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CANADIAN BANKERS ASSOCIATION

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August 27, 2012

Mr. David A. Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Comment Letter on the Proposed Interpretive Guidance on the Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038–AD57)

Dear Mr. Stawick:

The Canadian Bankers Association (the **CBA**) works on behalf of 54 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 274,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The CBA appreciates the opportunity to provide further comment on the Proposed Interpretive Guidance on the Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (the **Proposed Guidance**)[1] issued by the Commodity Futures Trading Commission (the **CFTC**). This letter is intended to supplement the preliminary letter submitted by the CBA dated August 13, 2012.

The CBA supports the efforts of the CFTC, as well as its counterparts in other jurisdictions, to reduce the systemic risks associated with the OTC derivatives market and increase the transparency of that market. We do have concerns about the potential negative effects of the CFTC's Proposed Guidance, however, and urge the CFTC to reconsider certain aspects of the Proposed Guidance as currently drafted.

1. The CBA requests that the CFTC complete essential tasks before imposing a deadline for non-U.S. entities such as Canadian banks required to register as swap dealers.

From the perspective of Canadian banks, imposing a deadline for swap dealer registration is premature until a reasonable period of time after the CFTC has resolved two important issues:

[1] Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 Fed. Reg. 41214 (July 12, 2012), available at: http://cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-16496a.pdf.

(a) the CFTC has resolved the inconsistencies, gaps and uncertainties in its proposed and final rulemaking under the Dodd-Frank Act, including its cross-border interpretations as laid out in the Proposed Guidance; and

(b) the CFTC (ideally in concert with the Securities Exchange Commission) has coordinated with Canadian regulators to determine how best to leverage, rather than replace or overlay, the already robust entity-level regulation in place for Canadian banks.

1.1 There are a number of key issues in the CFTC regulatory regime that remain unresolved.

Market participants and non-U.S. regulators continue to struggle with fundamental questions regarding the Proposed Guidance and related CFTC rules, including, but not limited to, the following. Requiring Canadian banks to register without a clear idea of the regulatory consequences is both an unnecessary drain on the resources of the CFTC and the National Futures Association and an obstacle to the Canadian banks' efforts to plan and organize compliance with Title VII.

(a) Definition of "U.S. Person"

Key market participants continue to struggle with fundamental questions such as identifying whether market participants are "U.S. Persons". The CFTC's definition of "U.S. Person," which is relevant both for determining which entities must register and what the obligations of those entities will be once they do, also remains in flux. The definition proposed by the CFTC, which was first unveiled less than two months ago, cannot be implemented without a swap dealer's counterparty acknowledging whether or not it is a U.S. Person. First, as the proposed definition is different from any similar definition used in any other regulatory context, Canadian banks do not have the information necessary to identify the status of their counterparties. Second, even if there were somehow a way to collect such information from all the relevant counterparties, many counterparties, particularly those organized as funds or collective investment vehicles, would have difficulty using the proposed definition to definitively determine their status. As has been noted in several comment letters already,[2] in order to be used by the market, the definition of U.S. Person cannot be subject to *ad hoc* revisions over time, as seems to the be the CFTC's intention given the prefatory phrase "would include, but not be limited to", which currently frames the proposed definition. Furthermore, certain components of the definition relating to funds and commodity pools are difficult, if not impossible, to administer. For example, most funds and certainly any publicly traded funds will not be able to monitor the U.S. Person status of the owners of their beneficial interest (particularly not if "indirect" ownership is also relevant, as suggested by prong (iv) of the definition), as the composition of owners may change rapidly over time. In addition, including in the definition, as prong (v) currently does, any commodity pool operated by an entity "which would be required to register as a commodity pool operator under the CEA" creates uncertainty for counterparties as long as other aspects of the CEA applicable to the registration requirement for commodity pool operators remain unsettled.

(b) Aggregation

[2] *See, e.g.*, the ISDA comment letter to the CFTC dated August 10, 2012.

