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July 1, 2011

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Attention: Comments
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Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA45
Federal Housing Finance Agency
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Office of Regulatory Policy
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Re: Title VII Capital and Margin Proposals

Ladies and Gentlemen:

The Institute of International Bankers appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "**Commission**") and the Prudential Regulators[1] on their proposals (the "**Proposed Rules**") regarding capital requirements for swap dealers ("**SDs**") and major swap participants ("**MSPs**") under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") and margin requirements for uncleared swaps.[2] We support the steps that the Commission and the Prudential Regulators have taken to implement a risk-based approach to capital and margin requirements that makes appropriate use of supervisory resources by leveraging existing regulatory regimes.

[1] In this letter, "Prudential Regulators" refers to the Board of Governors of the Federal Reserve System (the "**Board**"), the Office of the Comptroller of the Currency (the "**OCC**"), the Federal Deposit Insurance Corporation (the "**FDIC**"), the Federal Housing Finance Agency (the "**FHFA**") and the Farm Credit Administration (the "**FCA**").

[2] When used in this letter in the context of the Prudential Regulators' proposal, "swaps" refers to swaps and security-based swaps.

In this letter, we respectfully suggest certain modifications to the Proposed Rules designed to further achieve that objective in the cross-border context.[3]

I. Executive Summary

As the Commission and the Prudential Regulators are aware, there are many circumstances under which an entity subject to oversight by a foreign regulator, either directly or on a consolidated basis, might register as an SD or MSP. For instance, many foreign banks conduct swap activities through their U.S. branches or agencies, which under Dodd-Frank will be subject to capital and margin requirements established by the Board (for a state branch or agency) or the OCC (for a Federal branch or agency). Some foreign banks conduct swap activity with U.S. counterparties from branches and offices located outside the U.S.; under Dodd-Frank, those foreign banks will be subject to capital and margin requirements established by the Board. Finally, swap activity is also conducted by (i) foreign non-bank entities subject to direct supervision by a foreign regulator and (ii) U.S. and foreign non-bank subsidiaries of either foreign financial holding companies or foreign banks subject to consolidated prudential supervision (together, "**Foreign-Supervised Non-Bank SDs and MSPs**"). Foreign-Supervised Non-Bank SDs and MSPs, like other non-bank SDs and MSPs, will be subject to capital and margin requirements established by the Commission.

Each of these circumstances presents opportunities for the Commission and the Prudential Regulators to achieve Dodd-Frank's objectives of ensuring the safety and soundness of SDs and MSPs while also leveraging existing regulatory regimes. In this regard, the Institute and its members support the proposal to permit the use of approved models for computing capital and margin requirements and the proposal by the Board to continue its longstanding approach of deference to home country capital standards for SDs and MSPs that are foreign banks subject to comparable prudential supervision and oversight. Consistent with this approach, the international harmonization mandate of Section 752 of Dodd-Frank and the coordination efforts of the G-20 and the Basel Committee, we respectfully suggest the following modifications to the Proposed Rules:[4]

- **Capital**. As noted above, the Commission is responsible under Dodd-Frank for setting capital requirements for non-bank SDs and MSPs. For a Foreign-Supervised Non-Bank

[3] This letter does not address other issues raised by the Proposed Rules, such as those relating to calibration of initial margin levels, netting and risk offsets, segregation requirements, application of margin requirements to end users and foreign sovereigns and documentation requirements for uncleared swaps.

[4] Although the Securities and Exchange Commission ("**SEC**") has not yet proposed capital and margin rules under Title VII of Dodd-Frank, we recommend that the SEC also adopt a similar approach to the one we suggest for the Commission in this letter.

SD or MSP, the Commission should, consistent with the Board's proposal for foreign bank SDs and MSPs, defer to comparable home country capital and related requirements. As part of its comparability determination, the Commission should look to established benchmarks, such as pre-existing evaluations of the foreign regulator's supervisory framework by the Board or whether the foreign regulator administers a capital regime consistent with the Basel Accord.

- *Minimum Capital Requirement*. The Commission should permit a Foreign-Supervised Non-Bank SD or MSP (other than a registered futures commission merchant ("**FCM**")) that is subject to comparable minimum capital requirements in its home country (or whose parent is subject to such requirements) to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission requirements.

