ISDA Safe, Efficient Markets

August 10, 2012

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Proposed Interpretive Guidance and Policy Statement: Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038-AD57); Notice of Proposed Exemptive Order and Request for Comment (RIN 3038-AD85)

The International Swaps and Derivatives Association, Inc. ("**ISDA**") appreciates the opportunity to respond to the solicitation of comment by the Commodity Futures Trading Commission (the "**Commission**") with respect to the proposed interpretive guidance and policy statement (the "**Proposed Guidance**")[1] and the proposed exemptive order (the "**Proposed Order**")[2] described above.

ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers.

Although the Commission has made thoughtful efforts to implement its extraterritorial authority with respect to the swaps provisions added to the Commodity Exchange Act ("**CEA**") by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**"), ISDA believes that the Proposed Guidance may be better suited as a Notice of Proposed Rulemaking. In addition, ISDA believes that the Proposed Guidance and Proposed Order are unlikely to facilitate, and may hinder, cooperation or commonality of derivatives

1 77 Fed. Reg. 41,214 (July 12, 2012).

2 77 Fed. Reg. 41,110 (July 12, 2012).

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regulation in and among the G-20 nations.[3]

ISDA respectfully urges the Commission to begin its reconsideration of the Proposed Guidance and the Proposed Order with consideration of these fundamental issues. In addition, for the reasons explained below, we make the following substantive recommendations.

- In recognition that defining the scope of cross-border application of Title VII is substantively tantamount to defining which entities and transactions are covered, the Commission should further extend its temporary exemptive relief from all swap provisions of Title VII as though the final rules further defining "swap" had not been published, pending the issuance of final cross-border guidance developed in coordination with the Securities and Exchange Commission ("**SEC**") and international regulators. Should the Commission decline to follow this recommendation, then at a minimum it should permit market participants to use their individual established mechanisms for recording the nationality or residence of their counterparties for purposes of determining swap dealer or major swap participant ("**MSP**") status and complying with Transaction-level requirements for an appropriate transitional period.

- To avoid competitive distortions, the Commission should permit US swap dealers transacting (either directly or through a branch or affiliate) in a non-US jurisdiction to comply only with host country Transaction-level requirements in their transactions with non-US counterparties.

- The Commission should rework the proposed definition of "US person" to address its ambiguity and lack of administrability, in particular relating to collective investment vehicles, entities owned by US persons, supranational organizations, reliance on counterparty representations and certain other elements.

- A guarantee by a US person should not require the guaranteed non-US person to be treated as a US person for purposes of the Transaction-level requirements.

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3 The G-20 2009 commitment, as revisited by the G-20 in 2010, was to "implement global standards consistently in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage." Communiqué issued from the meeting of the Group of Twenty Finance Ministers and Central Bank Governors held in Gyeongju, Korea on October 23, 2010. The same cooperative spirit is in evidence in section 752(a) of the Dodd-Frank Act, which provides:

> In order to promote effective and consistent global regulation of swaps and security-based swaps, the Commission, the Securities and Exchange Commission, and the prudential regulators (as that term is defined in section 1a(39) of the [CEA]), as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps, security-based swaps, swap entities, and security-based swap entities and may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors, swap counterparties, and security-based swap counterparties.

- The Commission should make certain modifications to the proposed classification of Title VII requirements as Transaction-level or Entity-level, to the aggregation rule under the de minimis exclusion from swap dealer status, and to the Commission's views on the swap dealer status of persons acting as guarantors or indirect booking entities for swaps business in another jurisdiction.

- Non-US persons should be permitted to disregard transactions with foreign branches of US swap dealers in determining whether the non-US person exceeds the thresholds for MSP status.

- The Commission should tie the expiration of the Proposed Order's temporary exemptive relief to the publication of final cross-border guidance.

I. Miscast as Policy Statement

The Proposed Guidance is described as "proposed interpretive guidance and policy statement", which reflects an apparent characterization of the guidance as an "interpretive rule" and/or "general statement of policy" under the Administrative Procedure Act ("**APA**"). ISDA respectfully notes that the Proposed Guidance might be better characterized as a legislative rule under the APA (also referred to as a substantive rule). Interpretive rules do not "effect a substantive change in the regulations",[4] and general statements of policy provide agencies with the opportunity to announce their "tentative intentions for the future" in a non-binding manner.[5] In contrast, legislative rules are generally implementary rules to existing laws and impose fresh rights and obligations on the public.[6] The Proposed Guidance and the Proposed Order present a novel view of extra-territorial jurisdiction and establish a dedicated comparability regime.[7]

For the foregoing reasons, ISDA respectfully suggests that the Commission consider issuing final guidance in the form of a rule.[8] Further, ISDA requests that the Commission conduct a careful cost-benefit analysis assessing the unusually broad effects that an extraterritorial policy is likely to have on the economy and access to markets.[9] An apparent legislative rule of the scope and magnitude of the Proposed Guidance without any acknowledgement of its costs and benefits—let alone a reasoned cost-benefit analysis—risks appearing arbitrary.[10] Indeed, the statutory requirement under section 15(a) of the CEA that the

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4 Warder v. Shalala, 149 F.3d 73, 80 (1st Cir. 1998) (quoting Shalala v. Guernsey Mem'l Hosp., 514 US 87, 100 (1995)).