In the Final Entity Definition Rule,[3] all non-U.S. entities are required to aggregate all of their swap dealing positions, regardless of how minimal they may be, for purposes of determining whether ***each*** such entity is required to register. As the CFTC seems to acknowledge in the Proposed Guidance, such a rule would require ***every*** non-U.S. affiliate of a registered swap dealer also to be registered with the CFTC regardless of how minimal its swap dealing activity facing U.S. Persons would be. It appears, given that the CFTC has queried this outcome in Question 5 of the Proposed Guidance, that the CFTC agrees that the application of this rule needs to be reconsidered. We second the concerns about this point noted in other industry comment letters.[4]

1.2 Dialogue between US and Canadian regulators is necessary for harmonization of their respective regulatory regimes.

When applying the swap dealer registration rules to Canadian banks, we believe the CFTC must take into account the existence of the robust entity-level regulatory regime already present in Canada, supervised by the Office of the Superintendent of Financial Institutions Canada (**OSFI**), the prudential regulator of the Canadian banks. The prudential regulatory framework overseen by OSFI includes well-developed provisions designed to ensure capital levels that are adequate to deal with the range of banking risks, including those relating to swaps, a fully developed compliance regime and a risk management framework that has proven flexible enough to adjust to the creation of new businesses and markets.

Canadian regulators are actively engaged in formulating the rules and regulations required to implement Canada's G20 commitments. Canadian regulators have a well-deserved reputation for implementing international regulatory standards in a timely manner. Because this process is underway, we believe this presents a good opportunity for the CFTC to coordinate with Canadian regulators to ensure that (a) Canadian banks are appropriately regulated, (b) the CFTC can take into account the robust nature of Canada's bank regulatory system and (c) CFTC rules do not conflict with or create unnecessary redundancies with Canadian rules applicable to Canadian banks.

Rather than force Canadian banks to navigate compliance with two separate and potentially conflicting regimes, the CFTC should extend the registration deadline and pursue dialogue with the Canadian regulators to reach an agreement as to how the two regimes could be harmonized. The US and Canadian regulators should also agree that any residual cross-border application of US regulation will be on a principles-based regulatory recognition basis, rather than on an "individual requirement basis".[5] We note that regulators in other key markets have also called for the CFTC to undertake dialogue on a jurisdiction by jurisdiction basis before requiring entities regulated outside of the United States to register as swap dealers.[6]

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[3] 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 (May 23, 2012), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-10562a.pdf (the **Final Entity Definition Rule**).

[4] *See, e.g.,* the IIB comment letter to the CFTC dated August 9, 2012 and the SIFMA comment letter to the CFTC of August 13, 2012.

[5] *See* Proposed Guidance at 41229.

[6] *See* the Swiss FINMA comment letter to the CFTC dated July 5, 2012; the Financial Services Agency of Japan comment letter to the CFTC dated August 13, 2012; the Financial Services Authority comment letter

2. The CBA advocates for a regulatory recognition approach to substituted compliance.

We would like to express our general support for, and concurrence with, the comment letters submitted by the Global Financial Markets Association and the Futures and Options Association, both dated August 13, 2012, which provide color on the concept of regulatory recognition.

The substituted compliance process should take into account the following factors:

(a) the robust entity-level regulation in Canada provided by the OSFI framework;

(b) the regulatory philosophy of the Canadian regulators, which is less prescriptive than that of the CFTC; and

(c) the judgment of Canadian regulators regarding the relevance of certain regulatory requirements in Canada.

2.1 A regulatory recognition approach would take into account the robust regulatory regime already present in Canada.

Canadian banks are subject to a comprehensive regulatory regime consisting of the *Bank Act* (Canada), the regulations thereunder, numerous advisories, guidelines and interpretations published by OSFI and close supervision by OSFI itself. OSFI's guidelines, which address broad areas such solvency standards, prudential standards and sound business and financial practices, already prescribe standards and practices that correspond to many of the entity-level requirements the CFTC seeks to apply. We believe that the CFTC should acknowledge that this framework meets or exceeds the proposed standards applicable to swap dealers under CFTC regulation and should leverage the soundness of the Canadian regulatory system prior to requiring Canadian banks to register as swap dealers.