- *Market and Credit Risk Charges*. The Commission should permit Foreign-Supervised Non-Bank SDs and MSPs to use internal models for computing market and credit risk charges if those models are subject to approval and assessment by a foreign regulator (including a consolidated holding company group supervisor) whose approval and assessment standards are comparable to U.S. standards (any model subject to such approval and assessment is referred to as a "**Comparable Foreign-Supervised Model**").

- *Financial Recordkeeping and Reporting*. The Commission should permit a Foreign-Supervised Non-Bank SD or MSP subject to comparable financial recordkeeping and reporting requirements in its home country to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission requirements. The Commission and relevant foreign regulator should also, to the extent they have not already done so, establish an appropriate allocation of responsibility for the exercise of examination authority and access to financial, operational, and other supervisory information.

- **Margin**.

  - *Initial Margin Models*. The Commission should permit the use of Comparable Foreign-Supervised Models for computing initial margin requirements for uncleared swaps. Additionally, in approving the use of an internal model for computing initial margin requirements for uncleared swaps by an SD or MSP that is a foreign bank or a state or Federal branch or agency of a foreign bank, the

Prudential Regulators should recognize the supervisory approval of Comparable Foreign-Supervised Models by home country regulators.[5]

- *Extraterritorial Scope*. The Commission should, like the Prudential Regulators, clarify that an uncleared swap between foreign counterparties will not be subject to U.S. margin requirements.[6]

- *Inter-affiliate Swaps*. The Commission and the Prudential Regulators should confirm that uncleared swaps between persons under common ownership will not be subject to margin requirements.

- *Custodial Arrangements*. The Commission and the Prudential Regulators should take a more flexible approach toward the risk of a custodian's insolvency, consistent with the Commission's earlier proposal for addressing legal risk more generally.

II. Discussion

A. Capital Requirements

1. Prudential Regulators' Proposal

As part of the Prudential Regulators' proposal on capital and margin requirements for SDs and MSPs (the "**PR Proposal**"),[7] the Board has proposed to require that an SD or MSP that is a foreign banking organization (as defined in 12 C.F.R. § 211.21(o))[8] or state branch or agency

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[5] If, in the future, a foreign regulator adopts margin requirements for uncleared swaps that are comparable to U.S. requirements, then the Commission and the Prudential Regulators should permit a foreign SD or MSP subject to those requirements to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission or Prudential Regulator requirements.

[6] As discussed further below, we believe that this approach should apply to all swaps between foreign counterparties, whether the SD or MSP or its counterparty is ultimately U.S.- or foreign-owned.

[7] Margin and Capital Requirements for Covered Swap Entities, Board Docket No. R-1415, Docket No. OCC-2011-0008, FDIC RIN 3064-AD79, FHFA RIN 2590-AA45, FCA RIN 3052-AC69, 76 Fed. Reg. 27654 (May 11, 2011).

[8] We note that, as a technical matter, the "foreign banking organization" definition would not encompass a foreign bank that does not have U.S. operations. Dodd-Frank's "prudential regulator" definition, however, designates the Board as the Prudential Regulator for both a foreign bank with U.S. operations (under prong (A)(v) of definition, which covers a foreign bank that is treated as a bank holding company under section 8(a) of the International Banking Act of 1978) and a foreign bank not having any U.S. operations (under prong (A)(iii) of the definition, which covers a foreign bank which does not operate an insured branch). Moreover, the Board is best-situated to set and enforce capital and margin requirements for a foreign bank without U.S. operations because of its long experience with foreign banking supervision generally. Accordingly, we recommend that Board also include a

(footnote continued on next page . . .)

of a foreign bank (as defined in 12 U.S.C. §§ 3101(11) and (12)) comply with the capital requirements contained in § 225.2(r)(3) of the Board's Regulation Y.[9] Under § 225.2(r)(3), a foreign bank whose home country supervisor has adopted capital standards consistent with the Basel Accord is required to comply with those home country standards.[10]

We strongly support this proposal, which is consistent with the Board's longstanding framework for supervising the cross-border banking operations of a foreign bank. That framework is based on an understanding that the foreign bank is subject to primary supervision by its home country authority, with the Board, as a host country supervisor, exercising appropriate oversight of the bank's U.S. operations.[11] We believe that the policies underlying this framework, including international comity and the effective and efficient allocation of supervisory responsibilities, are equally applicable to prudential supervision under Title VII as they are to prudential supervision under the U.S. banking laws.

