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Mr David A. Stawick
Secretary
Commodities Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington D.C.

Subject: Comment letter proposed CFTC rules

Dear Mr Stawick,

The European Commission welcomes the opportunity to provide comments on the proposed Cross-Border Proposed Interpretive Guidance (RIN 3038-AD57) and the Proposed Exemptive Order (RIN 3038-AD85) as published by the Commodity Futures Trading Commission (CFTC) on 12 July.

These comments should be seen in the important context of our shared commitment in the G20 to comprehensively regulate over-the-counter (OTC) derivative markets. Two years ago in Toronto, G20 Leaders reaffirmed their commitment to improve transparency and regulatory oversight of OTC derivatives *"in an internationally consistent and non-discriminatory way"*. Since then the European Commission and the CFTC have engaged in a dialogue to fulfil those objectives. Regulatory frameworks that will improve the stability of the financial system are now in place in the US and the EU and we have both made great efforts to ensure the consistency of our requirements. We have also worked together with a shared objective of avoiding duplicative and conflicting requirements and rules to prevent their avoidance.

Nevertheless, we are of the view that the CFTC's proposed cross-border Guidance and proposed Exemptive Order require further review in order to contribute to achieving our common goal.

Definition of a 'US person'

The European Commission understands the CFTC's concern about exposing the US financial system to significant risks through connections with a foreign entity which is not resident or established in the US. To this end the CFTC proposes a wide definition of a 'US person'.

This wide definition determines the territorial scope of application of the Dodd-Frank Act. The European Commission notes the significant potential risk attached to this proposed approach. It will maximise the potential for overlap and duplication of US regulatory requirements with those of other jurisdictions, including the EU. An EU and a US firm that conclude an OTC derivatives contract will be simultaneously subject to EU and US requirements. This will lead to duplication of laws and to potentially irreconcilable conflicts of laws for market operators. Examples of such situations are the following:

- An EU-dealer could be subject for the same trade to the European regulatory requirements (under EMIR, MiFID, and CRD IV) and to CFTC requirements implementing the Dodd-Frank Act at the same time.

- A collective investment vehicle managed from the EU, but with a majority ownership by US persons would be subject to regulatory requirements in the EU and to Dodd-Frank in the US.

Legal uncertainty is increased by the fact that the CFTC's proposed interpretation of the term "U.S. person" is based on a non-exclusive list of entities that fall within the definition. It is important for the CFTC to provide further clarification about the process for determining any other types of entities that it deems to be "U.S. persons" in the future and how and when it intends to apply regulatory requirements to those entities.

A further consequence and source of concern about the CFTC's proposed approach is its practical and legal enforcement. The application of US rules to non-US firms implies that they would need to be enforced by US regulators. In addition to the potentially irreconcilable conflicts of laws firms will face and the significant resource implications for the CFTC in view of the potentially large number of firms involved, this will entail significant supervisory inefficiencies as non-US firms would be supervised by both the CFTC as well as their home regulators. A duplicative application of EU and US rules could also lead to distortive and discriminatory situations.

Although we have made significant efforts to develop common international standards in the field of OTC derivatives EU and US firms could face permanent legal uncertainty if this issue is not resolved. We therefore suggest that the definition of a 'US person' should be qualified and should not apply to a person or entity that is not resident or established in the US if the CFTC can establish that it is resident or established in a jurisdiction which has rules in force that are consistent with and comparable to those under the Dodd-Frank Act.

It is reasonable to expect US authorities to rely on those rules and recognise activities regulated under them as compliant where those activities have been subject to comparable standards under a foreign jurisdiction. The concept of substituted compliance introduced in the guidance is a positive step in this direction but does not go far enough to deliver the full benefits of this approach for a consistent international regulation of OTC derivatives markets (see below).

Registration

Under existing CFTC rules, Swap Dealers (SD) and Major Swap Participants (MSP) will be required to register with the CFTC within 60 days of the final publication of a joint CFTC/SEC rule defining swaps, i.e. before 12 October 2012.

