



**Americans for Financial Reform**  
1629 K St NW, 10th Floor, Washington, DC, 20006  
202.466.1885

July 3, 2013

The Honorable Gary Gensler  
Chairman  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, DC 20581

The Honorable Bart Chilton  
Commissioner  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

The Honorable Scott O'Malia  
Commissioner  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

The Honorable Jill Sommers  
Commissioner  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

The Honorable Mark Wetjen  
Commissioner  
Commodity Futures Trading Commission  
1155 21<sup>st</sup> Street N.W.  
Washington, DC 20581

Dear Members of the Commodity Futures Trading Commission:

On behalf of Americans for Financial Reform, we are writing to urge you to protect the U.S. economy and provide clarity to the markets by finalizing a strong guidance covering the cross-border application of the Commission's derivatives rules by July 12<sup>th</sup>.<sup>1</sup> It is important that this guidance be finalized rapidly, and also that it be strong enough to be effective in overseeing the full range of derivatives transactions that have a direct and significant connection to the U.S. economy. For this reason, this letter also details key strengths of the guidance already proposed by the Commission that must be retained in the final guidance, and identifies two specific weaknesses in the already proposed guidance that should be corrected.

As you know, July 12<sup>th</sup> marks the expiration date of the current order granting temporary exemptive relief from extraterritorial enforcement of Dodd-Frank derivatives rules. There is no excuse for further delay. The Commission has been considering cross-border issues for over two

---

<sup>1</sup> [Americans for Financial Reform](http://www.ourfinancialsecurity.org) is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, religious and business groups.

years, and the July 12<sup>th</sup> deadline will mark a year since the Commission first proposed its guidance concerning extraterritorial applicability of derivatives regulation. Over that time, the Commission has received over 300 comment letters and held numerous meetings, as well as public round tables.

The practical impact of failing to finalize cross-border rules in a timely manner would be to delay the effective implementation of derivatives oversight as a whole. Three years after the passage of the Dodd-Frank Act, this is unacceptable. Strong extra-territorial enforcement of derivatives reforms is absolutely central to protecting the U.S. economy and U.S. taxpayers from the risks of unregulated derivatives markets. Almost every major financial scandal involving derivatives – from the collapse of Long Term Capital Management's Cayman Island operations in the 1990s, to the bailout of AIG's London-based trades in 2008, to JP Morgan's recent "London Whale" trading losses – has involved U.S.-controlled derivatives transactions conducted through a nominally foreign entity. The largest global banks can shift derivatives risks and funding between numerous international subsidiaries at the touch of a computer keyboard. Indeed, major Wall Street banks currently conduct over half of their derivatives transactions through overseas subsidiaries, and could increase this percentage in response to weak cross-border jurisdiction. Without cross-border applicability, there is no effective regulation of derivatives.

The global derivatives market is a trans-national market that is not limited by geographical boundaries. We realize that there are complexities associated with the regulation of such a market. But such complexities cannot be addressed through indefinite delay. Other global jurisdictions significantly lag the United States in the implementation of their derivatives rules. The Commission is in fact the only global regulatory entity that was prepared to fully implement derivatives regulation by the agreed G-20 deadline of the close of 2012.<sup>2</sup> The Commission has already delayed action beyond this deadline for seven months; further delay would abandon a position of global leadership and replace it with a possibly indefinite wait for universal international consensus on the full scope of derivatives rules.

Furthermore a generalized strategy of deferring to host countries which do not bear liability for the failure of a U.S. bank is deeply misguided. Such deference will create significant incentives for a 'race to the bottom' in global regulation. The risks from unregulated derivatives transactions performed through foreign subsidiaries of U.S. banks, or foreign banks that are major dealers on the U.S. market, plainly impact the U.S. economy directly and can place U.S. tax payers at risk. Section 722 of the Dodd-Frank Act clearly instructs the Commission to enforce its regulatory mandate in such cases.

