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Ms. Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Cross-Border Security Based Swaps Activities; File Nos. S7–02–13; S7–34–10; S7–40–11

Americans for Financial Reform ("AFR") appreciates this opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") in regard to the Securities and Exchange Commission's ("SEC's") request for comment on the Commission's proposed rule on Cross-Border Security-Based Swap Activities[1] ("Proposed Rule") that sets forth guidelines for how the protections for security based swaps ("SBS") established by the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] ("Dodd-Frank") should apply on a cross-border basis.[3]

In 2008-2009, the American economy lost millions of jobs and trillions of dollars due to the largest financial crisis since the Great Depression. The unregulated, over-the-counter derivatives market was a significant contributor to this crisis. Risks taken by foreign subsidiaries, affiliates, branches, agencies, and other related entities of U.S. firms also played a significant role in the crisis. For example, the U.S. insurance conglomerate, AIG, required a $182 billion bailout after its U.K. subsidiary, AIG Financial Products, "nearly toppled the U.S. economy"[4] because of hundreds of millions of dollars uncollateralized and under-capitalized SBS. Citibank and Bear Stearns also suffered significant losses as a result of trades by their Cayman Island

[1] Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants; Proposed Rule, 78 Fed. Reg. 30968 (May 23, 2013) [hereinafter "Proposed Rule"].
[2] Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter "Dodd-Frank Act"].
[3] Americans for Financial Reform is an unprecedented coalition of more than 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, faith based and business groups.
[4] Financial Crisis Commission Report, p. 350 *Available at*: http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf

affiliates,[5] and in 2012, JPMorgan lost $6.2 billion on swaps trades performed by the "London Whale."[6]

The significance of this rule is underlined still further by the ubiquity of cross-border transactions in the current security based swaps market. As the Commission points out, only 7 percent of transactions in the U.S. SBS market in 2011 were conducted between two counterparties that were both domiciled in the United States.[7] Therefore, the procedures laid out in the Proposed Rule could govern over 90 percent of the SBS market.

Congress enacted Dodd-Frank "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system" and "to protect the American taxpayer by ending bailouts" and the "abusive financial services practices"[8] that led to the 2008 financial crisis. Establishing a regulatory regime that would allow U.S. financial institutions to easily circumvent U.S. financial regulations through their foreign affiliates would clearly conflict with this goal. Given that the overwhelming preponderance of transactions involving U.S. counterparties in the SBS market could be defined as 'cross-border', it is clear that routine oversight of many of these transactions under Dodd-Frank rules is necessary to achieve Congressional intent of improving the accountability and transparency of the U.S. financial system.

We and similarly-minded public interest organizations and individuals submitted numerous comment letters to the Commodity Futures Trading Commission ("CFTC") regarding its cross-border proposed guidance, dated August 13, 2012, August 27, 2012, and February 6, 2013. In fact, while the SEC clearly reviewed the financial service industry's and foreign regulators' comments to the CFTC on its cross-border guidance, the SEC does not acknowledge our substantial comments to the CFTC on this issue.[9] As we have repeatedly and publically asserted, it is essential that the regulatory agencies implementing Dodd-Frank protect American taxpayers from the risks associated with cross-border swap transactions.[10] Therefore, we incorporate these public comments by reference[11] and respectfully request that the SEC fully analyze and consider these documents as part of its cross-border rulemaking process.

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[5] Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act; Proposed Rule, Appendix 2 – Statement of Chairman Gary Gensler, 77 Fed. Reg. 41238, (July 12, 2012) (hereinafter "Gensler Statement").

[6] *Id*.

[7] 78 FR 30976

[8] *Id.* at Preamble.

[9] *See* Proposed Rule at 31278-81. The only pro-reform comments that the SEC lists as "considered" for this proposed rule is a letter by Better Markets. The other 84 letters are from the financial services industry or foreign regulators.

[10] Gary Gensler, CFTC Chairman, Keynote Address on the Cross-Border Application of Dodd-Frank Swaps Market Reforms Before the 2012 FINRA Annual Conference (May 21, 2012) [hereinafter "Gensler Keynote Address"] *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/opagensler-113.