Capital Adequacy

Canadian banks are already subject to OSFI's detailed capital adequacy guideline. Moreover, on August 7, 2012, OSFI issued a draft capital adequacy guideline which amends the existing guideline so as to fully implement in Canada the Basel III rules. OSFI has announced that it expects Canadian banks to comply fully with the Basel III requirements early in the transition period. The revised capital adequacy guideline includes rules relating to Canadian banks' exposures on OTC derivatives to qualifying central clearing counterparties (**QCCPs**) and to clearing members of QCCPs which implement the rules set out in the Basel Committee release of July 25, 2012.

Chief Compliance Officer

OSFI Guideline E-13 (*Legislative Compliance Management*) requires Canadian banks to establish an enterprise-wide framework of regulatory risk management controls which will include both day-to-day controls and independent oversight of a bank's activities to ensure that regulatory risks are being managed effectively. OSFI expects that each bank's legislative compliance management

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to the CFTC dated August 24, 2012; and the European Commission comment letter to the CFTC dated August 24, 2012.

(**LCM**) framework will include the identification, assessment, communication and maintenance of applicable regulatory requirements, compliance procedures, monitoring procedures and reporting procedures. OSFI expects that a Chief Compliance Officer (**CCO**) will be responsible for the LCM function and will report directly to the Board, including on any material compliance issues and their remediation.

Risk Management

Canadian banks are already subject to comprehensive risk management requirements. These include, for example, Guideline B-7 (*Derivatives Best Practices*) which sets out OSFI's expectations regarding the prudent conduct of a Canadian bank's derivatives business, OSFI Guideline E-18 (*Stress Testing*) which sets out OSFI's expectations regarding Canadian banks' stress testing practices (both scenario testing and sensitivity testing) and OSFI's Guideline B-1 (*Prudent Person Approach*) which sets out OSFI's expectation that Canadian banks' managements and Boards will establish policies outlining the circumstances in which derivative instruments can be used and applicable limits (by type and counterparty) for their use.

Moreover, on August 7, 2012, OSFI released for comment a draft of a revised Corporate Governance Guideline (the **Revised Guideline**). The draft Revised Guideline sets forth OSFI's expectations for Canadian banks' risk management programmes in respect of its activities, including derivatives trading activities.

The Revised Guideline will require that each Canadian bank establish a Risk Appetite Framework (**RAF**) that guides the amount of risk the Canadian bank is willing to accept in pursuit of its strategic and business objectives. The RAF is to be approved by the Board and implemented by senior management as an integral part of the overall risk management framework of the Canadian bank. OSFI expects that the RAF will set basic goals, benchmarks, parameters and limits, and will consider all applicable types of risks.

OSFI expects that the Board and senior management of a Canadian bank will receive regular reports on the effectiveness of, and compliance with, the RAF. The Revised Guideline will require that senior management oversee regular reviews of risk management systems and practices to ensure that they remain appropriate and effective in light of changing circumstances and risks. The Revised Guideline requires that the Board should periodically commission independent third-party reviews to assess the effectiveness of the Canadian bank's risk management systems and practices.

Finally, the Revised Guideline directs that, depending on the nature, size, complexity and risk profile of the Canadian bank, the board should establish a dedicated board risk committee to oversee risk management on an enterprise-wide basis. The Revised Guideline recommends that each Canadian bank have a designated Chief Risk Officer (**CRO**), with sufficient stature and authority within the organization, and who is also independent from operational management. The CRO should have access to the Board and risk committee without impediment, including a direct reporting line to the Board or risk committee. The risk committee is to be responsible for approving the mandate, competencies and resources of the CRO, at least annually. It should also approve the CRO's performance review and oversee the succession planning for the CRO position and other key positions within the risk management function.

