December 16, 2016

Mr. Christopher Kirkpatrick
Secretary
U.S. 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 Major Swap Participants [RIN 3038–AE54]***

Dear Mr. Kirkpatrick:

The Coalition for Derivatives End-Users (the "**Coalition**") represents hundreds of end-user companies—from manufacturing to health care to agriculture to energy to technology—that utilize swaps and other derivatives to manage risks related to their global commercial activities. We write to express our concerns over the sudden and costly departure that the U.S. Commodity Futures Trading Commission (the "**CFTC**" or the "**Commission**") has proposed in its notice of proposed rulemaking titled *Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants* (the "**Proposed Cross-Border Rule**"),[1] which would replace several key aspects of the Commission's Cross Border Interpretive Guidance.[2]

In particular, our members have significant concerns with the Commission's proposed introduction and implementation of the term "foreign consolidated subsidiary" ("**FCS**") for the purposes of calculating swap dealer ("SD") and major swap participant ("MSP") registration thresholds. Adoption of the FCS concept would have significant adverse effects on the ability of derivatives end-users to competitively and successfully operate their commercial businesses in foreign jurisdictions, particularly because they would disadvantage U.S. commercial businesses operating in foreign jurisdictions with non-U.S. counterparties. Worse, those non-U.S. counterparties would naturally be disincentivized to do business with a U.S. affiliate at all, given the complexity underlying the FCS concept.

The Coalition's comments to the Proposed Cross-Border Rule are discussed in greater detail in the four sections below. In particular we believe that: (I) there are no material changes in the swaps market that warrant the importation of the FCS concept from the Commission's Cross

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[1] Proposed Rule, *Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 71946 (Oct. 18, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-10-18/pdf/2016-24905.pdf.

[2] CFTC, *Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations*, 78 Fed. Reg. 45291 (July 26, 2013), *available at* https://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf.

Border Margin Final Rule[3] to apply more broadly to registration thresholds and other substantive requirements; (II) using the FCS concept in calculating registration thresholds would have significant adverse effects on U.S. commercial end-users doing business abroad and ultimately on the U.S. economy and job creation; (III) the proposed approach does not satisfy the statutory extraterritoriality standard set forth in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**");[4] and (IV) the use of the FCS concept would add significant costs to end-user businesses with no appreciable benefits or protections.

For all of these reasons, we respectfully request that the Commission refrain from moving forward with the FCS concept in this context and the Proposed Cross-Border Rule generally.[5] If the Commission decides to take further action defining the contours of its cross-border jurisdiction, we request that the Commission issue a new proposal, which promotes the health of domestic commercial end-users by allowing for such multinational entities to engage in prudent risk management activities.

## I. THERE ARE NO MATERIAL CHANGES IN THE SWAPS MARKET THAT WARRANT THE IMPORTATION OF THE FCS CONCEPT FROM THE COMMISSION'S CROSS BORDER MARGIN FINAL RULE

The Proposed Cross-Border Rule introduces the term FCS to identify those non-U.S. persons whose swap activities present "a greater supervisory interest relative to other non-U.S. market participants."[6] The Proposed Cross-Border Rule generally defines an FCS as a non-U.S. person that is consolidated for accounting and financial statement purposes under U.S. generally accepted accounting principles ("**U.S. GAAP**") with an ultimate parent entity, which is a "U.S. person" (as such term is also defined in the Proposed Cross-Border Rule).[7] The Commission

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[3] Final Rule, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements*, 81 Fed. Reg. 34818 (May 31, 2016), *available at* http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-12612a.pdf.

[4] *See* 7 U.S.C. § 2(i) (2016).

[5] The Coalition respectfully suggests that the Commission should not move forward with the Proposed Cross-Border Rule generally because the FCS concept is a critical element of the Commission's proposed cross-border framework. That is, without the FCS concept, the Proposed Cross-Border Rule would, in essence, only address the Commission's territorial jurisdiction.

