February 19, 2020

Via CFTC Comments Portal: https://comments.cftc.gov

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: RIN 3038–AE84
Notice of Proposed Rulemaking, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants

Dear Mr. Kirkpatrick:

Associated Foreign Exchange, Inc. and GPS Capital Markets, Inc. (collectively, the "**Companies**") submit this letter in response to the Commodity Futures Trading Commission's (the "**Commission's**") request for comment on the proposed rules addressing the cross-border application of the registration thresholds and certain requirements applicable to swap dealers and major swap participants, published in the Federal Register on January 8, 2020 (the "**Proposed Rules**").[1] The Companies appreciate the opportunity to provide the Commission with comments in response to the Proposed Rules.

By way of background, the Companies are nonbank money services businesses that offer international payment solutions and foreign exchange derivative products to small and medium-sized enterprises ("**SMEs**"). Although the Companies' customers may differ in size and industry, all commonly engage in multinational operations. The global footprint of these SMEs creates a demand for the conversion and subsequent remittance of foreign currencies. The Companies therefore become integral components of the day-to-day business operations of these SMEs.

Due to their multinational operations, the Companies' SME clients are subject to the risk of pecuniary loss created from the inherent volatility of foreign exchange markets. In an effort to mitigate this foreign exchange risk, the Companies offer certain over-the-counter foreign exchange derivatives. Several of these over-the-counter foreign exchange derivatives are swaps, as that term is defined in the Commodity Exchange Act and the Commission's regulations. In an

[1] *Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants*, 85 Fed. Reg. 952 (Jan. 8, 2020).

effort to manage the risk associated with swaps entered into with their SME counterparties, the Companies enter into back-to-back hedge swaps with provisionally registered swap dealers.

The Companies have non-U.S. affiliates that engage in swap transactions, consistent with the business model outlined above, with persons domiciled outside the U.S. As a result, the Companies are currently presented with challenges due to vague and imprecisely defined terminology such as "conduit affiliate" and "U.S. person" used in the Commission's Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations (**"Cross-Border Guidance"**).[2] The Proposed Rules, which would codify certain aspects of the Cross-Border Guidance with modifications, represent a welcome step forward in terms of streamlining and making it easier for market participants to comply with the Commission's rules, while not deprecating the Commission's regulation of systemic risk. This is particularly the case with regard to the counting of cross-border swaps toward the de minimis total. In this regard, the Companies wish to provide comments on the Proposed Rules regarding: (i) the elimination of the vague affiliate conduit concept from the Cross-Border Guidance; (ii) the new significant risk subsidiary ("**SRS**") category, which provides a more objective, risk-based approach; (iii) the more precise definition of U.S. person than in the Cross-Border Guidance; and (iv) the more precise definition of guarantee. As discussed in more detail below, the Companies generally support each of these proposals and urge the Commission to adopt them as proposed.

I. The Conduit Affiliate Concept Should Be Eliminated as Proposed

As the Commission notes in the Proposed Rules, although it did not define the concept of a "conduit affiliate" in the Cross-Border Guidance, it identified certain factors it believed were relevant to the determination of whether an entity would be considered a conduit affiliate of a U.S. person.[3] These factors are non-exclusive, and the Cross-Border Guidance further states that "[o]ther facts and circumstances also may be relevant."[4] Conduit affiliates, like guaranteed affiliates and U.S. persons under the Cross-Border Guidance, are required to count all of their swap transactions, whether or not with non-U.S counterparties, in their de minimis calculations.

The Commission states in the Proposed Rules that it is not separately including the concept of a "conduit affiliate" because the concerns posed by a conduit affiliate are intended to be addressed through the proposed definition and treatment of SRSs.[5] Nonetheless, the Commission requests comment on whether it should, in the interests of harmonizing with the rules of the Securities and Exchange Commission ("**SEC**"), use the concept of "conduit

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[2] 78 Fed. Reg. 45,291 (Jul. 26, 2013).