5 Pacific Gas and Elec. Co. v. Federal Power Commission, 506 F. 2d 33, 38 (D.C. Cir. 1974).

6 Citizens for Better Forestry v. United States Dep't of Agric., 481 F. Supp. 2d 1059, 1076-77 (N.D. Cal. 2007)

7 Note that the Commission previously has accorded the assertion of exemptive authority that gave rise to a comparability regime full rule-making. *See* Rule 30.10.

8 A similar request was made by Commissioner Sommers in Appendix 3 to the Proposed Guidance.

9 Commissioner O'Malia (in Appendix 4 of the Proposed Guidance) and Commissioner Sommers (in Appendix 3) also requested this analysis.

10 The Proposed Guidance cites AIG, Lehman and other high-profile matters as examples involving non-US activities that had a direct and significant effect on US commerce, but the Commission does not acknowledge that

Commission evaluate the costs and benefits of its proposed actions "before promulgating a regulation or issuing an order" arguably applies regardless of the form that the final guidance takes, as that provision includes no exception clearly available to the Commission in this context. Accordingly, ISDA believes that a cost-benefit analysis would further illuminate the impact of the Proposed Guidance on the US economy and global financial markets and also would be consistent with the current Administration's stated position regarding the necessity of considering costs and benefits in connection with agency rulemaking.[11]

II. The Commission's Vision of Substituted Compliance – Practical Concerns

The Proposed Guidance announces limited opportunities for "substituted compliance" through "comparability determinations" as virtually its only concessions to principles of comity.[12] The Proposed Order describes as one of its own principal benefits "increased international harmonization [by giving] registrants the latitude necessary to develop and modify their compliance plans as the regulatory structure in their home jurisdictions changes, which would promote greater regulatory consistency and coordination with international regulators."[13] However, the substituted compliance recognition process described in the Proposed Guidance appears too particularized and prescriptive to succeed. As described, it will fail to give the Congressional goals of restraint and harmonization, and principles of comity, their due. As for the Proposed Order's 12-months of "temporary exemptive relief", that would be an inadequate period of time even were it accompanying a comparability process appropriate in scope and nature to the challenge of global swaps regulation.

A. Comparability Determinations

The Proposed Guidance, on the one hand, refers to the Commission's prior comparability determinations as assurance that the Commission is experienced in such matters. On the other hand, the Proposed Guidance describes how the Commission would revise its approach to reflect "the heightened requirements and expectations under the Dodd-Frank Act." The Proposed Order offers no citation or authority for the proposition that the Dodd-Frank Act imposes heightened requirements in comparability determinations; nonetheless, the Commission will move to an undescribed "outcomes based approach" in assessing whether non-US requirements "are designed to meet the same regulatory objective of [sic] the Dodd-Frank Act".[14] The Commission would also "require a more robust and ongoing process of cooperation and coordination" with non-US regulatory authorities regarding ongoing compliance efforts.[15]

US regulators had or could have had access under then-existing regulatory regimes to relevant information and had direct jurisdiction over relevant managers and decision-makers. Nor does the Proposed Guidance analyze whether the proposed extraterritorial jurisdiction is needed or cost beneficial.

[11] *See* Executive Order 13,563 (although ISDA acknowledges that the Commission, as an independent regulatory agency, is not subject to that Executive Order).

[12] *See* Section III of the Proposed Guidance.

[13] Proposed Order at 41,118.

[14] Proposed Guidance at 41,232.

[15] *Id*.

Section IV of the Proposed Guidance indicates that the Commission will review the comparability of non-US law and regulation in 14 categories corresponding to most of the organizational categories that the Commission has used in developing its own Title VII regulations. The Commission asserts that it may find satisfactory comparability in a given jurisdiction in some, but not all, categories. The Commission "would retain broad discretion to determine that the objectives of any program element are met notwithstanding the fact that the foreign requirement(s) may not be identical to that of the Commission."[16]

This description of the comparability review process raises at least two important concerns. First, in matters as complex and sweeping as new regulation of a substantial global market, a principles-based approach to comparability is most appropriate. The G-20 commitments, after all, were to certain broad regulatory goals, not to global adoption of the Commission's paradigm of detailed regulation. That the Commission will seek to compare "outcomes", stopping somewhere short of identicality with the Commission's own paradigm, is of little comfort. The statutory goal of harmonization (see footnote 3 above) is best served by allowing for national differences in good faith fulfillment of common principles. Following a principles-based approach also creates an appropriately greater likelihood of success in comparability determinations. Second, that the Commission may find comparability in some areas and not others raises the prospect of businesses needing to incorporate disparate regulatory requirements piecemeal, with all the uncertainty and risk of error that may bring.[17] A principles-based approach to comparability will ease these concerns and will honor principles of comity and the message of restraint embedded in section 721 of the Dodd-Frank Act.

B. Memoranda of Understanding

The Commission has entered into a variety of memoranda of understanding ("**MOU**") with non-US regulators since 1986. These MOUs generally provide for different types of information sharing or for cooperative enforcement. The Commission, as referenced above, would now require some unspecified additional content or undertaking in its MOUs.