2. CFTC Proposal

The Commission's proposal on capital requirements for non-bank SDs and MSPs (the "**CFTC Capital Proposal**")[12] would require a non-bank SD or MSP that is a subsidiary of a U.S. bank holding company (other than a registered FCM or a U.S. nonbank financial company that has been designated a systemically important financial institution by the Financial Stability Oversight Council) to comply with minimum capital requirements consistent with those that apply to its holding company under Board regulations. The Commission has also proposed to permit such a non-bank SD or MSP that is a subsidiary of a U.S. bank holding company to utilize

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(. . . footnote continued from previous page)

foreign bank (as defined in 12 C.F.R. § 211.21(n)) as a covered swap entity subject to § 237.10(c) of its proposed rules.

[9] Similarly, the OCC has proposed to require an SD or MSP that is a Federal branch or agency of a foreign bank to comply with the capital adequacy guidelines that are applicable as generally provided under 12 C.F.R. § 28.14. Under those standards, the OCC looks to the capital of the foreign bank itself. See 12 C.F.R. § 28.14(a).

[10] If the foreign bank's home country supervisor has not adopted capital standards consistent with the Basel Accord, it must obtain a determination from the Board that its capital is equivalent to the capital that would be required of a U.S. banking organization.

[11] See Federal Reserve Board, "Policy Statement on the Supervision and Regulation of Foreign Banking Organizations" (Feb 23, 1979), Federal Reserve Regulatory Service 4-835; Federal Reserve Board Supervisory Letter SR 08-09 re Consolidated Supervision of Bank Holding Companies and the Combined U.S. Operations of Foreign Banking Organizations (Oct. 16, 2008).

[12] Capital Requirements of Swap Dealers and Major Swap Participants, CFTC RIN 3038-AD54, 76 Fed. Reg. 27802 (May 12, 2011).

internal models that have been reviewed and are subject to regular assessment by the Board to compute market and credit risk charges for its swap and related hedging positions. These proposals would apply to both U.S. and foreign subsidiaries of U.S. bank holding companies.

Under the CFTC Capital Proposal, however, a Foreign-Supervised Non-Bank SD or MSP that is not a subsidiary of a U.S. bank holding company would not be permitted to utilize an approach to capital that is equivalent to that proposed to be permitted for subsidiaries of U.S. bank holding companies. In this regard, the Commission has requested comment regarding whether it should permit an SD or MSP to compute market and credit risk charges using internal models subject to approval and assessment by a foreign regulator.[13]

The CFTC Capital Proposal explains that the Commission has determined to defer to the Board's existing capital requirements for subsidiaries of U.S. bank holding companies because doing so would remove incentives for regulatory arbitrage.[14] The Commission also notes that the Board's capital requirements address the full range of swap activity regulated under Dodd-Frank, sufficiently account for credit and market risk exposures, ensure the safety and soundness of the SD or MSP and are appropriate for the risk associated with the uncleared swaps positions of the SD or MSP.[15] The Commission also identifies the current and prospective levels of Commission resources as a factor in its decision to look to model approvals by the Board and the SEC.[16]

Many Foreign-Supervised Non-Bank SDs and MSPs are subject to extensive capital requirements and related supervision by their home country regulator. Foreign financial holding companies, foreign banks, and their respective U.S. and foreign subsidiaries are, in turn, often subject to consolidated capital requirements and related supervision by the consolidated prudential supervisor of the holding company group, as are U.S. bank holding companies. In many cases, both foreign and U.S. financial and bank holding companies use approved internal models for computing capital requirements for multiple trading entities.

We emphasize that the capital requirements for Foreign-Supervised Non-Bank SDs and MSPs and foreign financial holding companies are in many cases the same as for foreign banks. Additionally, in many cases those entities are supervised by the same supervisor that will be responsible for the capital oversight of foreign banks under the PR Proposal.

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[13] Id. at 27818.

[14] Id. at 27806.

[15] Id.

[16] Id. at 27808.

We strongly encourage the Commission to defer to home country capital and related requirements for Foreign-Supervised Non-Bank SDs and MSPs where those requirements are comparable to U.S. requirements. Such deference would have the same benefits as the Commission's proposed approach for subsidiaries of U.S. bank holding companies: avoiding regulatory arbitrage, applying comprehensive requirements that account for risk exposures and meet Dodd-Frank's safety and soundness standard, and making efficient use of Commission resources. It is also necessary to prevent Foreign-Supervised Non-Bank SDs and MSPs (including subsidiaries of both U.S. and foreign financial holding companies) that are already subject to capital requirements in their home countries from becoming subject to duplicative and inconsistent capital requirements under Commission requirements. Moreover, unless the Commission permits Foreign-Supervised Non-Bank SDs and MSPs that are not subsidiaries of U.S. bank holding companies to use Comparable Foreign-Supervised Models, its rules could violate principles of national treatment by providing significant advantages to U.S.-controlled SDs and MSPs based solely on the nationality of their parent entity.

