March 9, 2020

By Electronic Submission

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

Re: Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants (RIN 3038-AE84)

Ladies and gentlemen,

Better Markets, Inc. ("Better Markets")[1] appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC") proposed rulemaking[2] codifying and amending elements of the 2013 cross-border guidance[3] on the application of registration thresholds and other swaps-related requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[4] Better Markets agrees with certain aspects of the CFTC's proposal. However, numerous elements contravene the Commodity Exchange Act's ("CEA")[5] statutory commands to protect the safety and soundness of swap dealers ("SDs"), prevent disruptions to the integrity of derivatives markets, ensure the financial integrity of swaps transactions and the avoidance of systemic risk, and preserve the stability of the U.S. financial system.[6] The most problematic elements of the proposal open avenues to avoiding, if not

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[1] Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system, one that protects and promotes Americans' jobs, savings, retirements, and more.

[2] CFTC, 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), available at https://www.cftc.gov/sites/default/files/2020/01/2019-28075a.pdf.

[3] See CFTC, Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292 (Jul. 26, 2013) ("2013 Guidance"), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf.

[4] Pub. L. 111–203, 124, Stat. 1376 (2010).

[5] The CEA is codified at 7 U.S.C. § 1 et seq.

[6] See 7 U.S.C. § 5(b) (providing that, among other things, the CEA is intended "to deter and prevent . . . disruptions to market integrity; to ensure the financial integrity of all transactions . . . and the avoidance of systemic risk; and to promote . . . fair competition among boards of trade, other markets and market participants").

evading, U.S. derivatives markets reforms and therefore must be substantially revised, or withdrawn, in the public interest.

The CFTC's proposal also is notable for the substantive swaps-related regulations that it does not address, including real-time and regulatory reporting, capital, trade execution, clearing and trade processing, margin,[7] and other requirements.[8] A public comment period commensurate with the length, complexity, and importance of the CFTC's proposal would have permitted meaningful public comment on the intersection of these omitted (but affected) swaps markets reforms and the partial proposed cross-border framework. However, given the CFTC's apparently accelerated timeline to finalize a hurried, revised cross-border framework by mid-2020, we focus on select presently proposed regulations and the CFTC's related policy judgements, which largely reverse and/or substantially amend the 2013 cross-border guidance (as well as the now withdrawn cross-border framework from the 2016 cross-border proposal[9] on some of the same issues).

Accordingly, Better Markets respectfully submits comments on the following elements of the CFTC's present cross-border proposal, discussed in detail below:

- **Enforceability and Legal Reach of Title VII**: The CFTC's commendable decision to again propose clearly enforceable cross-border regulations, as opposed to guidance, in conjunction with a proper legal interpretation of the reach of the CFTC's jurisdiction under CEA section 2(i).

- **Guaranteed Entities**: The CFTC's narrowed proposed definition of "guarantee," which would exclude a host of financial arrangements between U.S. banks (and other U.S. legal entities) and non-U.S. legal entities. This definitional proposal alone could remove tens of thousands of swaps executed with U.S. financial support from the reach of U.S. law and perhaps result in de-registration of non-U.S. SDs posing risks to affiliated U.S. banks (and others) and the U.S. financial system.

- **Significant Risk Subsidiaries:** The CFTC's new proposed category of non-U.S. persons consolidated with a U.S. parent—the significant risk subsidiary ("SRS"). The proposed SRS tests for determining whether *sufficient* risk is presented to a U.S. parent, however, would exclude far too many (almost all) consolidated non-U.S. entities from the CFTC's oversight and would not address avoidance or evasion risks addressed by the conduit affiliate category it is proposed to replace.

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[7] See CFTC, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 (May 31, 2016), available at https://www.govinfo.gov/content/pkg/FR-2016-05-31/pdf/2016-12612.pdf.

[8] CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 979 (Jan. 8, 2020) ("The Commission intends to separately address the cross-border application of the Title VII requirements addressed in the Guidance that are not discussed in this release (*e.g.*, capital adequacy, clearing and swap processing, mandatory trade execution, swap data repository reporting, large trader reporting, and real-time public reporting.").

[9] CFTC, Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants, 81 Fed. Reg. 71946 (Oct. 18, 2016), available at https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2016-24905a.pdf. See also CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 954 (Jan. 8, 2020) ("The [CFTC] is today withdrawing the 2016 Proposal. The Proposed Rule reflects the [CFTC]'s current views on the matters addressed in the 2016 Proposal, which have evolved since the 2016 Proposal as a result of market and regulatory developments in the swap markets and in the interest of international comity, as discussed in this release.").

- **Foreign Branch Activities Restrictions**: The CFTC's proposed deviation from the SEC and its own previous guidance on "swaps conducted through a foreign branch," which fail to establish personnel restrictions that recognize that foreign branches of U.S. banks are themselves U.S. persons and therefore pose significant risks to U.S. banks and the U.S. financial system.

- **Swaps Arranged, Negotiated, or Executed through U.S.-Located Personnel**: The CFTC's proposed exclusion of swaps arranged, negotiated, or executed on behalf of non-U.S. persons (or foreign branches) by U.S.-located persons ("ANE Transactions"), which would unlawfully exclude U.S. territorial activities from the reach of U.S. law and thereby facilitate avoidance or evasion of the Dodd-Frank Act.

- **Global Dealing Aggregation:** The CFTC's proposed swap dealing aggregation requirement for global SD corporate groups, which would prevent avoidance or evasion of the de minimis threshold.

- **Exchange-Trading Exception**: The CFTC's reasonable proposed exclusion of certain exchange-traded and cleared swaps from swap dealing de minimis calculations. However, the CFTC must amend its proposal to limit the exclusion to DCO-cleared, anonymously SEF or DCM-executed swaps in which neither counterparty is subsequently disclosed through the practice of Post-Trade Name Give-Up.[10]

- **Substituted Compliance:** The CFTC's proposed standard of review for comparability determinations, which provides the CFTC unreasonably broad, if not unlimited, discretion to consider, or not to consider, several factors in connection with an assessment of foreign swaps regulatory frameworks.

Again, while we agree with certain elements, the CFTC's proposal remains in most of the above respects excessively and unlawfully deferential to foreign regulators. In those regards, the proposal would invite, if not guarantee, regulatory arbitrage and increase risks to SDs, counterparties, and the U.S. financial system. The CFTC therefore must refocus its regulatory efforts on the CEA's statutory public interest mandates to ensure the safety and soundness of SDs and the financial stability of the U.S. financial system, as well as promote appropriate risk management, fair competition, and transparency with respect to U.S. and non-U.S. sales and trading activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States."[11]

The CFTC's proposed cross-border framework, once finalized, is likely to leave a lasting legacy and be cited, studied, quoted, and analyzed based on financial markets developments in the coming years. With the U.S. well into its longest continued economic expansion in modern history,[12] the inevitable financial markets downturns, and eventual crises, ahead will undoubtedly expose any deficiencies in the adopted framework. **The CFTC must carefully consider, with due deliberation, the**

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[10] See Letter from Better Markets to the CFTC, Re: Prohibition of Post-Trade Name Give-Up on Swap Execution Facilities (RIN 3038-AE79) (Mar. 2, 2020), available at https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_Post-Trade_Name_Give-Up_on_Swap_Execution_Facilities%28RIN_3038-AE79%29%28March_2_2020%29.pdf.

[11] 7 U.S.C. § 2(i).

[12] See U.S. Bureau of Labor Statistics, Real Gross Domestic Product (GDPC1), FRED Economic Data, Federal Reserve Bank of St. Louis (accessed Mar. 9, 2020), available at https://fred.stlouisfed.org/series/GDPC1. In 2019, the U.S. entered its longest continuous economic expansion since at least 1947 without an intervening recession.

very real risks that would be posed to the U.S. financial system under the CFTC's revised cross-border approach.

I. Without regard to the specific substance of the re-proposal, the CFTC rightly seeks to finalize clearly enforceable cross-border regulations based on a reasonable legal interpretation of CEA section 2(i).

The CFTC's 2013 cross-border interpretive guidance and policy statement setting forth the commission's views on the application of the Dodd-Frank Act to global swaps activities (in most respects) raises a number of potential enforceability issues that would be addressed definitively by regulations finalized in accordance with the Administrative Procedures Act ("APA").[13] Although the CFTC has made clear that "section 2(i) provides it express authority over swap activities outside the U.S. when certain conditions are met"[14] (i.e., in cases where "activities outside the [U.S.] meet the statutory test of having a 'direct and significant connection with activities in, or effect on,' U.S. commerce"[15]), the CFTC has not interpreted CEA section 2(i) and related swaps provisions pursuant to usual rulemaking processes whereby it could provide definitive regulatory contours for the application of the Dodd-Frank Act. Instead, the CFTC has rightly acknowledged that CEA section 2(i) "operates independently"[16] of any CFTC administrative action and has relied upon a hydra-headed cross-border policy statement to set forth mere guidance on whether and how market participants ***might*** apply individual Title VII requirements to individual fact patterns.