[11] *See* Americans for Financial Reform, Comment Letter to the CFTC, "Exemptive Order Regarding Compliance With Certain Swaps Regulations," August 13, 2012; Americans for Financial Reform, Comment Letter to the CFTC, "Cross-Border Applications of Certain Provisions of the Commodity Exchange Act," August 27, 2012. *See also* I. Michael Greenberger, Comment Letter to the CFTC, "Exemptive Order Regarding Compliance with Certain Swap Regulations," August 13, 2012 ("Greenberger I"); I. Michael Greenberger & George Waddington, Comment Letter to the CFTC, "Proposed Guidance on Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act," August 27, 2013 ("Greenberger II"); I. Americans for Financial Reform, Michael Greenberger &

Summary

AFR believes that the proper implementation of Section 772(b) of the Dodd-Frank Act requires a cross-border regime that prevents the evasion of derivatives oversight rules in ways that undermine the core financial stability purposes of Title VII. Section 772 empowers and requires the Commission to regulate as necessary to prevent US financial institutions from evading Dodd-Frank by trading security-based swaps via networks of foreign subsidiaries, affiliates, and branches. We strongly support the Commission's position that the routine oversight of transactions that nominally occur outside of U.S. borders, yet involve U.S. entities, is necessary to achieve this goal.[12] We agree with the Commission that such oversight should not be understood as 'extraterritorial' in the sense of having a mere indirect relationship to the U.S. economy.

However, we have significant concerns with the territorial approach laid out by the Commission in the Proposed Rule. The Commission has chosen to define 'U.S. person' narrowly, in a way that does not incorporate overseas entities guaranteed by a U.S. parent. This definition fails to capture the swaps activities of nearly 5,700 subsidiaries of the seven largest U.S. bank holding companies. The Commission compounds this error by also extending many of the exemptions offered to non-U.S. persons to the overseas branches of U.S. persons. This narrow definition creates numerous possibilities for evasion of U.S. derivatives regulation, both in the determination of which entities qualify as swap dealers and in the application of various rules.

Given the possibilities for evasion created by the inadequate definition of U.S. person, it is vital to create protections that ensure coverage for the over 90 percent of SBS transactions on the U.S. market that involve a nominally foreign counterparty. The Commission proposes two broad forms of such protection. First, the Proposed Rule would apply Dodd-Frank oversight directly to transactions 'conducted within the United States', defined as a situation where a party located in the United States is involved in executing, soliciting, negotiating, or booking the swap, regardless of the nominal legal location of the counterparties. In cases where U.S. rules are not directly required, the Commission extends substituted compliance (the ability to use rules in the host jurisdiction so long as the Commission determines these rules are comparable) to a range of transactions conducted by foreign entities that are guaranteed by U.S. persons.

These protections are certainly necessary but they appear highly inadequate as proposed. They contain significant weaknesses that must be corrected.

First, the geographically based definition of a transaction 'conducted within the United States' is vague and will be difficult to enforce. It is inappropriate to base the application of derivatives protections on the geographic location of various administrative steps involved in the transaction. In today's global markets, the nature and reporting of these locations can be easily be manipulated. The inherent fluidity of this basis for enforcement will lead to continuing legal conflict over the exact definition and location of each administrative step. Instead, the application of Dodd-Frank rules should be based on the geographic location of the entity

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Brandy L. Bruyere, Comment Letter to the CFTC, "Comment on the CFTC's recent actions regarding the cross-border application of certain swaps regulations," February 6, 2013 ("AFR/Greenberger").

[12] 78 CFR 30984

ultimately responsible for swaps liabilities. To the extent possible, the Commission should apply Dodd-Frank rules to transactions in which the risk flows back to a U.S. entity, including transactions engaged in by guaranteed foreign subsidiaries and branches of U.S. entities.

Second, as currently written the Proposed Rule would result in the extensive use of substituted compliance, and certain transactions would escape even substituted compliance. The effectiveness of substituted compliance rests almost completely on the process for determining comparability between U.S. and foreign rules. We have serious concerns regarding the procedure for such comparability determinations laid out in the Proposed Rule. The Commission does appropriately reserve significant discretion regarding comparability determinations. Given the scope and complexity of derivatives rules, it is also appropriate that the Commission examines comparability separately in different areas of derivatives oversight, rather than issuing a single overall determination. However, the Commission proposes to compare only four broad areas of derivatives oversight, rather than undertaking a more careful comparison across a greater number of specific elements. Compounding this problem, the Commission proposes to use a general 'outcomes-based' standard for comparison. As the Proposed Rule does not specify what specific outcomes will be measured or how they will be measured, this appears to mean that a general and subjective determination of whether rules produce similar outcomes will be used. This appears far less reliable than a more objective comparison between the actual regulations operative in each jurisdiction. We recommend that the Commission expand the number of areas for comparison, and replace the 'outcomes-based' standard for comparison with a standard that requires comparability and similarity in the actual underlying rules.

Below, we outline these concerns in more detail.

