AFR Americans for Financial Reform

December 19, 2016

The Honorable Tim Massad, Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: "Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and MSPs", RIN 3038-AE54

To Chairman Massad:

Americans for Financial Reform ("AFR") appreciates this opportunity to comment on the above-referenced Proposed Rule and Interpretations (the "Proposal") by the Commodity Futures Trading Commission (the "Commission"). AFR is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1]

AFR and other public interest groups have consistently urged the Commission to fully implement the statutory provision in Section 2(i) of the Commodity Exchange Act that instructs the Commission to apply swaps requirements to all activities that "have a direct and significant connection with activities in, or effect on, commerce of the United States". If the Commission does not implement this provision and instead leaves loopholes which permit swaps activities directly connected with U.S. markets to be conducted free of regulatory oversight because they are conducted through nominally non-U.S. entities, then it will be a simple matter for large Wall Street swap dealers to channel their transactions through foreign subsidiaries and effectively evade regulation. This could easily lead to a restoration of the situation that existed prior to the 2008 financial crisis, where key elements of derivatives markets were transacted in the shadows and risks were not properly managed or controlled. Uncontrolled derivatives markets were a major contributor to that catastrophic global financial collapse.

The discussion of market structure on CFR 71947-71948 of the Proposal provides a valuable overview of the actual practices in derivatives markets. It explicitly describes the tightly integrated nature of derivatives activities in large global banks.

[1] A list of AFR member organizations is available at http://ourfinancialsecurity.org/about/our-coalition/.

As the Commission correctly states:

> "Despite its geographic expanse, a global financial group effectively operates as a single business, with a highly integrated network of business lines and services conducted through various branches or affiliated legal entities that are under the control of the parent entity. While each branch or affiliate may serve a unique purpose, they are ***highly interdependent and inextricably linked***, with affiliated entities within the corporate group providing financial or credit support for each other, such as in the form of a guarantee or the ability to transfer risk through inter-affiliate trades." [Emphasis added]

This passage is also footnoted (footnote 13) to state that "Even in the absence of an explicit arrangement or guarantee, the parent entity may, for reputational or other reasons, choose or be compelled to assume the risk incurred by its affiliates, branches, or offices located overseas."

The Commission's clearly stated understanding that the business model for global derivatives dealers involves operating as a single interdependent entity must be reflected in CFTC rules if derivatives regulation is to be effective.

Elements of this Proposal That We Support

This Proposal contains several elements that improve the structure of cross-border derivatives regulation of global dealers, and which we strongly support.

First, the Proposal reaffirms the definition of "Consolidated Foreign Subsidiary" (FCS) first used in its recent margin rules, and requires all FCS transactions to be consolidated for purposes of determining whether an entity meets the de minimis swap dealer threshold. As AFR stated in our comment on the cross-border margin rules, we strongly support using FCS status as the basis for cross border enforcement rather than the more amorphous and subjective "guaranteed subsidiary" status.[2] The conditions for FCS status, especially accounting consolidation and control, track membership in an interdependent global financial group in a way that explicit guarantees do not.

The inclusion of all transactions involving Foreign Consolidated Subsidiaries toward the de minimis limit for swap dealer designation is particularly important, as swap dealer designation is the status which triggers numerous other elements of derivatives oversight. We strongly support the Commission's proposal to count all FCS transactions toward dealer designation.

[2] Americans for Financial Reform, "Comment on Cross Border Application of Margin Requirements for Uncleared Swaps", September 14, 2015, available at http://ourfinancialsecurity.org/wp-content/uploads/2015/09/AFR-Comment-on-Cross-Border-Application-of-Margin-Requirements-for-Uncleared-Swaps.pdf

Second, the Proposal contains an interpretation of the circumstances in which U.S. personnel can be said to "arrange, negotiate, or execute" (ANE) a swap. The Proposal also clearly states that Dodd-Frank rules apply whenever an entity uses U.S. based-personnel to arrange, negotiate or executive a swap. As we have previously stated in our response to the request for comment on the 2013 Staff Advisory, we strongly support this interpretation.[3] It is critical that the Dodd-Frank rules apply in all cases where U.S. based personnel engage in market-facing elements of a transaction. To do otherwise, and base the application of derivatives oversight solely on the assumed risk exposure of a dealing entity regardless of its geographic location, would open the door to widespread evasion of derivatives oversight by U.S.-based entities.