Thus, while the CFTC's recognition of the considerable breadth of CEA section 2(i) permits it to proceed with adjudication based on the non-binding 2013 Guidance (and even beyond, to the "outer bounds of [CEA section 2(i)'s] authorization"[17]), the CFTC would enhance regulatory certainty and definitely defeat any enforceability challenge with a proper APA rulemaking providing a binding view on the application of CEA section 2(i). As of now, the enforceability of the CFTC's 2013 Guidance is complicated by the U.S. district court's reasoning in Sec. Industry & Fin. Markets v. U.S. Commodity Futures Trading Commission,[18] which (1) agreed with the CFTC's own contention that the 2013 Guidance was "a non-binding general statement of policy intended to 'communicate its views and intentions' to the regulated community regarding the scope of the Title VII Rules' extraterritorial applications" and (2) found that the 2013 Guidance "on its face is binding on neither the CFTC nor swaps market participants."[19] The CFTC's adoption of final regulations suitably addressing statutory mandates and objectives therefore would be

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13 5 U.S.C. §551 et seq.

14 CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 955 (Jan. 8, 2020).

15 Id at 955. CEA section 2(i)'s language providing a limited exclusion for activities outside of the United States ("U.S.") is as follows: "The provisions . . . relating to swaps that were enacted by [Title VII of the Dodd-Frank Act] (including any rule prescribed or regulation promulgated under that Act), shall not apply to activities outside the United States unless those activities— (1) Have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) Contravene such rules or regulations as the [CFTC] may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision [enacted under Title VII of the Dodd-Frank Act].

16 See Sec. Industry & Fin. Markets v. U.S. Commodity Futures Trading Commission, 67 Fed. Supp. 3d 373, 427 (Sept. 16, 2014), available at https://www.leagle.com/decision/infdco20141021g01.

17 CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 955 (Jan. 8, 2020).

18 Sec. Industry & Fin. Markets v. U.S. Commodity Futures Trading Commission, 67 Fed. Supp. 3d 373 (Sept. 16, 2014).

19 Id at 417.

preferable to the "general, non-binding framework"[20] currently guiding implementation of most Dodd-Frank Act requirements.

In finalizing its proposed regulations, however, the CFTC must rearticulate and finalize its proposed statutory construction of CEA section 2(i). The CFTC's proposed acknowledgement of the outer bounds of CEA section 2(i)'s "authorization" importantly distinguishes its legal *authority* and its claimed lawful discretion to "disapply" Title VII requirements in a manner that does not reach to full extent of that authority. **In this regard, we largely endorse the CFTC's well-reasoned legal views articulated in Section I.C.1 of the proposal**, which recognize that the CFTC has been provided expansive statutory authority to apply U.S. derivatives markets reforms to non-U.S. activities and non-U.S. persons engaging in such activities:

> [A] primary purpose of Title VII of the Dodd-Frank Act is to address risk to the U.S. financial system created by interconnections in the swap market. **Title VII of the Dodd-Frank Act gave the [CFTC] new and broad authority to regulate the swap market to seek to address and mitigate risks arising from swap activities that could adversely affect the resiliency of the financial system in the future**.
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> **In global markets, the source of such risk is not confined to activities within U.S. borders. Due to the interconnectedness between firms, traders, and markets in the U.S. and abroad, a firm's failure, or trading losses overseas, can quickly spill over to the [U.S.] and affect activities in U.S. commerce and the stability of the U.S. financial system.**
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> **Accordingly, Congress explicitly provided for cross-border application of Title VII to activities outside the [U.S.] that pose risks to the U.S. financial system**. Therefore, the [CFTC] construes section 2(i) to apply the swap provisions of the CEA to activities outside the [U.S.] that have either: (1) A direct and significant effect on U.S. commerce; or, in the alternative, (2) a direct and significant connection with activities in U.S. commerce, and through such connection present the type of risks to the U.S. financial system and markets that Title VII directed the [CFTC] to address. The [CFTC] interprets section 2(i) in a manner consistent with the overall goals of the Dodd-Frank Act to reduce risks to the resiliency and integrity of the U.S. financial system arising from swap market activities. Consistent with this overall interpretation, the [CFTC] interprets the term "direct" in section 2(i) to require a reasonably proximate causal nexus, and not to require foreseeability, substantiality, or immediacy.
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> Further, the [CFTC] does not read section 2(i) to require a transaction-by-transaction determination that a specific swap outside the [U.S.] has a direct and significant connection with activities in, or effect on, commerce of the [U.S.] to apply the swap provisions of the CEA to such transaction. Rather, it is the connection of swap activities, viewed as a class or in the aggregate, to activities in commerce of the [U.S.] that must be assessed to determine whether application of the CEA swap provisions is warranted.[21]

While we do not share the CFTC's implicit view that it has almost unlimited discretion not to apply Title VII requirements to non-U.S. activities and non-U.S. persons based on considerations of international

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[20] CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 953 (Jan. 8, 2020).

[21] Id at 956-957.

comity, we do agree with its description of the CFTC's "broad authority" to regulate swaps activities "outside of the United States." CEA section 2(i)'s mandatory exclusion of only certain, limited non-U.S. activities (i.e., those that do not have a direct and significant connection with activities in, or effect on, U.S. commerce) evidences clear congressional intent to preserve jurisdiction with respect to others, with the purpose of ensuring U.S. law broadly applies to non-U.S. activities having requisite U.S. connections or effects.

The congressional record supports that view. Congress, including legislators instrumental to the adoption of Title VII, intended the CEA's swap provisions to apply to non-U.S. swap dealing entities as appropriate to ensure such entities could not avoid the CEA and import risks to the U.S. financial system by elevating form over substance (e.g., reorganizing legal entities or revising contracts).[22] The structure of CEA section 2(i) is suggestive of this intent as well, coupling language relating to extraterritorial application of the CEA's swap provisions immediately with independent CFTC authority to regulate swaps activities that do not meet the statutory U.S. "activities" or "effects" nexus but nevertheless are determined, in the CFTC's judgment, to be "necessary or appropriate" to prevent evasion of "any provision" of the CEA.[23] These two provisions together make it abundantly clear that Congress determined it necessary to supplement regulation of global swap activities having a "direct" and "significant" U.S. nexus with CFTC authority to regulate ***other types of non-U.S. activities*** as well. It anticipated the booking strategies and formalistic arguments employed by non-U.S. swap dealing entities and others to escape Title VII swaps requirements.

In addition, CEA section 2(i) was adopted in a context that suggests Congress intended to apply swap-related provisions to non-U.S. activities. The Dodd-Frank Act was signed into law on July 21, 2010, shortly after the U.S. Supreme Court's unanimous decision on the applicability of the U.S. securities laws to non-U.S. conduct in Morrison v. National Australia Bank Ltd.[24] The Morrison Court held, in essence,

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22 The Congressional Record in the Senate alone contains more than a dozen statements suggesting CEA section 2(i) was intended to address regulatory "forum shopping" and the use of non-U.S. affiliates to remain outside of the purview of U.S. regulators. *See* Sen. Christopher Dodd, Cong. Rec., Vol. 156, Issue 104, S5835 (July 14, 2010) (stating that "allowing banks to shop for the most lenient regulators, in a similar fashion, by failing to put a strong cop on the consumer protection beat . . . we were building our wealth on a narrow and unstable Jenga foundation"); *see also* Sen. Christopher Dodd, Cong. Rec., Vol. 156, Issue 105, S5878-79 (July 15, 2010) (noting that international regulation is necessary to make sure "we don't have the kind of sovereign shopping that was going on with regulatory bodies, where major financial institutions would shop around the world for the nation of least resistance or the regulator of least resistance" and stating Dodd-Frank would establish "a more orderly system in our globe because, as we have all painfully learned, matters that occur thousands of miles away can affect the economy in our own country"); *see also* Sen. Mark Warner, Cong. Rec., Vol. 156, Issue 105, S5882-83 (July 15, 2010) (stating that a critical objective of Dodd-Frank was "to make sure the huge gaps that existed that allowed systemic regulatory arbitrage could no longer take place" and emphasizing that U.S. regulators should lead harmonization efforts to ensure "there is not an international ability to arbitrage with these large financial institutions"); *see also* Sen. Kaufman, Cong. Rec., Vol. 156, Issue 105, S5886 (July 15, 2010) (recognizing the importance of looking beyond the form of legal guarantees and stating that "[b]ecause of the reputational consequences of liquidating [Citibank's SIVs and other structured] funds and allowing them to default on their funding obligations, they were bailed out by the megabanks that spawned them even though the SIVs themselves were generally separate, off-balance-sheet entities with no official backing from the banks"); s*ee also* Sen. Jeff Merkley, Cong. Rec., Vol. 156, Issue 105, S5895 (July 15, 2010) (stating in the Volcker context that "recent history demonstrates that a financial firm will often feel compelled by reputation demands and relationship preservation concerns to bail out clients in a failed fund that it managed or sponsored" and noting that "[k]nowledge of such concerns creates a moral hazard among clients, attracting investment into managed or sponsored funds on the assumption that the sponsoring bank or systemically significant firm will rescue them if markets turn south"); s*ee also Id.* (stating in the Volcker context that "[r]egulators are expected . . . to tighten the range of investments and activities permissible for banking entities, whether they are at the insured depository institution or at an affiliate or subsidiary" and clarifying that Dodd-Frank was "not intended to permit a U.S. banking entity to avoid the restrictions . . . simply by setting up an offshore subsidiary or reincorporating offshore").