First, we suggest that in view of uncertainties and significant issues identified with the definition of a 'US person' proposed by the CFTC the registration requirement for non-US persons should be delayed at least until the final cross-border Guidance has been published. This will allow firms to determine whether they are required to register and will minimize the regulatory risk involved with incorrect registration.

Furthermore, as a consequence of the CFTC's proposed approach and wide definition of 'US persons', many EU firms may be subject to the registration requirement with the CFTC. This raises significant concerns.

- According to the CFTC's proposed interpretation of the Dodd-Frank Act, a registration requirement would apply to a legal person as a whole. In respect of a US branch of an EU firm, this may lead to a requirement for the EU-head office of the parent company to register with the CFTC. First, if a US branch of an EU entity trades only with other non-US persons, there would seem to be no question of exposing the US financial system to significant risks. Second, in response to the excessively wide scope of US rules, EU banks might consider converting their US branches into affiliates in order to avoid registration and its subsequent requirements applying to the parent company. This would have the perverse effect of introducing risk into the US, as an affiliate of a non-US bank will be a fully legally incorporated US entity. Furthermore, EU banks would face an increased cost in capital, since they would have to maintain separate capital in these affiliates.

- In terms of process, in the future EU firms would also have to monitor on an on-going basis if their volumes of swaps breach the registration thresholds proposed by the CFTC.

We are of the view that these uncertainties, as well as the significant and unnecessary incremental and running costs generated by the obligation to register, could be avoided completely if the CFTC were to consider an approach based on a wider recognition of EU rules and increased cooperation between EU and US regulators as discussed below.

The treatment of non-EU firms proposed by the Commission in its legislative proposal (MiFID II) in respect of trading in financial instruments in EU financial markets could be a significant step to opening access to EU financial markets for US firms. However, the CFTC's proposed registration requirements could put the adoption of this approach into question as it is difficult to envisage that the EU would adopt rules which would create an imbalance in treatment of EU firms under US law compared to the treatment granted to US firms under EU law.

'Substituted compliance'

We appreciate the statutory constraints under which the CFTC operates in the area of 'substituted compliance' and appreciate the efforts made to introduce this concept, which shares some similarities with the European 'equivalence' approach.

However, and to limit as much as possible the effects and the cost of registration for EU-based firms, we strongly urge the CFTC to remove the registration obligation for EU firms since they will be subject to equivalent and comparable requirements. This would reduce the incremental costs associated with the registration process and alleviate compliance costs. This is similar to the approach adopted in EU legislation.

We also appreciate that the proposed Exemptive Order addresses certain sequencing issues in relation to the application of a number of requirements. However, the proposal offers only temporary relief for entity level-requirements. We believe that this should also be extended to transaction-level requirements, including when they apply to non-US firms' transactions with US firms.

As regards *transaction*-level requirements, additional fundamental issues arise. We have reviewed closely and with great interest the concept of 'substituted compliance' described in the proposed rulemaking. It is similar in some respects, but not all, to the European concept of 'equivalence', and may to a degree also achieve the same results.

If we understand the CFTC's proposals correctly, substituted compliance would apply only to transactions between two non-US legal persons. Substituted compliance would not apply to trades involving one US legal person and a non-US legal person subject to comparable rules under a third-country regime. In other words, this cross-border application of the Dodd-Frank Act would imply that EU firms dealing with US counterparties would always be subject to Dodd-Frank, while US firms dealing with EU counterparties could not be subject to EU rules if the EU decides to grant equivalence to the US. Although the need for US authorities to have certainty about the proper regulation of trades entered into by subsidiaries of US firms is legitimate, it is difficult to understand why comparable foreign legislation would not equally legitimately achieve the same result. In our view, a comparable and consistent set of rules and requirements in the EU may equally legitimately achieve the result sought by the US authorities.