Accordingly, we urge the Commission to permit a Foreign-Supervised Non-Bank SD or MSP (other than a registered FCM) that is directly subject to comparable minimum capital requirements in its home country to comply with those requirements in lieu of U.S. requirements. Additionally, consistent with the Commission's proposal for subsidiaries of U.S. bank holding companies, the Commission should permit a Foreign-Supervised Non-Bank SD or MSP (other than a registered FCM) that is a subsidiary of either a foreign financial holding company or a foreign bank subject to comparable consolidated prudential supervision to comply with the minimum capital requirements of its holding company as though it were the holding company. In either case, a violation of home country requirements should be enforceable by the Commission as a violation of Commission requirements.

The Commission should also permit the use of Comparable Foreign-Supervised Models to compute market and credit risk capital charges. Those models may be approved and assessed by the foreign regulator that directly oversees the Foreign-Supervised Non-Bank SD or MSP, the consolidated prudential supervisor of the foreign financial holding company group, or a regulator that oversees an affiliate of the Foreign-Supervised Non-Bank SD or MSP.

We understand that the Commission may, in light of its current resource constraints, have limited capability to conduct detailed comparability assessments for foreign jurisdictions, at least in the near-term. There are, however, several established benchmarks that the Commission should leverage to make such determinations without overburdening its limited resources.

In reviewing applications by a foreign bank to establish a branch or agency or acquire a commercial lending company or a U.S. bank, the Board, consistent with its overall framework for supervising the U.S. operations of foreign banks, evaluates whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home country

supervisor ("**comprehensive consolidated supervision**").[17] We recommend that the Commission regard a Foreign-Supervised Non-Bank SD or MSP's home country capital requirements and model reviews and assessment to be comparable to U.S. requirements if the Foreign-Supervised Non-Bank SD or MSP, or its parent,[18] is subject to supervision or regulation by a foreign regulator that the Board has determined subjects the Foreign-Supervised Non-Bank SD or MSP or its parent to comprehensive consolidated supervision.[19] By taking this approach, the Commission would be leveraging the Board's existing supervisory framework much as it is currently proposing to do for non-bank subsidiaries of U.S. bank holding companies.

Additionally, as the Commission is aware, many foreign securities regulators, like their banking counterparts, apply Basel capital requirements. Those regulators are not, however, subject to assessment by the Board unless they also oversee banks. For Foreign-Supervised Non-Bank SDs and MSPs subject to capital oversight by such non-banking regulators, we urge the Commission, like the Board, to defer to home country minimum capital requirements and model reviews and assessments if the relevant foreign regulator applies capital requirements consistent with the Basel Accord.

Finally, the Commission should permit a Foreign-Supervised Non-Bank SD or MSP subject to comparable financial recordkeeping and reporting in its home country to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements

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[17] See 12 C.F.R. § 211.24(c). In the event that the Board is unable to find that a foreign bank meets this standard, the Board nevertheless may permit the bank to establish a U.S. branch if it determines that "the appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank." See 12 U.S.C. § 3105(d)(6)(A)(i). We recommend that the Commission similarly treat a foreign regulator that the Board has determined satisfies this "working toward" standard as one that the Board has determined administers a regime of comprehensive consolidated supervision.

[18] In cases where the parent of a Foreign-Supervised Non-Bank SD or MSP, but not the Foreign-Supervised Non-Bank SD or MSP itself, is subject to comprehensive consolidated supervision, then we suggest that the Commission take the same approach to the Foreign-Supervised Non-Bank SD or MSP as it is proposing to take for a non-bank subsidiary of a U.S. bank holding company, *i.e.*, the Foreign-Supervised Non-Bank SD or MSP would be (i) subject to the minimum capital requirement applicable to its holding company as though it were the holding company and (ii) permitted to use internal models for computing market and credit risk charges if those models are subject to review and regular assessment by the home country supervisor of the Foreign-Supervised Non-Bank SD's or MSP's holding company.

[19] While the Board's determination under 12 C.F.R. § 211.24(c) is, as a technical matter, made on an institution-by-institution basis, its evaluation of a foreign supervisor's regime is generally consistent across different institutions within a particular jurisdiction regulated by the same supervisor. Accordingly, we believe that the Commission should similarly regard a Foreign-Supervised Non-Bank SD's or MSP's home country capital requirements and model reviews and assessment to be comparable to U.S. requirements if (i) the Board has determined that another entity organized in the same jurisdiction as the Foreign-Supervised Non-Bank SD or MSP or its parent, as applicable, is subject to comprehensive consolidated supervision and (ii) that entity is under substantially the same supervision or regulation as the Foreign-Supervised Non-Bank SD or MSP or its parent.

would be treated as a violation of Commission requirements. This is necessary in order to prevent duplicative and inconsistent requirements, such as requiring a Foreign-Supervised Non-Bank SD or MSP to conduct its accounting under both U.S. GAAP and IFRS.[20]

The Commission and relevant foreign regulator (in coordination with the Board and the OCC, as applicable) should also, to the extent they have not already done so, establish an appropriate allocation of responsibility for the exercise of examination authority and access to financial, operational, and other supervisory information. We note that the Commission has proposed to require that a registered SD or MSP subject to prudential regulation be required, upon request, to provide the Commission with copies of its capital computations and all supporting schedules and other documentation. For a foreign bank SD or MSP, we urge the Commission to obtain this information in coordination with the Board, which has established protocols with foreign regulators for sharing information relating to capital and prudential supervision.

B. Margin Requirements for Uncleared Swaps

1. Calculation of Initial Margin Requirements

The PR Proposal would permit an SD or MSP that is a foreign bank or state or Federal branch or agency of a foreign bank to use internal models for calculating initial margin requirements for uncleared swaps if those models comply with certain requirements and are approved by the Board. The Commission's proposal on margin requirements for uncleared swaps (the "**CFTC Margin Proposal**")[21] would also permit the use of models, but only those models that are (i) currently used by a derivatives clearing organization for margining cleared swaps, (ii) currently used by an entity subject to regular review and assessment by a Prudential Regulator for margining uncleared swaps or (iii) made available for licensing to any market participant by a vendor. Neither proposal addresses models that have been approved by a foreign regulator.

Initial margin is related to capital. Models used to compute the potential market, and resulting credit, risks associated with swap positions must model these risks in a manner that is consistent with the modeling of these risks for capital computation purposes. As a result, it is critical that initial margin and capital requirements be administered within a consistent supervisory framework. This is particularly the case where the same modeling techniques or the same models are used for computing both capital charges and initial margin amounts. In those

[20] As and to the extent necessary, the Commission could require certain accommodations to be made, such as permitting the preparation of English translations and reconciliation from IFRS to U.S. GAAP.

[21] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants. CFTC RIN3038-AC97, 76 Fed. Reg. 23732 (April 28, 2011).

circumstances, the same regulator should be responsible for the requirements applicable to, and the review and assessment of, those models for purposes of both capital and margin requirements. The use of different, and separately supervised, models for capital and margin purposes could give rise to unidentified risks or capital inefficiencies.

As a result, while we believe it is appropriate for a U.S. SD or MSP that is a subsidiary of either a foreign financial holding company or a foreign bank to comply with U.S. margin requirements, and for a foreign SD or MSP to do so with respect to its U.S.-facing transactions, we do not believe that either such SD or MSP should be required to use different, separately supervised models for purposes of those requirements than the models it uses for purposes of capital requirements.[22]

Additionally, the review and assessment of initial margin models will undoubtedly present substantial logistical challenges for the Prudential Regulators, the Commission, the SEC and SDs and MSPS generally. In particular, within roughly the same period prior to effectiveness of the Proposed Rules, a large number of SDs and MSPs will seek to obtain approval of their internal models. Recognition of Comparable Foreign-Supervised Models would significantly increase the efficiency of that process.

Accordingly, we recommend that the Board and the OCC, in approving an initial margin model for an SD or MSP that is (i) a foreign bank or state or Federal branch or agency of a foreign bank and (ii) permitted to compute its capital in accordance with home country capital requirements, give recognition to the approval of that model by the home country regulator. Similarly, for a Foreign-Supervised Non-Bank SD or MSP permitted to comply with its home country capital requirements (or those of its consolidated holding company group) under the proposal described in Part II.A.2 above, the Commission should give recognition to the home country regulator's or consolidated prudential supervisor's approval of an initial margin model. In cases where an SD or MSP seeks to use a Comparable Foreign-Supervised Model that has been approved by the regulator of an affiliate of the SD or MSP, the Board, the OCC or the Commission (as applicable) should also give recognition to that regulator's approval.