The Commission has been able to achieve roughly one MOU for every year since it began its effort. This does not seem like sufficient grounds upon which to assume that the Commission can achieve a meaningful number of "expanded" MOUs prior to 2013, even assuming regulatory readiness and willingness in non-US jurisdictions.

C. Status of Regulation in Other Jurisdictions

The Commission implicitly posits that comparability determinations and MOU negotiations can be finalized within the one-year exemptive period applicable to non-US based swap dealers. The Commission reserves the option of extending the exemptive period; however, ISDA suggests that a fixed exemptive period in which realistic goals are achievable is a better option than an extendible period that may be stretched in an effort to reach unrealistic and

[16] Proposed Guidance at 41,233.

[17] A failure to follow appropriate business conduct rules with a particular counterparty could have substantial liability implications, for example.

inappropriate goals. In considering these options, it may be helpful to examine the prospects for success in pursuit of comparability determinations and memoranda of understanding in 2013.

Europe is a major regional participant in the global derivatives market and European countries are well represented among the G-20. The European Market Infrastructure Regulation ("EMIR"), which supplies much of what will be European derivatives regulation, is now law in the European Community. It awaits implementation, however, through publication of technical and implementing standards. Implementation is intended by January 1, 2013, but it is unclear if that will be achieved. Although EMIR provides many parallels with Title VII of the Dodd-Frank Act and thus a basis for a partial comparability assessment, other important parallel provisions will follow in the Markets in Financial Instruments Directive II ("MiFID II") or amendment of the Capital Requirements Directive. These provisions may deal with risk management and chief compliance officer matters, trade execution venue requirements, expansion of commodity derivatives regulation and wider applicability of capital requirements. MiFID II is still developmental, is not expected to be in effect until 2015, and will require nation-by-nation implementing action. Obviously, a whole comparability determination with respect to Europe will not be possible in the year planned by the Commission, and ultimately nation by nation determinations will be required to some degree.

Japan, representing an important portion of the global market, has moved promptly to implement its view of the G-20 requirements by passage of a statute to come into effect late in 2012. The statute is being amended to provide for trade execution, but possibly not effective until mid-2015. The statute does not provide for real-time reporting, confirmation practices, portfolio reconciliation or compression, or margin requirements for uncleared swaps (though the latter may follow from BIS action). Certain documentation requirements will apply only to relationships with nonprofessionals. The statute provides for clearing in a narrow range of transactions between certain types of counterparties. Despite the narrowness of the clearing requirement, it appears that it may in some cases demand use of a Japanese clearing house – potentially conflicting with US requirements.

Hong Kong and Singapore are also important Asian participants in the global markets. Although Hong Kong plans to implement a G-20 responsive regulatory regime by mid-2013, that will require passage of, first, primary conceptual legislation and then "subsidiary" rule-like legislation. It is not clear that all this can be done in time to meet the mid-2013 goal. At the moment, the Hong Kong legislative package would appear to omit aspects of Title VII dealing with trade execution, risk management and public reporting. Singapore has published proposed G20 responsive amendments to law, and has gathered comments, but next steps have not yet crystallized. Ultimately, a legislative process requiring a number of months will be required, and then implementing rules will need to be proposed and finalized. How much of this can be accomplished within the remainder of 2012 and 2013 is unclear. As in the case of Hong Kong, not all major Title VII elements yet have their place in the Singapore plan. Commodity derivatives generally will be on a separate, later track.

As these examples illustrate, it is not clear that anything other than piecemeal comparability may be determined within the designated year. It is also unclear how MOU progress can be maintained in the absence of comparability foundations. Consequently, we urge the Commission to reconsider both the nature of its comparability determinations and MOU plans, and the time-period needed to realize those projects.

III. Implementation Timing – An Uneven Playing Field for US Market Participants

The Proposed Order and Proposed Guidance rely on a division of the Title VII requirements into the two categories of Transaction-level requirements and Entity-level requirements. Read together, the Proposed Order and the Proposed Guidance establish a framework under which the Commission imposes on US swap dealers and US MSPs a substantially earlier rollout of Entity-level requirements and Transaction-level requirements with non-US persons in certain cases. Entity-level requirements relate largely to matters that are "internal" to the swap dealer or MSP, but still, of course, may have a profound effect on transactional relationships. The proposal that foreign branches of US dealers will be able to share in the grace period for Transaction-level requirements with non-US counterparties does not offset in full the disparity that may, by dint of added cost and complexity, drive business from the US swap markets. Therefore, in the interest of competitive parity between US and non-US entities, ISDA recommends that the Commission align the domestic and extraterritorial compliance dates of all requirements.

IV. Host Country Regulation

By requiring US-based swap dealers to apply Transaction-level requirements to their dealings with non-US counterparties in non-US jurisdictions, the Proposed Guidance may, for the same reasons, drive business from the US swap markets. To avoid this disparity, the Commission should permit US swap dealers transacting (either directly or through a branch or affiliate) in a non-US jurisdiction to comply only with host country Transaction-level requirements in their transactions with non-US counterparties, regardless of where the transactions are booked.