It is also important to note that the Commission's proposed cross-border guidance of July, 2012 contains ample provisions for accommodating regulatory overlap with foreign jurisdictions, once

---

<sup>2</sup> [G-20 Leaders' Statement](#), The Pittsburgh Summit (the "Pittsburgh Communiqué"), Pittsburgh, PA, September 24-25 2009, Paragraph 13.

such jurisdictions fully implement derivatives rules that are genuinely equivalent to U.S. rules. Indeed, AFR and other groups have criticized the Commission for what is if anything an excessive reliance on ‘substituted compliance’ with foreign rules, as well as for proposals which may permit U.S.-related transactions to evade Dodd-Frank altogether. Having crafted a proposed guidance that clearly includes extensive accommodation for the international nature of the derivatives markets, and having considered this proposal for a year, it is now past time for the Commission to act.

In order to provide clarity to the market and give the necessary direction to implementation efforts at international financial firms, the Commission’s action must decisively reject further delay. It would be reasonable for a finalized guidance to include a phased implementation schedule, in which specific dates are given on which particular elements of cross-border jurisdiction become operational. However, this schedule must be measured over months, not years. Approaches that continue to leave fundamental elements of the cross-border guidance in doubt and open to further delay and financial industry obstruction, including a possible ‘interim final guidance’, move in the wrong direction. It does not make sense to effectively restart the process of considering the proposed guidance.

It is also vital for the final guidance to effectively implement the statutory directive that the Commission’s regulations cover all transactions with a ‘direct and significant’ connection to the U.S. economy. Finalizing a weak guidance could be as destructive to effective derivatives oversight as additional delay. AFR’s various comment letters on the proposed guidance have criticized several broad issues with the Commission’s proposed guidance, including an overreliance on substituted compliance and a failure to fully address the issue of implicit guarantees for foreign subsidiaries that lacked an explicit written guarantee of derivatives liabilities.<sup>3</sup> This second issue has also been raised in a recent Congressional letter.

While holding to these criticisms, we realize that at this date it is valuable to focus on highly specific issues that are the highest priorities for correction in the final guidance. To this end, we would like to draw the Commission’s attention to two key weaknesses in the proposed guidance that must be corrected for a final guidance to be fully effective:

**The final guidance must define collective investment vehicles owned or promoted by U.S. persons and/or operated in the United States as U.S. persons:**

The final exemptive order of January, 2013, contained a specific carve out from the definition of U.S. person for collective investment vehicles (e.g. hedge funds) registered in other countries but operating in the U.S. from the definition of ‘U.S. person’.<sup>4</sup> This definition means that a hedge fund owned or sponsored by a U.S. person, operating in the United States, yet registered in a foreign jurisdiction would not be subject to Dodd-Frank regulation for its derivatives transactions. This description

---

<sup>3</sup> See e.g. Americans for Financial Reform, “[Comment For Proposed Rule 77 FR 41213](#)”, August 28, 2012.

<sup>4</sup> See CFR 879, “[Final Exemptive Order Regarding Compliance With Certain Swap Regulations](#)”, RIN 3038-AD85, Federal Register, Volume 78, No. 4, January 7, 2013.

applies to a large fraction of U.S. hedge funds, which are registered in foreign jurisdictions for tax purposes. It was exactly those kinds of entities that triggered the failure of Bear Stearns in early 2008. It is crucial that this loophole be addressed in the final guidance.<sup>5</sup>

**The final guidance must bring transactions between foreign companies and guaranteed subsidiaries or conduits of U.S. entities under Dodd-Frank regulation.** The proposed guidance of July 2012 divides U.S.-related derivatives transactions into several categories. Transactions involving U.S. persons are placed directly under U.S. derivatives regulation. Transactions between two entities that are not themselves U.S. persons, but are foreign subsidiaries guaranteed by U.S. persons or acting as a conduit entity for U.S. persons fall under U.S. jurisdiction but are eligible for substituted compliance (i.e. they can satisfy U.S. regulatory requirements by complying with comparable foreign regulations). However, a transaction between a guaranteed foreign subsidiary or conduit of a U.S. person and a genuinely foreign entity escapes any U.S. regulatory oversight whatsoever.<sup>6</sup> Thus, for example, a transaction between a guaranteed Hong Kong subsidiary of Goldman Sachs and a Chinese bank would escape Dodd-Frank transaction requirements altogether.