There may also be circumstances, at least initially, where foreign regulators are not yet in a position to approve initial margin models for uncleared swaps because, for instance, margin requirements are not yet in effect in the relevant jurisdiction. In those cases, we would expect the Board and the OCC to assess and approve the initial margin model directly (and for the Commission to do the same for non-bank SDs and MSPs once it has the resources to do so). At the same time, we recognize that the Board's and the OCC's resources for reviewing and

[22] As noted above, if a foreign regulator adopts margin requirements for uncleared swaps that are comparable to U.S. requirements, then the Commission and the Prudential Regulators should permit a foreign SD or MSP subject to such requirements to comply with those requirements in lieu of U.S. requirements, provided that a violation of those requirements would be treated as a violation of Commission or Prudential Regulator rules.

approving models will be limited, and that their review and approval process may take longer than the proposed 180-day pre-effective period for those SDs and MSPs with which the Board and the OCC are less familiar or to which the Board and the OCC currently devote less examination resources. As a result, we are concerned about the possibility that the margin requirements will become effective for some SDs and MSPs while the Board's and the OCC's model reviews are still pending, thereby imposing significant competitive disadvantages on those SDs and MSPs by subjecting them to standardized margin requirements that do not take into account portfolio offsets. Accordingly, we urge the Board and the OCC to set the effective date for the margin requirements based on the time that will be needed for the model approval process to be completed for all SDs and MSPs who initially apply, not just those to which the Prudential Regulators already devote significant examination resources.

2. Territorial Scope of Margin Requirements

a. PR Proposal

Under the PR Proposal, all swaps with U.S. counterparties would be subject to U.S. margin rules, but swaps between a foreign SD or MSP and a foreign counterparty would instead be subject to the margin requirements, if any, of the relevant foreign jurisdiction(s).[23] We strongly support this proposal. We also ask that the Prudential Regulators further confirm that this distinction will also apply in cases where U.S.-based personnel employed by a U.S. affiliate separate from the foreign SD or MSP (or the foreign counterparty) are involved, as agents of the foreign SD or MSP (or the foreign counterparty), in soliciting or negotiating with the foreign counterparty (or the foreign SD or MSP), although those personnel would need to comply with U.S. requirements applicable to introducing brokers or securities broker-dealers to the extent that the U.S. affiliate is so registered and those personnel are acting as employees or associated persons of the registered affiliate. We believe that this interpretation is consistent with the safety and soundness objectives of margin requirements under Dodd-Frank, since the location(s) of agent(s) involved in negotiating a transaction is wholly irrelevant to the transaction's effect on the SD or MSP's safety and soundness.

Additionally, we note that the PR Proposal would distinguish between U.S. and foreign-controlled firms – with U.S. firms' non-U.S. operations subject to U.S. margin rules and foreign-controlled firms subject to rules of the applicable foreign jurisdiction. We believe, however,

[23] We also note that many global banks conduct their trading activities through multi-branch master netting agreements. In such cases, we believe that netting effects from foreign transactions not subject to U.S. rules should be recognized when computing margin requirements for U.S.-covered transactions so long as those netting effects are legally enforceable. So, when a foreign SD or MSP has a swap with the U.S. branch of a global bank, on the one hand, and also an offsetting swap with a foreign branch of that bank, on the other hand, the foreign SD or MSP should be permitted to recognize that offset for purposes of calculating the amount of initial margin required for the swap with the U.S. branch, so long as both swaps are subject to the same enforceable netting agreement.

that all transactions entered into between foreign counterparties, regardless of whether conducted by a U.S. firm's foreign operation or by a foreign-controlled firm, should be subject to primary supervision by foreign regulators, not U.S. regulators. This approach is consistent with the territorial application of law (as embodied in Sections 722(d) and 772(b) of Dodd-Frank),[24] and expectations of market participants. Both foreign-controlled firms and the foreign operations of U.S. firms currently conduct business abroad subject to foreign regulation; such activity is due to the global character of financial markets and is not inherently evasive. The application of Dodd-Frank to any such foreign activity could lead to reciprocal extraterritorial application of financial regulation by foreign regulators to U.S. activities.[25]

b. CFTC Margin Proposal

Unlike the Prudential Regulators, the Commission has not proposed a distinction in the CFTC Margin Proposal between foreign and U.S. transactions, just as it has not generally addressed the extraterritorial application of its rules. In this regard, we very strongly urge the Commission also to distinguish, for a foreign SD or MSP (whether ultimately U.S. or non-U.S. owned), between swaps with U.S. versus foreign counterparties. Without clarity on the boundaries of the Commission's margin proposal, it will be impossible for SDs and MSPs to implement the proposal.