V. Recommended Changes

A. Definition of US Person

The creation and use of a custom definition of "US person" presents a number of compliance challenges for swap dealers and MSPs. Although several technical points and questions are presented below, the prime concern is regulatory certainty. ISDA strongly believes that the definition of "US person" should not be subject to ad hoc future expansion. That is, the prefatory phrase "includes, but is not limited to" creates regulatory uncertainty and should be struck. In light of the general use of "non-US person" throughout the Propose Guidance, the Commission could also affirmatively state that non-US persons are any persons who do not meet the definition of US person, although this may be moot if the prefatory language is struck.

1. Practical Considerations

(a) As a general matter, it may be difficult or impossible for a party to a swap to obtain the information needed to determine the status of their counterparties under the proposed US person definition and the subsidiary categories of persons guaranteed by or acting as conduits for US persons. Therefore, ISDA believes that as one option for determining such status the

Commission should permit reliance on representations from a counterparty regarding the counterparty's status as a US person, guaranteed person, conduit or non-US person.

(b) As the proposed definition applies to commodity pools, it raises ambiguity and requires potentially unascertainable information. To address these concerns, ISDA respectfully requests that at a minimum the Commission:

- Notwithstanding prong (iv) of the proposed definition of US person, treat as non-US persons any publicly traded commodity pool (or other collective investment vehicle) whose interests are traded on a secondary market if interests were offered initially in "offshore transactions" without registration of those interests under the Securities Act of 1933—i.e., to non-US persons under Regulation S; and

- Clarify the scope of prong (v) of the proposed definition of US person, which applies to collective investment vehicles where the operator "would be required to register" as a commodity pool operator, generally and in particular by stating that the mere fact that an operator has claimed a registration exemption, such as under Commission Rule 4.13, does not make the operator per se a US person.

(c) We note that the Commission has proposed a single definition of "US person" that would apply for classifying swap dealers and MSPs as well as their counterparties. It is not clear that this definition laden with situational complexities, is intended to have broader use under the CEA. ISDA urges the Commission to be clear as to the scope of use of this definition. ISDA also urges the Commission not to adopt more than a single definition of "US person" without first publishing such a proposal and allowing sufficient time for public comment.

2. Flawed Approach to Non-US Entity Ownership

ISDA believes that the inclusion in prong (ii)(B) of the proposed US person definition of any non-US entity in which the direct or indirect owners are responsible for liabilities and one or more of which are US persons may be unworkable for several reasons. First, the Commission has not offered any explanation of what it means to be "responsible for liabilities"—does this include guarantees (which are a subject of much focus elsewhere in the Proposed Guidance) and sureties, simple risk of loss of equity, or other types of exposure? Second, as noted above, there may be no way for a swap dealer, MSP or the counterparty itself to know the nature of the indirect owners of an otherwise non-US person counterparty. Third, there is no "control" concept, so even negligible ownership interests by US persons would turn non-US business entities into US persons. In response to question 1c. in the Proposed Guidance and the above concerns, ISDA respectfully suggests that regardless of the nature of "responsibilities" for liabilities (a) only direct owners of apparent non-US persons be considered, and (b) the Commission adopt a presumptive control threshold of 25% direct ownership for distinguishing between control persons and owners who need not be considered in assessing the personhood status of an entity.

3. Suggested Additions to the Definition

(a) ISDA requests that the Commission exclude supranational organizations, such as the World Bank and International Monetary Fund (and similar organizations listed in 22 USC 288) and their affiliates, from the definition of US person. No clear policy goal is served by treatment of such organizations as US persons.

(b) In the case of accounts, the Commission should adopt the concept used by the SEC under Regulation S of generally looking to the status of a person holding investment discretion rather than the beneficial owner of an account. For example, a US person who grants investment discretion to a non-US person would be perceived as a non-US person under Regulation S, but as a US person under the Commission's proposed prong (iii). The SEC recognizes an exception to this principle, which the Commission should also adopt —i.e., the exercise of investment discretion by a US fiduciary would not cause the fiduciary's non-US principal to be classified as a US person under Regulation S.

B. Burdens Imposed by the Proposed Guidance:

1. Impracticality of an Eleventh Hour Information Collection Mandate

The Proposed Guidance and Proposed Order come as the timeline for swap dealer and MSP registration is about to start running and leaves market participants with the task of gathering counterparty information based on new, complex criteria that do not resemble any of the categories of information that market participants, particularly non-US market participants, have customarily needed to collect. The Commission should recognize the impracticality of a challenging operational and information gathering exercise, imposed without advance notice, at the same time as market participants must engage in preparing for registration and compliance with Section 4s requirements. The approaching compliance date of the external business conduct rules (which will require swap dealers and MSPs to determine the US person status of their counterparties, unless the rules are to be applied indiscriminately to all counterparties) illustrates the magnitude of the challenge.

An interim solution

If the Commission declines to adopt our recommendation set forth in Section VIII, then the Commission should permit market participants that have established mechanisms to record the residency or nationality of their counterparties (for example, for a local regulatory purpose) to use those same mechanisms to classify counterparties for purposes of determining swap dealer or MSP status and complying with Transaction-level requirements for an appropriate transitional period. This mechanism, which would avoid imposing the costs of duplicative implementation of both a proposed definition (or possibly a different interim final definition) and a final definition, could be put in place through interim Commission guidance or order. The final cross border guidance should then allow an adequate transition period before its US person definition takes effect to allow market participants to collect the necessary counterparty information and make necessary system changes.