Second, wider application of substituted compliance by the CFTC is very important for our consideration of a positive equivalence decision in respect of the US. The adoption of an equivalence decision by the European Commission would allow us to determine that EU firms may be subject to the rules of a specific third country and still meet the requirements in EU legislation because they are considered to be equivalent. This is a direct and powerful instrument to avoid subjecting EU and US firms to duplicative and onerous central clearing and margining requirements. The application of multiple sets of rules to the same transaction undermines the G20's financial stability objectives (trades may not be cleared in either jurisdiction), it is economically and financially unsustainable for US and EU firms, and it is unwise from a market perspective as trades may migrate to other jurisdictions. The power and ability of the European Commission to adopt an equivalence decision to avoid all of these profoundly negative effects is subject to one important condition: the rules of the third-

country concerned must be applied in an 'efficient and non-distortive' manner. If this cannot be determined and the rules of a third country are considered to result in an unbalanced state of affairs which creates a discrimination of treatment between two jurisdictions, the European Commission could be prevented from granting equivalence.

Third, we must draw your attention to a requirement in EMIR for the Commission to adopt rules on the basis of technical standards drafted by ESMA specifying which transactions between non-EU entities have a 'direct, significant and foreseeable effect' on the EU. There are strong similarities between the potential scope of this rule – which has not yet been adopted – and section 722(d) of the Dodd-Frank Act. If the EU were to promulgate a rule with the same scope as the CFTC proposes in its guidance, swaps between two US affiliates of EU firms would be subject to EMIR thus leading to the application of multiple rules to US firms.

Process for substituted compliance

In addition to the limited scope proposed for substituted compliance, we also have serious reservations about the manner in which the CFTC proposes to apply that approach.

As proposed, a decision by the CFTC determining substituted compliance will not apply to jurisdictions (which is the case under EMIR in the EU) but only to specific *firms* after a chapter by chapter analysis and can be withdrawn from a firm at any time.

We encourage the CFTC to adopt a similar approach to that of the EU which is based on the recognition of 'equivalent' jurisdictions, and not of individual firms. EU entities will be subject to highly harmonised requirements for derivatives in the fields of clearing, reporting and margining (EMIR Regulation 648/2012, Markets in Financial Instruments Directive and Regulation - in the process of being updated), and the Capital Requirements Directive for banking and investment firm solvency. We understand that US firms are subject to similar rules and requirements. In this situation it would be duplicative to require each EU entity seeking to benefit from substituted compliance in the US to separately demonstrate the equivalence of these EU rules with Dodd Frank. When determining acceptability for substituted compliance we invite the CFTC to take into consideration whether another jurisdiction complies with consistent and comparable standards.

The approach proposed by the CFTC will introduce legal uncertainty and higher monitoring costs for EU firms than for US firms that might benefit from an EU equivalence decision. Moreover, the application on a firm by firm basis could lead to different and even discriminatory treatment between firms and jurisdictions.

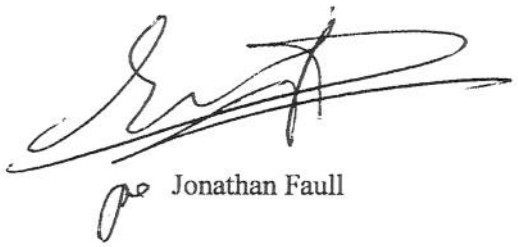
We are of the view, however, that an approach that is based on an effective system of 'substituted compliance' or 'equivalence' requires close cooperation between regulatory authorities. The conclusion of Memoranda of Understanding between regulators will be required to establish clear rules and obligations in important fields of regulatory cooperation such as access to information, on-site inspections, etc. The European Commission is prepared to provide any necessary assistance to facilitate a common framework for the conclusion of such agreements.

In conclusion, we are grateful for the opportunity to comment on the proposed Interpretative Guidance and Exemptive Order which provide the final cornerstones determining how the

CFTC intends to contribute to an internationally consistent and non-discriminatory regulatory framework for the global OTC derivatives markets. As explained in our comments we firmly believe that the CFTC's proposals require further review in order to meet that goal. In the absence of this we believe that the G20 commitments will not be met and that the efforts that the EU and the USA and other jurisdictions have made will potentially result in an uncoordinated, duplicative international regulatory framework for OTC derivative markets. This will bring neither comfort to regulators and policymakers, nor clarity and transparency to market operators. It will create frequent regulatory conflicts and will adversely impact the derivatives markets.

We look forward to discussing the issues raised in this comment letter with the CFTC.

Yours sincerely,



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