[3] *See* Cross-Border Guidance, 78 Fed. Reg. at 45,359. The conduit affiliate factors include: (i) the non-U.S. person is a majority-owned affiliate of a U.S. person; (ii) the non-U.S. person is controlling, controlled by or under common control with the U.S. person; (iii) the financial results of the non-U.S. person are included in the consolidated financial statements of the U.S. person; and (iv) the non-U.S. person, in the regular course of business, engages in swaps with non-U.S. third-party(ies) for the purpose of hedging or mitigating risks faced by, or to take positions on behalf of, its U.S. affiliate(s), and enters into offsetting swaps or other arrangements with its U.S. affiliate(s) in order to transfer the risks and benefits of such swaps with third-party(ies) to its U.S. affiliates. *Id.*

[4] *Id.*

[5] *See* Proposed Rules, 85 Fed. Reg. at 969, n.169.

affiliate," as defined in 17 CFR 240.3a71-3(a)(1), instead of the concept of SRS, or whether it should address both conduit affiliates and SRSs in its cross-border rules.[6]

The Companies believe that the Proposed Rules have it right -- the Commission should not use the concept of "conduit affiliate" from the Cross-Border Guidance in its rules. As noted above, the concept of a conduit affiliate is not a defined term in the Cross-Border Guidance, which only includes a *non-exclusive* list of factors that may be relevant in making a conduit affiliate determination. It is also not clear from the Cross-Border Guidance which of the factors, or combination thereof, would give rise to a determination that an entity is a conduit affiliate. The fourth factor appears to be the most significant, but the difficulty of parsing through its multiple facets, as noted by Commissioner Stump in her statement, generally does not lead to definitive conclusions that can be confidently supported.[7] In addition, the Cross Border Guidance states that "other facts and circumstances" may also be relevant, but does not articulate what those facts and circumstances might be, either specifically or in general. The Companies believe that, because of the vagueness of the conduit affiliate concept, market participants, including the Companies, have struggled to determine whether their affiliates constitute conduit affiliates under the Cross-Border Guidance.

In light of the inherent vagueness of the conduit affiliate concept, the Companies believe that it would not be appropriate to include the concept in the Commission's rules, which have the force and effect of law. The Companies fully expect that the Commission will bring enforcement actions for violations of its rules; therefore, it is imperative that the rules provide clear, objective criteria so that market participants can have adequate notice of what is expected and manage their affairs accordingly. The conduit affiliate concept, if included in the Commission's rules, would create legal uncertainty and would be difficult to comply with, since it is not clear what its boundaries are. By contrast, the objective, enumerated criteria established by the proposed SRS definition, which the Companies support as discussed below, and the risk-based approach the SRS definition embodies, is a more sensible, workable standard that should enable companies to comply with the swap dealer de minimis calculation rules.

The Companies do not believe that harmonization with the SEC's rule would be beneficial in this instance, since the objective standard established by the SRS definition in the Proposed Rules is superior in advancing the Commission's goals and in fostering compliance with the rules. The Companies believe that the SEC likely adopted a modified version of the conduit affiliate concept in order to harmonize with the Commission's guidance, since the Commission was the first mover in terms of addressing cross border issues. But that should not preclude the Commission from being a thought leader and taking a different, but more fundamentally sound, approach.

The Companies request that, for absolute clarity, since the release states that the Cross-Border Guidance remains in effect with respect to topics not addressed in the Proposed Rules,[8]

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[6] *See id.* at 969, question 13.
[7] *See* Statement of Commissioner Stump (Dec. 18, 2019), available at https://www.cftc.gov/PressRoom/SpeechesTestimony/stumpstatement121819.
[8] *See* Proposed Rules, 85 Fed. Reg. at 958.

the Commission expressly state in any final rules that the conduit affiliate concept has been superseded by the Proposed Rules and the SRS concept therein.

