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Submitted via rule-comments@sec.gov

July 13, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent, Release No. 34-74834, File No. S7-06-15

Secretary Fields:

The Institute of International Bankers (the "Institute") welcomes the opportunity to provide comments to the Securities and Exchange Commission (the "Commission") with respect to the captioned proposal (the "Proposal").[1] Under the Proposal, certain requirements under the Securities Exchange Act of 1934 (the "Exchange Act") that were added by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Title VII") would apply to a security-based swap (an "SBS") between a non-U.S. SBS dealer ("SBSD") and another non-U.S. person, neither of which is a conduit affiliate or guaranteed affiliate[2] (such an SBS, a "Non-U.S. SBS"), that is arranged, negotiated or executed by personnel located in a U.S. branch or office of the non-U.S. SBSD or in a U.S. branch or office of an agent of the SBSD.

1 80 Fed. Reg. 27,444 (May 13, 2015).

2 For purposes of this letter, the term "guaranteed affiliate" refers to a non-U.S. person whose non-U.S. SBS counterparty has rights of recourse against a U.S. person.

We support the respects in which the Proposal would tailor this "U.S. personnel test" to address the policy interests implicated by the SBS activity of U.S. personnel.[3] In particular, we support limiting the test to personnel engaged on behalf of a non-U.S. SBSD (as opposed to a non-SBSD counterparty) in "market-facing" activity (as opposed to internal activity), excluding risk-related rules (such as mandatory clearing and trade execution requirements) from the test and permitting SBS covered by the test to be eligible for substituted compliance. As described in greater detail below, however, we believe that additional steps would be necessary to prevent the U.S. personnel test from having a material adverse impact on effective risk management and U.S. and cross-border market liquidity.

INTRODUCTION

As an initial matter, we believe that it would be desirable to foster the continued use of U.S. personnel by non-U.S. SBSDs to engage in market-facing activities. These activities are important to effective risk management by non-U.S. SBSDs in connection with SBS involving U.S. reference entities. This is because the traders with the greatest expertise and familiarity with those types of SBS are best-positioned to risk manage those positions and are typically located in the United States. Use of U.S. personnel also promotes effective risk management in connection with SBS that trade on a 24-hour basis.

The pricing and risk management of SBS and other financial transactions are inextricably linked. When a non-U.S. SBSD offers liquidity in SBS, it generally does so simultaneously across its global counterparty base, adjusting the pricing for the SBS dynamically based on changes in the market price for the SBS, the market price for its underlier, potential trading interest from counterparties and the SBSD's risk exposures. To make those adjustments effectively based on the most current, accurate information, the non-U.S. SBSD must centralize pricing, hedging and other risk management responsibilities with trading personnel, who, as noted above, will sometimes be located in the United States for expertise or time zone reasons. The sales personnel who interact with non-U.S. counterparties must coordinate with these trading personnel. If counterparty-facing pricing negotiated by sales personnel is not effectively integrated with the SBSD's market expertise and ability to manage portfolio risk, sales personnel could assume unwarranted risk when they arrange, negotiate or execute SBS.

Centralization of pricing, hedging and risk management functions and workable integration of these functions with sales activity by non-U.S. SBSDs also helps to promote U.S. market liquidity by integrating trading interest from non-U.S. counterparties into the U.S. market. Intermediating trading interest from a wider range and larger number of counterparties allows non-U.S. SBSDs to price their SBS more accurately and hedge their exposures more

[3] For purposes of this letter, the term "U.S. personnel" refers to personnel located in a U.S. branch or office of a non-U.S. person or personnel located in a U.S. branch or office of an agent acting on behalf of a non-U.S. person.

efficiently, which in turn helps them to quote narrower spreads and deeper liquidity to U.S. and non-U.S counterparties alike.

Non-U.S. counterparties are, however, different from U.S. counterparties because non-U.S. counterparties can choose to trade in a manner that does not subject them to Title VII. Non-U.S. counterparties are likely to make this choice any time that their costs of compliance with Title VII outweigh the benefits. This dynamic exists regardless of whether the Commission adopts a U.S. personnel test. Absent a U.S. personnel test, non-U.S. counterparties can limit the extent to which they become subject to Title VII by limiting their interactions with U.S. SBSDs. With a U.S. personnel test, non-U.S. counterparties can do the same thing by limiting their interactions with U.S. personnel. This concern is not merely hypothetical: in Fall 2013, when the Commodity Futures Trading Commission appeared poised to put a U.S. personnel test into effect in connection with several of its Title VII swaps rules, many non-U.S. counterparties and trading platforms began taking steps to limit interactions with non-U.S. swap dealers' U.S. personnel.

To accommodate their non-U.S. counterparties, non-U.S. SBSDs would need to have front office personnel located abroad who could interact with those counterparties in connection with U.S.-centric markets and SBS, as well as during U.S. market hours. The geographic dislocation of those non-U.S. personnel from U.S. colleagues, counterparties and markets would necessarily limit the SBSD's ability to centralize its risk management. Artificial barriers between sales and trading personnel and the regionalization of risk management would directly increase costs. It also could cause a non-U.S. SBSD to offer SBS with non-U.S. counterparties at prices and in sizes that less reliably reflect current market prices or the SBSD's current risk appetite. To minimize the likelihood of executing such SBS, the non-U.S. SBSD would need to offer less competitive prices and provide less depth of liquidity. It also may need to relocate front office personnel from the United States, resulting in lost U.S. jobs.