2. Guarantees by US Persons

The proposed application of Transaction-level requirements to swaps with non-US persons guaranteed by US persons creates operational costs and complexity without a commensurate benefit to its stated goal of protecting against the importation of systemic risk to US guarantors. Transaction-level requirements primarily serve to safeguard the process by which counterparties enter into transactions and mitigate counterparties' exposure to the credit risks of swap dealers. However, the US guarantor's exposure is to the credit risk of the guaranteed non-US person (i.e., the primary obligor), not to the non-US swap dealer that is transacting with the primary obligor. The swap dealer never owes the guarantor money on the swap itself. Consequently, the proposed application of Transaction-level requirements does not follow from the Commission's stated rationale of protecting against the importation of risk.[18] This goal is adequately and more directly served by reporting of the positions of the US guarantor. A potential unintended consequence of the proposal could be to make it more difficult for US end-users to procure hedges through their non-US affiliates. Non-US dealer counterparties may be reluctant to deal with the affiliate without the US end-user's guarantee, but obtaining the guarantee would require either a comparability determination or compliance with US Transaction-level requirements.

3. MSP Threshold Computations for Transactions with Foreign Branches of US Swap Dealers

ISDA recommends that non-US persons be permitted to disregard transactions with foreign branches of US swap dealers in determining whether the non-US person exceeds the thresholds for MSP status. Although ISDA acknowledges the distinction between the risk-based nature of the MSP registration category, as opposed to the activities-based nature of the swap dealer definition, ISDA is concerned that the complexity of the MSP threshold computations would cause non-US persons to refrain from transacting with foreign branches of US swap dealers, rather than undertaking the effort to understand and implement a system for monitoring the MSP thresholds. Because US swap dealers will be subject to capital and other financial responsibility regulation by the Commission or prudential regulators, other means exist to address systemic concerns related to swap dealers incurring excessive counterparty credit exposure to putative non-US MSPs.

C. Entity Level and Transaction Level Requirements

ISDA believes that the proposed categorization of compliance requirements should be modified as described below. [19]

[18] *See* Proposed Guidance at 41,228, footnote 107. Stated differently, there is a non sequitur in the discussion between the Commission's statement that "the risk of non-performance *by the counterparty* [emphasis added] rests with the US [guarantor]" and its statement that it has a "strong regulatory interest in the performance of the swap *by both parties* [emphasis added]…." *Id*.

[19] We note that the Basel Committee on Banking Supervision (BIS) and the International Organization of Securities Commissions (IOSCO) have recently published a consultative paper on margin requirements for non-centrally-cleared derivatives. The CFTC has been participating in an international effort to harmonize margin requirements for uncleared swaps and has reopened the comment period on its proposed margin rules. We do not

1. SDR Reporting

The reporting component of the Part 45 Rules raises complex questions regarding the compatibility of reporting with local privacy and data protection laws. Because the application of these laws generally depends on the nationality of the swap dealer's counterparty, this issue could be alleviated by classifying SDR reporting as a Transaction-level requirement, which therefore would apply only to counterparties that are US persons. Guaranteed non-US persons are not likely to be regarded as US nationals under applicable privacy laws and, accordingly, SDR reporting should not apply to them.

2. Real-time Reporting and Trade Execution

ISDA believes that real-time reporting and trade execution should be treated in the same manner as the external business conduct rules – that is, they would not apply when the counterparty is a non-US person (except, as currently proposed, in the case of a US-based dealer transacting directly), without any need to establish substituted compliance. Similarly to the external business conduct rules, these requirements relate to price discovery at the time a counterparty decides to enter into a transaction. Moreover, these requirements relate primarily to market structure and client protections in the jurisdiction of the transaction, topics over which home country regulators have a greater supervisory interest than the Commission. The same considerations apply equally to a US swap dealer transacting directly with a non-US counterparty outside the United States. For that reason, and in the interest of competitive parity between US and non-US swap dealers, ISDA believes that these rules also should not apply to a US swap dealer transacting directly with non-US persons outside the United States.

3. Portfolio Compression

ISDA believes that the proposed classification of portfolio compression as Transaction-level is generally appropriate. ISDA requests, however, that the Commission clarify that participation in portfolio compression would be mandatory only for swap transactions between two swap dealers or MSPs that are Commission registrants.[20] This clarification would recognize that a swap dealer or MSP has no means to compel a counterparty that is not subject to the Commission requirement to participate in an offset or compression.

D. Technical Improvements and Inconsistencies with Other Commission Rules

1. De Minimis Exemption

(a) In its current form, the rule for aggregating affiliates' trades for purposes of the de minimis thresholds produces anomalous results. ISDA suggests that swaps by a registered swap

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see that the BIS-IOSCO paper would cause a change in the Commission's proposed characterization of the margin requirements as Transaction-level. Were such a change contemplated, we trust the Commission would provide notice and comment opportunity.

[20] Note 1 to the first table in Appendix B of the Proposed Guidance (page 41,237) states that participation would be mandatory for "dealer to dealer" trades, introducing ambiguity as to whether the statement is limited to Commission registrants.

dealer not be counted by the swap dealer's affiliates under their own de minimis computations. This would fix an anomaly in the de minimis rule: As the rule is currently formulated, if a swap dealer in the group transacts more than $8 billion in swaps, all of the swap dealer's affiliates (who must aggregate the swap dealer's swaps) become ineligible for the de minimis exemption.

(b) The proposed asymmetric application of aggregation (i.e., US affiliates aggregate the entire worldwide group, but non-US affiliates aggregate only the non-US group)[21] produces arbitrary results. Consider a group (either US or non-US) that has a US affiliate with $500m of swaps and a non-US affiliate with $7.6bn of swaps with US persons. As proposed, the US affiliate must register. It is unclear why such a bias toward registration of the US affiliate is appropriate. If an exclusion from aggregation for an affiliated swap dealer's swaps (as described in the preceding paragraph) were in place, then the group in this example could decide which entity registers (and thereby bring the swaps attributable to the other entity under the threshold).

(c) Under the Proposed Guidance, swap dealing transactions of a non-US person with other non-US persons are to be counted for de minimis test purposes if the obligations of the first non-US person (i.e., the one evaluating its de minimis status) are guaranteed by a US person. The rationale for this approach is to protect US guarantors by requiring swap dealer registration of the guaranteed party.[22] To the extent this is a valid concern (which we question), we suggest that it is more appropriately addressed in connection with the question of when (if ever) a US guarantor must register as a swap dealer, rather than as an element of the non-US person's registration analysis. In the typical case where the guarantor and guaranteed party are affiliates, the intra-group guarantee reflects an allocation of risks and activities within the corporate group and is not a dealing activity of the non-US entity. As the Commission recognized in adopting the Entity Definitions, transactions between majority-owned affiliates do not implicate the concerns that dealer regulation was meant to mitigate.[23] Similarly, the fact of a guarantee provided by one affiliate on behalf of another should not alter the nationality of the second affiliate.

2. <u>US Guarantors and Indirect Booking Entities</u>

(a) A US guarantor should never need to register as a swap dealer solely by reason of its guarantees of an affiliate's swaps. This is manifestly the case if the guaranteed affiliate is subject to capital regulation by either a US or a non-US regulator. The comparability of a non-US affiliate's capital and risk management regimes could be vetted through a Commission determination that does not entail full swap dealer registration of the non-US affiliate. We note that much complexity is engendered by the Commission's still inchoate treatment of guarantees in the final product definitions and its inconsistency with the SEC's position that guarantees of security-based swaps are not security-based swaps.

(b) The Proposed Guidance states that US persons to whom swaps are indirectly transferred by back-to-back swaps or other arrangements with non-US affiliates must register as

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21 *See* Proposed Guidance at 41,221.

22 *Id*.

23 *See* section 1.3(ggg)(6)(i) of the Commission's regulations.

swap dealers.[24] The statement of this interpretation makes no mention of a requirement that the non-US affiliate be engaged in swap dealing above a de minimis threshold, or that there be a direct correspondence between the non-US dealing and the back-to-back swaps. Unless clarified, this formulation could have the unintended consequence of requiring a large number of additional entities to register as swap dealers in circumstances where little purpose would be served by such registration. It would capture, for example, the scenario where a non-US dealing entity with solely non-US customers uses a US affiliate to hedge risks of US underliers. In addition, the interpretation is inconsistent with the inter-affiliate transaction exclusion (i.e., that inter-affiliate swaps are not considered in determining dealer status) articulated in the Entity Definitions. It fails to recognize differences between swap dealing and acting as a hedge provider to an affiliate engaging in non-US dealing activity. ISDA requests that the Commission clarify that the US affiliate may apply the inter-affiliate exclusion as set forth in the entity definitions in determining its status as a dealer. Similarly, back-to-back hedging arrangements between a US swap dealer and its non-US affiliates should not in and of themselves require the non-US affiliate to register as a swap dealer absent anti-evasion concerns.

3. Clearing and Related Rules

The Proposed Guidance does not consider questions relating to cross-border swap clearing. For example, it does not address the existing lack of clarity regarding the application of the futures commission merchant registration requirement to non-US clearing members, nor does it address the potential for conflicting clearing mandates. ISDA urges the Commission to address the extraterritorial impact of the Title VII clearing mandate generally through a rule proposal with an appropriate period for public comment.

This special need for clarity relates as well to issues created by the overlay of multiple regulatory strands in the cleared swap context. For example, the Proposed Order has the perhaps unintended effect that the compliance dates for Commission Rule 1.71(d) and Commission Rule 23.605(d), which address clearing-related conflicts of interest of, respectively, futures commission merchants and affiliated swap dealers/MSPs, no longer coincide, despite the fact that the cooperative efforts of both the futures commission merchant and the swap dealer/MSP affiliates will be required to implement the rules' requirements. ISDA requests that the Commission extend the compliance date for Rule 1.71(d) to coincide with the extended period offered to swap dealers and MSPs under the Proposed Order.