II. SRS Category Embodies a Risk-Based Approach that is Objective and Should Facilitate Compliance

Under the SRS concept in the Proposed Rules, a non-U.S. person would be considered an SRS if:

- the non-U.S. person is a "significant subsidiary" of an "ultimate U.S. parent entity," as those terms are proposed to be defined;[9]
- the "ultimate U.S. parent entity" has more than $50 billion in global consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year; and
- the non-U.S. person is not subject to either:
    - consolidated supervision and regulation by the Board of Governors of the Federal Reserve System ("Federal Reserve Board") as a subsidiary of a U.S. bank holding company ("BHC"); or
    - capital standards and oversight by the non-U.S. person's home country regulator that are consistent with the Basel Committee on Banking Supervision's "International Regulatory Framework for Banks" ("Basel III") and margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination with respect to uncleared swap margin requirements.[10]

If an entity is determined to be an SRS, the Commission proposes to apply the swap dealer and major swap participant registration threshold calculations to the entity in the same manner as a U.S. person and an entity that is guaranteed by a U.S. person ("**Guaranteed Entity**"), which is treated the same as a U.S. person. U.S. persons, Guaranteed Entities and SRSs would be required to count all of their swap transactions toward the de minimis total under the Proposed Rules.

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[9] For purposes of the SRS definition, a "significant subsidiary" means a subsidiary that meets one of 3 tests: (1) the three year rolling average of the subsidiary's equity capital is equal to or greater than five percent of the three year rolling average of its ultimate U.S. parent entity's consolidated equity capital, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year (the "equity capital significance test"); (2) the three year rolling average of the subsidiary's revenue is equal to or greater than ten percent of the three year rolling average of its ultimate U.S. parent entity's consolidated revenue, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year (the "revenue significance test"); or (3) the three year rolling average of the subsidiary's assets are equal to or greater than ten percent of the three year rolling average of its ultimate U.S. parent entity's consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year (the "asset significance test"). An "Ultimate U.S. parent entity" means the U.S. parent entity that is not a subsidiary of any other U.S. parent entity. *See* Proposed Rule 23.23(a)(13)(definition of "significant subsidiary") and (a)(18)(definition of "ultimate U.S. parent entity").

[10] *See* Proposed Rule 23.23(a)(12)(definition of the term "significant risk subsidiary").

The Companies believe the SRS concept, as noted above, is superior to the conduit affiliate concept because it establishes objective criteria that are appropriate for rules that have the force and effect of law. Moreover, these objective factors should facilitate compliance, in that they establish bright line tests for when an entity is considered an SRS. The Companies believe that the definition would further the Commission's stated goals of establishing a risk-based approach for determining which subsidiaries in a consolidated group should have to count all of their swap transactions toward the de minimis total as well as remaining consistent with international comity principles. A contrary approach, such as that proposed by the Commission in 2016, which would have required "foreign consolidated subsidiaries," regardless of the size of the consolidated group they are in or their significance within the corporate group, to count all of their swaps toward the de minimis total,[11] is overbroad, lacks a risk-based approach, and is inconsistent with international comity.

The Commission requests comment on whether the $50 billion global consolidated assets threshold is appropriate to determine when an ultimate U.S. parent entity may have a significant impact on the U.S. financial system.[12] The Companies believe that the $50 billion threshold is appropriate and note that, as the Commission states in the Proposed Rules, the Financial Stability Oversight Council initially used a $50 billion total consolidated assets quantitative test as one threshold to apply to nonbank financial entities when assessing risks to U.S. financial stability.[13] Non-guaranteed foreign subsidiaries of corporate groups with consolidated assets of lower than $50 billion simply do not have a significant impact on the U.S. financial system or otherwise raise systemic risk concerns that would warrant including all of their swaps in the corporate group's de minimis total.

Establishing a threshold of $50 billion would also provide relief for small corporate groups that engage in limited swap dealing activity, since they would not have to include their non-guaranteed foreign subsidiaries' swaps in the de minimis total. In turn, this would allow small corporate groups to grow their swaps businesses without prematurely having to register as swap dealers (and incur the compliance costs therewith), which would be the case if they had to count their non-guaranteed foreign subsidiaries' swaps toward the total. This fosters other Commission policy goals, such as that discussed in the de minimis threshold final rule release of encouraging new market participants to engage in swap dealing activity.[14] That is also vital for SME participants in derivatives markets, who often are unable to establish relationships with

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[11] *See Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 71,946, 955 (Oct. 18, 2016).

[12] *See* Proposed Rules, 85 Fed. Reg. at 969, question 8.