I. The SEC's definition of U.S. person does not fulfill Section 772 because it excludes foreign affiliates and subsidiaries of U.S. financial institutions, leaving ample opportunity for regulatory arbitrage and industry evasion

The Proposed Rule defines a U.S. person. This term has two important purposes in determining the SEC's cross-border jurisdiction for regulating SBS. First, entities who are U.S. persons must generally comply with many Dodd-Frank regulations directly. Second, the definition of U.S. person will determine which foreign entities, including those who are controlled by U.S. financial institutions, will have to register with the SEC as Security-based Swap Dealers ("SBSDs") or Major Security-based Swap Participants ("MSBSPs"). This is because swaps regulations include a *de minimis* exception,[13] where entities trading under a threshold notional amount (currently $8 billion notional value for credit default swaps and $400 million for other SBS) over a twelve month period will not have to register as a SBSD. [14] Once a dealer exceeds the de minimis level in SBS, that dealer must register with the SEC as a SBSD and then comply with all applicable regulations.[15]

[13] *See* Section 3(a)(71) of the Exchange Act.
[14] *See* Intermediary Definitions Adopting Release, 77 FR at 30626-43.
[15] Or, alternatively, substitute compliance with its home jurisdiction's regulatory regime, provided that the Commission has determined such regime is comparable and comprehensive.

The SEC proposes to define "U.S. person" to include any natural person who is a resident of the U.S., business entities[16] organized under the laws of a U.S. jurisdiction or having their principle place of business in the U.S., and any account of a U.S. person. This includes the branches and offices of U.S. persons, but not the foreign subsidiaries or affiliates of U.S. persons.[17] We support the SEC's decision to include the foreign branches and offices of U.S. financial institutions in regulatory efforts.[18] However, by excluding U.S. companies' foreign affiliates and subsidiaries, the SEC proposes a system that can be gamed, creating a significant loophole in Dodd-Frank that is contrary to Section 772.

A. The definition of U.S. person must include the guaranteed foreign affiliates and subsidiaries of U.S. financial institutions

The SEC clearly states that one objective of the definition of "U.S. Person" is to identify entities that "…by virtue of their location within the United States ***or their legal or other relationship with the United States*** are ***likely to impact the U.S. market*** even if they transact with [SBSDs] who are not U.S. persons."[19] Despite identifying this important regulatory goal, the SEC inexplicably excludes entities that have a critical relationship with the U.S. as well as a proven history of negatively impacting the U.S. market—the guaranteed foreign affiliates and subsidiaries[20] of U.S. financial institutions.

The $182 billion[21] taxpayer bailout of AIG clearly illustrates why it is critical that the SEC include U.S. guaranteed foreign subsidiaries as "U.S. persons" in order to protect the U.S. taxpayer. AIG's CDS business was largely conducted through a subsidiary called AIG Financial Products, which operated out of London and was "run with almost complete autonomy" with a $500 billion portfolio of CDS.[22] AIG "engaged in regulatory arbitrage" by "locating much of the business in London, and selecting a weak federal regulator."[23] Although AIG FP happened to be incorporated in the U.S., as the Commission admits, it could easily have been set up as a London subsidiary.

The Commission's rule proposal also cites data gathered from the Depository Trust and Clearing Corporation (DTCC) showing that over 90 percent of current U.S. SBS transactions involve at least one foreign-domiciled entity. As the DTCC counts guaranteed foreign subsidiaries of U.S. banks as foreign-domiciled, this is further evidence of the centrality of foreign subsidiaries and affiliates to the U.S. SBS market.

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[16] The term "business entities" will be used to describe the list of entities that the SEC includes in its Proposed Rule which are: partnerships, corporations, trusts, or "other legal person." *See* p. 80.
[17] *See* 78 Fed. Reg. 30968, 30997 (May 23, 2013).
[18] Note, we support the inclusion of foreign branches and offices as integral parts of the U.S. parent company. However, we have significant reservations about the treatment of such branches in terms of substituted compliance, discussed further below.
[19] *See* 78 FR at 30996.
[20] Throughout this comment, the phrase "guaranteed foreign affiliates and subsidiaries" will be used interchangeably with the phrase "guaranteed foreign subsidiaries" and will refer generally to those foreign entities that are guaranteed by a U.S. parent.
[21] Financial Crisis Commission Report, p. 350 *Available at*: http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf
[22] Gretchen Morgenson, "Behind Insurer's Crisis, Blind Eye to a Web of Risk," NY TIMES, Sept. 27, 2008. *Available at*: http://www.nytimes.com/2008/09/28/business/28melt.html?pagewanted=all
[23] Financial Crisis Commission Report, p. 352.

Despite such ample empirical evidence of the risk to parent companies and the U.S. economy posed by foreign subsidiaries that are guaranteed by U.S. parent institutions, the Proposed Rule cedes significant control and jurisdiction over these entities. The result is that U.S. parent institutions can continue to use their existing networks of foreign subsidiaries to engage in regulatory arbitrage and avoid the application of Dodd-Frank's important protections. As such, we respectfully urge the SEC to treat such guaranteed subsidiary, affiliate, and similar entities of U.S. parent institutions as "U.S. persons" for the purposes of applying the *de minimis* requirements for swap dealer registration and requiring compliance with Dodd-Frank more generally.