VI. International and Domestic Regulatory Coordination Required

A. International

Even before the Dodd-Frank Act was law, there was international consensus that only unified, consistent, international implementation of regulation could succeed in the global derivatives markets. This is clear from the declaration issued by the G-20, following the September 2009 Pittsburgh meeting.[25] The Pittsburgh consensus is the recognized source of the

24 Proposed Guidance at 41,222.

25 *See* Pittsburgh Summit Declaration, available at http://www.g20.org/images/stories/docs/eng/pittsburgh.pdf (the "**Leaders' Statement**").

primary goals of derivatives regulation that became embodied in vastly elaborated form in the US in the Dodd-Frank Act. The Pittsburgh meeting produced no mandate for unilateralism; the G-20 was designated by the leaders as "the premier forum for our international economic cooperation."[26] The G-20 saw its mission as implementing "global standards in a way that ensures a level playing field and avoids fragmentation of markets, protectionism, and regulatory arbitrage…."[27]

It is vitally important to observe that the G-20 set only four goals with respect to derivatives regulation: clearing and exchange trading of standardized derivatives; reporting to trade repositories; and higher capital requirements for uncleared trades.[28] Obviously, Title VII of the Dodd-Frank Act goes far beyond the G-20 goals. Yet, the Proposed Guidance would require international imposition of virtually all of Title VII, subject in certain cases to comparability determinations by the Commission that will (i) require a matching of regulatory outcomes across 14 categories of Title VII regulation and (ii) produce a patchwork of regulatory outcomes. This conflicts with the G-20 consensus approach and suggests that the United States is walling itself off, essentially putting its market (and market participants) at risk in order to convince the rest of the G-20 to follow the US lead in expanding derivatives regulation.

The timing of the Commission's implementation also is inconsistent with the spirit of G-20. Although the G-20 suggested year-end 2012 as the date by which OTC derivatives goals were to be achieved, the Financial Stability Board created by the G-20, however, has just noted that, from a global perspective, more time will be needed.[29] It appears inconsistent for the Commission to propose full-bore domestic implementation by the end of 2012 and extraterritorial implementation by the end of 2013, subject to the comparability determinations and related memorandum of understanding processes mentioned above. As described in Section II of our letter above, it is not clear that these determinations can be made and MOU processes completed in the designated time frame – leaving a fractured compliance map that will lead to regulatory arbitrage.

The Commission's expansive approach risks upsetting the broad international consensus established in Pittsburgh. Offering a speculative "comparability" recognition process and a year's difference between domestic and international implementation does little to diminish the acute departure from the principles of cooperation expressed at the Pittsburgh meeting.

The immediately distressing effects of Commission cross-border activism are of course not restricted to US "onshore" markets. Valued trading-partner jurisdictions, such as Japan (see Section II.C. above), for example, are important venues of transactions involving potential US persons. An array of potential regulatory conflicts or mismatches cannot fail to burden non-US market activity.

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[26] Leaders' Statement ¶ 19.

[27] Leaders' Statement ¶ 12.

[28] *See* Leaders' Statement at ¶ 13.

[29] *See* Third Progress Report on Implementation of OTC Derivatives Market Reforms, available at http://www.financialstabilityboard.org/publications/r_120615.pdf.

ISDA believes that section 752(a) of the Dodd-Frank Act, see footnote 3 above, evidences Congressional intent that the Commission engage in a constructive dialogue with non-US regulators during the formulation of the global regulatory framework rather than unilaterally setting a precedent for regulation to be subsequently imposed on non-US regulators through the "substituted compliance" analyses. ISDA also believes that the principles of comity recognized in passing by the Commission,[30] if considered with care should produce a less disruptive approach than that now proposed.

B. Domestic

In addition, Title VII of the Dodd-Frank Act essentially splits jurisdiction over the swaps market between the Commission and the SEC. Section 712 of the Dodd-Frank Act stipulates that the Commission shall consult and coordinate with the SEC "for the purpose of assuring regulatory consistency and comparability to the extent possible."[31] Although the SEC has its own extraterritorial mandate in section 772,[32] the need for regulatory consistency is undiminished. Many swap businesses will, of course, deal in products causing them to be subject to the jurisdiction of both regulators. Differences in treatment of extraterritorial issues will create obvious impediments to business success.

In its June 11, 2012 "Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps" (the "**SEC Policy Statement**"), the SEC indicated the primacy of extraterritorial concerns in its own regulatory plans.[33] Given the degree of importance granted to extraterritoriality by the SEC, it is an appropriate time for thoughtful inter-agency consultation intended to promote necessary consistency on the part of the two primary US swap regulators.

VII. Jurisdiction Based on Activities with Direct and Significant Effect on US Commerce

The Commission has proposed a novel and expansive extraterritorial framework different from its own past practice in stated reliance on CEA section 2(i). As added by Dodd-Frank Act section 722, this section provides:

> The provisions of [the CEA] 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 [emphases added] those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States; or (2) contravene

[30] Proposed Guidance at fn. 60 and accompanying text.