A similar dynamic is likely to exist if the costs of Title VII compliance for the non-U.S. SBSD itself exceed the benefits. Under a U.S. personnel test, such costs would include the establishment and maintenance of compliance systems, controls, policies and procedures that track and control the interactions of U.S. personnel with non-U.S. counterparties across a wide range of communication media, including telephone, chat, instant messaging and electronic trading platforms. A U.S. personnel test would also cause non-U.S. SBSDs to incur the greater costs of decentralized risk management, as described above. Particularly for smaller non-U.S. SBSDs, many of which might intend to operate under the *de minimis* threshold, these costs could be prohibitive to the use of U.S. personnel.

In light of these considerations, we believe that the Commission's approach to Non-U.S. SBS that are arranged, negotiated or executed by U.S. personnel should be tailored to address only the specific policy considerations raised by use of U.S. personnel. Such tailoring would reduce the likelihood of the adverse consequences described above. For example, more targeted measures could achieve the market integrity and anti-evasion objectives cited by the Commission in the Proposal without discouraging the use of U.S. personnel.

Likewise, while we support enhancing counterparty protections and professional standards, we believe that these objectives can also be achieved without requiring non-U.S. counterparties that interact with U.S. personnel to make significant documentation changes. Non-U.S. counterparties have shown great reluctance to undertake significant documentation changes due to the costs and resources necessary to obtain familiarity with a complicated body of foreign law.

We also believe that additional cost-benefit analysis is necessary before applying a U.S. personnel test to public dissemination rules. The ability of non-U.S. counterparties to avoid interacting with U.S. personnel, and therefore avoid subjecting their trades to public dissemination rules, is likely to make the transparency benefits of applying those rules to Non-U.S. SBS arranged, negotiated or executed by U.S. personnel much less significant than the benefits of applying those rules in other contexts.

Finally, competitive parity considerations do not, in our view, warrant as broad an application of the U.S. personnel test as that proposed by the Commission. Solely comparing the extent to which U.S. and non-U.S. SBSDs are subject to Title VII is not sufficient to establish whether one group of SBSDs has a competitive advantage over the other. Such a comparison does not take into account the costs borne solely by non-U.S. SBSDs in complying with their own home country laws. If such costs are greater than the costs of complying with Title VII, then non-U.S. SBSDs are at a competitive disadvantage regardless of whether the Commission adopts a U.S. personnel test. Even if such costs are lower than Title VII compliance costs, as long as there are any material home country compliance costs, then the duplicative application of Title VII based on a U.S. personnel test would put non-U.S. SBSDs at a competitive disadvantage.[4] Moreover, no matter what effects a U.S. personnel test has on the relative competitive positions of U.S. and non-U.S. SBSDs, by definition such a test would introduce a new, and highly undesirable, competitive disparity between U.S. and non-U.S. personnel because the use of U.S. personnel to engage in market-facing activity would trigger additional Title VII requirements.

DISCUSSION

A. SBSD Registration

Under the Proposal, a non-U.S. person would be required to include in its *de minimis* exception calculation any SBS dealing transaction with a non-U.S. counterparty that is covered by the U.S. personnel test.[5] Effectively, therefore, a non-U.S. person could become

[4] For example, a U.S. SBSD using U.S. personnel to trade with a Japanese counterparty would need to comply with U.S. and Japanese laws, whereas, under a U.S. personnel test, a U.K. SBSD in the same position would need to comply with U.S., Japanese and U.K. laws.

[5] *See* Proposal, 80 Fed. Reg. at 27,493-94.

subject to SBSD registration in connection with Non-U.S. SBS solely on the basis of the location of the personnel who arrange, negotiate or execute those SBS.

Such personnel, however, would be engaged solely in sales and trading activity occurring at the inception of the SBS. The non-U.S. counterparties to the SBS would remain responsible for the ongoing risks of the SBS. As a result, the Commission's policy interests in regulating the SBS and its counterparties are much more limited than if one of the parties was a U.S. person, guaranteed affiliate or conduit affiliate. It is not necessary for one of the parties to register with the Commission as an SBSD for the Commission to address these more limited policy objectives. For example, U.S. anti-fraud and anti-manipulation prohibitions will apply regardless of whether one of the parties is a registered SBSD. U.S. securities offering requirements will likewise apply to the SBS regardless of the parties' registration statuses. U.S. agents will be subject to broker-dealer registration requirements regardless of whether they act for a person that is registered as an SBSD. To the extent the Commission has concerns that certain structures could be employed to evade these requirements, targeted anti-evasion measures could address those concerns. Accordingly, we do not believe that the broad application of the SBSD registration requirement proposed by the Commission is necessary.

1. No U.S. Risk Mitigation Benefits

Incremental to the generally applicable U.S. securities law requirements described above, registration with the Commission as an SBSD would subject a non-U.S. market participant to an extensive and complex registration process,[6] trade acknowledgement and verification requirements,[7] external business conduct requirements,[8] chief compliance officer

[6] *See* Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 65,784 (Oct. 24, 2011).

[7] *See* Trade Acknowledgment and Verification of Security-Based Swap Transactions, 76 Fed. Reg. 3859 (Jan. 21, 2011) ("Acknowledgement Rule").

