February 6, 2013

Via Electronic Submission: http://comments.cftc.gov

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

Re: Further Proposed Guidance Regarding Compliance with Certain Swap Regulations: RIN 3038–AD85

Dear Sir or Madam:

Managed Funds Association ("**MFA**")[1] and Alternative Investment Management Association[2] ("**AIMA**", and together with MFA, "**we**") welcome the opportunity to provide comments to the Commodity Futures Trading Commission ("**Commission**") on its "Further Proposed Guidance Regarding Compliance with Certain Swap Regulations" ("**Further Proposed Guidance**").[3] We understand the difficult task that the Commission has in identifying which cross-border activities have a "direct and significant connection with activities in, or effect on, commerce of the United States"[4] such that the Commission should subject those activities to the swap provisions of the CEA. Therefore, we support the Commission issuing the Further

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[1] Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in over 40 countries.

[3] 78 Fed. Reg. 909 (January 7, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-01-07/pdf/2012-31734.pdf.

[4] Section 722(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**"), Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010), adding section 2(i) of the Commodity Exchange Act ("**CEA**").

Proposed Guidance to obtain additional public comments, in particular on the proposed "U.S. person" definition,[5] which will be helpful to it in issuing final interpretive guidance.[6]

I. Executive Summary

We appreciate that the Commission proposed alternative prongs (ii)(B) and (iv) of the "U.S. person" definition in response to the extensive public comments it received on the Proposed Guidance.[7] However, even with the Commission's proposed alternative prongs (ii)(B) and (iv), we remain concerned that, in its application, the proposed "U.S. person" definition would inconsistently and inappropriately subject certain non-U.S. market participants and transactions to U.S. regulatory requirements. We are particularly concerned about the implications for commodity pools, pooled accounts, collective investment vehicles and funds (collectively, "**Funds**") organized or incorporated outside of the United States ("**Non-U.S. Funds**")[8], as well as the proposed treatment of Funds as compared to corporations and other financial entities.

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[5] *See* Commission "Proposed Interpretive Guidance and Policy Statement on Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act", 77 Fed. Reg. 41214, 41218 (July 12, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16496.pdf ("**Proposed Guidance**"), where the Commission proposed to interpret "U.S. person" to include, but not be limited to:

> (i) any natural person who is a resident of the United States;
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> (ii) any corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund, or any form of enterprise similar to any of the foregoing, in each case either:
>
> > (A) organized or incorporated under the laws of the United States or having its principal place of business in the United States, or
> >
> > (B) in which the direct or indirect owners thereof are responsible for the liabilities of such entity and one or more of such owners is a U.S. person;
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> (iii) any individual account (discretionary or not) where the beneficial owner is a U.S. person;
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> (iv) any commodity pool, pooled account, or collective investment vehicle (whether or not it is organized or incorporated in the United States) of which majority ownership is held, directly or indirectly, by a U.S. person(s);
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> (v) any commodity pool, pooled account, or collective investment vehicle the operator of which would be required to register as a commodity pool operator under the CEA;
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> (vi) a pension plan for the employees, officers, or principals of a legal entity with its principal place of business inside the United States; and
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> (vii) an estate or trust, the income of which is subject to United States income tax regardless of source.

[6] Further Proposed Guidance at 910, where the Commission notes the approximately 288 letters it received in response to the Proposed Guidance and its need to consider those public comments further.

[7] *See id*.

[8] For example, as proposed, the Proposed Guidance would subject Non-U.S. Funds to more stringent regulatory requirements than foreign banks, dealers or corporations or foreign subsidiaries of U.S. banks. *See*

Because Fund structures are complex and vary dramatically, we understand the difficulty of determining what constitutes a direct and significant U.S. nexus in the Fund context. Therefore, to assist the Commission with ensuring equal and appropriate treatment of different types of legal entities, including Funds, we make several recommendations in respect of prongs (ii), (iv) and (v) of the proposed "U.S. person" definition. Specifically, we respectfully suggest that the Commission:

(1) provide the same treatment for Funds and corporate entities by incorporating all Funds into alternative prong (ii)[9] of the "U.S. person" definition and eliminating alternative prong (iv);[10]

(2) clarify that, for purposes of the "principal place of business" test in prong (ii)(A) of the "U.S. person" definition, the Commission will not impute the principal place of business of a Fund's investment manager (including entities that are part of its corporate structure) or other service provider on the Fund;

(3) modify alternative prong (ii)(B) to apply only a direct (and not indirect) ownership test;

(4) modify the exclusionary parenthetical for limited liability companies ("**LLCs**") and limited liability partnerships ("**LLPs**") in alternative prong (ii)(B) to clarify that it applies to all entities where the owners have limited liability;[11] and

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Section III.A below for analysis of this disparate treatment of Funds as compared to corporate entities under the proposed "U.S. person" definition.