23 7 U.S.C. § 2(i)(2).

24 Morrison et al v. National Australia Bank Ltd. et al, 561 U.S. 247 (2010) (stating that "[i]t is a 'longstanding principle of American law' that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States"). Morrison was decided on June 24, 2010.

that the courts must apply a presumption against the extraterritorial application of U.S. statutes in the absence of a clear textual basis for the application of such statutes to non-U.S. activities.[25] While we do not want to overstate the causal connection between the adoption of CEA section 2(i) and the Morrison opinion,[26] Congress did, in fact, ratify CEA section 2(i)'s extraterritorial application in close proximity to the Morrison decision. Indeed, it adopted a statutory provision that irrefutably applies the CEA's swap provisions to certain non-U.S. activities, providing the precise type of clear textual basis for extraterritorial application of U.S. law that the Morrison Court insisted upon.[27]

II. The CFTC must revise its proposed definition of "Guaranteed Entity" to include all forms of U.S. financial support used to facilitate dealing through non-U.S. affiliates. Financial arrangements posing potential risks to U.S. persons and the U.S. financial system include more than solely contractual guarantees contained in swap trading relationship documentation between non-U.S. counterparties.

The CFTC proposes to "generally" interpret "swap activities involving guarantees from U.S. persons to satisfy the 'direct' and 'significant' test under CEA section 2(i)."[28] In doing so, however, the CFTC proposes to adopt a narrow definition of "guarantee" relative to the 2013 guidance, which it acknowledges would have "possible significant adverse effects" with respect to U.S. guarantors and the U.S. financial system. One reason that the definition would have such "possible adverse effects" is that it would permit non-U.S. dealing entities to avoid the application of regulatory requirements otherwise applicable to certain swaps entered into by a Guaranteed Entity, while still benefiting from direct financial support from a U.S. person. In addition, the proposed definition would facilitate de-registration of London-based and other global derivatives dealers presenting ongoing risks to U.S. banks and the U.S. financial system.

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[25] Noting a "presumption against extraterritoriality," the Court stated that "[w]hen a statute gives no clear indication of an extraterritorial application, it has none." Id at 255. The Court noted, however, that its views were based on "a canon of construction, or presumption about a statute's meaning, rather than a limit upon Congress's power to legislate." Id. The Morrison holding therefore is not relevant where Congress provides a clear textual basis for extraterritorial application of a U.S. statute, as it does in CEA section 2(i).

[26] The Morrison opinion was issued on June 24, 2010, more than six months after House Report 111-370 proposed the first version of CEA section 2(i). 155 Cong. Rec. H14685 (December 10, 2009). That provision contained the language "direct and significant connection with activities in or effect on United States commerce" and was likely modeled on the then-understood application of the antifraud provisions of the U.S. securities laws under the Second Circuit's precedent.

[27] Congress's intent in that respect also is evidenced by CEA section 2(i)'s focus on "activities in" and "effects on" U.S. commerce, a two-part analysis that resembles the "conduct and effects" analysis considered by the Morrison Court. Congress effectively reinstated conduct-and-effects jurisdiction to the antifraud provisions of the U.S. securities laws at the same time that it adopted CEA section 2(i). See 15 U.S.C. Sec. 77v(c), 78aa(b) (2012). See Rep. Bachus, 156 Cong. Rec. H5205, H5237 (June 30, 2010) (stating "[t]his bill's provisions concerning extraterritoriality . . . are intended to rebut th[e] presumption [against extraterritoriality] by clearly indicating that Congress intends extraterritorial application in cases brought by the SEC or the Justice Department"). It is noteworthy that U.S. Representative Bachus previously offered an amendment during a House Financial Services Committee markup that would have restricted the CFTC's jurisdiction over non-U.S. swap activities but for then-Chairman Barney Frank's objection and agreement to consider a provision with a U.S. effects, rather than strictly territorial, formulation. H. Fin. Serv. Comm. Mark Up on Discussion Draft of Over-the-Counter Derivatives Markets Act of 2009, 111th Congress, 1st Sess. (Oct. 14, 2009).

[28] CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 963 (Jan. 8, 2020).

A. The CFTC's proposed narrowing of the "guarantee" definition would elevate form over substance and have "possible significant adverse effects" on the U.S. financial system, as acknowledged by the CFTC.

Proposed § 23.23(a)(8) defines "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."[29] That provision also provides that "a party to a swap has rights of recourse against a guarantor if the party has a . . . legally enforceable right to receive or otherwise collect . . . payments from the guarantor with respect to its counterparty's obligations **under the swap**."[30] The CFTC indicates that the terms of the "guarantee" need not "necessarily be included within the swap documentation or even otherwise reduced to writing (so long as legally enforceable rights are created under the laws of the relevant jurisdiction)."[31] It focuses on whether a swap counterparty, in essence, has a legally enforceable right to receive financial support from a U.S.-person guarantor in connection with the non-U.S. person's obligations under the swap."[32]

The CFTC's proposed definition and explanation of the term "guarantee" contains a number of ambiguities. **The most critical ambiguities with respect to the scope of the new definition are resolved, however, by the CFTC's explicit acknowledgement that the proposal is "narrower in scope than the ['guarantee' definition] used in the [2013] Guidance."**[33] That is a significant policy reversal. The 2013 Guidance contemplated a broad definition of "guarantee" applicable to various types of "formal arrangements" as follows:

> [T]he [CFTC] would interpret the term "guarantee" generally to include not only traditional guarantees of payment or performance of the related swaps, but also other formal arrangements that, in view of all the facts and circumstances, support the non-U.S. person's ability to pay or perform its swap obligations with respect to its swaps. The [CFTC] believes that it is necessary to interpret the term "guarantee" to include the different financial arrangements and structures that transfer risk directly back to the United States. In this regard, **it is the substance, rather than the form, of the arrangement that determines whether the arrangement should be considered a guarantee for purposes of the application of section 2(i).**[34]

Relative to the proposal's definition, this language in the 2013 Guidance emphasizing the substance, rather than solely the form, of U.S. person financial arrangements with non-U.S. persons captures a far broader

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29 Proposed § 23.23(a)(8). CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 1002-1003 (Jan. 8, 2020).

30 Id (emphasis added). The CFTC explains that the proposed term "guarantee" would apply "regardless of whether such right of recourse is conditioned upon the non-U.S. person's insolvency or failure to meet its obligations under the relevant swap," and "regardless of whether the counterparty seeking to enforce the guarantee is required to make a demand for payment or performance from the non-U.S. person before proceeding against the U.S. guarantor." CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 963 (Jan. 8, 2020).

31 Id.

32 Id.

33 Id.

34 CFTC, Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292, 45320 (Jul. 26, 2013).

range of U.S.-person financial arrangements used to facilitate dealing and other financial transactions and activities through affiliated non-U.S. persons.

Astonishingly, while acknowledging "**possible significant adverse effects**" that may be a consequence of its proposed "guarantee" definition, the CFTC contends that a narrower definition is defensible, because it would "achieve a more workable framework for non-U.S. persons."[35] The CFTC candidly explains the unfortunate and expected consequences of the proposed "guarantee" definition as follows:

> The [CFTC] is aware that ***many*** other types of financial arrangements or support, other than a guarantee as defined in the Proposed Rule, may be provided by a U.S. person to a non-U.S. person (*e.g.,* keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements). **The [CFTC] understands that these other financial arrangements or support transfer risk directly back to the U.S. financial system, with possible significant adverse effects, in a manner similar to a guarantee with a direct recourse to a U.S. person**.[36]

Yet, the CFTC proposes a puzzling trade-off that ignores the CEA's clear elevation of systemic risk reduction and other public interest objectives above any vague, non-statutory concerns, like achieving a supposedly more "workable" regulatory framework. By "workable," the CFTC appears to mean that a narrow definition would be more convenient and lower cost than the 2013 Guidance's "guarantee" policy statement. In fact, the CFTC reasons that a definition posing "possible significant adverse effects" on the U.S. financial system nevertheless should be adopted, merely because an existing "guarantee" definition in the margin context mirrors the proposal and therefore would not demand "a separate independent assessment."[37]

That is neither a valid statutory purpose nor a benefit that outweighs, or even reasonably approximates, its costs. CEA section 5(b) and a number of related SD provisions make clear that the CFTC's core statutory policy objectives are to protect the safety and soundness of SDs,[38] prevent disruptions to the integrity of derivatives markets, ensure the financial integrity of swaps transactions and the avoidance of systemic risk, and preserve the stability of the U.S. financial system.[39] Contrary to all of

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35 Id.