[8] *See* Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, 76 Fed. Reg. 42,396 (July 18, 2011) ("Business Conduct Rule").

rules,[9] financial reporting and recordkeeping requirements[10] and capital, margin and segregation requirements.[11]

With the exception of external business conduct requirements, which we discuss in more detail below, each of these SBSD requirements is designed to mitigate risk to the U.S. financial system. For example, trade acknowledgement and verification requirements are intended to promote the efficient operation of the SBS market and facilitate market participants' management of their SBS-related risk.[12] The Commission's SBSD capital, margin and segregation proposal is based in large part on existing broker-dealer financial responsibility requirements, whose goal is mitigation of risk to the U.S. markets.[13] SBSD registration itself, as well as the corollary financial reporting, recordkeeping and chief compliance officer requirements, are intended to provide the Commission with enhanced oversight over the SBS market participants most likely to pose risks to the U.S. financial system.

These risk mitigation requirements associated with SBSD registration are inapposite in the context of Non-U.S. SBS. The risks that these rules are intended to address are not borne by the personnel who arrange, negotiate or execute an SBS, but rather by the legal entities that are parties to the SBS. In the case of a Non-U.S. SBS, however, neither counterparty is a U.S. person or has transferred the risks of the SBS to a U.S. person through a conduit or guarantee relationship. Thus, the risks of a Non-U.S. SBS do not flow back to the U.S. financial system. This fact is not changed by the involvement of U.S. personnel.

As a result, requiring non-U.S. market participants to register as SBSDs merely because U.S. personnel arrange, negotiate or execute their Non-U.S. SBS would not help to achieve the intended benefit of most of the rules associated with SBSD registration. Nor would requiring SBSD registration in such circumstances be necessary for the Commission to apply anti-fraud, anti-manipulation and other generally applicable U.S. securities laws to activities engaged in by U.S. personnel. Although requiring SBSD registration would also result in the incremental application of U.S. external business conduct rules, in many cases those rules will likely duplicate existing, already applicable non-U.S. sales practice rules. In addition, as

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9 *See id.* at 42,458-59.

10 *See* Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers, 79 Fed. Reg. 25,194 (May 2, 2014) ("Recordkeeping Rule").

11 *See* Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, 77 Fed. Reg. 70,214 (Nov. 23, 2012) ("Capital Rule").

12 *See* Acknowledgement Rule, 76 Fed. Reg. at 3861.

13 *See* Capital Rule, 77 Fed. Reg. at 70,216.

discussed in the following section of this letter, many of the relevant U.S. personnel will already be subject to sales practice regulation by the Commission and the Financial Industry Regulatory Authority ("FINRA") as registered personnel of a broker-dealer.

While the benefits of doing so would be limited, applying a U.S. personnel test to the SBSD registration requirement would result in significant costs, including the market fragmentation and related costs described previously in this letter. Furthermore, applying a U.S. personnel test to the SBSD registration requirement would cause the Commission itself to incur the significant, unnecessary costs of overseeing additional SBSD registrants headquartered abroad whose risk-based connection to the United States does not rise to the threshold established by the Commission when it defined its registration categories, but which would nonetheless be required to register because of the involvement of U.S. personnel in connection with Non-U.S. SBS that pose no risk to the U.S. financial system.

In light of these considerations, while the Commission does have certain legitimate policy interests in the regulation of U.S.-based conduct, we believe that a non-U.S. person should not be required to include in its *de minimis* calculation a Non-U.S. SBS merely because U.S. personnel or agents are involved in arranging, negotiating or executing such SBS.

2. Intermediation by a Registered Broker-Dealer

If, despite the considerations described immediately above, the Commission nonetheless believes it is necessary to apply a U.S. personnel test to the SBSD registration requirement, then we believe the Commission should reconsider its application of that test to registered personnel located in a U.S. branch or office of an agent that is registered with the Commission as a broker-dealer.

In these circumstances, any U.S. territorial conduct is engaged in by the broker-dealer, not the foreign SBSD on whose behalf the broker-dealer is acting. This distinction has historically served as the basis for the Commission's cross-border application of the broker-dealer registration requirement under Exchange Act Rule 15a-6.[14] Given the relationship between the SBS markets and the markets for the securities underlying SBS, a consistent approach to registration across the two markets would help reduce the incentives for regulatory arbitrage and prevent non-U.S. dealers from incurring the increased compliance costs associated with applying different registration standards to activity in economically comparable instruments. It also would be consistent with Congress' decision to define SBS as a type of security. Finally, the rationale cited by the Commission for taking a different approach to SBSD

[14] *See* Registration Requirements for Foreign Broker-Dealers; Proposed Rulemaking, Release No. 34-25801, 53 Fed. Reg. 23,645, 23,647-48 (June 23, 1988) (discussing the staff positions that served as the precedent for Rule 15a-6).

than broker-dealer registration – *i.e.*, the bilateral, executory credit risk inherent in SBS[15] – is not relevant in the case of Non-U.S. SBS, where no U.S. counterparty or other source of risk to the U.S. financial system is involved.

Moreover, any conduct by U.S. broker-dealer personnel will already be subject to comprehensive regulation by the Commission and FINRA. Such regulation would include (a) sales practice requirements that are similar in many respects to Title VII external business conduct rules (and which FINRA could, if desirable, harmonize with those rules in the case of SBS transactions intermediated by a broker-dealer), (b) books and records requirements that the Commission has used as its model for SBSD recordkeeping requirements[16] and (c) examination and inspection by the Commission and FINRA. Further, the broker-dealer and both non-U.S. parties to the Non-U.S. SBS would remain subject to Commission anti-fraud and anti-manipulation jurisdiction.

3. Anti-Evasion

In the Proposal, the Commission states its preliminary belief that, irrespective of the regulatory framework applicable to its U.S. branch or office or its U.S. agents, a non-U.S. person engaged in SBS dealing activity through its own personnel or the personnel of a U.S. agent acting on its behalf should be subject to SBSD registration if such activity exceeds the *de minimis* threshold. However, the concerns expressed by the Commission as the basis for this belief could be addressed through more targeted anti-evasion measures that are less likely to deter the use of U.S. personnel by non-U.S. SBSDs and give rise to the related adverse consequences described above.

First, the Commission observes that an agent using U.S. personnel would not be required to register as a broker-dealer if it could avail itself of certain exceptions under the Exchange Act and the rules or regulations thereunder, such as the exception from the Exchange Act's "broker" definition for U.S. banks and U.S. branches of foreign banks. Such exceptions, it is feared, would allow the relevant activity to escape comprehensive Commission regulation. The Commission could address this issue by exercising its anti-evasion authority to require a non-U.S. person to include in its *de minimis* calculation SBS dealing transactions arranged, negotiated or executed on behalf of the non-U.S. person by personnel located in a U.S. branch or office of an agent if such personnel are not (a) registered personnel of a registered broker-dealer or (b) personnel of a U.S. bank or U.S. branch of a foreign bank that, in connection with its U.S. personnel's SBS arrangement, negotiation and execution activity, (i) complies with external

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15 *See* Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, 78 Fed. Reg. 30,968, 30,995 (May 23, 2013) ("Cross-Border Proposal") (noting that, unlike most other securities transactions, SBS transactions give rise to ongoing obligations between the transaction counterparties).

16 *See* Recordkeeping Rule, 79 Fed. Reg. at 25,196.

business conduct requirements as set forth in Part B below, (ii) maintains related books and records, and (iii) provides the Commission with access to such books and records and testimony of the relevant U.S. personnel.

Second, the Commission expresses concern that, even in the case of an SBS dealing transaction intermediated by a U.S. agent registered as a broker-dealer, the Commission's access to books and records relating to the transaction would be limited to the books and records of the agent, not the non-U.S. person dealer on whose behalf the agent is acting. We note that the Commission was also presented with this issue in the context of the non-SBS securities markets. In that context, the Commission addressed the issue by requiring a foreign broker-dealer entering into transactions intermediated by a U.S.-registered broker-dealer to (a) provide the Commission with access to books and records of the foreign broker-dealer (and testimony of the foreign broker-dealer's associated persons)[17] and (b) consent to service of process for any civil action brought by or proceeding before the Commission or a self-regulatory organization.[18] The Commission could exercise its anti-evasion authority to impose similar requirements in the context of SBS dealing transactions involving personnel of the U.S. branch or office of, or intermediated by a U.S.-registered broker-dealer acting on behalf of, a non-U.S. SBSD that is not itself registered with the Commission.

We further recognize that, notwithstanding the additional protections described above, concerns could exist that a financial group might seek to avoid the application of Title VII regulation to its SBS dealing transactions (including those with other dealers) by booking those transactions to a non-U.S. subsidiary located in a jurisdiction that has not adopted comparable entity-level regulation, even while conducting the related sales and trading activity through a U.S. broker-dealer, a U.S. bank or a U.S. branch of a foreign bank. The Commission could exercise its anti-evasion authority to address this concern by requiring a non-U.S. person to include in its *de minimis* calculation SBS dealing transactions arranged, negotiated or executed on behalf of the non-U.S. person by personnel located in its U.S. branch or office or in a U.S. branch or office of an agent (whether or not such agent is registered as a broker-dealer) if the non-U.S. person is not supervised by a home country prudential supervisor which is (i) a member of the Basel Committee or (ii) located in a jurisdiction that is a member of the Group of 20 ("G-20") countries.

This further anti-evasion requirement would reflect the fact that, aside from external business conduct requirements – the objectives of which would already be addressed by the rules applicable to its registered U.S. broker-dealer agent or by applying such requirements to personnel located in the U.S. branch or office of a non-U.S. SBSD as described above–

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17 *See* Rule 15a-6(a)(3)(i)(B) under the Exchange Act.

18 *See* Rule 15a-6(a)(3)(iii)(C) under the Exchange Act.

subjecting a non-U.S. SBSD to registration with the Commission would impose entity-level requirements intended to mitigate risk. Chief among those are minimum capital requirements, the international standard for which is the Basel Capital Accords.[19] Supervisors who apply Basel-compliant capital standards also typically apply related risk management (including compliance and operational risk management) requirements based on international standards. Non-banking supervisors in G-20 jurisdictions also typically apply rigorous capital and risk management standards to their registrants. Given that, were it to register with the Commission, a foreign SBSD subject to comparable home country capital and risk management standards would be eligible for substituted compliance with the parallel Title VII requirements, such a foreign SBSD engaging in SBS dealing transactions with non-U.S. persons through U.S. personnel would not be avoiding Title VII.[20]

Adopting these anti-evasion requirements would address the policy considerations raised by Non-U.S. SBS dealing transactions arranged, negotiated or executed by U.S. personnel at a significantly lower cost than applying SBSD registration on the basis of all such transactions. Non-U.S. SBSDs would not need to track the location of personnel for purposes of assessing their eligibility for the *de minimis* exception, but rather could look to the clear, bright-line criteria embodied in these anti-evasion requirements. The Commission also would not need to devote its limited resources to comprehensively overseeing (or assume direct responsibility for the comprehensive oversight of) the non-U.S. operations of non-U.S. SBSDs who are already subject to comprehensive oversight and not transacting above a *de minimis* level with U.S. counterparties.

B. External Business Conduct Requirements

The Commission's proposed external business conduct rules are generally designed to enhance counterparty protection by expanding the obligations of SBSDs in dealing with their counterparties.[21] In our view, these rules can be divided into three categories: (a) trading relationship rules; (b) special entity rules; and (c) communication-based rules.

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19 The Federal Reserve has, consistent with its longstanding approach to the U.S. branches of foreign banks, proposed that a foreign bank registered as an SBSD whose home country supervisor has adopted such Basel-compliant capital standards would satisfy its Title VII capital requirements by complying with those home country standards. *See* Margin and Capital Requirements for Covered Swap Entities; Proposed Rule, 79 Fed. Reg. 57,348, 57,381-82 (Sept. 24, 2014).

20 We recognize that the home country requirements described in this section would not include SBS reporting requirements. As described in Part D of this letter, we do not believe that the U.S. personnel test should apply to reporting requirements. However, even if the Commission ultimately decides that reporting requirements should apply to Non-U.S. SBS arranged, negotiated or executed by U.S. personnel, we note that the Commission's proposal in this regard is not premised on the registration statuses of the non-U.S. parties to such an SBS. Accordingly, the applicability of reporting requirements should not be a relevant factor in determining whether SBSD registration should be subject to a U.S. personnel test.

21 *See* Business Conduct Rule, 76 Fed. Reg. at 42,398.

1. Trading Relationship Rules

Trading relationship rules would include: counterparty status; disclosure of daily marks; know your counterparty; and counterparty suitability. These rules apply across an SBSD's overall trading relationship with a counterparty. An SBSD would typically satisfy these rules through counterparty relationship documentation and due diligence executed or conducted upon the establishment of a trading relationship. For many non-U.S. SBSDs, the non-U.S. SBSD's relationship with its non-U.S. counterparty will have been established by non-U.S. personnel.

In those circumstances, a non-U.S. counterparty is likely to be surprised by any need to provide representations, agree to covenants or fill out questionnaires designed to comply with U.S. requirements that may only potentially apply in the future should U.S. personnel arrange, negotiate or execute isolated SBS with the counterparty. The non-U.S. counterparty is moreover likely to have concerns if the representations, covenants and questionnaires differ significantly from what it expects based on local, non-U.S. onboarding requirements applicable in the home country of the non-U.S. counterparty and/or the non-U.S. SBSD. Faced with these additional documentation burdens, the non-U.S. counterparty is likely to refuse to interact with U.S. personnel, with resulting adverse consequences as described previously in this letter.

These considerations are much less likely to apply if the non-U.S. counterparty elected to establish an SBS trading relationship with a U.S. SBSD, since it would be more reasonable for the non-U.S. counterparty to expect the SBSD to be subject to U.S trading relationship rules in that context. Also, in that context, only trading relationship rules in the United States and, possibly, the counterparty's home country jurisdiction, would apply. In contrast, non-U.S. SBSDs are typically subject to their own home country trading relationship rules. So, while the presence of a competitive disparity between U.S. and non-U.S. SBSDs would require an evaluation of the relative burdens of U.S. and non-U.S. trading relationship rules, subjecting non-U.S. SBSDs using U.S. personnel to duplicative application of both sets of rules would necessarily put non-U.S. SBSDs, and the U.S. personnel who arrange, negotiate or execute their SBS, at a competitive disadvantage.[22]

We also note that non-U.S. counterparties' expectations are generally aligned with the relative interests of their regulatory authorities. In the context of SBS between a non-U.S. SBSD and a non-U.S. counterparty, the home country regulators of the two parties to the SBS are likely to have a significantly more compelling counterparty/investor protection interest than the Commission.

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[22] For an example, *see* Note 4, *supra*.

For these reasons, we do not believe that the Commission should apply a U.S. personnel test to trading relationship rules. If, however, the Commission does apply a U.S. personnel test to those rules, then substituted compliance should be available to a non-U.S. SBSD regardless of whether U.S. personnel arrange, negotiate or execute SBS on behalf of the SBSD.[23]

2. Special Entity Rules

Special entity rules would include: special requirements for SBSDs acting as advisors to special entities; special requirements for SBSDs and major security-based swap participants ("MSBSPs") acting as counterparties to special entities; and requirements relating to political contributions by certain SBSDs. Given that the Commission appears to have determined that special entities would be U.S. persons because they are legal persons organized under the laws of the United States,[24] those rules would already apply to all SBS with special entities whether or not U.S. personnel are involved. For this reason, we do not believe that it is necessary to apply a U.S. personnel test to special entity rules.

3. Communication-Based Rules

In contrast to the other external business conduct rules described above, a different analysis may be relevant to communication-based rules. These rules would include: disclosures of material risks and characteristics and material incentives or conflicts of interest and related recordkeeping; disclosures regarding clearing rights and related recordkeeping; product suitability (not counterparty suitability); fair and balanced communications; and supervision.

These rules are focused on regulating the activities of front office personnel in the context of particular communications and transactions. There may be some benefit to applying them uniformly to all front office personnel located in the United States, as a supplement to the generally applicable U.S. anti-fraud and anti-manipulation rules that would already apply to activities occurring within the United States.

In addition, compliance with communication-based external business conduct rules typically does not entail wholesale modifications to counterparty relationship documentation or onboarding processes, so long as a non-U.S. SBSD is permitted to satisfy disclosure rules applicable to Non-U.S. SBS through disclosure delivered through whatever

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23 *See* Proposal, 80 Fed. Reg. at 27,477.

24 *See* Cross-Border Proposal, 78 Fed. Reg. at 30,997 n.286. In light of the limited U.S. regulatory interest in applying special protections to foreign pension plans, municipal entities and endowments, we agree with the Commission's determination in this regard.

means are acceptable for the disclosure of material information under the rules of the relevant non-U.S. jurisdiction(s).[25] Nor is compliance with these rules typically effected through back-office systems that are difficult to redesign and modify. The incremental costs of compliance are therefore unlikely to be as significant with these rules as the other external business conduct rules, and applying a U.S. personnel test to these rules is much less likely to discourage non-U.S. counterparties from interacting with U.S. personnel.

We note, however, that if personnel of a registered broker-dealer are subject to these communication-based rules, it will be important for the Commission, together with FINRA, to harmonize the existing sales practice requirements that will apply to such personnel's SBS activities due to the inclusion of SBS in the "security" definition. To the extent that these requirements differ from Title VII communication-based rules, the resulting unnecessary duplication and conflicts would likely foster competitive disparities between SBSDs acting through broker-dealer agents and other SBSDs.

4. Opt-Out for Sophisticated Counterparties

As discussed above, we do not believe that the Commission should apply a U.S. personnel test to trading relationship or special entity rules, but that application of such a test to certain communication-based rules may be appropriate in some circumstances. If the Commission ultimately decides to apply any external business conduct rules to Non-U.S. SBS, we believe that it should also consider allowing sophisticated non-U.S. counterparties to "opt-out" of those rules, thereby allowing them to continue to trade under their existing documentation rather than requiring them to agree to U.S.-specific documentation that they may find more confusing than helpful.

C. Mandatory Clearing and Trade Execution

Under the Proposal, the U.S. personnel test would not apply to Title VII's mandatory clearing and trade execution requirements. As the Commission explained, a "key objective of the clearing requirement is to mitigate systemic and operational risk in the United States, but the counterparty credit risk and operational risk of [Non-U.S. SBS] reside outside the United States."[26] The Commission also observed that imposing mandatory clearing requirements based on a U.S. personnel test "would impose a significant burden on certain market

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[25] If a non-U.S. counterparty was required to consent in writing to specific methods of disclosure under Commission rules, the resulting costs and consequences would be similar to applying trading relationship sales practice rules to Non-U.S. SBS.

[26] Proposal, 80 Fed. Reg. at 27,481.

participants."[27] In addition, because Non-U.S. SBS would not be subject to the clearing requirement, they would also not be subject to mandatory trade execution.[28]

We agree with the Commission's proposed approach to mandatory clearing and trade execution. As discussed above with respect to other rules designed to mitigate risks to the U.S. financial system, applying a U.S. personnel test to such rules is not necessary because the involvement of U.S. personnel in the arrangement, negotiation or execution of Non-U.S. SBS does not present the possibility for risk to flow back to the United States.

D. Regulation SBSR

The Proposal would amend the Commission's Regulation SBSR[29] to address the application of public dissemination and regulatory reporting requirements to certain cross-border SBS transactions. In particular, the Proposal would apply the U.S. personnel test to public dissemination and regulatory reporting requirements, including for non-U.S. persons engaged in dealing activity below the SBSD *de minimis* threshold. Non-U.S. SBS would also become subject to public dissemination and regulatory reporting requirements based on execution on a national securities exchange or security-based swap execution facility or by a registered broker-dealer. In light of the different regulatory goals involved, we address the public dissemination and regulatory reporting requirements separately below.

1. Public Dissemination

As the Commission recognized in the Proposal, the goal of public dissemination requirements is to enhance the level of transparency in the U.S. SBS market.[30] However, we do not believe that applying a U.S. personnel test to public dissemination requirements would materially advance that objective because of the incentives it would create for non-U.S. counterparties to avoid interactions with U.S. personnel.

Trading in a manner that would subject a non-U.S. counterparty's own SBS to public dissemination would potentially cause the non-U.S. counterparty to receive worse execution pricing on those SBS. The reason for this adverse outcome is that an SBSD, when providing a price for an SBS subject to public dissemination, must account for the possibility that it will not be able to hedge the SBS fully before it is publicly disclosed. Once that public

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27 *Id*. at 27,482.

28 *Id*.

29 *See* Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 80 Fed. Reg. 14,564 (Mar. 19, 2015); *see also* Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 80 Fed. Reg. 14,740 (Mar. 19, 2015); Cross-Border Proposal.

30 *See* Proposal, 80 Fed. Reg. at 27,483.

disclosure occurs, other market participants can front run the SBSD's hedges. To counteract this risk, an SBSD may widen its bid-ask spread for SBS that are subject to public dissemination. To avoid this dynamic, a non-U.S. counterparty would prefer to trade in circumstances where its SBS are not subject to public dissemination.

Although U.S. counterparties face similar incentives, they are not in the same position as non-U.S. counterparties to avoid the application of U.S. public dissemination requirements. Also, a non-U.S. counterparty can still obtain the benefits of increased U.S. price transparency, without incurring the countervailing costs, by accessing publicly available price data and taking that data into account when negotiating its SBS with the non-U.S. personnel of a non-U.S. SBSD. Because of these different dynamics, the Commission's existing analysis of the trade-off between price transparency and market liquidity does not fully address the costs and benefits of applying a U.S. personnel test to public dissemination requirements.