[9] *See* Further Proposed Guidance at 912, which provides that alternative prong (ii) would be as follows: "(ii) A corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of enterprise similar to any of the foregoing, in each case that is either (A) organized or incorporated under the laws of a state or other jurisdiction in the United States or having its principal place of business in the United States or (B) directly or indirectly majority-owned by one or more persons described in prong (i) or (ii)(A) and in which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity (other than a limited liability company or limited liability partnership where partners have limited liability)."

[10] *See id*. at 913, which provides that alternative prong (iv) would be as follows: "(iv) A commodity pool, pooled account, investment fund, or other collective investment vehicle that is not described in prong (ii) and that is directly or indirectly majority-owned by one or more persons described in prong (i) or (ii), except any commodity pool, pooled account, investment fund, or other collective investment vehicle that is publicly-traded but not offered, directly or indirectly, to U.S. persons".

[11] Based on our recommendations, modified prong (ii) would be as follows:

"A corporation, partnership, limited liability company, business or other trust, association, joint-stock company, commodity pool, pooled account, investment fund, other collective investment vehicle or any form of enterprise similar to any of the foregoing, in each case that is either

(A) organized or incorporated under the laws of a state or other jurisdiction in the United States or having its principal place of business in the United States or

(5) remove prong (v) in its entirety.

In addition, we ask the Commission to clarify that, for purposes of the ownership test, Funds may rely on representations from investors as to their prong (i) or (ii)(A) U.S. person status, and not require independent verification of such status. Moreover, since an entity's U.S. person status may change over time, we recommend that when such changes of status occur, the Commission provide the relevant entities and their affected counterparties with one year to comply with the applicable entity-level[12] and transaction-level requirements.[13] Taken together, we believe the foregoing recommendations will assist the Commission in issuing final interpretive guidance on the cross-border application of Title VII of Dodd-Frank ("**Title VII**") that will allow market participants to determine with certainty their U.S. person status, ensure the continued robustness of the derivatives markets and result in regulation of activities that fall within the Commission's mandate.

We also want to emphasize that we appreciate that "Commission staff has actively engaged in discussions with their foreign counterparts in an effort to better understand and develop a more harmonized cross-border regulatory framework".[14] Given that other domestic and international regulators similarly will issue proposals related to the cross-border application of their regulations,[15] we agree that global consistency with respect to the extraterritorial scope of all these regimes is critical. In particular, we encourage international coordination of substituted compliance regimes that address not only the application to U.S. and non-U.S. swap dealer ("**SDs**") and major swap participants ("**MSPs**"), but also to their counterparties in order to

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(B) directly majority-owned by one or more persons described in prong (i) or (ii)(A) and in which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity (other than an entity, such as a limited liability company or limited liability partnership, where the owners have limited liability)."

[12] *See* Proposed Guidance at 41224, which provides that the entity-level requirements are: (i) capital adequacy; (ii) chief compliance officer; (iii) risk management; (iv) swap data recordkeeping; (v) swap data reporting; and (vi) physical commodity swaps reporting .

[13] *See id*. at 41225, which provides that the transaction-level requirements are: (i) clearing and swap processing; (ii) margining and segregation for uncleared swaps; (iii) trade execution; (iv) swap trading relationship documentation; (v) portfolio reconciliation and compression; (vi) real-time public reporting; (vii) trade confirmation; (viii) daily trading records; and (ix) external business conduct standards.

[14] Further Proposed Guidance at 910.

[15] *See* the Securities and Exchange Commission's ("**SEC**") notice of "Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security- Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act", 77 Fed. Reg. 35625, 35627 (June 14, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-06-14/pdf/2012-14576.pdf, where the SEC indicates that it will address the international implications of Title VII in a single proposal that would present an approach to the registration and regulation of foreign entities engaged in cross-border security-based swap transactions. *See also* the European Securities and Markets Authority ("**ESMA**") final report on "Draft technical standards under the Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, CCPs and Trade Repositories" (September 27, 2012) at 6, available at: http://www.esma.europa.eu/system/files/2012-600_0.pdf, where ESMA indicates that it will issue draft regulatory technical standards on contracts that are considered to have a direct substantial and foreseeable effect in the Union.

ensure appropriate recognition of comparable regulatory frameworks, alleviate duplicative regulation and minimize transaction and compliance costs to the extent possible.

II. Support for Continued Implementation of Mandatory Clearing Requirements

We note that, as customers to SDs and MSPs in the derivatives market, the Commission's proposed transaction-level requirements are the Title VII obligations that most directly affect our members. With respect to the implementation of those transaction-level requirements, we strongly support efforts to promote central clearing of OTC derivatives and reduce systemic risk, and we have consistently urged regulators to adopt timetables to implement OTC derivatives reforms, including central clearing of derivatives for clients.[16] In various markets, our members have undertaken significant steps to prepare for greater, open access to clearing, and we appreciate that mandatory clearing of appropriately liquid and standardized swap products will begin in the near future. Therefore, while the Commission continues to consider the suitable scope and phase in of the transaction-level requirements, we emphasize the importance of ensuring that mandatory clearing continue to progress in a timely manner and apply to appropriate market participants.