Distinguishing between transactions by a foreign SD based on the nationality of its counterparty would be consistent with Congress' intent to authorize the Commission and the SEC to designate and regulate persons as SDs for limited purposes. Specifically, Dodd-Frank's SD definition provides that a "person may be designated as a swap dealer for a single type or single class or category of . . . activities and considered not to be a swap dealer for other types, classes, or categories of . . . activities" (emphases added).[26] Accordingly, in circumstances where it is appropriate to require SD registration, the Commission should designate and regulate a foreign person as an SD only with respect to its execution of swaps from within the U.S. or

[24] We note that the Supreme Court has recently interpreted language very similar to 722(d) (in the 2004 Empagran decision) and 772(b) (in the 2010 Morrison decision) and affirmed that, under long-established canons against the extraterritorial application of U.S. law, the relevant language should be interpreted generally to limit U.S. jurisdiction, with language that would apply U.S. law extraterritorially interpreted narrowly. See F. Hoffman-La Roche Ltd v. Empagran S.A., 524 U.S. 155 (2004) and Morrison v. National Australia Bank, 130 S. Ct. 2869 (2010); see also United States v. Philip Morris USA Inc., 2011 U.S. Dist. LEXIS 32053 (D.D.C., Mar. 28, 2011) (noting that the Supreme Court in Morrison "intended the presumption against extraterritoriality to apply to all statutes, not simple the Exchange Act").

[25] Additionally, distinguishing between counterparties based on whether they are controlled by a U.S. person poses significant practical difficulties, since margin requirements must largely be implemented in real time through automated systems that are not conducive to facts-and-circumstances determinations and the PR Proposal does not contain a clear, bright-line test (or any test) for "control."

[26] See § 1a(49)(B) of the CEA, as amended by Dodd-Frank.

with U.S. counterparties. This would be consistent with principles of international comity, with the *bona fide* expectations of foreign counterparties, and with the objectives of international regulatory cooperation underpinning Section 752 of Dodd-Frank.

In contrast, applying U.S. margin rules (or other transaction-specific rules) to swaps between foreign counterparties merely because one of those parties is registered in the U.S. as an SD or MSP would strongly discourage participation in the U.S. market by foreign market participants. This is because, under such an approach, any participation in the U.S. market that resulted in a U.S. SD or MSP registration requirement would also result in extraterritorial application of U.S. margin rules or would require U.S. swap activities to be conducted through a separately incorporated U.S. subsidiary. We emphasize that the significant negative impacts on capital, netting and risk management resulting from conducting derivatives trading through multiple U.S. and non-U.S. legal entities would impose significant costs on U.S. customers and foreign SDs and MSPs alike and reduce liquidity available to U.S. market participants generally.

3. Inter-Affiliate Transactions

Neither the PR Proposal nor the CFTC Margin Proposal addresses the application, or non-application, of margin requirements to transactions between entities under common ownership. In this regard, we note that, to centralize risk management, a U.S.-based SD or MSP may use swap transactions to allocate the market risk arising from its swap activities to a foreign affiliate through back-to-back transactions or other similar arrangements. Similarly, a foreign SD or MSP may use swap transactions to allocate the market risk arising from its swap activities to a U.S. affiliate so that personnel employed by that U.S. affiliate can manage that risk. Such arrangements can be used, for instance, so that a global organization's U.S. dollar interest rate portfolio is managed centrally by expert personnel in the U.S. where the greatest liquidity for such product exists, and similarly its non-U.S. dollar interest rate portfolio can be managed centrally by expert personnel of a relevant non-U.S. affiliate.