B. The SEC should include transactions with foreign branches, offices, and guaranteed subsidiaries of U.S. financial institutions in foreign entities' calculation of SBS dealing volumes that count toward the 'de minimis' registration threshold.

We support the premise that the offices and branches of U.S. persons would be treated as "an integral part of the U.S. person" as they "[lack] the legal independence to be considered a non-U.S. person.[24] However, the SEC proposes to treat branches very differently from their U.S. parent institutions in ways that are inconsistent with the view that branches are an "integral part" of the parent. Instead, the Proposed Rule actually will encourage entities to offshore trading activity in order to avoid direct application of Dodd-Frank's regulatory protections.

Under the Proposed Rule, foreign entities[25] will not be required to calculate SBS with foreign branches of U.S. banks towards the *de minimis* calculation. In other words, a hedge fund in the Cayman Islands can execute a SBS with JPMorgan's London branch, and despite the fact that the risk for the trade resides in the U.S., the swap would not count toward the foreign hedge fund's *de minimis*. Similarly, if a foreign dealer such as Deutsche Bank wanted to trade with U.S. entities without being subject to Dodd-Frank, the foreign dealer could simply choose to execute trades with U.S. branches. The end result would leave U.S. financial institutions incurring significant financial risk without clear or robust regulatory oversight, which is problematic especially since the U.S. Federal Reserve served as a lender of last resort to numerous foreign banks during the financial crisis.[26]

The proposal also provides a substantial loophole for U.S. entities trading in SBS, because foreign affiliates and subsidiaries are not U.S. persons, and non-U.S. persons do not need to include trades with foreign branches of U.S. persons in their *de minimis* calculation.[27] In other words, a guaranteed foreign affiliate of Goldman Sachs could execute a SBS with

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[24] 78 FR at 30997.
[25] A term that includes the guaranteed affliates and subsidiaries of U.S. parent institutions.
[26] Bloomberg, "The Fed's Secret Liquidity Lifelines," available at: http://www.bloomberg.com/data-visualization/federal-reserve-emergency-lending/#/overview/?sort=nomPeakValue&group=none&view=peak&position=24&comparelist=&search= In fact, Deutsche Bank at one point owned the Fed $66 billion. Credit Suisse, Barclays, and Dexia incurred similar amounts of debt.

[27] 78 FR at 30989.

JPMorgan's London branch, and yet the Goldman Sachs entity would not include this trade for purposes of determining whether it must register with the SEC. It is difficult to imagine that any guaranteed foreign affiliates of U.S. persons would fall under the SEC's regulatory regime, because of the ability to avoid Dodd-Frank by to simply trading with foreign branches and guaranteed foreign affiliates of U.S parent institutions.

A similar exemption would apply to trades with guaranteed foreign subsidiaries and affiliates of U.S. entities. Thus, SBS transactions with a guaranteed foreign affiliate of a U.S. bank will not count toward the requirement to register as a U.S. swap dealer.

With these incentives, it is unlikely that any foreign entities will choose to trade within the U.S. directly, and quite likely that U.S. financial institutions will simply advise their clients to trade with their foreign branches if they want to avoid Dodd-Frank. The Proposed Rule also incentivizes U.S. institutions to execute SBS indirectly by using foreign affiliates, subsidiaries, branches, and offices. In other words, U.S. entities will incur risk by trading with foreign entities without the full regulatory protections of Dodd-Frank, which contradicts Section 772(b).

C. A broader definition of U.S. person is necessary and appropriate in order to prevent the evasion of Dodd-Frank through regulatory arbitrage

In light of the loopholes that currently exist in the Proposed Rule, we respectfully urge the SEC to broaden its definition of "U.S. Person" and treatment of SBS for the purposes of the *de minimis* such that market participants are not able to easily evade Dodd-Frank. Specifically, there are several key provisions that would improve the rule:

- Include affiliates and subsidiaries of U.S. parent financial institutions with a guarantee from the parent institution.
- Both explicit and implicit guarantees of support from the parent institution should be counted. This could be implemented by establishing a rebuttable presumption that a subsidiary of a U.S. entity is guaranteed. This presumption could be rebutted by showing clear evidence that counterparties were informed of the absence of a guarantee.
- Should the SEC not include guaranteed affiliates and subsidiaries in the definition of U.S. person, at the very least SBS with such entities should count towards entities' *de minimis* calculation.[28]
- Require all market participants to include SBS with the branches of U.S. institutions in their *de minimis* calculation.