36 CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 963 (Jan. 8, 2020) (emphasis added).

37 See CFTC, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 (May 31, 2016). 17 C.F.R. § 23.160(a)(2).

38 For example, the CEA provides the CFTC a prudential mandate to establish capital and margin regulations not just to limit but "[t]o ***offset*** the greater risk to the [SD] . . . ***and the financial system*** arising from the use of swaps that are not cleared." 7 U.S.C. § 6s(e)(2)(B) (emphasis added). For a more detailed discussion of capital requirements applicable to SDs and others, see Better Markets Letter to CFTC, Re: Capital Requirements of Swap Dealers and Major Swap Participants (RIN 3038-AD54) (Mar. 3, 2020), available at https://bettermarkets.com/sites/default/files/Better_Markets_Inc._Comment_Letter_on_Capital_Requirements_for_Swap_Dealers_and_Major_Swap_Participants_RIN_3038-AD54_%28March_3_2020%29.pdf. For a more detailed discussion of the margin requirements applicable to SDs and others, see Better Markets Letter to the Board of Governors of the Federal Reserve et al., Re: Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59970 (Nov. 7, 2019) (Dec. 9, 2019), available at https://bettermarkets.com/sites/default/files/Better_Markets_Inc_Letter_on_Margin_and_Capital_Requirements_for_Covered_Swap_Entities_12-9-2019.pdf.

39 See 7 U.S.C. § 5(b) (providing that, among other things, the CEA is intended "to deter and prevent . . . disruptions to market integrity; to ensure the financial integrity of all transactions . . . and the avoidance of systemic risk; and to promote . . . fair competition among boards of trade, other markets and market participants").

these statutory objectives, the proposed definition of "guarantee" is actually acknowledged to do the opposite: To "significantly" and "adversely" increase potential risks to U.S. persons, which, of course, is a logical consequence of the increased risks to the largest too-big-to-fail U.S. banks and the U.S. financial system.

Moreover, the CFTC's extension of the margin-related "guarantee" definition is not appropriate for a proposed regulation affecting multiple elements of the Title VII requirements, including those excluded from the proposal. Margin requirements on uncleared swaps are market (variation) and credit (initial) risk mitigants that, by their nature, must be imposed on specific portfolios of derivatives with specific counterparties. For this reason, it makes sense for the CFTC—at least initially—to focus on positions giving rise to market and credit risks with respect to specific swaps comprising a margined portfolio between specific counterparties, in particular as regulatory and voluntary margin on over-the-counter ("OTC") swaps is collected and posted in accordance with swap trading relationship documentation. The proposed "guarantee" definition, on the other hand, addresses far broader systemic risk reduction and other policy objectives, including CEA section 2(i)(2)'s statutory concerns about the evasion of U.S. law through legal entity booking strategies.

Some might contend that the narrower "guarantee" definition, as proposed, would serve to insulate U.S. banks and their affiliates (and other types of legal entities) from the covered risks originating in foreign swaps. In this view, schemes to "de-guarantee" foreign swaps should be viewed as a desirable U.S. risk-reducing outcome, not as evasion or avoidance. **These contentions do not withstand scrutiny**. First, if the primary objective were to encourage de-guaranteeing that actually—not just apparently—de-links swaps-related risks in the U.S. and swaps-related risks outside of the U.S., then the most effective proposal would be one in which the definition of "guarantee" broadly contemplates all measures facilitating the migration of risks to U.S. entities. Unlike the narrow proposed "guarantee" definition, that approach would encourage U.S. persons to holistically sever as many forms of financial recourse as possible. In addition, a broad "guarantee" definition would not only sever some of most direct linked risks but also facilitate resolution planning, legal entity simplification, and other policy objectives supported by the independence of non-U.S. persons.[40]

The proposed definition of "guarantee" instead would permit non-U.S. persons to evade or avoid U.S. law, while posing continued swaps-related risks to their U.S. affiliates. Non-U.S. SDs, in particular, undoubtedly would "de-guarantee" individual trading relationships and transactions, placing even basic transactional information beyond the CFTC's oversight. **That does not just fail to insulate the U.S. person; it increases risks to the U.S. person**, **because the previously guaranteed entity would be relieved of numerous risk-mitigating U.S. regulatory requirements.** Furthermore, the evasion or avoidance concern is not merely theoretical. Even with the broad "guarantee" definition from the 2013 Guidance, non-U.S. SDs re-structured transactions to ostensibly "de-guarantee" swaps conducted through non-U.S. affiliates, without changing the nature of inter-entity financial support.[41] This demonstrates the fatal flaw of the CFTC's proposed focus on form over substance—it would permit dealers to circumvent U.S. law with little more than a few strokes of a pen. In the process, it would perhaps permit non-U.S. SDs to de-guarantee and de-register as SDs altogether.

None of this is novel to the CFTC. Indeed, the CFTC's own reasoning for the broad scope the "guarantee" policy statement is worth recalling:

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[40] Of course, this approach would not address all risks or policy concerns. For example, we discuss the obvious risks associated with consolidation of U.S. and non-U.S. persons in Section III below.

[41] See C. Levinson, U.S. banks moved billions of dollars in trades beyond Washington's reach, Reuters (Aug. 21, 2015), available at https://www.reuters.com/investigates/special-report/usa-swaps/.

> [A]s the recent financial crisis has demonstrated, in a moment of crisis—whether at the firm-level or more generally, marketwide—it matters little whether the parent guarantees are capped or otherwise qualified. **In the face of solvency concerns, the parent guarantor will find it necessary to assume the liabilities of its affiliates.** For these reasons, the [CFTC] declines to incorporate in the Guidance commenters' suggestions that only certain types of guarantees (e.g., under which there is a material likelihood of liability) should be considered for purposes of registration determinations for non-U.S. persons . . .
>
> Thus, for example, while keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements, and any other explicit financial support arrangements may provide for different third-party rights and/or address different risks than traditional guarantees, the [CFTC] does not believe that these differences would generally be relevant for purposes of section 2(i). **Under these agreements or arrangements, one party commits to provide a financial backstop or funding against potential losses that may be incurred by the other party, either from specific contracts or more generally. In the Commission's view, this is the essence of a guarantee.**[42]

The CFTC's previous focus on the substance of a guarantee, rather than form, is the only reasonable and lawful course of action pursuant to CEA section 2(i). As the CFTC previously concluded, "swap activities outside the United States that are guaranteed [in the broad sense contemplated by the 2013 Guidance] by U.S. persons would generally have a direct and significant connection with activities in, or effect on, U.S. commerce in a similar manner as the underlying swap would generally have a direct and significant connection with activities in, or effect on, U.S. commerce ***if the guaranteed counterparty to the underlying swap were a U.S. person***."[43]

Finally, we encourage the CFTC to very carefully consider the actual application and effect of its proposed "guarantee" definition on existing SDs. **For example, one form of direct financial support or arrangement presently employed by U.S. banks with respect to their non-U.S. derivatives dealing activities is the deed poll guarantee.** Such guarantees present ambiguities with respect to the proposal, however, because they (1) may not be viewed as a contractual right; (2) perhaps may be viewed as a "legally enforceable right" in common law jurisdictions; and (3) depending on their content, may or may not be viewed as a guarantee with respect to obligations "under a swap." Rather than leaving the door open to conflicting interpretations—with the potential consequence that U.S. guarantors, broadly considered under the 2013 Guidance (but not the proposal), could de-register foreign-affiliate SDs without any accompanying reduction in risks to the U.S. person itself or the U.S. financial system[44]—the CFTC simply should codify the 2013 Guidance's broad "guarantee" framework. Otherwise, the proposal's "de-guarantee" loophole very likely would result in increased risks to U.S. banks (and other U.S. persons) accepting various forms

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[42] CFTC, Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292, 45320 (Jul. 26, 2013).

[43] Id at 45319 (emphasis added).

[44] This is because the narrow proposed 'guarantee" definition would permit non-U.S. dealers to exclude many dealing transactions from SD registration thresholds. In relevant respects, the proposal would require a non-U.S. person to include in its de minimis dealing threshold (1) those swap dealing transactions in which the obligations "under the swaps" are subject to a "guarantee" by a U.S. person—i.e., those dealing transactions for which it constitutes a Guaranteed Entity; and (2) those swap dealing transactions with Guaranteed Entities (which should be retained). CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 971 (Jan. 8, 2020). The proposal in this regard would be reasonable and necessary but insufficient, facilitating the avoidance of U.S. law and regulatory arbitrage.

of financial responsibility in support of foreign derivatives trading and dealing activities in non-U.S. affiliates.

B. The narrow proposed definition of "guarantee" would result in fewer swaps transactions being treated as conducted by "Guaranteed Entities," opening a loophole for dealing conducted through unregistered affiliates of U.S. banks that nevertheless benefit from direct U.S. financial support.

Remarkably, as explained above, the CFTC acknowledges that excluding "financial arrangements or support" that "transfer risk directly back to the U.S. financial system" would have "possible significant adverse effects"[45] and also could result in fewer SD registrations and additional unregulated and less regulated swaps activities presenting "some measure of material risk to the U.S. financial system."[46] Even more remarkably, though, the CFTC asserts that the proposed "guarantee" definition could be finalized "without undermining the protection of U.S. persons and the U.S. financial system."[47] These propositions are squarely contradict each other. Facilitating swaps transactions with "possible significant adverse effects" on the U.S. financial system necessarily "undermines the protection of U.S. persons and the U.S. financial system."

The proposal essentially would permit non-U.S. dealers to choose whether and when they would like to comply with U.S. law based solely on the commercial necessity of attaching U.S. financial support to swaps transactions. Consider the CFTC's description of the operation of the proposed "guarantee" definition:

> A non-U.S. person may be a Guaranteed Entity with respect to swaps with certain counterparties because the non-U.S. person's swaps with those counterparties are guaranteed, but would not be a Guaranteed Entity with respect to swaps with other counterparties if the non-U.S. person's swaps with the other counterparties are not guaranteed by a U.S. person. **In other words, depending on the nature of the trading relationship, a single entity could be a Guaranteed Entity with respect to some of its swaps, but not others.**[48]

This form over substance approach—again, focused on paperwork rather than actual risk—makes non-U.S. dealing activities, and the foundational de minimis calculation, all but impossible to effectively supervise and oversee. The undeniable consequence of the proposal to redefine the term "guarantee" would be to exclude an unknown amount of swaps dealing activities from U.S. law, even where a U.S. guarantor—not considered as such under the proposal—financially supports non-U.S. dealing activities through arrangements that remain outside of the four corners of the swap trading relationship documentation (and perhaps even manages the risks of those activities through interaffiliate transactions with the non-U.S. legal entity).

Thus, the CFTC's proposed "guarantee" is necessary but dangerously insufficient. We agree with the CFTC, of course, that "the swap obligations of a Guaranteed Entity are identical, in relevant aspects, to

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[45] CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 963 (Jan. 8, 2020).

[46] Id.

[47] Id.

[48] Id at 964.

a swap entered into directly by a U.S. person."[49] The CFTC is also fundamentally correct that "the U.S. guarantor bears risk arising out of the swap as if it had entered into the swap directly" and also that the financial relationship between the U.S. guarantor and the non-U.S. guarantee permit the two legal entities to "effectively act together to engage in the dealing activity."[50] Furthermore, we agree with the CFTC's reasoning as follows:

> **[T]reating a Guaranteed Entity differently from a U.S. person could create a substantial regulatory loophole**, incentivizing U.S. persons to conduct their dealing business with non-U.S. persons through non-U.S. affiliates, with a U.S. guarantee, to avoid application of the Dodd-Frank Act SD requirements. Allowing transactions that have a similar economic reality with respect to U.S. commerce to be treated differently depending on how the parties structure their transactions could undermine the effectiveness of the Dodd-Frank Act swap provisions and related Commission regulations addressed by the Proposed Rule. Applying the same standard to similar transactions helps to limit those incentives and regulatory implications.[51]

The logic is irrefutable. We simply request that it be appropriately extended to avoid evasion and avoidance of U.S. law and most importantly, the resulting increased risks to U.S. persons and the U.S. financial system.

III. The SRS proposal could be a critically important improvement to the 2013 Guidance, but significant amendments would be necessary to ensure that the SRS concept (1) is not too narrowly defined and (2) accounts for evasion and avoidance and interaffiliate risks addressed by the conduit affiliate policy statement.

The CFTC proposes a new category of non-U.S. persons—significant risk subsidiaries—subject to most Title VII regulations for most swaps and required to include all dealing transactions in de minimis calculations of purposes of SD registration.[52] Under the proposal, a non-U.S. person would be considered an SRS if it meets each of the following conditions:

(1) The non-U.S. person is a "significant subsidiary"[53] of an "ultimate U.S. parent entity"[54] ("U.S. Parent"), each as proposed to be defined;

(2) The U.S. Parent of the non-U.S. person has at least $50 billion in global consolidated assets at the end of the most recently completed fiscal year;[55] and

(3) The non-U.S. person is not subject to each of the following:

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49 Id at 972.

50 Id.

51 Id.

52 Id at 971.

53 Proposed § 23.23(a)(13).

54 Proposed § 23.23(a)(18).

55 Proposed § 23.23(a)(12).

(a) Consolidated supervision and regulation by the Board of Governors of the Federal Reserve System ("FRB") as a subsidiary of a U.S. bank holding company ("BHC");[56] or

(b) Basel III compliant capital standards and oversight by the non-U.S. person's home country regulator and margin requirements for uncleared swaps in a jurisdiction for which the CFTC has issued a comparability determination.[57]

Entities meeting these conditions are required to comply with many Title VII regulatory requirements as if they were U.S. persons.

Before we address deficiencies in the proposed SRS definition, we first emphasize that the CFTC's application of U.S. law to non-U.S. persons consolidated with U.S. persons—even in the absence of formal guarantees or interaffiliate transactions—could be a critically important policy improvement to the 2013 Guidance. Nevertheless, significant amendments would be necessary to ensure the proposed SRS category serves the essential purposes served by the straightforward "foreign consolidated subsidiary" definition in § 23.160(a)(1) ("FCS")[58] and the "conduit affiliate" policy statements in the 2013 Guidance.[59] Two objectives must be served by the CFTC's final determination with respect to the SRS category:

(1) The SRS category must account for evasion and avoidance and interaffiliate risks addressed by the 2013 Guidance's "conduit affiliate" category, which the proposed SRS category would replace; and

(2) The SRS category must ensure the SRS category includes all subsidiaries relevant to the stated objectives of the SRS test in the proposal.

We discuss potential amendments to address these objectives below.

A. The CFTC must adopt an SRS framework that addresses the significant financial and reputational risks consolidated entities pose to U.S. Parents.

U.S. BHCs conduct a very significant volume and notional amount of dealing activities through non-U.S. affiliates organized in global derivatives hubs. Frequently, for example, a London subsidiary of a U.S. BHC might execute swaps with European entities; and a Hong Kong subsidiary might execute swaps with Asian entities. Non-U.S. counterparties often prefer to enter into swaps with local dealing entities for legal, regulatory, and other reasons. Yet, the risks from the non-U.S. dealing activities are directly and indirectly posed to U.S. BHCs, because many such subsidiaries are financially consolidated with U.S. BHCs and interaffiliate swaps may be used to migrate the individual or aggregated risks of trades into a U.S. risk

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56 Proposed § 23.23(a)(12)(i).

57 Proposed § 23.23(a)(12)(ii).

58 See 17 C.F.R. § 23.160(a)(1).

59 CFTC, Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45292, 45358-45359 (Jul. 26, 2013) ("Where the conduit is located outside the United States, but is owned and controlled by a U.S. person, the [CFTC] believes that to recognize the economic reality of the situation, the conduit's swaps should be attributed to the U.S. affiliate(s). The fact that the conduit is located outside the [U.S.] does not alter the economic reality that its swaps are undertaken for the benefit of, and at the economic risk of, the U.S. affiliate(s), and more broadly, for the corporate group that is owned and controlled by a U.S. person. Under these circumstances, the [CFTC] believes that the swap activities of the non-U.S. conduit may meet the 'direct and significant' jurisdictional nexus within the meaning of CEA section 2(i).").

management entity under common control. Each of these direct and significant forms of risk transfer must be addressed by the SRS framework.

The CFTC correctly acknowledges that "U.S. persons accrue risk through the swap activities of their non-U.S. subsidiaries that, in aggregate, may have a significant effect on the U.S. financial system."[60] Thus, the CFTC also rightly acknowledges that "consolidated non-U.S. subsidiaries of U.S. persons may appropriately be subject to [CFTC] regulation due to their direct and significant relationship to their U.S. parent entities."[61] It also acknowledges that "consolidated non-U.S. subsidiaries of U.S. parent entities present a greater supervisory interest to the CFTC" than other non-U.S. persons and are squarely within the CFTC's regulatory interest "in preventing the evasion of obligations under the CEA."[62] We agree in all regards.