We also note that the Commission has separately decided to apply public dissemination requirements to an SBS accepted for clearing by a clearing agency having its principal place of business in the United States.[31] As a result, applying a U.S. personnel test to public dissemination requirements would only incrementally capture uncleared SBS and SBS cleared outside the United States. Because prices for uncleared SBS reflect bilateral credit considerations and, in many cases, bespoke terms that are not visible in publicly disseminated data, the transparency benefits of publicly disseminating those SBS are much less significant than for cleared SBS. With respect to Non-U.S. SBS cleared outside the United States, foreign regulators have a relatively greater interest than the Commission in establishing applicable transparency requirements.

Applying a U.S. personnel test to public dissemination requirements would accordingly encourage non-U.S. counterparties to refuse to interact with U.S. front office personnel, with resulting adverse consequences for effective risk management and U.S. market liquidity and no meaningful incremental transparency benefits. Similar considerations are also raised by the proposal to apply public dissemination requirements to Non-U.S. SBS effected by a registered broker-dealer. For these reasons, we believe that the Commission's public dissemination requirements should not apply to Non-U.S. SBS, regardless of whether U.S. personnel or agents are involved in arranging, negotiating or executing such SBS or such SBS are effected by registered broker-dealers. If the Commission nonetheless decides to apply public dissemination requirements to Non-U.S. SBS, we believe that such requirements should be eligible for substituted compliance.

2. Regulatory Reporting

Unlike public dissemination requirements, whose primary purpose is market transparency, the objective of regulatory reporting is to provide the Commission with the tools

[31] *See* Rule 908(a)(1)(ii) of Regulation SBSR.

for market surveillance and oversight of its regulated markets. We believe that the scope of SBS data that will be available to the Commission based on reporting by U.S. persons, guaranteed affiliates and registered non-U.S. SBSDs will provide the Commission with sufficient data to accomplish these objectives. Applying the regulatory reporting requirements to SBS transactions where neither reporting side includes a U.S. person, guaranteed affiliate or registered SBSD would likely capture only a very small portion of SBS transactions for which the Commission believes it has a regulatory interest.

Moreover, such reporting would come with significant cost. Most SBS market participants have already designed and implemented reporting systems based on the "status-based" approach to the scope of reporting requirements that is reflected in the cross-border guidance adopted by the Commodity Futures Trading Commission[32] and the trade reporting rules being implemented in other major jurisdictions. To modify its reporting systems in connection with a U.S. personnel test for SBS, a non-U.S. SBSD (including one operating below the *de minimis* threshold) would need to install or modify a trade capture system capable of tracking, on a dynamic, trade-by-trade basis, the location of front-office personnel. The non-U.S. SBSD would then need to feed that data into its reporting system and re-code that system to account for the different rules that apply to non-U.S. SBS depending on whether they are arranged, negotiated or executed by U.S. personnel. The non-U.S. SBSD would also need to train its front office personnel in the use of this new trade capture system and develop policies, procedures and controls to require, track and test the proper use of that system. In addition, the non-U.S. SBSD would need to seek and obtain waivers from non-U.S. counterparties – to the extent such waivers are even permitted – with respect to privacy, blocking and secrecy laws in local jurisdictions.

In addition, Regulation SBSR, as amended under the Proposal, would assign reporting responsibility based in part on the registration status of each counterparty. However, until the Commission's SBSD and MSBSP registration requirements come into effect, no market participants will be registered. Thus, if the compliance date for Regulation SBSR were to occur prior to the effectiveness of those registration requirements, even a non-U.S. SBS counterparty that is not a registrant or engaged in SBS dealing activity would need to track whether each of its non-U.S. counterparties is engaged in SBS dealing activity and whether, for any given transaction with such a counterparty, that counterparty used U.S. personnel to arrange, negotiate or execute the transaction.

The costs of these changes could be significant enough to lead some non-U.S. SBSDs to prevent their U.S. front office personnel from interacting with non-U.S. counterparties and some non-U.S. counterparties to avoid interactions with U.S. personnel. If reporting was required solely based on the involvement of a registered broker-dealer, similar costs and complexities would arise, fostering incentives for non-U.S. counterparties to avoid transacting through registered broker-dealers. Such market fragmentation would lead to the adverse effects

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[32] *See* Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013).

on effective risk management, market liquidity and U.S. jobs described in the introduction to this letter.

Accordingly, we believe that the Commission's regulatory reporting requirements should not apply to Non-U.S. SBS that do not involve a registered SBSD, regardless of whether U.S. personnel or agents are involved in arranging, negotiating or executing such SBS or if such SBS are effected by or through a registered broker-dealer. To the extent that any Non-U.S. SBS are subject to regulatory reporting requirements, whether on the basis of a party's status as a registered SBSD or the involvement of U.S. personnel or a registered broker-dealer, such Non-U.S. SBS should be eligible for substituted compliance. We also believe that it is important that the Commission delay effectiveness of Regulation SBSR until after SBSDs and MSBSPs have registered.

E. Scope of the U.S. Personnel Test

We appreciate the Commission's efforts to provide guidance regarding the scope of the U.S. personnel test. In particular, we support the Commission's focus on personnel acting on behalf of a foreign SBSD, rather than its counterparties. We also support the Commission's focus on "market-facing" interaction with counterparties, as opposed to internal functions, and the transactional (as opposed to relationship-wide) focus of the test. It is also appropriate to apply the U.S. personnel test based on the involvement of personnel located in a U.S. branch or office, rather than non-U.S. personnel temporarily present in the United States.

There are, however, a few respects in which we believe that the Commission should modify or clarify the scope of the U.S. personnel test:

Registered Broker-Dealer Personnel. As proposed, the Commission's U.S. personnel test would be triggered by the involvement of registered personnel of a registered broker-dealer. As discussed in Part A.2 above, the activities of such personnel would already be subject to comprehensive regulation by the Commission and FINRA with respect to the policy objectives relevant to their U.S. activities. Applying the U.S. personnel test on the basis of their activity would result in duplicative and potentially conflicting rules, without any material, incremental benefits. We therefore believe that any U.S. personnel test should exclude the activity of registered broker-dealer personnel.

Electronic Trading. The Proposal indicates that the U.S. personnel test would cover a non-U.S. SBSD using U.S. personnel to execute Non-U.S. SBS electronically.[33] We are concerned about the implications of this interpretation in the context of Non-U.S. SBS executed on an electronic platform that is not required to register with the Commission as a national

[33] *See* Proposal, 80 Fed. Reg. at 27,468 n.178.

securities exchange or SBS execution facility because, for example, it permits only *indirect* access by U.S. personnel.[34] Non-U.S. counterparties trading on such a platform usually will have no idea whether their non-U.S. SBSD counterparty is using U.S. personnel. As a result, such counterparties are unlikely to want, or expect, their SBS transactions executed on that platform to be subject to Title VII sales practice or reporting requirements. Subjecting those transactions to those requirements based on the application of a U.S. personnel test would deter non-U.S. counterparties from trading on those platforms or, more likely, lead those platforms to prohibit even indirect access by U.S. personnel, with resulting adverse consequences as previously described in this letter.

We also do not believe that applying a U.S. personnel test to non-U.S. SBSDs using U.S. personnel to execute Non-U.S. SBS electronically is necessary to address the Commission's concerns regarding abusive or manipulative conduct. Even absent application of the proposed U.S. personnel test, the Commission would retain anti-fraud and anti-manipulation jurisdiction over the relevant trading activity. Also, any multilateral trading platform that provided direct access to U.S. persons or U.S. personnel would still be required to register as a national securities exchange or SBS execution facility, thus subjecting trading on such a platform to self-regulatory oversight by the exchange or execution facility and comprehensive Commission oversight and regulation, including reporting requirements.

In light of the foregoing, we do not believe that the U.S. personnel test should apply to electronic trading activity by U.S. personnel acting on behalf of a non-U.S. SBSD, where such trading activity takes place on an SBS trading platform that is not required to register as a national securities exchange or SBS execution facility.

After-Hours Trading Activity. A U.S.-located trader or salesperson also may, for time zone reasons, commit a non-U.S. SBSD to an SBS with a non-U.S. counterparty outside the counterparty's local market hours. When the U.S.-located trader or salesperson engages in this activity, it typically does so pursuant to product, credit and market risk parameters established by supervisory or management personnel of the non-U.S. SBSD who are located outside the United States. Although the trader or salesperson's location within the United States may not be incidental, his or her arrangement, negotiation or execution of transactions on behalf of the non-U.S. SBSD is solely incidental to the hour of the day when the non-U.S. counterparty desires to trade. We do not believe that a non-U.S. SBSD using U.S. personnel in these limited circumstances is engaged in SBS dealing activity within the United States "as a regular business."[35] We also note that, in connection with the non-SBS securities markets, the

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34 *See* Cross-Border Proposal, 78 Fed. Reg. at 31,054-55.

35 *See* Section 3(a)(71)(C) of the Exchange Act (exception from the SBSD definition for a person entering into SBS for its own account "not as part of a regular business").

Commission staff has previously recognized the benefits of facilitating this type of incidental, after-hours trading activity.[36]

In contrast, applying Title VII rules to non-U.S. SBS arranged, negotiated or executed by U.S. personnel in these after-hours trading scenarios would present a significant obstacle to continued U.S. participation in markets that operate across multiple time zones. To accommodate non-U.S. counterparties, non-U.S. SBSDs would likely need to maintain an after-hours staff in non-U.S. jurisdictions, which may be composed of front office personnel re-located from the United States. To prevent these adverse consequences, the Commission should not consider U.S. personnel to "arrange, negotiate or execute" non-U.S. SBS based on interactions with a non-U.S. counterparty that take place outside the counterparty's local market hours, where the U.S. personnel act pursuant to product, credit and market risk parameters established by non-U.S. personnel of the non-U.S. SBSD.

F. Phased Implementation

As described above, any adoption of a U.S. personnel test would have far-reaching consequences for how non-U.S. SBSDs and their non-U.S. counterparties organize their business activities and manage their risk. It also would require significant modifications to existing compliance and/or risk management systems, controls, policies and procedures. These changes may prove unnecessary, however, if the non-U.S. SBSDs subject to the U.S. personnel test are ultimately able to rely on substituted compliance because the Commission later determines that the non-U.S. jurisdictions where those non-U.S. SBSDs are located have adopted comparable rules. Accordingly, if the Commission adopts a U.S. personnel test, it should defer the compliance date for the application of that test until it has had an opportunity to make comparability determinations for key non-U.S. jurisdictions, such as Australia, Canada, the European Union, Japan and Switzerland.

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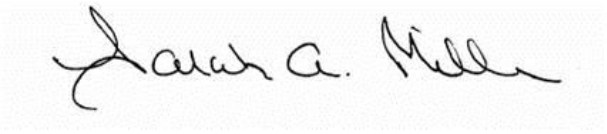
[36] *See Cleary, Gottlieb, Steen & Hamilton* (avail. Apr. 9, 1997).

The Institute appreciates the Commission's consideration of these matters. If the Commission or its staff has any questions regarding this letter, please do not hesitate to contact the undersigned at (212) 421-1611.

Respectfully submitted,



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