[6] Proposed Cross-Border Rule. 81 Fed. Reg. at 71950.

[7] "(5) U.S. person means: (i) A natural person who is a resident of the United States; (ii) An estate of a decedent who was a resident of the United States at the time of death; (iii) A corporation, partnership, limited liability company, business or other trust, association, joint-stock company, fund or any form of entity similar to any of the foregoing (other than an entity described in paragraph (aaaaa)(5)(iv) or (v) of this section)("legal entity"), in each case that is organized or incorporated under the laws of the United States or that has its principal place of business in the United States, including any branch of the legal entity; (iv) A pension plan for the employees, officers or principals of a legal entity described in paragraph (aaaaa)(5)(iii) of this section, unless the pension plan is primarily for foreign employees of such entity; (v) A trust governed by the laws of a state or other jurisdiction in the United States, if a court within the United States is able to exercise primary supervision over the administration of the trust; (vi) A legal entity (other than a limited liability company, limited liability partnership or similar entity where all of the owners of the entity have limited liability) that is owned by one or more persons described in paragraphs (aaaaa)(5)(i) through (v) of this section and for which such person(s)

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notes that the usage and definition of FCS are based on, and are intended to be consistent with, the Commission's Cross Border Margin Final Rule.[8]

The Proposed Cross-Border Rule further proposes to include the FCS concept in calculating the registration thresholds for SDs and MSPs. In particular, the Proposed Cross-Border Rule would generally expand this calculation by requiring a non-U.S. person to count all of its swap transactions when determining whether it meets or exceeds the SD *de minimis* threshold calculation, which is currently set at $8 billion U.S. dollars.[9] Additionally, the Proposed Cross-Border Rule would generally require a non-U.S. person that is not an SD to count all swap positions of its FCSs toward the MSP threshold calculations. In an attempt to alleviate some of these calculation burdens, the Proposed Cross-Border Rule, in both cases, would allow such non-U.S. person to exclude from the SD *de minimis* threshold calculation or MSP threshold calculations, as appropriate, those transactions that are: (i) executed anonymously on a swap execution facility, designated contract market or foreign board of trade; and (ii) cleared.

The Coalition believes that the Commission's importation of the FCS concept into the Proposed Cross-Border Rule would be harmful to commercial end-users because it would cast a wider net, which would result in the significant expansion of registration obligations, including the registration of several more foreign market participants that otherwise do not have a direct connection or nexus with the U.S. financial system. Particularly troubling with this proposed expansion is that no exigent market events have occurred and no new risks have arisen that would necessitate the CFTC supplanting its Final Cross-Border Guidance with a different and more "maximalist" regulatory approach. In fact, the global regulatory landscape for swaps and other derivatives is arguably much safer since that time in large part because other jurisdictions have adopted substantive new rules and standards to supervise swap markets and swap market participants in their respective jurisdictions.[10]

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bears unlimited responsibility for the obligations and liabilities of the legal entity, including any branch of the legal entity; or (vii) An individual account or joint account (discretionary or not) where the beneficial owner (or one of the beneficial owners in the case of a joint account) is a person described in paragraphs (aaaaa)(5)(i) through (vi) of this section." Proposed Cross-Border Rule at 71973.

[8] The Proposed Cross-Border Rule expressly defines "FCS" to mean "a non-U.S. person in which an ultimate parent entity that is a U.S. person has a controlling financial interest, in accordance with U.S. GAAP, such that the U.S. ultimate parent includes the non-U.S. person's operating results, financial position and statement of cash flows in the U.S. ultimate parent entity's consolidated financial statements, in accordance with U.S. GAAP." *See* Proposed Cross-Border Rule at 71950. *See also* Final Rule, *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants-Cross-Border Application of the Margin Requirements*, 81 Fed. Reg. 34817, 34847-48 (May 31, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-05-31/pdf/2016-12612.pdf, where the Commission uses a similar definition for FCS but does not refer to the term "person," but instead uses the term "covered swap entity."

[9] 17 C.F.R. § 1.3(ggg)(4). Per the phase-in period established by the Commission, the *de minimis* exception would decrease to $3 billion on December 31, 2017. *See* CFTC, *Order Establishing De Minimis Threshold Phase-In Termination Date*, 81 Fed. Reg. 71605 (Oct. 13, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-10-18/pdf/2016-25143.pdf.

[10] For example, with respect to European-based firms, the mandatory clearing obligation and the bilateral margin requirements for non-cleared trades under the European Market Infrastructure Regulation ("**EMIR**"),

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## II. USING THE FCS CONCEPT IN CALCULATING REGISTRATION THRESHOLDS AND APPLYING OTHER SUBSTANTIVE SWAPS REQUIREMENTS WOULD HAVE SIGNIFICANT ADVERSE EFFECTS ON U.S. COMMERCIAL END-USERS' FOREIGN OPERATIONS

As noted above, the Proposed Cross-Border Rule would require a non-U.S. person that falls within the definition of FCS to count its worldwide swaps for the purpose of calculating the SD and MSP registration thresholds. It also would require non-U.S. persons that transact swaps with FCSs to count their swap transactions for that same purpose. In respect of the latter requirement, the introduction and implementation of this concept would have three significant, adverse impacts on U.S. Main Street businesses with overseas operations. First, it would put U.S. commercial end-users operating in foreign jurisdictions at a significant disadvantage—both in terms of reduced liquidity and in terms of competition relative to their foreign counterparts. Second, using the FCS concept for these purposes would have a reductive impact on market liquidity globally, which in turn would hurt U.S. commercial end-users' ability to efficiently operate multinational businesses. Third, the implementation of the FCS concept would likely create confusion around when U.S. intervention will apply to purely non-U.S. affairs and activities, and lead to retaliatory action by foreign regulators.

### A. Using the FCS concept would significantly disadvantage U.S. commercial businesses operating in foreign jurisdictions

Many commercial end-users operate multinational enterprises that have affiliates within their corporate group that provide goods and services to consumers around the globe. When conducting business in foreign jurisdictions, commercial end-users choose a diverse group of counterparties for hedging their commercial exposures and other localized risks in these jurisdictions. Having greater numbers of potential counterparties increases the likelihood that commercial end-users can find competitive pricing when entering into hedging transactions and can significantly reduce counterparty credit exposures through the dispersion of risk across those counterparties. Further, in certain jurisdictions, it is imperative that a foreign affiliate has access to local banks in those jurisdictions, particularly for lending and hedging activities, in order to remain competitive in those markets and for effective risk management.

The Proposed Cross-Border Rule would lead to many non-U.S. counterparties ceasing to transact swaps with commercial end-users' FCSs as transactions with FCSs would require a non-U.S. counterparty (e.g., a local foreign bank) to track all of its activities and could ultimately trigger registration as an SD or MSP. As a result, it would disrupt the mechanisms employed by these end-users to mitigate commercial risks in foreign jurisdictions and to disperse risk across

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Regulation EU No. 648/2012, apply or will apply to financial firms and to non-financial firms that exceed thresholds as low as EUR 1-3 billion measured over a 30-day period. Additionally, certain other risk mitigation and reporting requirements apply to all firms and all applicable trades irrespective of whether their trading activity falls above or below the EMIR threshold. Thus, the CFTC would obtain only a marginal benefit from requiring aggregated swap dealing information considering these firms already must comply with equivalent regulations.

multiple liquidity providers as end-users will face fewer counterparties with which to transact. The ability to address local risks in foreign jurisdictions is a necessary function that foreign counterparties specifically provide to commercial end-users' non-U.S. affiliates. Moreover, commercial end-users would no longer have access to potentially more cost-effective transactions in the local jurisdiction in which they do business, and could be forced to return to U.S. markets to hedge their foreign commercial risks.[11] As U.S. counterparties may be less familiar with specific foreign risks unique to the end-user's foreign operations, it is likely that U.S. multinational commercial end-users will end up with a less liquid hedging market and less favorable terms, when compared to the current practice of dealing with local counterparties.