Borrowing heavily from its previous views supporting the FCS definition, the CFTC again articulates a compelling reason to apply the Title VII requirements to swaps executed by non-U.S. subsidiaries consolidated with U.S. Parents:

> Pursuant to the consolidation requirements of U.S. GAAP, the financial statements of a U.S. parent entity reflect the financial position and results of operations of that parent entity, together with the network of branches and subsidiaries in which the U.S. parent entity has a controlling interest, including non-U.S. subsidiaries, which is an indication of connection and potential risk to the U.S. parent entity . . . **By virtue of consolidation then, a non-U.S. subsidiary's swap activity creates direct risk to the U.S. parent.** That is, as a result of consolidation and financial control, the financial position, operating results, and statement of cash flows of a non-U.S. subsidiary are included in the financial statements of its U.S. parent and therefore affect the financial condition, risk profile, and market value of the parent. Because of that relationship, risks taken by a non- U.S. subsidiary can have a direct effect on the U.S. parent entity.
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> Furthermore, a non-U.S. subsidiary's **counterparties may generally look to both the subsidiary and its U.S. parent for fulfillment of the subsidiary's obligations under a swap, even without any explicit guarantee**. In many cases, the [CFTC] believes that counterparties would not enter into the transaction with the subsidiary (or would not do so on the same terms), and the subsidiary would not be able to engage in a swap business, absent this close relationship with a parent entity. In addition, the [CFTC] notes that a non-U.S. subsidiary may enter into offsetting swaps or other arrangements with its U.S. parent entity or other affiliate(s) to transfer the risks and benefits of swaps with non-U.S. persons to its U.S. affiliates, which could also lead to risk for the U.S. parent entity. **Because such swap activities may have a direct impact on the financial position, risk profile, and market value of a U.S. parent entity, they can lead to spill-over effects on the U.S. financial system**.[63]

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[60] CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 964 (Jan. 8, 2020).

[61] Id.

[62] Id.

[63] Id.

We appreciate the CFTC's fair assessment and discussion of these U.S. risk transfer issues with respect to non-U.S. consolidated entities. To achieve its systemic risk reduction and other public interest objectives, the CFTC must apply its regulations to FCSs.

B. The SRS definition contains numerous elements and conditions that would exclude material foreign consolidated subsidiaries from the reach of U.S. law.

The CFTC substantially limits the scope of the proposed SRS category by requiring qualifying non-U.S. persons to meet multiple conditions, including the "significant subsidiary" limitation[64] and the $50 billion threshold for U.S. parents.[65] For practical reasons we discuss below, we recommend that the CFTC supplement the proposed SRS framework by applying Title VII requirements to FCSs engaging in a threshold amount of certain trading or dealing activities. Our recommendation for Risk Transfer and a Risk Acceptance Test (below), in part, stems from the fact that the actual application and effect of the SRS proposal is unknown.

The CFTC proposes three "significant subsidiary" tests. The term "significant subsidiary" would mean, in essence, a subsidiary, including its own subsidiaries, meeting any of the following three tests:

(1) Equity Capital Significance Test, which requires an average measure of the subsidiary's equity capital to be at least five percent of an average measure of its ultimate U.S. parent entity's consolidated equity capital;[66]

(2) Revenue Significance Test, which requires an average measure of the subsidiary's revenue to be at least ten percent of an average measure of its ultimate U.S. parent entity's consolidated revenue;[67] or

(3) Asset Significance Test, which requires an average measure of the subsidiary's assets to be at least ten percent of an average measure of its ultimate U.S. parent entity's consolidated assets.[68]

These three tests attempt to conceptually capture some (but likely not nearly enough) of the risks associated with FCSs.

1. The CFTC must adopt supplemental Risk Transfer and Risk Acceptance Tests that avoid the perverse regulatory outcome associated with the relative Equity Capital, Revenue, and Asset Significance Tests.

The three proposed significance measures are diminished as the size and systemic importance of the U.S. Parent increases. That has a perverse effect of potentially excluding from the definition of "significant subsidiary" those entities that are a relevant and critical component of the most significant U.S. parents. For this reason, if the CFTC proceeds with the SRS concept, it should at least consider a supplemental test that would apply to (capture) large and undoubtedly "significant" subsidiaries of the largest BHCs. In this regard, we recommend two potential sub-prongs for a fourth test, intended to address

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64 Proposed § 23.23(a)(13).

65 Proposed § 23.23(a)(12).

66 Proposed § 23.23(a)(13)(i).

67 Proposed § 23.23(a)(13)(ii).

68 Proposed § 23.23(a)(13)(iii).

the policy concerns previously motivating the conduit affiliate approach and the concerns with respect to financial consolidation above.

The new independent, supplemental test—at a minimum—must include as "significant subsidiaries" those legal entities meeting at least one of the following:

(1) **Risk Transfer Test:** The CFTC should calibrate a test that would capture those subsidiaries used to engage in foreign-based dealing activities that are ultimately risk-managed in the U.S., raising the supervisory and regulatory interests directly and significantly of concern to the CFTC and other U.S. regulators. The CFTC should calibrate the Risk Transfer Test to be objective, avoiding terms like "regular" and "frequent" and "substantial" in favor of actual measures that are less susceptible to varying interpretations and avoidance (e.g., the CFTC might consider using an $8 billion de minimis level with respect to the total gross notional swaps back-to-backed into all U.S. legal entities within the consolidated group).

(2) **Risk Acceptance Test:** The CFTC should calibrate a test that would capture those subsidiaries used to engage in foreign-based dealing activities above a specified threshold, which could serve as a proxy for risks introduced through derivatives trading activities. The CFTC should again avoid subjective standards, like "substantial" or "regular" trading, as well as malleable risk measures in foreign jurisdictions, like initial margin, in favor of measures that are less susceptible to varying interpretations and avoidance (e.g., the CFTC might consider using absolute trading volume or notional measures, for example whether the subsidiary engages in trading meeting some threshold with respect to counterparties, trades, *or* gross notional activities on average over a specified 3-month period).

While the Revenue Significance Test and the Asset Significance Test each have numerators in their calculation methodologies that would serve as reasonable proxies for swaps-related activities, our recommended alternatives would be better tailored to those activities specifically, while, again, better serving the purposes of the conduit affiliate policy statement and avoiding the perverse policy outcome associated with a relative test.

2. The CFTC must eliminate both of the exclusions from the SRS tests, which would exclude the very significant subsidiaries most relevant to the CFTC's systemic risk reduction and other public interest mandates.

The CFTC's proposal creates two independent exclusions from the SRS test that essentially swallow the proposed rule. Proposed §§ 23.23(a)(12)(i)–(ii) provide that "a non-U.S. person would not be an SRS to the extent the entity is subject to prudential regulation as a subsidiary of a U.S. BHC or is subject to comparable capital and margin standards."[69] These exclusions should be eliminated in their entirety. They would have the effect of excluding all non-U.S. subsidiaries that are FRB regulated as part of the consolidated group or subject to Basel III and margin regulations in certain jurisdictions. The intent is clear. That, in essence, substitutes prudential regulation by the FRB for the prudential and market regulations imposed by the CFTC for activities outside of the U.S. having a direct and significant effect on U.S. activities.

The CFTC's primary rationales for not applying Title VII to all non-U.S. consolidated subsidiaries is that "the principles of international comity counsel against applying its swap regulations to all non-U.S.

69 Proposed § 23.23(a)(12)(i).

subsidiaries of U.S. parent entities"[70] and that "swap activity [subject to prudential supervision and capital and margin regulation] poses less risk to the financial position and risk profile of the ultimate U.S. parent entity, and thus less risk to the U.S. financial system than the swap activity of a non-U.S. subsidiary of an ultimate U.S. parent entity that is a not a BHC."[71] That is true but irrelevant. Those non-U.S. entities that remain unregulated in the U.S. probably do pose more than risk those that are regulated by the FRB. But the CFTC must consider not just whether such non-U.S. entities are regulated in some way—but also in what ways, and whether those are consistent with statutory commands and congressional intent with respect to the underlying activities.

The CFTC does not have the discretion to determine whether and when to apply U.S. regulatory requirements based on vague principles of international comity essentially asserted as a conclusory matter. CEA section 2(i) provides the scope of the exclusions from U.S. law—it provides that Title VII shall not apply to activities outside of the U.S., unless such activities have a direct and significant connection with activities in, or effect on, U.S. commerce. For the reasons discussed above, the CFTC itself has concluded that "**U.S. persons accrue risk through the swap activities of their non-U.S. subsidiaries that, in aggregate, may have a significant effect on the U.S. financial system**" and that it has legally cognizable supervisory and regulatory interests in the swaps activities of foreign consolidated subsidiaries of U.S. parents. Thus, the CFTC has not cited a legally valid basis for its repeated reliance on international comity, where it simultaneously acknowledges direct and significant risks to U.S. BHCs and the U.S. financial system.