We also support the interpretation of the scope of ANE laid out in the Proposal. The Commission is correct to specify that the scope of ANE includes all market-facing involvement in the transaction, regardless of whether this involvement is claimed to be merely occasional or is claimed due to supposed special circumstances such as the timing of market opening and closing in other jurisdictions. This clarification of the scope of ANE achieves the dual purposes of covering all market-facing involvement by U.S. personnel while excluding merely clerical or bookkeeping tasks. The clarity and completeness of the scope of ANE here is crucial in making effective the application of Dodd-Frank rules to all U.S. transactions.

The FCS definition, the inclusion of all cross-border transactions involving a FCS for the purposes of swap dealer designation, the application of Dodd-Frank rules to all swaps arranged, negotiated, or executed in the U.S., and the scope of the ANE interpretation, are all major strengths of this rule and must be maintained in any final rule.

Elements Of The Proposal That Are Flawed And Should Be Corrected

Despite the above-listed strengths of the Proposal, there are several elements of this Proposal that we disagree with and believe should be changed.

First, we strongly disagree with the Commission's proposal to exclude a wide range of transactions involving foreign branches and affiliates of U.S. swap dealers from external business conduct requirements. The Commission justifies this proposal with the claim that the integrity of U.S. markets is not implicated in transactions that involve only non-U.S. persons. This might be true if the Commission had defined U.S. person expansively. But the very narrow

[3] Americans for Financial Reform, "Response to Request For Comment on Application of Commission Regulations to Swaps Between U.S. Swap Dealers and Non-U.S. Counterparties", March 10, 2014. Available at http://ourfinancialsecurity.org/wp-content/uploads/2014/03/Final-AFR-Response-To-March-10th-Request-for-Comment-3.10.14.pdf

definition of U.S. person promulgated by the Commission means that numerous entities closely tied to U.S. markets would not benefit from business conduct requirements if such requirements are limited to U.S. persons alone. As discussed above, in this Proposal the Commission clearly states that global financial groups transacting in derivatives operate as a "single business", including all subsidiaries and affiliates. To exclude the subsidiaries and affiliates of global U.S. businesses from business conduct protections would thus impact the integrity of U.S. markets.

To address this issue, we urge the Commission that external business conduct requirements should not be limited to U.S. persons alone but, at a minimum, should be extended to all foreign consolidated subsidiaries of U.S. persons. As such FCS represent a part of the "single business" of a global financial group, they should not be excluded from the external business conduct standards designed to protect U.S. market integrity. Excluding them from these standards would make it simple to evade external business conduct standards, since, as the Commission notes, risk can easily be transferred between such FCS and U.S. persons that are also part of the group.

Second, the definition of "guaranteed subsidiary" in this Proposal is flawed. As we stated in our comment on the cross-border margin rules, the narrower definition of "guarantee" used here, which is based on the cross-border margin rules, is deeply flawed.[4] This definition of "guarantee" requires a legally enforceable right of recourse. This is much narrower than the 2013 Guidance definition, which uses a facts and circumstances definition that includes implicit guarantees and a number of formal arrangements that may not technically create a legal right of recourse for the end customer. Putting such a narrow definition of "guarantee" into the rules set opens the door to evasion of the rules. This flaw is not as harmful when the application of a rule is tied to FCS status as well as or instead of "guaranteed subsidiary" status, as is done in the case of consolidation rules in this Proposal. But in cases where a rule is tied solely to guaranteed subsidiary status this narrow definition will be an invitation to evasion. We recommend that the definition of "guarantee" be changed to instead reflect the broader 2013 definition.

Thank you for the opportunity to comment on this Proposal. Should you have any questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,
Americans for Financial Reform

[4] Americans for Financial Reform, "Comment on Cross Border Application of Margin Requirements for Uncleared Swaps", September 14, 2015, available at http://ourfinancialsecurity.org/wp-content/uploads/2015/09/AFR-Comment-on-Cross-Border-Application-of-Margin-Requirements-for-Uncleared-Swaps.pdf