[28] We acknowledge that the SEC will require the U.S. guarantor to count such trades for determining whether the guarantor is a MSBSP. *See* 78 FR at 31032. However, MSBSPs are subject to fewer regulatory requirements than SBSDs so this is not a satisfactory method for addressing the risks presented by U.S. parent institutions guaranteeing the swaps of foreign subsidiaries and affiliates.

- Include collective investment vehicles such as hedge funds based on majority ownership and/or actual control locations of the entity, regardless of its location of incorporation.

These provisions would ensure that the SEC can fulfill its statutory mission of protecting the U.S. taxpayer and preventing market participants from evading regulations. Otherwise, regulatory arbitrage could leave much of the market insufficiently monitored or policed.

II. Substituted Compliance And The Application of Dodd-Frank Mandates To Foreign Entities

The Commission proposes to address a number of the potential loopholes discussed above through the use of substituted compliance. Substituted compliance would be required for many foreign affiliates, subsidiaries, and branches of U.S. financial institutions, allowing them to comply with "comparable" regulatory regimes abroad in lieu of complying with Dodd-Frank. Substituted compliance potentially has a legitimate role to play in a cross-border regulatory regime. However, the greater the scope for substituted compliance, the more strict the controls on the ability to substitute foreign for U.S. rules should be. Given the potentially vast scope for substituted compliance in this Proposed Rule, potentially encompassing a significant majority of the SBS market, the controls on substituted compliance in this proposal are inadequate.

In order to prevent regulatory arbitrage, the SEC must rigorously ensure that the "substitute" rules are a meaningful attempt to rigorously enforce the regulatory regime of Dodd-Frank. The Proposed Rule does not create a substituted compliance framework that provides assurances of appropriate standards and enforcement. This section will first discuss some of the regulatory gaps created by substituted compliance and other permitted exemptions, and then address some of the weaknesses of the Commission's proposal in regards to the comparability process for determining substituted compliance eligbility.

A. By Outsourcing Regulatory Oversight in Key Areas, the Proposed Rule Does Not Meet the Statutory Goals of Transparency and Monitoring of Financial Markets

Substituted compliance, as proposed, will entrust foreign regulators with a substantial level of regulatory oversight even where the risk of a swap is held by U.S. financial institutions. As discussed below, in certain cases even substituted compliance is not required.

The SEC justifies some provisions as "promoting access of foreign branches of U.S. banks to local markets."[29] This is in error for two reasons. First, the SEC should not place the interests of financial institutions in maintaining operations in overseas markets over the statutory mandate of Dodd-Frank to preserve U.S. financial stability. Indeed, there is no directive or mandate in Dodd-Frank that would justify prioritizing the profit levels of overseas subsidiaries of U.S. banks over the full and effective application of derivatives rules to U.S. entities incurring risks in derivatives markets. Second, there is no evidence given that the application of more stringent safety and soundness regulation to U.S. banks overseas would in fact harm their ability to compete.

[29] 78 FR at 31094.

We will briefly highlight some of the key issues in the Proposed Rules:

Reporting[30]

- Even where one party to the trade is a U.S. person, dealers could apply a foreign regime's "comparable" reporting regulations.

- Meanwhile, U.S. guaranteed institutions are not U.S. persons, so U.S. financial institutions could trade between their branches and guaranteed foreign affiliates under 'comparable' reporting rules.[31] For example, JPMorgan's London branch, using only the branch's staff, could execute an uncleared SBS via telephone with Goldman Sachs in New York under British reporting requirements. [32]

- We strongly support the Commission's requirement that the U.S. maintain access to electronic data in "comparable" jurisdictions, as a condition to permitting substituted compliance. This is a critical requirement for adequate monitoring of risks to U.S. financial stability and must be maintained.

- However, data access under substituted compliance does not necessarily indicate full compatibility with Dodd-Frank reporting requirements. Unless reporting requirements are substantially identical, there will be inconsistencies in the formatting of trading data across jurisdictions. The Financial Stability Board has identified lack of common data reporting standards as a major impediment to timely and comprehensive swaps data surveillance, and cites the CFTC's rules on data aggregation as a progress indicator in global OTC derivatives regulation.[33] The SEC should ensure that data reporting and aggregation requirements, including any permitted under substituted compliance, harmonize with those of the CFTC. Under the Proposed Rule, it is unclear whether the Commission could analyze data from foreign repositories in conjunction with U.S. sourced data to determine full swaps exposure of a global entity. This argues for strengthening substituted compliance requirements in the reporting area.