However limited the scope of the proposed SRS category, the CFTC's logic for counting all dealing swaps conducted through SRSs is worth citing in its entirety:

> **[T]reating an SRS differently from a U.S. person could create a substantial regulatory loophole, incentivizing U.S. persons to conduct their dealing business with non-U.S. persons through significant non-U.S. subsidiaries to avoid application of the Dodd-Frank Act SD requirements.** Allowing swaps entered into by SRSs, which have the potential to impact the ultimate U.S. parent entity and U.S. commerce, to be treated differently depending on how the parties structure their transactions could undermine the effectiveness of the Dodd-Frank Act swaps provisions and related Commission regulations addressed by the Proposed Rule. Applying the same standard to similar transactions helps to limit those incentives and regulatory implications.[72]

We agree and would expand those principles to Title VII generally.

IV. Foreign branches are U.S. persons and therefore should be treated as U.S. persons for all purposes of the CFTC's cross-border regulations.

The CFTC proposes a "foreign branch" definition that incorporates "concepts" from the FRB's Regulation K, the Federal Deposit Insurance Corporation's International Banking Regulation, and the Office of the Comptroller of the Currency's "foreign branch" definition.[73] The CFTC's acknowledgement

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70 CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 964 (Jan. 8, 2020).

71 Id at 966.

72 Id at 971.

73 Id at 967.

that it merely incorporates concepts, however, raises the question of whether the four prong foreign branch definition leaves any ambiguities that could permit U.S. banking entities to escape appropriate oversight and application of Title VII regulations.

Rather than merely borrowing "concepts" and incorporating them into a new definition of "foreign branch," we recommend that the CFTC amend the proposed regulations to ensure compliance with "foreign branch" definitions used for years by prudential regulators as follows (please see our edits in redline):

§ 23.23 Cross-border application.

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(2) *Foreign branch* means any office of a U.S. bank that:

i. Is located outside the United States;

ii. Operates for valid business reasons;

iii. Maintains accounts independently of the home office and of the accounts of other foreign branches, with the profit or loss accrued at each branch determined as a separate item for each foreign branch;

iv. Is engaged in the business of banking and is subject to substantive regulation in banking or financing in the jurisdiction where it is located; and

v. Is operated pursuant to U.S. banking laws and regulations and in compliance with applicable restrictions.

That last prong would serve as a prophylactic measure fully consistent with the CFTC's proposed four-prong definition and its fundamental purposes "to prevent evasion of the Dodd-Frank Act requirements."[74] While adding no additional burden on or required analysis for U.S. banks, the revised definition ensures a foreign branch cannot be established outside of the considered restrictions and substantive requirements of U.S. law.

In a related regard, the CFTC must adopt its appropriate proposed definition for a "swap conducted through a foreign branch."[75] The first and last prongs of the proposed definition (see immediately below) are necessary to ensure appropriate formalisms are followed to permit effective oversight of foreign branch activities and reflect existing practices for the booking of swaps (please see our edits in redline):

§ 23.23 Cross-border application.

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(16) *Swap conducted through a foreign branch* means a swap entered into by a foreign branch where:

i. The foreign branch or another foreign branch is the office through which the U.S. person makes and receives payments and deliveries under the swap pursuant to a master netting or similar

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74 Id.

75 Id at 967-968.

trading agreement, and the documentation of the swap specifies that the office for the U.S. person is such foreign branch;

ii. The swap is entered into by such foreign branch in its normal course of business;~~ and~~

iii. The swap is reflected in the local accounts of the foreign branch~~.~~; and

iv. The swap is arranged, negotiated, and executed on behalf of the foreign branch solely by persons located outside the United States.[76]

In the preamble, the CFTC emphasizes that the second prong is an anti-evasion measure that seeks to appropriately "prevent a U.S. bank from simply routing swaps for booking in a foreign branch so that the swap would be treated as a swap conducted through a foreign branch for purposes of the SD and MSP registration thresholds or for purposes of certain regulatory requirements applicable to registered SDs or MSPs."[77] Our proposed new prong serves similar goals.

The CFTC also explains that § 23.23 would not prevent personnel of the U.S. bank located in the U.S. from participating in the negotiation or execution of a swap so long as the swaps that are booked in the foreign branch are ***primarily entered into by personnel located in the branch*** (or another foreign branch of the U.S. bank).[78] In other words, the CFTC "proposes that a swap will be deemed to be entered into by such foreign branch in the normal course of business if swaps of the type in question are primarily, but not exclusively, entered into by personnel located in the branch (or another foreign branch of the U.S. bank)."[79] That defers too significantly to the foreign branches themselves to decide whether the "primarily" restriction has been met.

The CFTC also notes that "the proposed definition of 'foreign branch' does not include the requirement that the employees negotiating and agreeing to the terms of the swap (or, if the swap is executed electronically, managing the execution of the swap), other than employees with functions that are solely clerical or ministerial, be located in such foreign branch or in another foreign branch of the U.S. bank."[80] Obviously, our recommendation changes that and strengthens the "primarily" constraint by adopting a foreign branch booking restriction that harmonizes with the SEC's approach to trades "conducted through a foreign branch," which, it must be remembered, is merely a bookkeeping and regulatory convenience (some would say, fiction) that masks the irrefutable fact that foreign branches remain part of the U.S. person in the most critical, risk-related respects.

IV. The CFTC's proposal to permit U.S.-located personnel to arrange, negotiate, or execute swaps on behalf of the non-U.S. affiliates of U.S. BHCs (and others) and yet remain outside of the

[76] This language is consistent with SEC Rule § 3a71–3(a)(3), 17 C.F.R. § 240.3a71–3(a)(3), under the Securities and Exchange Act of 1934.

[77] CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 968 (Jan. 8, 2020).

[78] Id (emphasis added).

[79] Id at 970.

[80] Id at 968.

reach of U.S. law and the full panoply of U.S. regulations facilitates avoidance, if not evasion, and regulatory arbitrage.

The swaps markets under the CFTC's jurisdiction are global, a fact that was very well understood by Congress when it passed CEA section 2(i) as part of the Dodd-Frank Act's derivatives reforms. Yet, more than 87% percent of the reported $201 trillion notional in derivatives within the U.S. banking system is controlled by dealers within just four U.S. BHCs,[81] which also facilitate trading in a significant percentage of the $640 trillion notional in global derivatives markets through affiliated non-U.S. dealers.[82] These BHCs engage in trading and dealing with both U.S. counterparties and non-U.S. counterparties established or located in other jurisdictions, very often using different legal entities in different jurisdictions to book swaps based on sales, trading, and risk management activities that occur in or have consequences for more than one jurisdiction.

The CFTC proposes that swaps between non-U.S. persons but arranged, negotiated, or executed using U.S.-located personnel would not be "considered a relevant factor for purposes of applying the Proposed Rule."[83] However, any statutory analysis of the CFTC's swaps jurisdiction must be guided by and consistent with the specific jurisdictional language included in Title VII of the Dodd-Frank Act. Because the plain language and meaning of CEA section 2(i) has been all but commandeered to facilitate non-U.S. trading activities (in direct contravention of its purposes), we review the precise jurisdictional language as follows:

> The provisions . . . relating to swaps that were enacted by [Title VII of the Dodd-Frank Act] (including any rule prescribed or regulation promulgated under that Act), **shall not apply to activities outside the United States** unless those activities—
>
> > (1) Have a direct and significant connection with activities in, or effect on, commerce of the United States; or
> >
> > (2) Contravene such rules or regulations as the [CFTC] may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision [enacted under Title VII of the Dodd-Frank Act].[84]

There may be a number of fact patterns that present interesting, legitimate questions concerning the CFTC's swaps jurisdiction, turning, for example, on whether non-U.S. trading activities outside of the United States have a sufficiently direct and significant connection with activities in, or effect on, U.S. commerce. **The CFTC's ANE Transactions proposal is not one of them. It involves transactions solely inside of the**

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[81] Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, Third Quarter 2019 (Dec. 2019), available at https://www.occ.gov/publications-and-resources/publications/quarterly-report-on-bank-trading-and-derivatives-activities/files/pub-derivatives-quarterly-qtr3-2019.pdf (noting that "[a] small group of large financial institutions continues to dominate trading and derivatives activity in the U.S. commercial banking system" and that "four large commercial banks represented 87.2 percent of the total banking industry notional amounts and 83.2 percent of industry net current credit exposure").

[82] Bank for International Settlements, Statistical release: OTC derivative statistics at end-June 2019 (Nov. 8, 2019), available at https://www.bis.org/publ/otc_hy1911.pdf (noting that "[l]arge dealers in advanced economies (AEs), who report data to the semiannual survey, accounted for the overwhelming majority (92% of notional amounts, 87% of gross market value) of outstanding positions at end-June 2019").

[83] CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 978 (Jan. 8, 2020).

[84] 7 U.S.C. § 2(i).

United States. Therefore, CEA section 2(i)'s jurisdictional exclusion for swaps "activities outside of the United States" are simply are irrelevant.

The CFTC tortures Congress' plain language, legislative intent, and legislative history in proposing an unlawful exemption that would facilitate avoidance, if not evasion, of critical derivatives markets reforms by the four BHCs mentioned above (and, of course, others). **However, what is most remarkable about the CFTC's proposal to exempt ANE Transactions is that CFTC, in essence, agrees with our statutory construction and legal conclusion:**

> **A person that, in connection with its dealing activity, engages in market-facing activity using personnel located in the United States is conducting a substantial aspect of its dealing business in the United States.** But, because the transactions involve two non-U.S. persons, and the financial risk of the transactions lies outside the United States, the [CFTC] considers the extent to which the underlying regulatory objectives of the Dodd-Frank Act would be advanced in light of other policy considerations, including undue market distortions and international comity, when making the determination as to whether the Dodd-Frank Act swap requirements should apply to ANE Transactions.[85]

We cite the CFTC's full view to avoid any potential for taking the preamble statements out of context (and we already addressed the CFTC's incorrect contention above that "the financial risk of the [ANE] transactions [only] lie outside of the United States," which is demonstrably untrue and even conflicts with the CFTC's own views elsewhere in the proposal). **For present purposes, the key CFTC acknowledgement is that market-facing activities using U.S.-located personnel involve a "substantial aspect of [the] dealing business *in the United States*," falling squarely in the CFTC's territorial jurisdiction and in no way implicating the narrow jurisdictional limitations contemplated in CEA section 2(i).**

The application of U.S. law to transactions conducted, in very significant part, within U.S. territory is the norm across financial markets activities and should be hardly in need of a lengthy explication. If activities regulated under U.S. law occur within the U.S. itself, it is quite intuitive and logical that U.S. law would apply to such U.S.-based activities. If trading and other activities leading to the execution of a swap are conducted in the U.S., the initial or event subsequent location of credit or other risks—which often present ongoing risks to U.S. persons and the U.S. financial system through interaffiliate transactions—cannot be the sole investigation for whether the CFTC applies the Dodd-Frank Act's derivatives reforms. There, U.S.-located or U.S.-based activities clearly affect U.S. interests and must subject to U.S. law. **There is simply no way to lawfully ignore the fact that trading conducted, facilitated, arranged, negotiated, and executed in New York or another U.S. locale involves activities in the United States. Therefore, CEA section 2(i)'s exclusions are irrelevant[86] and a territorial presumption for the application of U.S. law must control.** Even if the exclusions were relevant, however, there can be no doubt that such activities have a direct and significant "connection with" activities in U.S. commerce, because the activities literally ***are in U.S. commerce***.

V. The CFTC's proposed aggregation test for global SDs would prevent structuring to avoid the de minimis threshold and must be adopted as proposed.

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85 Id at 978 (emphasis added).

86 CEA section 2(i)'s statutory exclusion not only solely applies to "activities outside the United States" but actually ***excludes from that non-U.S. activities exclusion*** "activities outside the United States" having a "direct or significant connection with activities in . . . commerce of the United States."

The CFTC's proposed aggregation test would prevent structuring to avoid the de minimis threshold and must be adopted as proposed. Under existing regulations, the CFTC already requires that, in determining whether its swap dealing transactions exceed the de minimis threshold, a person must include the aggregate notional value of any swap dealing transactions entered into by its affiliates under common control. The CFTC merely proposes to apply "the same aggregation principles to all affiliates in a [global] corporate group," which is logical and appropriate.

We emphasize one important fact:

> [A] potential SD, whether a U.S. or non-U.S. person, would aggregate all swaps connected with its dealing activity with those of persons controlling, controlled by, or under common control with the potential SD **to the extent that these affiliated persons are themselves required to include those swaps in their own de minimis threshold calculations**, unless the affiliated person is itself a registered SD.[87]

While we agree with the CFTC's aggregation proposal, the "to the extent" phrase highlights the fairly obvious concern that any infirmities in aspects of the CFTC's proposed regulations would carry through to the aggregation provisions. For example, if certain dealing transactions with U.S.-supported non-U.S. entities or foreign branches of U.S. persons are wrongly excluded from de minimis counts, they would be wrongly excluded from the aggregation of such de minimis counts as well.

Nevertheless, as the CFTC rightly notes, its "proposed approach would ensure that the aggregate notional value of applicable swap dealing transactions of all such unregistered U.S. and non- U.S. affiliates does not exceed the de minimis level."[88]

VI. The CFTC's proposal to exclude certain exchange-trade and cleared swaps from de minimis calculations is conceptually sound but must be amended to limit the exclusion to DCO-cleared, anonymously SEF or DCM-executed swaps in which neither counterparty is subsequently disclosed through the practice of Post-Trade Name Give-Up.

The CFTC proposes to adopt the general approach to excluding anonymously executed and cleared swaps from the 2013 guidance. In particular, the proposal would allow certain non-U.S. persons to exclude from de minimis threshold calculations any cleared swap (at a derivatives clearing organization ("DCO") or exempt DCO) that it anonymously enters into on a designated contract market ("DCM"), an exempt or registered swap execution facility ("SEF"), or a foreign board of trade ("FBOT"). The CFTC's reasoning is generally sound:

> When a non-U.S. person enters into a swap that is executed anonymously on a registered or exempt SEF, DCM, or registered FBOT, the [CFTC] recognizes that the non-U.S. person would not have the necessary information about its counterparty to determine whether the swap should be included in its de minimis threshold calculation. The [CFTC] therefore believes that in this case the practical difficulties make it reasonable for the swap to be excluded altogether.[89]

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87 CFTC, Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants, 85 Fed. Reg. 952, 972-973 (Jan. 8, 2020).

88 Id.

89 Id.

We object to the expansion of the exchange-trading exclusion, however, for any swaps anonymously executed or cleared through an exempted intermediary.

VI. The CFTC's proposed standard of review for substituted compliance-related comparability determinations provides almost unlimited discretion for the CFTC to consider, or not to consider, factors.

The CFTC proposes a standard of review pursuant to which the CFTC would determine whether a foreign jurisdiction's regulatory standards are comparable to certain of the Dodd-Frank Act's swaps-related requirements. Unfortunately, the CFTC's proposed standard contemplates almost unlimited discretion for the CFTC to consider, or not to consider, various non-binding factors. Indeed, the CFTC intends to broaden an already broad comparability determination approach as described below:

> While the [CFTC] has historically taken a similar outcomes-based approach to comparability determinations, the Proposed Rule would allow the [CFTC] to take **an even more holistic view of a foreign jurisdiction's regulatory regime**. Specifically, the Proposed Rule would allow the [CFTC] to consider all relevant elements of a foreign jurisdiction's regulatory regime, **thereby allowing the [CFTC] to tailor its assessment to a broad range of foreign regulatory approaches**. Accordingly, pursuant to the Proposed Rule, a foreign jurisdiction's regulatory regime would not need to be identical to the relevant [CFTC] requirements, so long as both regulatory frameworks are comparable in terms of holistic outcome.
>
> Under the Proposed Rule, **in assessing comparability, the [CFTC] may consider any factor it deems appropriate**, which may **include**: (1) The scope and objectives of the relevant foreign jurisdiction's regulatory standards; (2) whether, despite differences, a foreign jurisdiction's regulatory standards achieve comparable regulatory outcomes to the [CFTC]'s corresponding requirements; (3) the ability of the relevant regulatory authority or authorities to supervise and enforce compliance with the relevant foreign jurisdiction's regulatory standards; and (4) whether the relevant foreign jurisdiction's regulatory authorities have entered into a memorandum of understanding or similar cooperative arrangement with the [CFTC] regarding the oversight of swap entities. The Proposed Rule would **also enable the [CFTC] to consider other relevant factors**, including whether a foreign regulatory authority has issued a reciprocal comparability determination with respect to the [CFTC]'s corresponding regulatory requirements. Further, given that some foreign jurisdictions may implement prudential supervisory guidelines in the regulation of swaps, the Proposed Rule would **allow the [CFTC] to base comparability on a foreign jurisdiction's regulatory standards, rather than regulatory requirements**.[90]

For present purposes, we simply note that the proposed discretion is remarkable and perhaps unprecedented. It provides almost no constraint on the CFTC and almost no meaningful guidance on the comparability determination standards.

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[90] Id at 987.

VI. Conclusion

Better Markets appreciates the opportunity to comment on the CFTC's proposed cross-border framework.

We hope our comments are helpful.

Sincerely,

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