DODD-FRANK DERIVATIVES REFORM: CHALLENGES FACING U.S. AND INTERNATIONAL MARKETS

HEARING

BEFORE THE

SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT

OF THE

COMMITTEE ON AGRICULTURE HOUSE OF REPRESENTATIVES

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DODD-FRANK DERIVATIVES REFORM: CHALLENGES FACING U.S. AND INTERNATIONAL MARKETS

THURSDAY, DECEMBER 13, 2012

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Subcommittee met, pursuant to call, at 8:59 a.m., in Room 1300 of the Longworth House Office Building, Hon. K. Michael Conaway [Chairman of the Subcommittee] presiding.

Members present: Representatives Conaway, King, Neugebauer, Austin Scott of Georgia, Crawford, Huelskamp, Ellmers, Gibson, Hultgren, Hartzler, Lucas (*ex officio*), Boswell, Walz, McGovern, David Scott of Georgia, Courtney, Welch, Sewell, and Garamendi.

Staff present: Tamara Hinton, Kevin Kramp, Josh Mathis, John Porter, Matt Schertz, Nicole Scott, Suzanne Watson, Jason Goggins, Liz Friedlander, C. Clarke Ogilvie, John Konya, Debbie Smith, and Caleb Crosswhite.

OPENING STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE IN CONGRESS FROM TEXAS

The CHAIRMAN. All right. This hearing of the Subcommittee on General Farm Commodities and Risk Management to review Dodd-Frank derivatives reform and the challenges facing U.S. and international markets will come to order. A bit of a brief explanation, we have votes around 11 o'clock, and with the gracious consent of our four presenters today, we have combined the two panels into one in an attempt to make sure that we respect the fact that the U.S. regulators are here as well as our foreign regulators who have come a long way to visit with us. And to only get through one panel and then leave to go vote and that covey of quail disbursement looking thing that happens when we finish votes is disrespectful, so we have combined them into one. And we ask unanimous consent that Mr. Garamendi, who is not yet on the Committee, will be joining us today if everybody is okay with that. All right.

The Subcommittee is honored to have Commissioner Jill Sommers and Commissioner Bart Chilton from the United States Commodity Futures Trading Commission to join us today. In addition, we have Mr. Masamichi Kono from the Financial Services Agency of Japan and Mr. Patrick Pearson from the European Commission. And I believe this is the first time the United States Congress has welcomed international regulators to testify with respect to the Dodd-Frank Act. And I want to thank them for traveling to Washington, D.C., to appear before us today and we are looking forward to their testimony.

Today's meeting of the General Farm Commodities and Risk Management Subcommittee continues a series of hearings that started in 2011 aimed at examining problems that have arisen as regulators continue to work through the Dodd-Frank rulemaking process. This summer, the CFTC issued its proposed cross-border guidance to the marketplace for review and comment. What followed was an almost universal outcry of foreign governments and international regulators. Regulators who oversee the vast majority of derivatives markets outside the United States expressed deep concerns that the CFTC's proposed application of Dodd-Frank outside of the U.S. borders.

Respect for equivalent, but not identical, regulatory standards has been a cornerstone of international banking regulations for decades. But now, the CFTC, pushed by Mr. Gensler, appears poised to rewrite that standard of international cooperation and extend the reach of U.S. law to regulate activity in foreign jurisdictions over the objections of the sophisticated and accountable regulators.

I understand the international regulators have met with the Chairman and his staff several times in recent months to discuss how to resolve these cross-border concerns. However, based on his testimony yesterday to the Financial Services Committee, it does not appear that the Chairman is ready to accept that foreign efforts and regulatory reform will be equivalent to the rule proposed by the CFTC. Without a willingness to trust international regulators and their ability to regulate their own markets, I fear that next month's talks in Brussels will be just that—more talk.

A major concern voiced by international regulators is that the global derivatives markets may become regionalized as institutions and customers transact a majority of business within their home jurisdictions. Such an outcome would concentrate risk in various economies and sectors of the world. Here at home, American end-users who use swaps to manage everyday business risk may have fewer counterparties to deal with. Fewer counterparties will of course mean less competition and less liquidity in the market and, I believe, will lead to higher costs for those end-users and a higher concentration of risks in the United States. With our economy facing an uncertain future, we can ill afford to implement reforms without a good faith attempt to cooperate with the international community so we do not negatively impact global markets.

Getting the Dodd-Frank regulatory scheme right is more important than getting it done quickly. Congress can never become complacent. Our work did not end when this law was signed by the President in 2010. Examining the rulemaking process for errors, unfair instructions, or unintended consequences and then fixing the mistakes is the essential part of our job.

I want to thank all the Members of the Subcommittee on both sides of the aisle for their continued commitment to good oversight. It is important that Dodd-Frank, irrespective of our ideological differences, is implemented in a way that is logical and fair and beneficial for the participants who depend on the financial markets.

[The prepared statement of Mr. Conaway follows:]

PREPARED STATEMENT OF HON. K. MICHAEL CONAWAY, A REPRESENTATIVE IN CONGRESS FROM TEXAS

Good morning, thank you all for joining us for this important hearing to examine challenges facing U.S. and international markets as we continue implementing the Dodd-Frank Act.

The Subcommittee is honored to have Commissioner Jill Sommers and Commissioner Bart Chilton from the U.S. Commodity Futures Trading Commission join us today.

In addition, I would like to extend a warm welcome to Mr. Masamichi Kono from the Financial Services Agency of Japan and Mr. Patrick Pearson from the European Commission.

I believe this is the first time the U.S. Congress has welcomed international regulators to testify with respect to the Dodd-Frank Act, and I thank them for traveling to Washington to appear before us—we look forward to their testimony.

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With our economy facing an uncertain future, we can ill-afford to implement reforms without a good faith attempt to cooperate with the international community so we do not negatively impact global markets.

As I have said, getting Dodd-Frank right is more important than getting it done quickly. Congress can never become complacent; our work did not end when this law was signed by the President in 2010. Examining the rulemaking process for errors, unclear instructions, or unintended consequences, and then fixing the mistakes is an essential part of our job.

I want to thank all the Members of this Subcommittee, on both sides of the aisle, for their continued commitment to good oversight. It is important that Dodd-Frank, irrespective of our ideological differences, is implemented in a way that is logical, fair, and beneficial for the participants who depend on the financial markets.

With that, I will turn to our Ranking Member, Mr. Boswell, for his opening remarks and then to our witnesses.

The CHAIRMAN. With that, I will turn to our Ranking Member, Mr. Scott, for his opening remarks and then we will move on to our witnesses. Mr. Scott?

OPENING STATEMENT OF HON. DAVID SCOTT, A REPRESENTATIVE IN CONGRESS FROM GEORGIA

Mr. DAVID SCOTT of Georgia. Thank you very much, Chairman Conaway. Chairman, I had to do sort of a double-check on the calendar on the way over here this morning to make sure that it was really December 2012 and not December 2010 because I sort of had a serious case of *déjà vu* while walking over. It seems like we have had countless hearings over the last few years on the issues before us today, so many that they are starting to sort of blur together in my mind. And yet, after fielding more complaints about a lack of timing and coordination on behalf of the CFTC and their implementation of Dodd-Frank regulations on derivatives transactions, here we are once again trying to get answers to the questions that we have been asking ever since the beginning.

Now, make no mistake about it, the complaints I—and I am sure others—have heard are not just market participants crying wolf. The consequences of poor sequencing of rules and implementation dates, poor coordination both with other domestic regulators and foreign regulators as well, are real and they are very damaging to U.S. companies. As we saw earlier this year, domestic banks can and they will lose business to foreign competitors if Title VII rules are not implemented properly and in a timely fashion. And that will in turn harm the end-user companies that they serve and that we on this Committee care so very much about.

So again, Chairman Conaway, I want to thank you for holding the hearing. I hope we can make some progress on getting to the bottom of an issue that has frustrated us for some time now and, at the very least, remind the CFTC that they need to do better in implementing Title VII of Dodd-Frank.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Scott.

Before we turn to our witnesses, I would like to, with unanimous consent, yield a couple of moments to Mr. Boswell, my Ranking Member, who I have worked with for years now and is a good friend. So, Mr. Boswell?

OPENING STATEMENT OF HON. LEONARD L. BOSWELL, A REPRESENTATIVE IN CONGRESS FROM IOWA

Mr. BOSWELL. Well, thank you very much, Mr. Chairman. And I just want to make some, if I could, farewell remarks.

You know, I have no animosity about anything that has happened. This place works as it works and we all know that. And it has been a privilege to work with you, Mr. Chairman, and your predecessor, and back when I was chair and all those things. But we have a tremendous responsibility, so as the patriarch of this Committee, I guess, age has something to do with it. And Mr. King, you don't have to smile that much. Yes, I am much older than you.

But anyway, as I look out here at Mr. Chilton and some of the rest of you who I have learned a lot about and you have taught us a lot, and it is a tremendous responsibility here. And I think back to the debacle that took place and what certainly contributed to this recession and all the things we are struggling with now and it seems like it is really hard to get to and think about what CFTC has done and so on. The CFTC, as you well know, Mr. Chairman, didn't cause the problem. They have done their job. And we know that and it is just a point. And as we have learned recently on other issues—and I am rambling here little bit so if it is okay, then I will stop and I will be full stop.

The CHAIRMAN. All right.

Mr. BOSWELL. Thank you.

You know, if we don't give the tools to do the job, for example, to the IRS and if this fiscal cliff thing happens, they don't have the capacity to deal with their responsibility. Well, I see the same thing with you folks that have the CFTC responsibility, whether we like Dodd-Frank or we don't like it, we have done it. If we have the will or the desire to change it, well, maybe that will happen, but meanwhile, we have charged the CFTC with a lot of responsibility, which we should. But they got to have the tools.

And I know when I came back, Steve, from all those years gone in the army and I had to learn how to take care of machinery again, I didn't have the right toolboxes. And here I am stuck with a massive 750 out there and a bearing going out and I don't have the things in my toolbox to deal with it. But when I did, I could. And maybe that is an oversimplification, but we have to give them the tools. We have said this is your responsibility.

You know, Mr. Chairman, you and I have talked about this and we have not exactly agreed on everything, but that is part of the process, which we both respect very much and it is what makes our country great. You got to have the wherewithal to do what we have asked you to do. I think you have done pretty darn good considering the things you have accomplished. So my caution, I guess, or my counsel or whatever you want to call this as I depart this responsibility is, a lot weighs on the welfare of the country to do this right, to have daylight is a term I learned to use, to have daylight on stuff so they know what is going on. And if we know what is going on, we got the possibility of doing what we need to do, which might include leave it alone and or do something that needs to be done to keep our country on its path.

So I would just leave this thought with you. If we are going to change it, well, then, change it. If we can't, let us at least give the Commission the tools they need, the hardware, and the people to do the job we have said you have to do and not just be critical of it when they can't get it done because they don't have the tools.

And with that, I just want to say to David, thank you for responding when this hearing was coming up. You know, I am going out the door and I know that and I did want to come and participate, but I thought it better for the continuity and going on if you or somebody would step up, and you have, and I thank you for it.

And Mr. Conaway, I just appreciate you and your sincerity about what you do and expertise that you bring with your vast experience in accounting and so on. And since I did a little thing called roughnecking down in your part of the country when I was a youngster, I have a lot of respect for West Texas. You know, I was on a standard rig—I probably told you one time—when the oil came in. Wow.

What an experience. But anyway, so much for that. That is too much reminiscing but I wish you well.

The CHAIRMAN. Thank you.

Mr. BOSWELL. I thank you for the opportunity to have a moment, and I will try not to interfere anymore, but if I have to, I will.

But thank you.

The CHAIRMAN. Thank you. Mr. Boswell yields back.

Mr. Chilton, 5 minutes.

STATEMENT OF HON. BART CHILTON, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Mr. CHILTON. Thank you, Mr. Chairman. It is a pleasure to be with you. Thank you, Members of the Subcommittee, and particularly thank you, Chairman Boswell, for all your service. It has been an honor and personal privilege to work with you, sir.

And I am also pleased to testify with my fellow regulator, Commissioner Sommers. We did so last year. And as you know, she heads our Global Markets Advisory Committee and does a superb job. And I thank her for all her counsel and assistance over the years.

And as Chairman Boswell was talking, it reminded me of that movie around this time of year, *It's a Wonderful Life*. Do you remember that circumstance where Uncle Billy loses the money and George says to him, "Where is that money you stupid, silly, old fool? Where is that money? Do you realize what this means? It means bankruptcy and scandal and prison. That is what it means. One of us is going to jail and it is not going to be me."

And the reason I raise that is that back in 2008—and I get this question asked all the time and perhaps you do back in your districts—how come nobody went to jail for what happened in 2008 for tanking the economy? Well, part of the reason is there wasn't a law against what they did, what was done to the economy. That is why Dodd-Frank is important. I think it is a good law.

But as many Members, including Chairman Conaway has pointed out, if we don't implement it correctly, it could be bad. We have to do this right. We have to have a balanced approach. And that is particularly important with regard to cross-border issues, because as you all know and have spoken to us about in no uncertain terms, these markets are correlated. They are impacted globally. So we have to make sure that what we do doesn't put our U.S. firms at a competitive disadvantage, but we do want, ultimately, harmonized global regulations to the extent that it is practical.

So with regard to that, if you go back to when Dodd-Frank was passed in 2010, at that point, it looked like other nations, and particularly the European Union, were maybe 2 years behind implementing their financial reforms—2 years. So there is a big concern about regulatory arbitrage. What if the U.S. went first and did the things by the dates we required, July of 2011? But it turns out since we have taken our time—as Chairman Conaway has written to us many times, take your time, go slow, get it right—we have listened to you. You have been correct, sir. So we have slowed down. We have about ⅔ our regs done so far but we are still trudging along. But in that delay, now there is not that big 2 year difference anymore. Now there is only maybe 5, 6 months difference between us and the EU. Some of the other nations are little bit behind that.

So the thought that seems to make sense to me—and I am pleased that Commissioner Sommers and I are of a fairly like mind on this—is that let us sort of jump into the pool at the same time. Let us perhaps delay compliance for 6 months with some of these things in order that we can all do this at the same time. There is no regulatory arbitrage, and we don't negatively impact our companies, our U.S. financial firms. So I am not suggesting that that delay, Mr. Chairman, will make it like a super great wonderful life for financial firms, but it will definitely improve things.

And one final note, I have given to the clerk some sheets that I have unrelated to this issue of cross-border, I know you guys are dealing with the farm bill, but we do have a reauthorization coming up next year and there are some issues that are critical. I have just provided one page for you. If you can take them and maybe we can talk about them next year, but they have to do with a need for an insurance fund in the derivatives sector because now derivatives customers are treated as second-class citizens compared to the securities side; second, the need to increase our penalty regime. We have these antiquated penalties where we only charge very little; and third, dealing with high-frequency traders, these traders I call cheetah traders, no mention of them in Dodd-Frank because they weren't seen as a problem. The Flash Crash of 2010 happened just a couple of months before the bill. So to the extent you want to engage in that, I am happy to talk about it whenever.

And I do thank you for the opportunity to be here, Mr. Chairman.

[The prepared statement of Mr. Chilton follows:]

PREPARED STATEMENT OF HON. BART CHILTON, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Good morning, Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee. Thank you for the opportunity to be with you today regarding the harmonization of global derivatives market regulatory reform. The Subcommittee's oversight of the CFTC is critical to the work we do and I appreciate your attention to this and other matters. It is a pleasure, as it was last year, to testify alongside Commissioner Sommers, the Chair of our global Markets Advisory Committee (GMAC). She does a superb job.

Today, I'm pleased to discuss the progress we've made, as well as some of the challenges we've encountered in implementing the Wall Street Reform and Consumer Protection Act of 2010—otherwise known as Dodd-Frank. We are always guided by the law and in this case we also have been considering the 2009 Pittsburgh G20 Communiqué (reaffirmed this year at the G20 Mexico summit), which set forth key directives for December 2012 implementation of clearing, trading, reporting, and prudential rules for G20 member countries. The recent statement issued by international financial regulators is a welcome signal that we've made significant progress in this area.

Dodd-Frank is a good and needed law. While it is our law—a U.S. law—these are global, interrelated financial markets and financial firms. They are connected and correlated and rules and regulations need to be attentive to that fact. Dodd-Frank can, if we implement it correctly, avoid systemic risk to our economy and make markets more efficient and effective and devoid of fraud, abuse and manipulation. But, I said "if" we implement it correctly.

We've known since passage of Dodd-Frank that, unless we strike the right balance and provide appropriate guidance and relief on cross-border issues, we risk significant market disruption and migration, as well as regulatory arbitrage, due to an imbalance in global regulatory scope and content. As Chairman Conaway cautioned in an August letter, "Absent consistent regulatory standards proposed by our own domestic regulators, effective coordination between the U.S. and foreign regulators would seem virtually impossible." With the leadership of our Chairman and Commissioner Sommers, we have engaged in an international dialogue to move forward on a balanced approach to these regulations.

In that regard, the entire regulatory process has taken longer than Dodd-Frank deadlines. Most regulations were to be completed by July of 2011. The European Union appeared perhaps 2 years behind the U.S. at the time of Dodd-Frank's passage. It appeared that if the U.S. went first, and by 2 years so, the impact could create havoc for markets and market participants. Since the law passed, there have been those (including some on this Subcommittee) who have urged regulators to go slow. Particularly as to the impact of the new law on the international front, they were right. The regulatory reform rulemaking process has shown us that we needed much more information about the over-the-counter (OTC) space in order to promulgate appropriate and reasonable rules. We've proposed and re-proposed and extended comment periods and amended our rules, provided comprehensive guidance, and where needed, appropriate relief. It has not always been a graceful exercise, but by and large, I believe we have gotten things right. If we haven't, we'll hear about it. And we've shown that we can be flexible in implementation content and timing. The result is that during these delays, the rest of the world, and particularly the European Union, has caught up to us. It now appears that EU regulations will be implemented in a matter of months after U.S. rules may be finalized, as opposed to the 2 years originally envisioned.

In June, we proposed interpretive guidance and exemptive relief on extraterritoriality issues. We are now poised to provide final guidance in this area, to give clarity as to the application of Dodd-Frank on those operating outside our territorial borders. We need to ensure that we strike that correct balance in carrying out the mandates of the law, and at the same time confirm that appropriate substituted compliance is available to market participants.

Given that global financial reform regulations can be completed on a more similar time horizon, it's clear to me that we need to provide for phased-in compliance and appropriate relief from rules for an interim period—perhaps 5 or 6 months. We do not want to repeat the process we—and the markets—underwent in October. In that instance, market participants were unclear what things would truly be required on the October 12th compliance date. We ended up working it all out, but it should have, and could have, been done in a more open and streamlined fashion. We need to avoid that now as we approach January 1, 2013 implementation of certain rules and regulations. This would give markets and participants time to comply with the new regulatory environment and also would provide assurance to global markets and regulators that we are not causing unnecessary market disruptions. I've made specific recommendations which are:

1. Extend the narrower, territorial definition of U.S. Person used in the CFTC's October 2012 staff no-action letter.
2. U.S. and foreign SD and MSP registrants would have interim relief from compliance with external business conduct standards, and during the interim period, should operate under a "good faith" compliance standard.
3. Allow non-U.S. dealers to not register when facing registered U.S. swaps dealers. (*i.e.,* their obligation to register would be based on swaps with U.S. end-users. This is intended to reduce the incentive for non-U.S. G20 dealers to conduct their swaps with foreign branches and affiliates of U.S. SDs and MSPs as opposed to trading with regulated U.S. SDs and MSPs.)
4. Provide relief as to the swaps dealing aggregation standard (*i.e.,* swap dealing counting toward the *de minimis* level would happen on an individual entity, not enterprise level).

These seem to be common-sense measures that can be taken which would ease the transition to compliance, and reduce incentives for regulatory arbitrage, or a race to the thinnest rule book.

Finally, we need to immediately respond to those who have requested relief from the Agency. I'm not suggesting we will grant exemptions, but at the least we need to respond . . . and now. Furthermore, in the limited meantime prior to requiring compliance, it would not be appropriate, reasonable, or responsible for the Commission to proceed against entities for non-compliance with Dodd-Frank rules unless and until they have received a response from the Agency to an existing request. And, importantly, I cannot envision the Commission moving forward with such an action.

Separate from these issues of international harmonization, I look forward to working with the Subcommittee on the CFTC reauthorization this next year. In that regard, I believe we should do at least three things: First, increase penalties for those that violate our financial laws; second, create a futures insurance fund; and third, we need to develop a meaningful oversight regime for high frequency traders. I have a one-pager on each of these matters for Members and I will leave it to the Chairman if these three pages should be included in the hearing record.

Thank you for the opportunity to present this testimony today.

The CHAIRMAN. Thank you, Mr. Chilton.

Ms. Sommers?

STATEMENT OF HON. JILL E. SOMMERS, COMMISSIONER, COMMODITIES FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Ms. SOMMERS. Good morning, Chairman Conaway, Ranking Member Boswell, and Members of the Committee. Thank you for inviting me to testify today. It is a pleasure to be here with my colleagues to speak about the challenges facing U.S. and international markets resulting from the Dodd-Frank derivatives reforms.

I have worked in the derivatives industry for over 15 years and have been a Commissioner at the CFTC since August of 2007. During my time at the Commission, I have served as Chairman and sponsor of the CFTC's Global Markets Advisory Committee and have represented the Commission at meetings of the International Organization of Securities Commissions. I am pleased to give you my perspective on the enormous challenges facing regulators across the globe in their quest to meet the commitments on OTC derivatives reform made by the G20 leaders in 2009, and in particular, the challenges for U.S. regulators in interpreting the cross-border scope of Dodd-Frank.

In May of 2011, Commissioner Chilton and I testified in front of this Subcommittee regarding the harmonization of global derivatives reform and its impact on U.S. competitiveness and market stability. At that time, I discussed three concerns: first, there were substantive differences between derivatives reform in the U.S. and in other jurisdictions; second, other jurisdictions were not as far along in their reform process, which could harm the global competitiveness of U.S. businesses due to regulatory arbitrage; and third, our failure to clarify how our rules would apply internationally was creating a great deal of uncertainty, both in the U.S. and abroad.

Although my concerns today remain the same, since then, I have had the benefit of significant dialogue and feedback from foreign regulators and market participants regarding the cross-border proposal the CFTC released in June. I have two specific solutions: first, the Commission should not act outside the jurisdictional limits that were set for us by Congress. Section 722(d) of the Dodd-Frank Act, which added Section 2(i) to the Commodity Exchange Act, provides that the Act "shall not apply to activities outside the United States unless those activities have a direct and significant connection with activities in, or affect on, commerce of the United States, or contravene rules or regulations prescribed by the Commission designed to prevent evasion."

In my view, those words *direct* and *significant* should be read together. It should not be enough that a swap transaction involves a U.S. counterparty. Rather, the connection to the United States must be direct and significant. I do not believe that every single swap a U.S. person enters into, no matter what the swap or where it is transacted, has a direct and significant connection with activities in, or effect on, commerce of the United States.

Second, it is imperative for U.S. regulators to harmonize their approach with global regulators on the extraterritorial reach of Dodd-Frank. While we have been consulting regularly with the SEC and other regulators, our approaches are far from consistent. It does no good to coordinate with our fellow regulators if we are not going to listen to them or incorporate their suggestions. The Commission has worked for decades to establish relationships with our foreign counterparts built on respect, trust, and information sharing, which has resulted in a successful history of mutual recognition of foreign regulatory regimes in the futures and options markets spanning over 20 years.

At the Pittsburgh Summit in 2009, all G20 nations agreed to a comprehensive set of principles for regulating the OTC derivatives markets. We should rely on their regional expertise and try to the best of our ability to avoid overlapping rules or dual regulations. While the pace of implementing reforms among the various jurisdictions has been uneven, I have no reason to believe that comparable or equivalent regulation is unachievable. It is obvious that more time is needed to facilitate an orderly transition to a regulated environment. This task is not going to be easy and we have a long way to go, but we must continue to work with our colleagues both domestically and internationally to coordinate our approaches to regulation of the global swaps market. Global coordination is key to successfully regulating these global markets. In order to accomplish harmonization with the rest of the world both in substance and timing, my hope is that in the coming days the Commission will issue clear and concise relief from having to comply with various Dodd-Frank requirements for both domestic and foreign swap entities. These are very complex issues but we should not make cross-border guidance more confusing than necessary.

I am grateful for the opportunity to be able to discuss these important issues and happy to answer any questions.

[The prepared statement of Ms. Sommers follows:]

PREPARED STATEMENT OF HON. JILL E. SOMMERS, COMMISSIONER, COMMODITY FUTURES TRADING COMMISSION, WASHINGTON, D.C.

Good morning, Chairman Conaway, Ranking Member Boswell, and Members of the Committee. Thank you for inviting me to testify on the challenges facing U.S. and international markets resulting from the Dodd-Frank derivatives reforms. I have worked in the derivatives industry for over fifteen years and have been a Commissioner at the Commodity Futures Trading Commission (CFTC or Commission) since August of 2007. During my time at the Commission I have served as the Chairman and sponsor of the CFTC's Global Markets Advisory Committee (GMAC) and have represented the Commission at meetings of the International Organization of Securities Commissions (IOSCO), one of the principal organizations formed to develop, implement and promote internationally recognized and consistent standards of regulation, oversight and enforcement in the securities and derivatives markets. I am pleased to give you my perspective on the many challenges facing regulators across the globe in their quest to meet the commitments on over-the-counter (OTC) derivatives reform made by the G20 Leaders in 2009 and, in particular, the challenges presented in interpreting the cross-border scope of Dodd-Frank. The views I present today are my own and not those of the Commission.

Section 722(d) of the Dodd-Frank Act, which added Section 2(i) to the Commodity Exchange Act, provides that the Act shall not apply to activities outside the United States unless those activities have a direct and significant connection with activities in, or effect on, commerce of the United States, or contravene rules or regulations prescribed by the Commission designed to prevent evasion. In 2011 the Commission acknowledged the growing uncertainty surrounding the extraterritorial reach of Dodd-Frank and in August of that year held a 2 day roundtable, followed by a public comment period. In July 2012 the Commission published proposed guidance setting forth an interpretation of how it might construe Section 2(i), followed by another round of public comment. The guidance included a proposed definition of "U.S. person," the types and levels of activities that would require foreign entities to register as U.S. swap dealers or major swap participants (swap entities), and the areas in which such swap entities might be required to comply with U.S. law and those in which the Commission might recognize substituted compliance with the law of an entity's home jurisdiction.

On November 7, 2012 I convened a meeting of the GMAC to further discuss the Commission's proposed interpretive guidance and to identify questions and areas of concern in implementing the CFTC's proposed approach. A number of foreign jurisdictions were represented, including regulators from Australia, the European Commission, the European Securities and Markets Authority, Hong Kong, Japan, Quebec and Singapore. Representatives of the U.S. Securities and Exchange Commission (SEC) also attended to discuss the SEC's perspective. A common theme that emerged was concern over the breadth of CFTC's proposed definition of "U.S. person," the implications of having to register in the U.S., the uncertainty of the Commission's proposal on substituted compliance, and the need to identify areas where complying with a particular U.S. requirement might conflict with the law of a foreign swap entity's home country regime.

On November 28, 2012 regulatory leaders from Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Quebec, Singapore, Switzerland and the United States met in New York to continue the dialogue. In a press statement issued after the meeting the leaders supported the adoption and enforcement of robust and consistent standards in and across jurisdictions, and recognized the importance of fostering a level playing field for market participants, intermediaries and infrastructures, while furthering the G20 commitments to mitigating risk and improving transparency. The leaders identified five areas for further exploration, including:

- the need to consult with each other prior to making final determinations regarding which products will be subject to a mandatory clearing requirement and to consider whether the same products should be subject to the same requirements in each jurisdiction, taking into consideration the characteristics of each domestic market and legal regime;
- the need for robust supervisory and cooperative enforcement arrangements to facilitate effective supervision and oversight of cross-border market participants, using IOSCO standards as a guide;
- the need for reasonable, time-limited transition periods for entities in jurisdictions that are implementing comparable regulatory regimes that have not yet been finalized and to establish clear requirements on the cross-border applicability of regulations;
- the need to prevent the application of conflicting rules and to minimize the application of inconsistent and duplicative rules by considering, among other things, recognition or substituted compliance with foreign regulatory regimes where appropriate; and
- the continued development of international standards by IOSCO and other standard setting bodies.

The authorities agreed to meet again in early 2013 to inform each other on the progress made in finalizing reforms in their respective jurisdictions and to consult on possible transition periods. Future meetings will explore options for addressing identified conflicts, inconsistencies, and duplicative rules and ways in which comparability assessments and appropriate cross-border supervisory and enforcement arrangements may be made.

The Commission has worked for decades to establish relationships with our foreign counterparts, built on respect, trust, and information sharing, which has resulted in a successful history of mutual recognition of foreign regulatory regimes in the futures and options markets spanning 20+ years. At the Pittsburgh summit in 2009 all G20 nations agreed to a comprehensive set of principles for regulating the OTC derivatives markets. We should rely on their regional expertise. While the pace of implementing reforms among the various jurisdictions has been uneven, I have no reason to believe that comparable or equivalent regulation is unachievable. It is obvious that more time is needed to facilitate an orderly transition to a regulated environment. It is important that assessments of comparability be made at a high level, keeping in mind the core policy objectives of the G20 commitments rather than a line-by-line comparison of rule books. It is also important to avoid creating an unlevel playing field for U.S. firms just because the U.S. is ahead of the rest of the world in finalizing reforms. U.S. firms should not be disadvantaged by tight compliance deadlines set by the CFTC. Global coordination is key. It is my hope that in the coming days the Commission will issue clear and concise relief from having to comply with various Dodd-Frank requirements, for both domestic and foreign swap entities, until we have a better sense of the direction in which we are all headed.

I am grateful for the opportunity to speak about these important issues and am happy to answer any questions.

The CHAIRMAN. Right, thank you, Ms. Sommers.

I need unanimous consent to insert this statement in the record just ahead of Mr. Kono's testimony. Mr. Kono is recognized as a representative of a foreign organization whose statements are being provided under the terms of diplomatic immunity given to the officials of the Government of Japan. The statements are being given in cooperation and freely for the information of the U.S. House of Representatives and the House Committee on Agriculture.

So thank you, Mr. Kono.

Mr. Kono, 5 minutes?

STATEMENT OF MASAMICHI KONO, VICE COMMISSIONER FOR INTERNATIONAL AFFAIRS, FINANCIAL SERVICES AGENCY OF JAPAN; CHAIRMAN OF THE BOARD, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, TOKYO, JAPAN

Mr. KONO. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Committee, it is my great honor and pleasure to be here today to speak to you about issues concerning cross-border regulation of OTC derivatives markets. My name is Masamichi Kono representing the Financial Services Agency of Japan. I am also currently the Chairman of the Board of IOSCO, the International Organization of Securities Commissions. But I must mention that any views I express today are not necessarily the views of the organizations that I represent.

You will recall that G20 leaders agreed at the Pittsburgh Summit in September 2009 on the basic elements of reform and OTC derivatives markets, and a number of jurisdictions, including U.S. and Japan, have been making significant progress in implementing the G20 commitments towards the agreed deadline of the end of 2012. Actually, the regulations which Japan has already implemented from November this year, not exactly identical to U.S. regulations, but are fully consistent with the objectives of the G20 commitments to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse. In this respect, our laws and regulations, which we have implemented from November of this year, share the same goals as the Dodd-Frank Act.

One important issue that has surfaced lately, as having been mentioned by previous speakers, is how to deal properly with the risks of cross-border activities and transactions in OTC derivatives, which is very much a globalized market. One point that I would wish to make today is that such risks need not be addressed by extraterritorial application of U.S. laws and regulations. Rather, the U.S. authorities could rely on foreign regulators upon establishing, of course, that the foreign regulators have the required authority and competence to exercise appropriate regulation and oversight over those entities and activities. This is what we consider as the most efficient and effective approach in line with the principles of international comity between sovereign jurisdictions.

Such reliance on foreign regulators ensures that there is no conflict or overlap of applicable rules to entities operating cross-border and to transactions that take place across borders. It not only enables an efficient and effective use of our limited supervisory resources, but also, even more importantly, it removes legal uncertainty and significantly reduces the compliance costs of market participants and infrastructure operators in all jurisdictions. This will ultimately lead to significant cost savings for the investor and for the taxpayer as well, and actually in some cases, certain activities or transactions could be prevented from taking place because of conflicting regulations by different jurisdictions, and this can be avoided through enhanced coordination and cooperation between regulators.

Thus, there are now growing calls internationally for taking the required steps to avoid conflicting or overlapping regulation and for demonstrating much greater coordination and cooperation among regulators. And regulators around the world will have to respond to those calls. Actually, it is very much in this spirit that a group of regulators, including ourselves, issued on December 4 a joint press statement entitled, *Operating Principles and Areas of Exploration in the Regulation of the Cross-Border Derivatives Market*.

Now, in recent months, foreign regulators have expressed their concerns with regard to the CFTC's proposed reforms, primarily because they find potential conflicts or overlaps with our own rules that are or will be implemented soon. In this regard, we of course appreciate very much the ongoing efforts by the CFTC in addressing those issues raised by foreign regulators, but much needs to be done.

Now, I might not have the time to go through each and every subject, but let me try very briefly. First, it is important that the details of the applicable laws and regulations are made clear as much as possible before their implementation in order to minimize regulatory uncertainty. Second, once the details are made available, regulators should work together to avoid outright conflicts and minimize overlaps as much as possible, ideally again before the rules are applied in their jurisdictions. Third, a sufficient transition period and adequate relief measures for foreign entities and infrastructure operators are needed. Fourth, when adopting an approach of reliance on foreign regulators, it should be based on a clear recognition of the foreign regulators' primary authority and competence.

And in the U.S., our view is that the scope of application of substituted compliance can be further extended to a broader set of regulated entities and transaction requirements. And of course as a national regulator, we would like to be recognized as a primary regulator of the entities established in Japan.

Fifth, cross-border transactions by their very nature will be subject to regulations of two or more jurisdictions so we need arrangements across different jurisdictions to avoid duplication. And in Japan, we have taken steps to refrain from applying our rules to cross-border transactions in anticipation of an international coordination arrangement at the outset of our implementation.

Now, as I mentioned, we have made some efforts in recent days. We look forward to continuing to work with our counterparts in other jurisdictions to achieve this goal, and certainly, we would like to do our best to minimize the cost to the economy that has been referred to earlier.

So thank you very much for providing this opportunity to share my views with you today, and let me emphasize again that we are very much intending to cooperate and coordinate with each other as much as possible in the coming days and weeks. It is a huge challenge but one that has to be pursued if we are to have globally interconnected financial markets that serve well to help those in the real economies worldwide.

Thank you very much.

[The prepared statement of Mr. Kono follows:]

PREPARED STATEMENT OF MASAMICHI KONO, VICE COMMISSIONER FOR INTERNATIONAL AFFAIRS, FINANCIAL SERVICES AGENCY OF JAPAN; CHAIRMAN OF THE BOARD, INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, TOKYO, JAPAN

Introduction

Mr. Chairman and Members of the Subcommittee on General Farm Commodities and Risk Management. It is my great honor and pleasure to be invited to today's hearing to speak to you about issues concerning cross-border regulation of OTC derivatives markets. My name is Masamichi Kono, Vice Commissioner for International Affairs at the Financial Services Agency of Japan. In my capacity, I represent my Agency in various international organizations of financial regulators and supervisors. I am also currently the Chairman of the Board of IOSCO, *i.e.,* the International Organization of Securities Commissions. I must mention that any views I express today are not necessarily identical to the official views of the organizations that I represent.

In response to the financial crisis that started in 2007–2008, G20 Leaders agreed at the Pittsburgh Summit in September 2009 that all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest, and OTC derivative contracts should be reported to trade repositories.

A number of jurisdictions, including Japan and the United States, have been making significant progress in implementing the G20 commitments in an internationally consistent and coordinated manner towards the agreed deadline of end-2012. The regulations which Japan implemented from November this year are not identical to the U.S. regulations, but are fully consistent with the objectives of the G20 commitments to improve transparency in the derivatives markets, mitigate systemic risk and protect against market abuse. In this respect, our laws and regulations which we have implemented from November this year share the same goals as the Dodd-Frank Act.

As to the cross-border application of national laws to OTC derivatives, we can understand the CFTC's concern that risks emanating from an overseas commercial presence of a U.S. financial group could directly flow back to the U.S. and cause significant systemic disruptions, and this should be avoided. The same would apply if a non-U.S. financial group had significant commercial presence in U.S. territory. We believe, however, that such risks need not be addressed by extraterritorial application of U.S. laws and regulations.

If the overseas commercial presence of the U.S. financial group or the non-U.S. financial group is appropriately regulated by foreign regulators, the U.S. authorities could rely on the foreign regulators upon establishing that the foreign regulators have the required authority and competence to exercise appropriate regulation and oversight over those entities and activities abroad. This is what we consider as proper treatment in line with the principles of international comity between sovereign jurisdictions.

