.S. person. For many transactional requirements we see no reason why an EU institution regulated under EMIR (the European Market Infrastructure Regulation) should not be recognized with regard to comparable EU regulations, especially if such EU institution is dealing with a U.S. person that is fully compliant with the Title VII DFA requirements as implemented by the CFTC.

5. We urge the CFTC to provide relief for swap transactions between banks in Germany that are non-U.S. Swap Dealers and the U.S. subsidiaries of their German corporate clients

German corporate clients often have U.S. subsidiaries which conclude foreign exchange or derivative transactions through their German parent company with our member banks in Germany which are non-U.S. Swap Dealers. While in these cases the contractual relations are directly between the U.S. subsidiary of the German parent and the bank in Germany, this bank's client contact is (almost) exclusively through the German parent of the U.S. subsidiary, mostly because the corporate client has a central treasury at its German parent that does the trading for parent and subsidiaries centrally but if for the subsidiary, in the latter's name.

According to the proposed guidance, these subsidiaries would qualify as U.S. persons for the non-US Swap Dealer and be subjected to the full scale of Title VII requirements. We regard this as an overreach of Title VII rules that would put the non-U.S. Swap Dealer in a disadvantaged position compared to banks in Germany which are not Swap Dealers.

For practical purposes, all material aspects of the respective transactions take place outside the U.S. Imposing Dodd-Frank standards would mean that processes relating to these transactions both at the bank as well as at the client would have to be treated differently compared to transactions done between the bank and the German parent. Clients will be reluctant to accept such a split of regimes with a negative impact on the German corporates' handling of the financing and hedging needs of their U.S. affiliates, thereby making it more complicated for German corporates to operate subsidiaries in the U.S. and reducing the attractiveness of investments in the U.S., especially for mid-size German corporates.

We understand that the proposed guidance does provide regulatory relief to a non-U.S. Swap Dealer for swaps with a non-U.S. person whose performance is guaranteed by a U.S. person, a non-U.S. "conduit" for a U.S. person to execute swaps, or with non-U.S. branches or agencies of a U.S. person. With respect to these, under the proposed guidance substituted compliance would be available to the non-U.S. Swap Dealer in regard to Entity Level Requirements and most Transaction Level Requirements and no Title VII External Business Conduct rules would apply.

May we, therefore, suggest either treating such U.S. subsidiaries of German corporates the same way as a non-U.S. person whose swap obligations are guaranteed by a U.S. person or clarifying that the German parent company is deemed to be a branch or agency of its U.S. subsidiary if the business relations are conducted outside the U.S. Should the CFTC not be inclined to follow this suggestion, we respectfully request the Commission to consider such relief at least in cases where the German parent guarantees its U.S. subsidiary, thereby shifting the risk of the transaction to outside the United States, and the business relations are conducted outside the U.S.

6. Registration is overly burdensome

As the requirements now stand, it is not clear who the “Principals” of a Swap Dealer are for the purposes of Form 8-R. In our view the definition of “Principal” should be limited to the members of the management board (Germany: Vorstand) and, at the most, the executive level below such board who are in fact responsible for trading and sales activities in relation to swaps. For a wider definition of “Principal”, requiring fingerprints of principals seems overly bureaucratic and intrusive in privacy matters.

7. Large Trader and swap data reporting requirements raise concerns over bank secrecy obligations

German banks are under obligation to clients to maintain bank secrecy; this limits their ability to report client data unless exemptions apply. Our concern is that the Commission’s rules requiring Large Traders to report client data also in respect to non-U.S. clients would not fall under any of these exemptions thereby exposing the reporting Large Trader to legal and supervisory risk at home.

Obtaining client consent will be on the agenda of banks regarding all G-20 related OTC regulation. Getting the documents in place will require considerable time and would not be started until at least the EU regulations are final. Even this approach may not solve all concerns as clients with existing positions may refuse to consent or not respond while their positions and data would still have to be reported under the Large Trader Reporting Requirement.

For the same bank secrecy reasons, giving the representations set out in Form 7-R would have to be made subject to applicable home bank secrecy laws and regulations. These concerns also go for the Commission’s swap data requirements.

In our view, an internationally synchronized reporting regime is the only solution. Until such a regime is in place, non-U.S. persons should fall outside the scope of the Large Trader and swap data reporting requirements.

Conclusion

We respectfully urge the Commission to consider our proposals with regard to an appropriately balanced implementation of Title VII DFA that respects international comity and the ongoing process of consistent international reform of derivatives rules and avoids any undue burden for non-U.S. banks in terms of both timing and content of requirements.

Should you have any questions or require any further information, please do not hesitate to contact us (+49-30-1663-1110; tobias.unkelbach@bdb.de).

Yours sincerely,

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