[13] *Id.* at 965. The Companies also note that Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act originally required the Federal Reserve to establish regulatory standards based on individualized risk analysis for bank holding companies with assets greater than $50 billion that are more stringent than those that apply to bank holding companies with fewer assets, which do not pose similar risks to the financial stability of the United States. *See* Section 165 of Pub. L. No. 111-203, 124 Stat. 1,376 (July 21, 2010)(Congress later increased this threshold to $250 billion, *see* Section 401 of Pub. L. No. 115-174, 132 Stat. 1,356 (May 24, 2018)). Thus, the $50 billion threshold has been a metric used in several contexts to determine whether a consolidated entity poses risk to the financial stability of the United States.

[14] *See De Minimis Exception to the Swap Dealer Definition*, 83 Fed. Reg. 56,666, 668 (Nov. 13, 2018).

large registered swap dealers, and therefore rely upon smaller market participants to meet their hedging and risk mitigation needs.

III. U.S. Person Definition

The proposed rules would define "U.S. Person" as follows:

- A natural person resident in the United States;
- A partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;
- An account (whether discretionary or non-discretionary) of a U.S. person;
- An estate of a decedent who was a resident of the United States at the time of death.[15]

The Proposal notes that the definition is also limited to the persons enumerated in the rule and does not contain the "include, but not be limited to" prefatory language contained in the Cross-Border Guidance.[16]

The Companies support the definition of U.S. person in the Proposed Rules. The elimination of the "include, but not be limited to" language from the Cross-Border Guidance, as well as the more streamlined categories included within the U.S. person definition, is appropriate and should help facilitate compliance with the Commission's rules. Such compliance will also be facilitated by the Proposed Rules' statement, as applied to all of the definitions including that of U.S. person, that a person may rely on a written representation from its counterparty that the counterparty does or does not satisfy the criteria for one or more of the definitions, unless such person knows or has reason to know that the representation is not accurate.[17]

IV. Guarantee Definition

The Proposed Rules would define a "guarantee" to mean an arrangement, pursuant to which one party to a swap has rights of recourse against a guarantor, with respect to its counterparty's obligations under the swap.[18] For these purposes, a party to a swap has rights of recourse against a guarantor if the party has a conditional or unconditional legally enforceable right to receive or otherwise collect, in whole or in part, payments from the guarantor with respect to its counterparty's obligations under the swap.[19]

The Companies support the guarantee definition as proposed because it represents a significant improvement over the definition of "guarantee" contained in the Cross-Border Guidance. The Cross-Border Guidance's definition would apply not only to traditional guarantees of payment or performance of the related swaps, but also other arrangements that, in

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[15] *See* Proposed Rule 23.23(a)(22).
[16] *See* Proposed Rules, 85 Fed. Reg. at 961.
[17] *Id.* at 959 and Proposed Rule 23.23(a).
[18] *See* Proposed Rule 23.23(a)(8).
[19] *Id.*

view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations.[20] Examples noted in the Cross-Border Guidance included keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, and liability or loss transfer or sharing agreements.[21] This very broad and vague definition of guarantee, which includes consideration of "facts and circumstances" and a non-exclusive list of examples, would not be appropriate for inclusion the Commission's rules. The more precise definition of guarantee contained in the Proposed Rules is objective and as a result should facilitate compliance without sacrificing the Commission's risk-based concerns about systemic risk flowing back to the United States. It also would be more workable because, as the Commission notes in the Proposed Rules, it is consistent with the definition of guarantee in the uncleared swaps margin rules, so that a separate assessment with regard to guarantees need not be made.[22]

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The Companies appreciate the opportunity to provide comments in response to the Proposed Rules. If there are any questions regarding these comments, please do not hesitate to contact the undersigned.

Respectfully submitted,

Anthony L. Rodriguez
Chief Risk Officer
Associated Foreign Exchange, Inc.

Al Manbeian
Chief Financial Officer
GPS Capital Markets, Inc.

Cc: Julian E. Hammar, FisherBroyles LLP

[20] *See* Cross-Border Guidance, 78 Fed. Reg. at 45,320.
[21] *Id.* at n.267.
[22] *See* Proposed Rules, 85 Fed. Reg. at 963.