Application of margin requirements to such transactions would in some instances completely prevent, and in others seriously reduce the efficiency of, those transactions – thereby undermining Dodd-Frank's objective of mitigating systemic risk. It is also unnecessary so long as a U.S.-registered SD or MSP is involved in the transaction, since in such case any outward, U.S.-facing swaps would be subject to U.S. margin requirements. To the extent that the Prudential Regulators or the Commission are concerned about inter-affiliate credit risk, that risk is better addressed through applicable capital rules. Furthermore, Dodd-Frank's expansion of Section 23A of the Federal Reserve Act, which will subject some (but not all) inter-affiliate derivatives transactions to collateralization requirements, strongly suggests that Congress did not intend for Title VII's more generally applicable margin requirements to apply to inter-affiliate transactions, since otherwise Dodd-Frank's amendments to Section 23A would be superfluous.

4. Custodial Arrangements

The PR Proposal would require that, for swaps between a bank SD or MSP and another SD or MSP, initial margin be segregated at an independent custodian located in a jurisdiction that applies the "same insolvency regime" to the custodian as would apply to the *posting* bank SD or MSP. The CFTC Margin Proposal would require that, for swaps between a non-bank SD or MSP and another SD or MSP, *both* the initial margin *posted* by that non-bank SD or MSP and the initial margin *received* by that non-bank SD or MSP be segregated at an independent custodian located in a jurisdiction that applies the "same insolvency regime" to the custodian as would apply to the non-bank SD or MSP.

These proposals would result in several significant practical costs and complications. For a swap between a bank SD or MSP and a non-bank SD or MSP, the parties would be faced with inconsistent custodial requirements: the bank SD or MSP would be required to have the collateral it posts held at a bank custodian, and the non-bank SD or MSP would be required to hold that same collateral at a non-bank custodian. Similarly, the CFTC Margin Proposal seems to require that, for a swap between two non-bank SDs or MSPs located in separate jurisdictions, each non-bank SD or MSP would be required to hold the collateral it receives at an independent custodian located in its own jurisdiction, while at the same time the counterparty non-bank SD or MSP posting that same collateral would be required to have that collateral held by an independent custodian located in its own, different jurisdiction. Of course, the same custodian cannot simultaneously be a bank and a non-bank or simultaneously be located in two different jurisdictions.

Moreover, even if these inconsistencies were resolved, any requirement for the use of two different custodians by the parties to the same transaction would result in unnecessary increased costs and operational complexities and risks. In many cases, such a requirement would also disrupt existing swap trading relationships with different custodial arrangements. The further requirement for the use of unaffiliated custodians would, in turn, result in increased concentration of custodial assets at a handful of institutions – thereby further increasing risks – and reduced competition among custodians – thereby further increasing costs.

While we agree that SDs and MSPs should take steps to mitigate legal risks associated with the insolvency regime of their custodians, we believe that a more flexible approach can address this objective without giving rise to the unintended consequences noted above. In this regard, we note that the Commission has already proposed to require SDs and MSPs, as part of their risk management program, to adopt policies and procedures to mitigate legal risk.[27] We recommend that the Prudential Regulators and the Commission adopt a similar requirement that SDs and MSPs establish, maintain, and enforce policies and procedures reasonably designed to

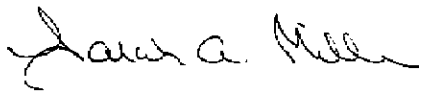
[27] See Regulation Establishing and Governing the Duties of Swap Dealers and Major Swap Participants, CFTC RIN 3038-AC96. 75 Fed. Reg. 71397 (Nov. 23. 2010).

assess the legal risks associated with their custodial relationships. This requirement would address the legal risks identified by the Prudential Regulators and the Commission while also recognizing that the nature of that legal risk, and the trade-offs with reputational, credit and other risks, can vary depending on specific facts and circumstances. It also would not raise the unintended consequences of the more rigid requirements contained in the Proposed Rules.[28]

* * *

The Institute appreciates the opportunity to submit these comments in connection with the Proposed Rules. Please do not hesitate to contact the undersigned at (212) 421-1611 with any questions or if we can be of assistance to the Commissions.

Sincerely,



Sarah A. Miller
Chief Executive Officer

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

[28] If, however, the Prudential Regulators and the Commission believe it to be necessary to place more prescriptive requirements on the identities of custodians used by SDs and MSPs, then we urge the Prudential Regulators and the Commission to adopt the following recommendations: (i) an unaffiliated custodian should not be required, (ii) the custodian should not be required to be in the same insolvency jurisdiction as the SD or MSP and (iii) if a specific insolvency jurisdiction is required, then it should be the insolvency jurisdiction of the SD or MSP receiving the collateral.