



AFR Statement Regarding CFTC Guidance On Cross Border Derivatives

With this guidance the CFTC has made clear its intent to ensure that derivatives trading conducted in foreign subsidiaries of U.S. banks complies with the new derivatives protections in the Dodd Frank Act. Wall Street has lobbied hard to limit the reach of the CFTCs oversight in ways that would totally undermine effective regulation of derivatives markets, and AFR applauds the CFTC for its intent to maintain the reach of the law.

Over half of the derivatives operations of major Wall Street banks are conducted through foreign subsidiaries. Wall Street banks are global businesses, and effective derivatives regulation will be impossible unless they are regulated as such. In 2008, the London activities of AIG Financial Products led to a massive bailout by U.S. taxpayers. Today, over \$5 billion in derivatives losses in JP Morgan's London office are again demonstrating that losses in foreign subsidiaries rebound directly on the U.S. parent company. The Dodd Frank Act recognizes the potential threat to the U.S. financial system from derivatives transactions conducted overseas by requiring the CFTC to oversee all derivatives activities that have an effect on U.S. commerce. This guidance implements that directive.

The guidance does envision a major role for so-called 'substituted compliance', in which the CFTC could stipulate that the foreign country regulatory regime satisfies Dodd-Frank derivatives requirements. The Commission proposes to permit substituted compliance even where the connection between derivatives activity and risks to the U.S. economy is extremely clear, such as transactions involving foreign subsidiaries of U.S. firms that are guaranteed by the parent company. To avoid major loopholes in derivatives regulation that could threaten the stability of the U.S. financial system, it is vital that permitting substituted compliance not be a pro forma exercise. Substituted compliance must only be permitted in cases where both the requirements and the enforcement of derivatives protections are genuinely equivalent between the foreign regime and the United States. It is encouraging in this regard that the guidance refers to a comprehensive process for the determination of comparability. Properly implemented, substituted compliance can create a powerful incentive for major financial centers to

coordinate around a strong and effective derivatives oversight regime, and is compatible with recognized principles of international comity

An additional important issue raised by the guidance is the question of when an international subsidiary or affiliate is guaranteed by its U.S. parent. The CFTC correctly recognizes that such guarantees create a direct relationship between U.S. economic activity (including risks to the U.S. financial system) and foreign affiliate derivatives transactions. However, it is crucial that the full range of guarantees be recognized as significant, including informal or de facto guarantees driven by reputational considerations. This is especially true since under this guidance trades involving non-guaranteed affiliates could escape any U.S. oversight whatsoever.

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