[31] The duty to consult extends to the prudential regulators. Although the prudential regulators have a more limited role in swap regulation than the CFTC or SEC, their long, successful practice in home/host country regulation could provide a useful model

[32] That abbreviated provision would appear to be an artifact of the appearance of a key US Supreme Court decision shortly before passage of the Dodd-Frank Act. *See* Morrison v. National Australia Bank Ltd., 130 S. Ct. 2869 (2010). Although Morrison deals with SEC jurisdiction, there is no reason to believe the general principles espoused by the decision do not apply equally to the Commission's jurisdiction.

[33] 77 Fed. Reg. 35625, 35629.

> such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of [the CEA] that was enacted by [Title VII of the Dodd-Frank Act].[34]

This provision mandates restraint ("not…unless") not exhibited in the Proposed Guidance. The provision calls for a circumspect focus on specific activities and, as section 752(a) provides, due regard for international harmonization.

The Proposed Guidance, however, states the Commission's view that the level of swap dealing that is substantial enough to require a person to register when conducted by a US person also constitutes a "direct and significant connection" within the meaning of CEA section 2(i)(1) when such dealing activities are conducted by a non-US person with US persons as counterparties.[35] Once registered, it appears that the Commission views a non-US swap dealer (or non-US MSP) as entirely subject to the Dodd-Frank Act's provisions, despite that the statutory authority is focused on *activities* to be regulated, not the registration status of the persons potentially engaged in those activities. In other words, the Commission's interpretation overshoots the statutory mark. For example, how can the duties of a chief compliance officer, or elements of a risk management program, as they apply to swaps activities with non-US counterparties, have a direct or significant effect on US commerce? In effect, the Proposed Guidance expresses the view that registration either turns all subsequent activities into activities with direct and significant effect on US commerce or implies that registration is consent to Commission jurisdiction with respect to any activities thereafter that otherwise would not have such effect.

Similarly, the Proposed Guidance purports to impose compliance obligations (however unclear) on a non-US person that is not registered as a swap dealer or MSP for clearing, trade execution, real-time reporting and SDR reporting when the non-US person's counterparty is a US person, even when the transaction is outside the United States.[36] It is not apparent how or when this fact pattern will have a direct and significant effect on US commerce. ISDA recommends that the Commission reconsider the application of the Entity-Level Requirements and Transaction-Level Requirements in light of the statutorily required "activities"-oriented review. Such a review should, at the least, militate in favor of our recommendation set forth below.

VIII. Concluding Recommendation

ISDA recommends that the Commission postpone issuance of final cross-border guidance until an understanding in principle as to overlapping jurisdiction and comparable regulatory

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34 After initially listing the full text of CEA section 2(i) on page 41,217, the Proposed Guidance makes no further mention of subsection 2(i)(2). It appears that the Commission has rightfully concluded that the second subpart is directed only at actions abroad that might conceal a domestic violation and accordingly does not provide an independent basis for extraterritorial projection of prophylactic rules.

35 *See* Proposed Guidance at 41,219. A similar view is expressed with respect to MSPs at 41,220.

36 *See* Proposed Guidance at 41,234. As a technical point, this is inconsistent with SDR Reporting Rule 45.8, which says that for a swap between a US person and a non-US person, the US person is the reporting party.

content is reached among the Commission, the SEC, and important non-US regulators.[37] Until the effective date of this final guidance, the Commission should further extend its temporary exemption from all swaps provisions in and under Title VII of the Dodd-Frank Act, as though the final "swap" definitions had not been published. As expressed by the SEC in the SEC Policy Statement, defining the extraterritorial boundaries of Title VII is as fundamental to an orderly implementation of its provisions as the product and entity definitional rules. Although the lack of certainty and of an adequate period to adapt to the novel elements of the Proposed Guidance might appear to affect only the extraterritorial application of Title VII, a comparably extended timeline for compliance domestically is necessary so as not to distort the competitive dynamics of the marketplace and to allow decisions regarding the allocation of swaps business among US and non-US affiliates to be made in an environment of legal certainty.

In order to allow an adequate preparation period and give the market notice as to its duration, the Commission should tie the expiration of the temporary exemptive relief to the publication of final cross-border guidance.

Ultimately, upon completion of the regulatory agenda by the G-20 jurisdictions, the Commission will be able to determine whether they have ultimately produced consistent regulations. Assuming this outcome, the Commission could promote simplicity, consistency and a level playing field by adopting a reciprocal mutual recognition regime along the following lines. First, non-US swap dealers regulated by a G-20 jurisdiction would not be subject to US regulation, except with respect to Transaction-Level requirements on trades done with US persons where the person exercising trading discretion on behalf of the US counterparty is physically located in the United States. Second, this relief should be conditioned on a reciprocal arrangement with the non-US swap dealer's home country regulators to the effect that US swap dealers should never be subject to regulation by that jurisdiction, except in respect of trades done with residents of that jurisdiction where the person exercising trading discretion on behalf of the non-US counterparty is physically located in the non-US jurisdiction.

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ISDA appreciates the opportunity to provide these comments. Should you require further information, please do not hesitate to contact me or ISDA staff.

Sincerely,

Robert Pickel
Chief Executive Officer

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[37] As an example of the type of process this would entail, we note the Commission's participation in international efforts to harmonize margin requirements for uncleared swaps and its reopening of the comment period on its own proposed margin rules. See footnote 19 above.