This problem would be further compounded as the Proposed Cross-Border Rule would also create an uneven playing field that directly advantages foreign competitors of U.S.-owned FCSs. Specifically, as foreign counterparties begin to avoid transacting with FCSs due to registration thresholds, non-U.S. commercial end-users will have the benefit of better access to local derivatives pricing, which would result in more competitive consumer pricing. In turn, multinational U.S. commercial businesses could be competitively priced out of foreign markets when trying to offer the same consumer products and services.

B. Using the FCS concept would have a reductive impact on the U.S. economy and job creation

Commercial end-users use swaps and other derivatives to improve their planning and forecasting and to offer more stable prices to consumers and more stable contributions to economic growth in the United States. Implementation of the FCS concept in the Proposed Cross-Border Rule would likely increase costs borne by U.S.-based multinational commercial end-users by concentrating their market risks, eliminating their counterparty pools and, as noted above, increasing costs associated with prudent risk management. These effects would ultimately raise prices for Main Street consumers who rely on reasonably priced products and services and would hurt the standing of U.S. companies with foreign operations to compete globally. In other words, U.S. businesses with FCSs would find themselves at a significant disadvantage to their non-U.S. counterparts because of their higher prices for the same products and services, resulting in harm to U.S. businesses, and potentially driving away FCSs' overseas consumers. The flight of FCSs' overseas consumers would be the result of competitive realities caused directly by implementation of the FCS concept.

In addition, the inclusion of FCSs within the proposed calculation regime provides no discernable benefit to domestic or international financial markets. These entities in particular are bankruptcy remote and unlikely to affect the ultimate U.S. parent entity in the event that a swaps transaction with a non-U.S. person fails. Commercial end-users—in recognizing the risk-reducing nature of such structures—often implement such structures for their overseas entities.

[11] It is worth noting that some jurisdictions (e.g., China, Brazil and Indonesia) impose considerable currency restrictions on multinational commercial business, which prevent end-users from hedging their foreign commercial risks in U.S. derivatives markets. As a result of the Proposed Cross-Border Rule, commercial end-users operating in these foreign jurisdictions would have to pay prohibitive hedging costs, leave their currency exposures unhedged, or cease operations in those local markets. None of these outcomes is desirable.

Instead of reducing risks and streamlining efficiency, the Proposed Cross-Border Rule would add additional costs to commercial end-users, which employ such structures. By regulating highly unlikely risks, the Proposed Cross-Border Rule, if adopted, would cause undue harm to the engines of our economy and would likely increase costs for sustainable real-world growth.

To ensure sustainable growth within U.S. commercial markets, the Commission should reconsider the scope and application of the FCS concept in light of, among other things, the effects it will have on downstream participants—namely, Main Street businesses that are derivatives end-users.

### C. The implementation of the FCS concept would likely create confusion and lead to retaliatory action by foreign regulators

The fear of, and confusion around, U.S. intervention in purely non-U.S. affairs and activities through the FCS concept could likely spill over into other markets and result in non-U.S. persons seeking to avoid engaging in all types of transactions with FCSs. These disincentives would discourage a non-U.S. person from doing business generally with an FCS, resulting in compounding financial harm to Main Street businesses. Ultimately, this financial harm would negatively impact the overall U.S. economy and hamper job creation.

A related, but different, issue may also arise in that many foreign swap counterparties may simply decide to assume that any entity with U.S. ownership is an FCS, even when such entity does not fall within the proposed FCS definition.[12] The overall impact, as a practical matter, would extend the application of Dodd-Frank far beyond those circumstances where the swaps of FCSs could have a direct and significant (albeit unlikely) effect on U.S. commerce.

Lastly, the FCS concept also could invite other jurisdictions to extend their regulatory reach into the United States creating transatlantic and even global duplication that ultimately harms the competitiveness of American businesses, and runs counter to other policy initiatives designed to strengthen the U.S. economy and promote job creation. It is our view that economic effects should be at the center of the Commission's actions when it contemplates new proposals and guidance regarding its extraterritoriality authority.

## III. THE COMMISSION'S PROPOSED APPROACH DOES NOT SATISFY THE EXTRATERRITORIALITY STATUTORY STANDARD SET FORTH IN DODD-FRANK AND CONFLICTS WITH INTERNATIONAL COMITY

Putting aside the devastating implications of the FCS concept on Main Street businesses operating in foreign jurisdictions, the Commission's proposed approach does not satisfy the statutory extraterritoriality standard set forth in Dodd-Frank. In addition, the FCS concept conflicts with principles of international comity.

[12] Consider that a foreign swap counterparty could reduce its burdens of collecting questionnaires from U.S. owned non-U.S. end-user counterparties in order to determine if they are FCSs by simply taking the position that all subsidiaries and affiliates of a U.S. parent company are FCSs.

A. The FCS concept does not satisfy the requisite Commodity Exchange Act Section 2(i) analysis

The FCS concept is inconsistent with the Dodd-Frank mandate that Title VII will not apply to activities outside the United States unless those activities, in part, have a direct and significant connection with activities in, or effect on, commerce of the United States or when they contravene such rules as the CFTC may adopt to prevent evasion.[13] This statutory extraterritoriality standard is set forth in Section 2(i) of the Commodity Exchange Act ("**CEA**").[14] Subjecting an FCS's non-U.S. counterparty to the requirements of Dodd-Frank solely because they may enter into transactions with counterparties that have a business affiliation with a U.S. person would result in an excessively broad application of this statutory extraterritoriality standard. To do so would impose significant regulatory obligations on non-U.S. persons that have only a remotely tangential nexus to the United States. In other words, the connection with U.S. activities is therefore indirect, and the transactions would not have a significant effect on U.S. commerce because both counterparties are non-U.S. persons and the transactions are related to the activities of those non-U.S. persons.

Sweeping the activities of non-U.S. subsidiaries that do not have any nexus to the United States other than through business ownership and financial accounting concepts is unprecedented and is unnecessary to achieve the Commission's intended purposes. The only tie to the United States is the business affiliation of the U.S. commercial end-user's parent entity and consolidation with the parent entity's balance sheet. We do not believe that that tie alone is sufficient to meet the standard for extraterritorial application.

Additionally, the Commission's proposal on this concept does not expressly consider or put forth an analysis of the statutory provisions under CEA Section 2(i). Instead, the Commission's recent interpretation of its jurisdictional limits inappropriately focuses on mere business affiliation and tethers its analysis to accounting and financial reporting rules. Business affiliation in and of itself does not alter the location of activity, the residency of a participant or the amount of risk that may be imported back into the United States. Given that there is no legal basis under CEA Section 2(i) for asserting jurisdiction based on a business ownership, the Coalition strongly believes that the Commission should refrain from moving forward with the implementation of the FCS concept and the Proposed Cross-Border Rule generally.

B. The FCS concept conflicts with principles of international comity

The FCS concept conflicts with principles of international comity and bruises the United States' relationships with foreign jurisdictions.[15] Principles of international comity should produce a

[13] 7 U.S.C. § 2(i).

[14] *Id.*

[15] Under Section 752 of Dodd-Frank, the CFTC has the obligation to coordinate with foreign regulators. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 752, 124 Stat. 1376-2223 (2010) ("In order to promote effective and consistent global regulation of swaps and security-based swaps, the Commodity Futures Trading Commission. . .as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including

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less disruptive approach than what the Commission has proposed. Foreign sovereigns have legitimate regulatory interests in the trading of swaps by multinational Main Street businesses in their local jurisdictions. The Commission must honor these principles in order to respect the legitimate interests of other nations to regulate lawfully organized foreign entities and oversee purely local activities.

Furthermore, and as noted above, the FCS concept will likely provoke these nations to develop strict swaps rules in retaliation that unfairly and unnecessarily burden U.S. businesses. That is, by following the same rationale espoused in the Commission's Proposed Cross-Border Rule, foreign regulators will likely begin redrawing the scope of their cross-border jurisdiction in order to cover strictly U.S. activities and participants.[16]

## IV. THE COMMISSION'S USE OF THE FCS CONCEPT WOULD ADD SIGNIFICANT COSTS WITH NO APPRECIABLE BENEFITS

Introduction and implementation of the FCS concept as proposed by the Commission would be highly disruptive to, and a material operational burden for, U.S. markets generally and for commercial end-users specifically. The Proposed Cross-Border Rule completely re-writes the scope of the CFTC's Final Cross-Border Guidance with little regard for its content, with which all market participants have spent significant financial resources (in the billions) over the last several years working to comply. In particular, commercial end-users would likely face increased costs of hedging in foreign jurisdictions where local counterparties are generally used for hedging and would be placed at a disadvantage over non-U.S. competitors. For example, if local counterparties refuse to trade with commercial end-users' FCSs, these FCSs would be forced to hedge with a smaller group of counterparties that may not be as active in those local markets, leading to wider spreads and other transaction-related charges not otherwise imposed by local counterparties.

Based on the experience that Coalition member companies have had in the years since the Commission issued the Final Cross Border Guidance, we believe that the Commission must take additional steps in order to appropriately address some of the practical issues that would arise should the Commission adopt the FCS concept as proposed. In promulgating any new rules that seek to supplant the regime governing cross border transactions established by the Final Cross Border Guidance, it is important for the Commission to take into account the steps that companies like the Coalition's members already have taken to comply with the Final Cross

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fees) of swaps, security-based swaps, swap entities, and security-based swap entities and may agree to such information-sharing arrangements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors, swap counterparties, and security-based swap counterparties.")

[16] Although it relates to a different context, we highlight that the European Commission's recently published legislative proposals to require large non-EU banking firms to establish intermediate holding companies in the European Union are widely regarded as retaliation to the U.S. requirement for European banks to establish U.S. intermediate holding companies. The proposals to amend Capital Requirements Regulation 575/2013 and the Capital Requirements Directive 2013/36/EU are available at: http://ec.europa.eu/finance/bank/regcapital/crr-crd-review/index_en.htm#161123.

Border Guidance. Indeed, the Commission also should cogently consider the concerns of multinational Main Street businesses that use swaps and other derivatives to hedge commercial risks outside of the United States.

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For the foregoing reasons, we respectfully urge the Commission, at a minimum, to refrain from moving forward with adopting the FCS concept in the Proposed Cross-Border Rule.

The Coalition appreciates the ability to provide its comments on the Commission's Proposed Cross-Border Rule and looks forward to working with the Commission as it continues to consider this important issue. The Coalition's members would be pleased to discuss these comments with the Commission and Commission staff. Please feel free to contact Michael Bopp at 202-955-8256 or at mbopp@gibsondunn.com at your convenience.

Respectfully submitted,

Agricultural Retailers Association
Financial Executives International
National Association of Corporate Treasurers
National Association of Manufacturers
U.S. Chamber of Commerce

cc: Hon. Timothy Massad, Chairman, Commodity Futures Trading Commission
Hon. Sharon Bowen, Commissioner, Commodity Futures Trading Commission
Hon. Christopher Giancarlo, Commissioner, Commodity Futures Trading Commission