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[16] *See e.g.*, MFA letter to the Chairman of the Commission, Gary Gensler, and to the Chairman of the U.S. SEC, Mary Schapiro dated March 24, 2011, in which we provided our recommendations for facilitating prompt implementation of OTC derivatives reforms in the U.S., available at: http://www.managedfunds.org/wp-content/uploads/2011/06/3.24.11-MFA-Letter-to-Chairman-Schapiro-3-24-11-1.pdf; MFA letter to the Commission on its notice of proposed rulemaking on "Swap Transaction Compliance and Implementation Schedule: Clearing and Trade Execution Requirements under Section 2(h) of the CEA" dated November 4, 2011, available at: https://www.managedfunds.org/wp-content/uploads/2011/11/CFTC-Implementation-Rules-on-Clearing-Execution-Documentation-and-Margining-Final-MFA-Letter.pdf; AIMA's response to CPPSS-IOSCO's "Consultation on the application of the 2004 CPSS-IOSCO Recommendations for Central Counterparties to OTC derivatives CCPs and considerations for trade repositories in OTC derivatives markets" dated 24 June 2010: http://www.aima.org/download.cfm/docid/2CED9CAC-FBDE-4D20-9C7B0800A3D3334D; MFA's "Response to Proposed Regulation of OTC Derivatives, Central Counterparties and Trade Repositories" dated November 11, 2010, available at https://www.managedfunds.org/wp-content/uploads/2011/11/Final-MFA-White-Paper-EC-Derivatives-Proposed-Regulation.pdf; AIMA's submission to the European Commission and U.S. Treasury concerning extra-territorial effects in the European Union and U.S. regulation of derivatives dated 5 July 2011: http://www.aima.org/objects_store/joint_ta_letter_re_extra_territoriality_-_5_jul_2011.pdf; MFA comment letter to the Hong Kong Monetary Authority ("**HKMA**") and the Securities and Futures Commission ("**HKSFC**") on their joint "Consultation paper on the proposed regulatory regime for the over-the-counter derivatives market in Hong Kong" ("**Hong Kong Consultation**") dated November 29, 2011, available at https://www.managedfunds.org/wp-content/uploads/2011/11/Hong-Kong-OTC-Derivatives-Regulatory-Regime-Final-MFA-Letter.pdf; AIMA's response on the Hong Kong Consultation dated 7 December 2011, available at: http://www.aima.org/objects_store/aima_response_to_sfc_consultation_on_otc_derivatives-7_december_2011.pdf; MFA comment letter to the Monetary Authority of Singapore ("**MAS**") on its "Consultation Paper on Proposed Regulation of OTC Derivatives" ("**Singapore Consultation**") dated March 26, 2012, available at: https://www.managedfunds.org/wp-content/uploads/2012/03/MAS-OTC-Derivatives-Consultation-Paper-Final-MFA-Letter-3-26-2012.pdf; AIMA's response on the Singapore Consultation dated 26 March 2012, available at http://www.aima.org/objects_store/aima_response_to_mas_consultation_on_otc_derivatives_reform.pdf.

III. Recommendations on "U.S. Person" Definition

In the Further Proposed Guidance, the Commission sets forth alternative prongs (ii)(B) and (iv) to the "U.S. person" definition for public comment. However, we remain concerned about multiple prongs of the proposed definition as well as the composite effect of the Proposed Guidance on Funds. Although we appreciate that the Commission has modified its proposals from the Proposed Guidance, the Further Proposed Guidance does not strike the right balance between asserting CFTC jurisdiction in furtherance of Title VII and deferring to foreign regulators as a matter of international comity to create a workable international framework. Therefore, below we provide specific views and recommendations on alternative prongs (ii)(B) and (iv) of the Further Proposed Guidance, and we reiterate concerns on other aspects of the Proposed Guidance for the Commission's consideration as it continues to refine the final interpretive guidance that it will adopt.[17]

A. Funds' Swap Activity with Dealers is Regulated

We note that Funds are buy-side market participants and, as such, typically have a dealer as their counterparty on every derivatives trade into which they enter. In addition, U.S. dealers that have registered or will register with the Commission as SDs and foreign affiliates of those U.S. dealers represent a significant portion of trading that takes place in the U.S. swaps market.[18] Since the Proposed Guidance would apply the transaction-level requirements to all swaps where: (1) a U.S. SD is a party, or (2) a foreign affiliate of a U.S. SD engages in swap dealing but the swaps are directly booked by the U.S. SD,[19] the Commission will have oversight and reporting of many swaps to which Non-U.S. Funds will be parties, whether or not the Non-U.S. Funds are U.S. persons. In addition, because we expect that many non-U.S. dealers (including foreign affiliates of U.S. SDs whose swaps are not booked in the U.S.) will be subject to comparable regulation in other jurisdictions, we believe that, once those regulations are implemented, Non-U.S. Funds' swap transactions with such non-U.S. dealers will also be subject to sufficient regulation. Therefore, as the Commission considers our proposed modifications and clarifications related to the proposed "U.S. person" definition, we emphasize that our view is that implementing our recommendations will not create gaps in the global regulation of derivatives. Rather, we believe our proposals will appropriately apply the definition to Funds with a direct and significant U.S. nexus whilst allowing for swaps by non-US entities to be regulated under the appropriate, comparable overseas regulations, reducing the likelihood of duplicative regulation for market participants.