Given the existence of these detailed requirements, it would be unnecessarily confusing and potentially unhelpful for Canadian banks to begin to implement a parallel risk management framework in order to comply with U.S. rules. For that reason, we advocate that the CFTC coordinate with Canadian regulators to adopt appropriately harmonized regulation before requiring registration of Canadian banks.

2.2 The CFTC's prescriptive approach should not override the regulatory philosophy of the Canadian regulators.

The CFTC and Canadian bank regulators have substantially different regulatory styles; the CFTC is more prescriptive, while historically Canadian regulators have adopted a more purposive and principles-based regulatory regime, requiring firms to achieve certain standards and objectives in a manner tailored to the individual firm and its circumstances. Canadian regulators should, as a matter of international comity, be afforded primacy in application of regulation to Canadian banks' activities and not be subject to inconsistency and unnecessary complication due to the differences in the CFTC's proposed approach. This is especially true in light of Canadian bank regulators' well-earned reputation in applying a regulatory system geared toward the safety and soundness of Canadian banks and the Canadian financial system.

For example, the CCO requirement under the CFTC regulations requires that the CCO be responsible for, among other things, administering the swap dealer's compliance policies and procedures, resolving conflicts of interest, taking reasonable steps to ensure compliance, reporting to the board of directors and certifying compliance to the CFTC. As noted above, Canadian banks are required to establish a legislative compliance management function and to appoint a CCO. Senior management is ultimately responsible for ensuring legislative compliance, but the CCO has an independent responsibility to ensure such compliance and to report to the Board. While the Canadian rules are much less prescriptive than the CFTC rules and there is no requirement that the CCO make an annual attestation of compliance or potentially incur personal liability, the same objectives are required to be observed in the same rigorous manner under both the Canadian and CFTC regimes. If the CFTC adopts a rigid rule-by-rule approach to substituted compliance, the CFTC's rules would conflict with and potentially supplant existing Canadian regulation. Absent a reasonable basis to interfere with the effective regulation of Canadian banks by the LCM system and prudential regulation, the CFTC should deem compliance with the existing Canadian regime to be sufficient for the CFTC's purposes.

2.3 The CFTC should defer to the judgment of Canadian regulators regarding the relevance of particular aspects of regulation in Canada.

The CFTC should defer to Canadian regulators in determining whether certain regulatory requirements are appropriate or necessary in Canada. The CFTC should consider the absence of a directly comparable detailed rule in Canada as strong evidence that such omission was intentional.

For example, rather than enforcing compliance with CFTC's registration rule,[7] which requires that senior board members of the swap dealer file Form 8-R (which contain background check information) and a fingerprint card, the CFTC should be encouraged to recognize that Canadian regulation of these individuals and firms is sufficient. OSFI Guideline E-17 (*Background Checks*

[7] Registration of Swap Dealers and Major Swap Participants, 77 Fed. Reg. 2613 (January 19, 2012), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-792a.pdf.

on Directors and Senior Management of FREs), for example, requires Canadian banks to implement internal processes for assessing the ongoing suitability and integrity of Board members and senior management. The range of investigations to be conducted initially and periodically thereafter include checking for any criminal convictions, securities-related sanctions or disciplinary actions by professional regulatory bodies, civil proceedings relating to financial or business misconduct, fraud or mismanagement and conflicts of interest. We are not aware that this issue, which creates substantial burdens for the affected individuals and firms, is currently addressed in any CFTC rule or guidance.

Any difference in regulatory approach between Canada and the U.S. that stems from a different set of decisions about what aspect of the regulatory framework is appropriate or necessary is unlikely to be bridged by anything less than a regulatory recognition approach.

In closing, we thank you for the opportunity to share our comments on the Proposed Guidance. We have taken this opportunity provide some high-level comments that are of significant concern to our member banks that operate in the U.S. derivatives market, and would be pleased to respond directly to any questions you may have regarding the foregoing. Thank you in advance for taking our views into consideration.

Yours truly,