This does not make sense. These kinds of transactions clearly do have a connection to the U.S. economy, as they expose the U.S. financial institution involved to the threat of default by the foreign counterparty. It is precisely these sorts of transactions between a U.S. entity and a foreign bank that were bailed out by the U.S. taxpayer in the case of, for example, AIG Financial Products.<sup>7</sup> Given their clear connection to the U.S. economy, it is unclear why these transactions were not covered by at least a requirement for substituted compliance. Certainly the creation of U.S. jobs or economic activity cannot provide a public policy justification for this exemption. The exemption could create incentives to outsource derivatives business to foreign subsidiaries of U.S. banks. Any relationship between the derivatives business of foreign subsidiaries and the creation of U.S. jobs is unclear and may be negative. Furthermore, the assurance of proper risk management practices created by adhering to derivatives rules may create a competitive advantage. Derivatives transactions between foreign subsidiaries of U.S. entities and non-U.S. institutions should be covered by Dodd-Frank rules, at least on a substituted compliance basis.

---

<sup>5</sup> This could easily be done by simply striking the language “other than funds or collective investment vehicles” from the language defining ‘U.S. person’ at Part 1(ii)(B) of the January, 2013 exemptive order (CFR 879). It is the inclusion of this language that is most important in creating the loophole described here, although it would also be useful to add additional language specifying that hedge funds sponsored by U.S. persons are defined as U.S. persons regardless of location.

<sup>6</sup> See for example the explanatory charts on CFR 41237 of the Commission’s [“Cross-Border Application of Certain Provisions of the Commodity Exchange Act”](#), Federal Register, RIN 3038-AD57, Volume 77, No. 134, July 12, 2012.

<sup>7</sup> Mary Williams Walsh, [“AIG Lists Banks It Paid With U.S. Bailout Funds”](#), New York Times, March 15, 2009.

In addition to correcting these two weaknesses in the Commission's proposed guidance, the final guidance must retain some key strengths of the proposed guidance. These include:

- **Ensuring that transactions involving one U.S. counterparty fall under full Dodd-Frank oversight:** Given the narrowness of the U.S. person definition in the proposed guidance, it is crucial that transactions involving a U.S. person be fully subject to Dodd-Frank rules and not substituted compliance. Failing this, an unacceptably large proportion of the U.S. derivatives market is likely to fall under substituted compliance. For example, the so-called 'New Jersey trade' – a transaction between a swap dealer that is not a U.S. person and a full U.S. person located or operating in the U.S. – should fall under Dodd-Frank and not substituted compliance. This is true under the current proposed guidance and should be true in the final guidance.
- **Retaining coverage of both conduit and guaranteed transactions by non-U.S. persons under substituted compliance:** AFR and other groups criticized the Proposed Guidance last year for inadequate coverage of foreign subsidiaries that are non-U.S. persons. That said, one way in which the proposed guidance does provide some protections with regard to such subsidiaries is its coverage - under substituted compliance - of transactions between non-U.S. persons which are either 1) explicitly guaranteed by U.S. persons, or 2) acting as a conduit for U.S. persons. It is crucial that both of these provisions are kept in the final guidance. It is vital to keep full coverage of conduit transactions, as this is the only mechanism by which the Proposed Guidance addresses the possibility of an implicit subsidy for a subsidiary that plays a critical role for the corporate group but does not have an obvious written guarantee.
- **Preserving an explicit point-by-point comparability procedure for determining substituted compliance:** Given the broad scope of substituted compliance in the Commission's proposals, it is vital that a full and complete comparability procedure be retained for determining eligibility for substituted compliance. The proposed guidance has such a procedure. It requires an extensive point-by-point comparison between each specific area of U.S. and foreign regulations to determine whether rules are actually equivalent and substituted compliance is permitted. The final guidance should retain this procedure. A presumption of comparability for major jurisdictions must be avoided, as must a broad determination of comparability based on shared principles or undefined 'outcomes' that could easily be so general as to be meaningless.

Thank you for your consideration of this letter. Again, we urge you to finalize a strong cross-border guidance by the July 12<sup>th</sup> deadline, a guidance which addresses key weaknesses in the proposed guidance and also retains the strong points of that proposal. Should you have questions, please contact Marcus Stanley, AFR's Policy Director, at (202) 466-3672 or [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org).

## **Following are the partners of Americans for Financial Reform.**

*All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.*

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International

- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defender's League
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- Institute for Trade and Agriculture Policy
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club

- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

*List of State and Local Partners*

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC

- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending

- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

***Small Businesses***

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET