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[17] *See* MFA and AIMA joint comment letter to the Commission in response to the Proposed Guidance dated August 28, 2012, available at: https://www.managedfunds.org/wp-content/uploads/2012/08/CFTC-Cross-Border-Guidance-Letter-MFA-AIMA-Final-Letter.pdf.

[18] See Office of the Comptroller of the Currency "OCC's Quarterly Report on Bank Trading and Derivatives Activities Third Quarter 2012", available at: http://www.occ.gov/topics/capital-markets/financial-markets/trading/derivatives/dq312.pdf.

[19] *See* Proposed Guidance at 41228-31, setting forth the proposed application of the transaction-level requirements to U.S. SDs and their foreign affiliates.

B. Merging Alternative Prongs (ii) and (iv)

We understand that the Commission's intent with alternative prong (iv) is "to capture collective investment vehicles that are created for the purpose of pooling assets from U.S. investors and channeling these assets to trade or invest in line with the objectives of the U.S. investors".[20] We recognize that the complexity and variety of Fund structures makes it difficult for the Commission to determine which Funds have a direct and significant U.S. nexus, and we agree that the "U.S. person" definition should capture certain Funds.[21] However, we do not believe that a Fund's pooling of assets is a fundamental difference that denotes a greater U.S. nexus than the pooling of assets by corporations or other financial entities because Funds are corporate entities. As a result, we think it problematic that alternative prong (iv) creates a more onerous standard for Non-U.S. Funds than alternative prong (ii) creates for corporate or other financial entities (especially other foreign entities), such that the result is an overly broad application of the "U.S. person" definition to Non-U.S. Funds.

For example, alternative prong (ii)(B) incorporates the same direct or indirect majority ownership test as alternative prong (iv), but alternative prong (ii)(B) also includes additional language that limits its application only to entities in which "such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity".[22] Under the Further Proposed Guidance, Non-U.S. Funds would need to apply the tests under both alternative prongs (ii) and (iv) to determine whether they are U.S. persons, whereas corporate entities would be subject only to alternative prong (ii). As a result, under alternative prong (ii)(B), if 100% of a corporation's direct owners were U.S. persons, but the corporation was formed as an LLC, it would not be a U.S. person. In contrast, a Non-U.S. Fund organized as an LLC and with direct ownership by a majority of U.S. persons would be a U.S. person under alternative prong (iv), even though the Non-U.S. Fund's impact on U.S. commerce could be indistinguishable from the impact of the above corporation.

In addition, the Proposed Guidance specifically excludes foreign subsidiaries of U.S. SDs from the Dodd-Frank transaction-level requirements, even if their U.S. parent guarantees their obligations.[23] By contrast, because of the breadth of alternative prongs (ii) and (iv) and the inclusion of prong (v), without modification of the "U.S. person" definition, many Non-U.S. Funds would be U.S. persons, even if the Non-U.S. Funds have no U.S. investors. Thus, unlike

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[20] Further Proposed Guidance at 913.

[21] For example, we agree that a Fund organized or incorporated in the United States should be a "U.S. person".

[22] *Supra* note 9 for Commission proposed prong (ii) language.

[23] *See* Proposed Guidance at 41218, where the Commission states that it, "[u]nder this interpretation, the term ''U.S. person'' generally means that a foreign branch or agency of a U.S. person would be covered by virtue of the fact that it is a part, or an extension, of a U.S. person. By contrast, a foreign affiliate or subsidiary of a U.S. person would be considered a non-U.S. person, even where such an affiliate or subsidiary has certain or all of its swap related obligations guaranteed by the U.S. person."

foreign subsidiaries of U.S. SDs, these Non-U.S. Funds would be subject to the transaction-level requirements of Dodd-Frank.

To be clear, we strongly support the combined direct U.S. ownership and unlimited liability tests in alternative prong (ii)(B). We agree with the Commission that when direct U.S. owners are "ultimately liable for the entity's obligations and liabilities, the connection to activities in, or effect on, U.S. commerce satisfies the requisite jurisdictional nexus".[24] However, we do not think, from either a direct and significant U.S. nexus or a systemic risk perspective, that Dodd-Frank provides any justification for more onerous treatment of Non-U.S. Funds than for corporations and other similar legal entities, such as foreign corporations or foreign subsidiaries of U.S. SDs. The Commission should apply the definition (including the unlimited liability test) consistently to, and should provide equal treatment of, different types of foreign entities. As a result, we recommend that the Commission subject Funds and corporate entities to the same U.S. person standards, and we specifically ask the Commission to merge alternative prong (iv) and alternative prong (ii) of the "U.S. person" definition by incorporating all Funds into alternative prong (ii) and eliminating prong (iv) as redundant.[25]