Clearing

- The Proposed Rule would apparently not apply any clearing mandate whatsoever to transactions conducted outside the U.S. where one counterparty is a foreign branch or guaranteed foreign affiliate of a U.S. person, and the other counterparty

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[30] This term describes regulatory reporting and public dissemination requirements.
[31] SBS would be eligible for substituted compliance for reporting so long as one counterparty "is either a non-U.S. person or a foreign branch" and "no person within the United States is directly involved in executing, soliciting, or negotiating" the swap. *See* 78 FR at 31093.
[32] *See* 78 FR at 31094, Example 2. Note, specific names are utilized only to contextualize the example by substituting a company's name where the SEC uses a generic phrase such as "U.S. person" or "foreign branch of a U.S. bank."
[33] "OTC Derivatives Reform: Fifth Progress Report on Implementation," Financial Stability Board, 16-18. http://www.financialstabilityboard.org/publications/r_130415.pdf

is either a non-U.S. person or not guaranteed by a U.S. person.[34] The only apparent justification for this regulatory gap is concern for the 'competitiveness' of U.S. subsidiaries in foreign jurisdictions. As discussed above, this is not justified by Dodd-Frank's mandate to protect U.S. financial stability, and the competitiveness concerns are in any case not supported in the Proposed Rule.

- The SEC proposes to exempt some SBS from the clearing mandate even though such SBS are conducted within the U.S. by foreign entities.[35] While the Commission properly limits this exemption to cases where neither entity is a U.S. person or guaranteed by a U.S. person. no provision of Dodd-Frank justifies exempting SBS that occur within our borders from U.S. regulatory requirements.

- The Proposed Rule frames the two scenarios above as "exceptions,"[36] and the Rule does not discuss substituted compliance as an alternative to the clearing mandate.[37] While we urge the SEC to remove these exceptions, should these provisions be included in the final rule, the SEC should at least require substituted compliance rather than simply exempting these SBS from clearing.

- The SEC also proposes to allow broad use of foreign clearinghouses that are the subject of a substituted compliance regime in lieu of a clearinghouse that is regulated under Dodd-Frank.[38] This is true even where a SBS is conducted outside the U.S., but foreign branch of a U.S. bank or a SBSD guaranteed by a U.S. person is a counterparty to the trade.

The Commission should not leave regulatory oversight to other regimes where significant U.S. interests are at stake, in favor of counterparties' preference or foreign regulatory requirements. Instead, substituted compliance should be treated more as an exception rather than the preferred result. However, where the SEC does allow substituted compliance, the determination process must be public and thorough.

B. Substituted Compliance Determinations Must Be Rigorous, Robust, and Made in a Transparent Manner to Promote Accountability and Notice to the Public

When determining whether a regulatory regime is comparable and comprehensive to Dodd-Frank, we urge the SEC to adopt a more rigorous approach to analyzing other countries' regulatory regimes. Specifically, we urge the Commission to expand the current four areas for comparability to encompass the 13 specific areas adopted by the CFTC. We also urge the Commission to replace the apparently subjective 'outcomes-based' standard for comparison with a more rigorous and objective standard based on the underlying rules.

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[34] 78 FR at 31208; Section 240.3Ca-3 Paragraph b(1).
[35] 78 FR at 31208. Section 240.3Ca-3 Paragraph b(2). Note, the SEC correctly limits the exemption to trades that do not involve a U.S. person, a registered SBSD, or a trade guaranteed by a U.S. person.
[36] *See* Proposed Rule 240.3Ca-3—Application of the mandatory clearing requirement to cross-border security-based swap transactions, 78 FR at 31208.
[37] *Id*.
[38] 78 FR at 31098-99.

The SEC identifies four important "categories of requirements"[39] for the purposes of comparing to other regimes, and proposes that a regime could be found comparable for one category, but not others. While we support the SEC's rejection of sweeping regime-wide comparability determinations, the four-category approach is still overly broad. For example, a foreign regulatory regime could be found "comparable" where a jurisdiction has robust regulatory reporting requirements, but is lacking in terms of real-time public reporting. We urge the SEC to at minimum utilize the CFTC's approach, where substituted compliance determinations will be made in thirteen categories.[40] This will allow for more rigorous market oversight and allow the Commission's comparability determinations to be more detailed, ensuring that the statutory objectives of Dodd-Frank are truly met through substituted compliance.

The Commission states that it intends to determine comparability by making a "holistic" and "outcomes" based comparison of other jurisdictions' regulatory frameworks.[41] The Proposed Rule does not appear to specify either specific outcomes to be compared or how these outcomes will be measured. The 'outcomes-based' assessment of regulation is thus likely to be far more subjective than a careful, point-by-point comparison of the actual substance of the rules. While foreign rules may be comparable without being identical in every respect, such comparability must be judged based on the substance of the rules themselves. A hypothesized similarity in outcomes for sets of rules that are quite different in substance should not suffice to certify comparability.

Another reason that 'outcomes-based' assessment may not be adequate is that the inter-operability of different rule sets may be critical to the effectiveness of the overall international regime. As discussed above, this is the case for standardization of data formats in reporting, and may also be true for various risk management elements that must be standardized across a global financial institution.

Additionally, we urge the SEC to improve transparency within its process for making substituted compliance determinations. While we support the SEC's proposal to disallow anonymous substituted compliance applications and potentially invite public comment through the Federal Register on applications, there are still transparency concerns with the proposed determination process.[42] For example, applicants may "seek confidential treatment" of their applications at the SEC's "sole discretion,"[43] which would foreclose any public comment, debate, or analysis of the applicant's claims about the foreign regulatory regime, leading to an industry-led process. Substituted compliance determinations are a critical decision, as a regulatory regime that does not meet the same objectives and outcomes of Dodd-Frank would invite arbitrage and evasion of Dodd-Frank. Thus, we urge the SEC to disallow confidential treatment of substituted compliance applications and to invite public comment as foreign

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[39] The categories are margin & capital, regulatory & public reporting, clearing, and trade execution.
[40] *See* 78 Fed. Reg. 45292, 45331-35 (July 26, 2013). These include capital adequacy, risk management, swap data recordkeeping, clearing, swap processing, margin & segregation, & swap trading relationship documentation, portfolio reconciliation & compression, daily trading records, and real-time public reporting. *Available at*: http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf
[41] 78 FR at 31085.
[42] 78 FR at 31088.
[43] 78 FR at 31088.

jurisdictions are considered for comparability in order to promote transparency and facilitate a full public debate which acknowledges the concerns of diverse groups of stakeholders.

Finally, AFR does support the SEC's proposal to "periodically review" substituted compliance determinations and, where necessary for reasons such as "failure of a foreign regulatory to exercise its supervisory or enforcement authority," permit the SEC to "withdraw a substituted compliance determination."[44] We also support the retention of significant discretion for the Commission to reject comparability based on the substantive enforcement of foreign regulatory regimes.

C. As Foreign Regulators Continue to Delay Complying with their 2009 G20 OTC Derivatives Commitments, the SEC Must Finalize Rules and Apply Dodd-Frank's Regulations Where Foreign Rules Are Lacking

Nearly four years after G20 countries met in Pittsburgh and committed to providing transparency and oversight to the previously-opaque OTC derivatives markets,[45] most countries have yet to implement their regulatory regimes.[46] For example, less than six months after finalizing rules, European regulators recently asked the European Commission for an additional year to implement certain reporting requirements, which would delay implementation until at least January, 2015.[47] European regulators also have not yet determined which derivatives contracts will be subject to a clearing mandate, and Summer, 2014 is the current best-case scenario for clearing of some derivatives products. [48]

Meanwhile, while Singapore recently passed legislation addressing the G20 Commitments, regulations will not come into effect until around the third quarter of 2013.[49] Even then, Singapore "will likely start with implementing the reporting mandate [alone because] this will help [Singapore] better formulate the implementation of clearing and other mandates[.]"[50] Thus, it is unlikely Singapore will have clearing or margin requirements until at least sometime in 2014, since these regulations will be dependent upon the results of reporting that will not begin until at least late 2013.[51]

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[44] 78 FR at 31089.

[45] For more information regarding the G20 Summit, *see* Ella Kokotsis, "The G20 Pittsburgh Summit Commitments," issued Sept. 25, 2009, provided by the University of Toronto, Munk School of Global Affairs. *Available at*: http://www.g20.utoronto.ca/analysis/commitments-09-pittsburgh.html

[46] We acknowledge that Japan has made significant progress towards meeting its G20 Commitments. However, most other jurisdictions fall far short of comparable regulation.

[47] ESMA, "ESMA proposes delay to reporting date for Exchange Traded Derivatives," August 8, 2013. *Available at*: http://www.esma.europa.eu/node/67001

[48] ESMA, "EMIR indicative timeline," July 5, 2013. *Available at*: http://www.esma.europa.eu/page/European-Market-Infrastructure-Regulation-EMIR *See also* Clifford Chance, "EMIR: illustrative implementation timeline—update," June, 2013. *Available at*: http://www.cliffordchance.com/publicationviews/publications/2013/06/emir_illustrativeimplementationtimeline.html

[49] *See also* Singapore Business Review, "Singapore Gears up for Derivative Regulations," Nov. 29, 2012. *Available at*: http://sg.finance.yahoo.com/news/singapore-gears-derivative-regulations-013700131.html

[50] *Id*., (*quoting* Lee Chuan Teck, Assistant Managing Director, Monetary Authority of Singapore).

[51] *See* Monetary Authority of Singapore, "Consultation Paper on Draft Regulations Pursuant to the Securities and Futures Act for Reporting of Derivatives Contracts," p. 6, June 26, 2013. *Available at*:

Substituted compliance relies on the existence of fully implemented comparable and comprehensive foreign regimes, not simply the hope of future regulation. The SEC correctly acknowledges that enforcement is an important component of a substituted compliance determination, and there can be no enforcement prior to implementation. Therefore, while other regimes continue to work on finalizing their G20 Commitments, the SEC should endeavor to finalize its rules as soon as practicable and apply Dodd-Frank where the U.S. economy is at risk.

III. The proposed application of full Dodd-Frank oversight to "transactions conducted within the United States" is an important regulatory protection but is inferior to the full application of Dodd-Frank oversight to all guaranteed foreign subsidiaries, affiliates, and branches of U.S. entities.

In several areas, the Commission also seeks to address the loopholes created by the narrow definition of 'U.S. person' by requiring that Dodd-Frank oversight apply to transactions conducted within the United States, even where these transactions involve counterparties that are not U.S. persons.[52] 'Transactions conducted within the United States' are SBS which are "solicited, negotiated, executed, or booked within the United States, by or on behalf of either counterparty to [the SBS], regardless of the location, domicile, or residence status of either counterparty".[53] Importantly, such transactions are not granted substituted compliance.

The full application of Dodd-Frank to transactions geographically conducted in the United States does help address some of the gamesmanship encouraged by the narrow U.S. person definition discussed in Part I. As the SEC notes in the context of aggregation rules,

> "...requiring non-U.S. persons to include in their *de minimis* calculations only transactions with U.S. person counterparties *would enable such persons to engage in significant amounts of [SBS] dealing activity within the United States without Commission oversight*…This would be the case if the potential dealer operated out of a branch, office, or affiliate, or utilized a third-party agent acting on its behalf within the United States…the Commission preliminarily does not believe this would be consistent with Dodd-Frank."[54]

It is thus crucial to at least maintain the protection of the full application of Dodd-Frank to these U.S.-based transactions, and not to weaken any requirement that transactions actually conducted within the U.S. are fully subject to Dodd-Frank. Given the finding that over 90 percent of U.S. SBS transactions involve a foreign-domiciled entity, in the absence of such a requirement, it is likely that only a small minority of U.S. SBS would be properly subject to U.S. rules. Such a result must be avoided.

However, this proposed regulatory framework based on the location at which elements of a transaction are conducted has major weaknesses compared to the alternative of applying rules

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http://www.mas.gov.sg/~/media/MAS/News%20and%20Publications/Consultation%20Papers/CPReportingRegs.pdf

[52] 78 FR at 30999.

[53] *Id.*

[54] 78 FR at 31000.

based on the location of the entity who takes the ultimate risk for the derivatives transaction. The location of each step qualifying a transaction as 'conducted in the U.S.' -- solicitation, negotiation, execution, and booking – can be manipulated or made unclear using telephone or email communication. It is also likely that the exact definition of these steps will become subject to challenge and controversy. For example, suppose a representative of a U.S. firm approaches a counterparty located in the U.S. to inquire concerning a swap, and is then told to have their London office contact the London office of the counterparty to arrange and execute the precise details of the swap. Would this swap have been 'conducted in the U.S.'? Given incentives to blur the geographic location in which a swap was 'solicited, negotiated, executed, or booked', it is likely that regulated entities will be able to do exactly that. Policing such behavior will be a serious drain on Commission resources, if it is even possible.

We therefore urge the Commission to instead apply its jurisdiction where U.S. interests are clearly at stake—specifically, where a U.S. person guarantees the SBS transaction. For one, these transactions have clear jurisdictional ties to the U.S. through the parties' legal relationship. Also, counterparties seeking SBS that are guaranteed by U.S. parent companies are on notice and should reasonably expect that U.S. regulations would apply to such trades. Finally, regulatory oversight and enforcement is facilitated by using guarantees to determine jurisdiction, because a guarantee will generally be an explicit part of SBS Master Agreement and thus U.S. jurisdiction is clear to both market participants and regulators. In cases where a guarantee is implicit, the use of a rebuttable presumption of a guarantee will put the burden on the foreign affiliate in question to demonstrate to regulators that it is not guaranteed. This will also greatly lessen the oversight burden on the Commission.

Thank you for the opportunity to comment on this Proposed Rule. Should you have questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672, or Brandy Bruyere, Legal and Policy Analyst at the University of Maryland School of Law, at bbruyere@law.umaryland.edu or 410-706-4287.

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 Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- 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
- Blu
- Bowden-Gill Environmental
- 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 MedPAC
- 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

- Diversified Environmental Planning
- 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
- Hayden & Craig, PLLC
- 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
- Mid City Animal Hospital, Pheonix AZ
- 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 Holographic Repatterning Institute at Austin
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- UNET
- 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