C. Prong (ii)(A) – Organizational Test

In the Further Proposed Guidance, the Commission modified prong (ii), but only with respect to the unlimited liability test in (ii)(B). Therefore, as it relates to prong (ii)(A), we remain concerned about the application of the "principal place of business" test[26] to Funds for purposes of determining U.S. person status. As the Commission recognized in the Final Exemptive Order "the application of the principal place of business element may be complex for funds and collective investment vehicles".[27]

Because Dodd-Frank requires the Commission to regulate entities with a direct and significant U.S. nexus,[28] we understand and support the Commission's desire to use principal place of business (in addition to location of organization or incorporation) as an indicator of certain entities direct and significant U.S. nexus. However, we feel strongly that the Commission should not impute the principal place of business of a Fund's investment manager (including entities that are part of its corporate structure) or other service provider onto the Fund for purpose of its U.S. person status. A Fund, whether organized within or outside of the U.S., typically has a number of service providers, each of which a Fund may elect to replace from time to time. As such, we believe that the fact that a Fund's service provider has a principal place of business in the U.S. does not create a direct and significant U.S. nexus. Thus, we respectfully

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[24] Further Proposed Guidance at 912.

[25] *Supra* note 11 for our recommended modified prong (ii).

[26] *Supra* note 5 for proposed prong (ii)(A).

[27] Final Exemptive Order at 864.

[28] *See* Section 722(d) of Dodd-Frank, adding Section 2(i) of the CEA.

request that the Commission clarify that a Fund's principal place of business is its jurisdiction of organization or incorporation.

D. Alternative Prong (ii)(B) – Unlimited Liability Test

1. Addressing Practical Indirect "Look-Through" Issues

As modified by the Further Proposed Guidance, alternative prong (ii)(B) relates to direct or indirect majority ownership by persons or entities described in prong (i) or (ii) of the "U.S. person" definition.[29] In alternative prong (iv), the Commission eliminated the indirect "look-through" for pools which are publicly-traded but not offered to U.S. persons because it correctly recognized that "ownership verification is particularly difficult for pools, funds, and other collective investment vehicles that are publicly traded".[30] However, we emphasize that ownership verification is difficult, if not impossible, for ***all*** Funds and other corporate entities. Thus, in addition to merging alternative prong (iv) with alternative prong (ii)(B), it is important that the Commission eliminate the indirect "look-through".

As a practical matter, it is often extremely difficult, if not impossible, for any organization to establish and track indirect ownership status with certainty. Many Funds have investors that include, among others, fund-of-funds, pension plans or shareholders in a listed entity, each of which may also have its own direct and indirect owners. Also, the indirect ownership of such fund-of-fund, pension plan or other Fund investors may change during the period of investment and Funds will not have knowledge of such changes. Although in theory Funds could obtain representations from their investors as to the U.S. person status of all the investors' direct and indirect owners, in practice investors have difficulty verifying that information and would be unable or unwilling to make such representations.[31] As a result, since there is no limit to the indirect "look-through" in alternative prong (ii)(B), the result is that Funds would need to know every indirect owner in the ownership chain no matter how remote that ownership and no matter how frequently that indirect ownership changes. Funds have no ability to obtain such information and make such determinations.[32]

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[29] Further Proposed Guidance at 912, which provides that alternative prong (ii) would be as follows: "(ii) A corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of enterprise similar to any of the foregoing, in each case that is either (A) organized or incorporated under the laws of a state or other jurisdiction in the United States or having its principal place of business in the United States or (B) directly or indirectly majority-owned by one or more persons described in prong (i) or (ii)(A) and in which such person(s) bears unlimited responsibility for the obligations and liabilities of the legal entity (other than a limited liability company or limited liability partnership where partners have limited liability)".

[30] *Id.*

[31] We note that because the "U.S. person" definition is a non-exhaustive list and it may change in the future, it creates additional complexity for an entity seeking to obtain representations as to U.S. person status of its direct and indirect owners.

[32] For example, a fund-of-funds would not reveal the names of its investors to the Fund for competitive and privacy reasons.

In addition, as proposed in the Further Proposed Guidance, application of alternative prong (ii)(B) also depends on whether a Fund's investor satisfies prong (i) or (ii)(A) of the "U.S. person" definition. This language adds an additional level of complexity in that it requires the Fund not only to know all of its owners (no matter how indirect their ownership), but it also requires Funds to be able to ascertain the owners' status as it relates to prong (i) and (ii)(A). Therefore, since alternative prong (ii)(B) makes it extremely difficult for Funds to know with any certainty whether they are U.S. persons, we urge the Commission to modify alternative prong (ii)(B) by eliminating the indirect "look-through" and instead determine a Fund's status solely by reference to whether it has direct majority ownership by U.S. persons.[33]

We also request that the Commission clarify that Funds may rely on representations from direct investors as to their prong (i) or (ii)(A) U.S. person status, and not require Funds to verify independently such status. The investors themselves (and not the Funds) have the necessary information, and thus, are in the best position, to make such determinations. We believe these modifications are consistent with the Commission's intent to capture "collective investment vehicles that are created for the purpose of pooling assets from U.S. investors and channeling these assets to trade or invest in line with the objectives of the U.S. investors",[34] while also ensuring that Funds can apply alternative prong (ii)(B) from a practical standpoint.

2. Including All Limited Liability Entities in Exclusion

Alternative prong (ii)(B) applies to entities where the direct or indirect owners are responsible for the liabilities of such entity, and the entity is majority-owned by persons or entities described in prong (i) or (ii) of the "U.S. person" definition.[35] In addition, in alternative prong (ii)(B), the Commission proposes to carve out LLCs and LLPs where partners have limited liability.[36]

We support the Commission excluding LLCs and LLPs from alternative prong (ii)(B) as we agree that limiting the liability of an entity's investors also limits the U.S. nexus.[37] Our concern with this exclusion is technical in that we believe the Commission's intent is to exclude all entities where the owners have limited liability, but because in the U.S. limited liability entities are often organized as LLCs and LLPs, those entities are the only ones the Commission provided for in the exclusion.

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33 *Supra* note 11 for recommended prong (ii) language.

34 Further Proposed Guidance at 913.

35 *Supra* note 9 for Commission proposed alternative prong (ii).

36 *See id*.

37 Further Proposed Guidance at 912, where the Commission explains that its proposed alternative prong (ii)(B) language reflects that "when the structure of an entity is such that the U.S. direct or indirect owners are ultimately liable for the entity's obligations and liabilities, the connection to activities in, or effect on, U.S. commerce satisfies the requisite jurisdictional nexus".

We note that corporations and limited partnerships in the U.S. and other types of entities in other jurisdictions are also organized with limited liability but they are not called LLCs or LLPs.[38] Moreover, the owners of such limited liability entities could be called members, partners, shareholders or otherwise. As a result, in recognition of the global scope and application of the Further Proposed Guidance, we ask the Commission to modify the exclusion for LLCs and LLPs so that it refers to all entities where the owners have limited liability.[39]

E. Prong (v) – CPO Registration Test

In the Proposed Guidance, the Commission included prong (v), which determined U.S. person status by reference to whether a Fund's operator was required to register as a commodity pool operator ("**CPO**") under the CEA.[40] Our understanding is that the Commission intends to remove this prong from the "U.S. person" definition that it will adopt in its final interpretive guidance. If this understanding is correct, we applaud the Commission and agree with its determination.

We have significant concerns with proposed prong (v) because we believe that the CPO status of a Fund operator is not by itself indicative of any direct and significant U.S. nexus. While we realize that the Commission already has oversight of CPOs and will subject them to stringent regulation, including receiving substantial information about their activities through Form CPO-PQR, regulating an operator's activity as a CPO should not equate with subjecting a Non-U.S. Fund to the full panoply of Title VII regulations without other indicators of a more substantial U.S. nexus.

Moreover, following the recent rescission of Commission Rule 4.13(a)(4)[41] and Dodd-Frank's extension of the Commission's regulatory ambit to global swap markets, operators of Non-U.S. Funds that are active in swaps and do not meet the *de minimis* test are required to register as CPOs, even if the Non-U.S. Fund has no U.S. investors. Therefore, if the Commission retains prong (v) in the final interpretive guidance, many Non-U.S. Funds will become "U.S. persons" by virtue of their operator's CPO status. As discussed herein, given that foreign dealer entities that are wholly-owned, majority-owned or partly-owned by "U.S. persons" would not themselves be a U.S. persons, we believe the same treatment should apply to Non-U.S. Funds and that the Commission should eliminate prong (v) of the "U.S. person" definition.

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[38] For example, in the United Kingdom, a limited liability entity is called a "private company limited by shares", and in various countries, such as France, Switzerland and Luxembourg, a limited liability entity is called a "société à responsabilité limitée".

[39] *Supra* note 11 for recommended prong (ii)(B) language.

[40] Proposed Guidance at 41218.

[41] Commission Rule 4.13(a)(4) exempted CPOs from registering with the Commission if all investors in the funds were "qualified eligible persons" or certain types of "accredited investors".

F. Changes to U.S. Person Status

The Commission's proposed "U.S. person" definition provides a non-exclusive list of the entities that fall within the definition.[42] We understand that the "include, but not be limited to" language preserves flexibility for the Commission to otherwise deem an entity to be a U.S. person in the future if the Commission determines its activities have a direct and significant effect on the U.S. However, if the Commission were to modify this definition by including entities other than those set forth in the enumerated list, such modification could create new uncertainty in the derivatives markets and with respect to other domestic and international derivatives reforms.

To preserve the Commission's flexibility while providing the intended certainty to global market participants, we would appreciate it if the Commission could explicitly clarify the process for determining, and phased-in compliance for, other types of entities that it deems to be "U.S. persons" in the future. In particular, we recommend that at such time, prior to updating the "U.S. person" definition in its final interpretive guidance, the Commission give the public notice and provide an opportunity for public comment and, following modification of the definition, provide affected market participants one year to comply with the related entity-level and transaction-level requirements.

Similarly, an entity's "U.S. person" status may change over time if, for example, a Fund's investment manager is currently exempt from registration as a CPO, but due to increased trading in commodities or swaps, the manager becomes subject to CPO registration in the future. Such a Fund would need a phase-in period prior to being subject to the full Title VII requirements. We would again recommend that when such a change of status occurs, the Commission provide the Fund and its affected counterparties with one year to comply with the related entity-level and transaction-level requirements.[43] This concern seems particularly relevant to prong (iv) (and prong (v) to the extent not removed in the final interpretive guidance), because a Fund's status with respect to these prongs may change with some regularity, whereas status under the other proposed prongs seems likely to be static.

IV. International Harmonization and Substituted Compliance

We greatly appreciate the Commission's recognition of "the critical role of international cooperation and coordination in the regulation of derivatives in the highly interconnected global

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[42] Proposed Guidance at 41218, where the Commission interprets the term "to include, but not be limited to" certain types of entities.

[43] Please note that MFA has made a similar request to the Commission in a comment letter requesting interpretive guidance relating to regulatory treatment of funds whose trading may begin to exceed the quantitative gross futures and swaps market exposure and margin restrictions, dated August 27, 2012, available at: https://www.managedfunds.org/wp-content/uploads/2012/08/MFA-Letter-to-CFTC-for-Transition-Period-Section-4-13a3-guidance-final-8-27-12.pdf.

market"[44] and that regulators are in "different stages of implementing their regulatory reform".[45] As a general matter, we strongly support an internationally coordinated approach to derivatives market reform that ensures consistent regulation, reflects the global nature of the markets and promotes competition and innovation. In addition, we understand the need to ensure that, where a market participant's activities have a direct and significant effect in a jurisdiction, that market participant is subject to adequate regulation in that jurisdiction. However, we are increasingly concerned that the duplicative scope of the various international reforms will create substantial regulatory conflicts that if not resolved, could impair the derivatives markets.

For example, if a U.S. SD desires to enter into a swap with a non-U.S. person, or a non-U.S. SD desires to enter into a swap with a U.S. person, the Proposed Guidance would require the SDs to comply with the relevant transaction-level requirements.[46] However, the non-U.S. person and non-U.S. SD will likely also be subject to regulation in their jurisdiction of organization. Since we expect international derivatives regulations to be of similar scope to Title VII, if the applicable regulations are not substantially identical, the result would be overlapping and duplicative regulation of the parties and the trade.[47] We, therefore, encourage the Commission to consider widening the scope of substituted compliance proposed in the Proposed Guidance. The widened scope would allow for the recognition of foreign regulatory regimes in respect of those transaction-level requirements that arise where a U.S. SD enters into a swap with a non-U.S. person, or a non-U.S. SD enters into a swap with a U.S. person.

We appreciate that, as a failsafe to prevent duplicative regulation and in consideration of international comity principles, the Commission has proposed substituted compliance for certain activities between non-U.S. persons and: (1) non-U.S. SDs or MSPs, or (2) foreign branches, agencies or affiliates of U.S. SDs or MSPs.[48] Unfortunately, with limited exception,[49] the Proposed Guidance does not permit substituted compliance in the example described above. Therefore, we urge the Commission, in the final interpretive guidance, to permit all parties to seek substituted compliance, with the understanding that, if the parties or trade are not subject to comparable regulation in another jurisdiction, the Commission will require the Title VII requirements to apply.

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[44] Further Proposed Guidance at 910.

[45] *Id.*

[46] *See id.* at 41219, where the Commission states that "[o]nce required to register as a swap dealer or MSP, the person becomes subject to all of the requirements imposed on swap dealers or MSPs under Title VII".

[47] We recognize that some regulatory overlap is inevitable, but it is critical to reduce that overlap to the extent possible.

[48] Proposed Guidance at 41229.

[49] *See id.* at 41228, where the Commission asserts that for purposes of swap data reporting and physical commodity swaps reporting, it will permit substituted compliance with respect to swaps between a non-U.S. swap dealer/MSP and a non-U.S. counterparty.

We also respectfully request that the Commission focus on addressing the details of how substituted compliance will work in practice. Although the Proposed Guidance provides some information about how the Commission will make its comparability determinations, a number of areas remain a concern.

Market participants require greater clarity where foreign regulators have intentionally chosen to vary their regulatory requirements from that required by Title VII, and thus, it is not an issue of duplicative regulation. For example, in the case of trade execution requirements, other foreign regulators have chosen to implement such a requirement with a different scope than that of the Commission[50] or they have elected not to propose a trade execution requirement.[51] Although the Commission and other regulators will make independent comparability determinations, these processes and the results of the determinations are interconnected, therefore, a global understanding between regulators and greater transparency of the comparability determinations process to market participants is important.

As a result, we strongly encourage the Commission to continue to maintain an open dialogue with its domestic and international counterparts and actively work toward developing harmonized regulations not only that have a complementary scope, but also that have comparable and coordinated substituted compliance processes to address issues of overlapping or intentionally divergent requirements that do arise. As the Commission knows, substantive and practical differences in international regulations and their implementation may unintentionally and adversely affect the derivatives markets and hamper trading by parties that seek in good faith to comply with the various regulatory requirements applicable to them.

Market participants also require greater clarity as to how the Commission would make a comparability determination in respect of a foreign jurisdiction that has proposed but not finalized its OTC derivative regulations. For instance, we expect that once implemented, the OTC derivatives regulations in the European Union will be comparable to the Commission's final regulations. However, based on the current delay with respect to ESMA's final draft regulatory technical standards, we expect the Commission to begin its implementation of mandatory clearing of swaps many months before the clearing obligation in Europe begins. In such circumstance, we believe that it would be an inappropriate outcome for the Commission to declare that the European regulations are not comparable because they are not final, and thus,

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[50] *See* Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC, dated October 20, 2011, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0656:FIN:EN:PDF, which is proposing to require sufficiently liquid OTC derivatives to be traded on exchanges or organized trading facilities.

[51] *See* the Hong Kong Consultation, dated October 2011, at 32, available at: http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=11CP6; Singapore Consultation Paper, dated February 2012, at 23, available at: http://www.mas.gov.sg/~/media/resource/publications/consult_papers/2012/13%20February%202012%20Proposed%20Regulation%20of%20OTC%20Derivatives.ashx, which each state that they have determined not to implement a trading mandate at this time.

require many market participants to accelerate the creation of infrastructure and systems to comply with the Commission's earlier implemented regulations. We recognize the difficulty the Commission faces in making a comparability determination with respect to 'proposed' regulation of a foreign jurisdiction. In this regard, we would again encourage the Commission to actively engage, and maintain an open dialogue with, foreign regulators when assessing comparability with respect to proposed foreign regulation. This would enable the Commission to make a comparability determination with same degree of certainty it would have were such foreign regulation to be in final form.

In furtherance of the Commission's statement that "comparable does not necessarily mean identical",[52] we would also encourage the Commission to take a principles-based approach to its comparability assessments by focusing on a jurisdiction's OTC derivatives regulations as a whole, rather than making determinations of comparability "on an individual requirement basis".[53] We recognize that a comparison of Title VII and the regulatory regime of a foreign jurisdiction may reveal differences between corresponding regulations when conducted on a line-by-line basis. However, minute and non-substantive regulatory differences should not preclude the Commission from rendering such regimes 'comparable' such that substituted compliance would apply. In this regard, we support the responses to the Proposed Guidance submitted by several foreign regulators.[54] These responses highlight the need for the Commission to give sufficient deference to foreign regulators and their related regulatory and supervisory regimes. Such deference is necessary because each foreign regulator has the most comprehensive knowledge of the special characteristics of its jurisdiction, and thus, is able to determine the most effective way to achieve the G20 objectives for mitigating systemic risk and improving transparency in the derivatives markets. We are also supportive of the demands by those foreign regulators for an assessment of substituted compliance that would take into account whether a foreign regime complies with those standards set by international bodies such as the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions.

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52 Proposed Guidance at 41233.

53 *See id*. at 41233.

54 *See* the European Commission's response to the Proposed Guidance dated 28 August 2012: available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58431&SearchText; the UK Financial Service Authority's response to the Proposed Guidance dated 24 August 2012, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58433&SearchText; the joint response of the Australian Securities and Investments Commission, the Federal Reserve Bank of Australia, the HKMA, the HKSFC, and the MAS to the Proposed Guidance dated 27 August 2012, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58444&SearchText; the Japanese Financial Services Agency and the Bank of Japan's response to the Proposed Guidance dated 13 August 2012, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58383&SearchText; the Autorité de contrôle prudentiel, the Autorité des marches financiers and the French Ministry of Economy and Finance's response to the Proposed Guidance dated 27 July 2012, available at: http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58417&SearchText.

We recognize that it is not solely the responsibility of the Commission or U.S. policymakers to ensure that international coordination and harmonization of OTC derivatives regulation proceeds in a thoughtful and expedient manner; therefore, we have made similar comments to regulators and policymakers in others jurisdictions as well.[55] We want to emphasize that ensuring that regulations are consistent wherever possible, will serve both the global development of the market as well as the ability of all regulators to oversee it effectively.

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We thank the Commission for the opportunity to provide comments on the Further Proposed Guidance. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact Stuart J. Kaswell or Carlotta King of MFA at (202) 730-2600 and Jiří Król or Wesley Lund of AIMA at +44 (0) 20 7822 8380 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

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cc: The Hon. Gary Gensler, Chairman
The Hon. Bart Chilton, Commissioner
The Hon. Jill E. Sommers, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner

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55 *Supra* note 16.