Such reliance on foreign regulators ensures that there is no conflict or overlap of applicable rules to entities operating cross-border, and to transactions that take place across borders. It not only enables an efficient and effective use of the limited supervisory resources of the regulator, but also, even more importantly, removes legal uncertainty and significantly reduces the compliance costs of market participants and infrastructure operators in all jurisdictions. This will ultimately lead to significant cost-savings for the investor, and for the taxpayer. In some cases, certain activities or transactions could be prevented from taking place because of conflicting regulation, and this can be avoided through enhanced coordination and cooperation between regulators. Needless to say, such reliance can only be possible when mutual trust is established between regulators, and appropriate supervisory arrangements exist between them.

In recognition of the above, there are now growing calls internationally for taking steps to avoid conflicting or overlapping regulation, and for demonstrating much greater coordination and cooperation among regulators. Regulators around the world will have to respond to those calls. It is very much in this spirit that a group of regulators including ourselves issued on December 4 a joint press statement entitled "Operating Principles and Areas of Exploration in the Regulation of the Cross-border OTC Derivatives Market". I will come back to explain the background of this important press statement later.

OTC Derivatives Market Reforms in Japan

Since September 2009, Japan has exerted its utmost efforts to put in place legislative and regulatory measures to reform the OTC derivatives markets, for the purpose of fulfilling the G20 commitments. Our Financial Instruments and Exchange Act (FIEA) has been amended in two stages.

The first stage of legislation dates back to May 2010, when mandatory clearing requirements and requirements to report transactions to trade repositories were introduced. Those amendments took effect from 1 November this year, with phase-in arrangements for product designation and reporting requirements.

As to the second stage, our Diet passed this September legislation introducing requirements for usage of electronic trading platform (ETP) and for enhancing price transparency. In consideration of the need to provide sufficient time for preparation on the part of market participants, and to address the potential impact on market liquidity that those measures could have, the implementation of this second stage of legislation will be phased in for a period of up to 3 years.

With respect to the mandatory clearing requirement that entered into force last month, only Japanese index-based CDSs (*i.e.,* the iTraxx Japan Index Series) and plain-vanilla Japanese Yen-denominated Interest Rate Swaps (IRS) with reference to LIBOR are subject to mandatory clearing. The scope of products subject to mandatory clearing will be expanded to the products, such as JPY-denominated IRSs with reference to TIBOR, foreign currency (USD and EURO) denominated IRSs, and single-name CDSs referencing Japanese companies, taking into consideration such factors as the volume of transactions and the degree of standardization.

Also, at the outset, the application of mandatory central clearing requirements is limited to transactions between large domestic financial institutions registered under the FIEA, who are members of licensed clearing organizations. In this regard, it should be noted that currently in Japan there is only one licensed CCP under the amended FIEA. Foreign CCPs are invited to be licensed in Japan, with less onerous requirements applicable in light of their foreign status. Going forward, the clearing requirements could be expanded to transactions between the above financial institutions and foreign financial institutions (not registered under FIEA), taking into account international coordination efforts currently underway on cross-border regulation.

On reporting requirements, financial institutions registered under the FIEA are required to report their OTC derivatives transactions to trade repositories (TRs) for products such as (i) credit derivatives, and (ii) forward, option and swap transactions in relation to interest rates, foreign exchanges, and equities.

Need To Avoid Conflicting Or Overlapping Cross-Border Regulations

In recent months, foreign regulators have expressed their concerns with regard to the CFTC's proposed reforms primarily because they find potential conflicts or overlaps with their own rules that are or will be implemented soon. Certainly the concerns described below are particularly relevant with regard to U.S. regulations, but it should be noted that many of them are, by nature, pertinent to any set of national or regional rules applied to entities operating cross-border and to cross-border transactions. In this regard, we appreciate very much the ongoing efforts by the CFTC in dealing with those issues raised by foreign regulators.

First, it is important that the details of the applicable laws and regulations are made clear as much as possible before their implementation, in order to minimize regulatory uncertainty.

Regarding the need for this transparency up front, more clarity on the detailed elements of the applicable rules is urgently requested in the case of the U.S. The examples of such elements are: the definition of a U.S. person, the terms and conditions for applying substituted compliance to foreign entities and cross-border transactions, and the method to be employed for aggregating transaction volumes of group firms worldwide in relation to the *de minimis* threshold for registration of swap dealers.

Second, once the details are made available, regulators should work together to avoid outright conflicts and minimize overlaps as much as possible, ideally *before* the rules are applied in their jurisdictions. Reliance on foreign regulators can be arranged through approaches of mutual recognition, substituted compliance, and exemptions, or a combination of those approaches.

Starting the implementation of U.S. regulations under the current circumstances has already created uncertainty in the markets. If not managed properly, significant reductions in market liquidity and/or shifts in transaction venues or counterparties could occur as a result.

Third, a sufficient transition period and adequate relief measures for non-U.S. entities and infrastructure operators are needed to address the difficulties that they face in complying with U.S. regulations. A certain amount of time is also required to work to avoid regulatory conflicts and inconsistencies arising from differences in the content and the timing of implementation of national or regional regulations. Foreign market participants and regulators would require some additional time to fully prepare for the new U.S. requirements. In Japan, as described above, we are taking a two-stage approach in introducing new rules, and providing sufficient time for their phased implementation.

Fourth, when adopting an approach of reliance on foreign regulators, it should be based on a clear recognition of the foreign regulators' primary authority and competence in exercising effective regulation of entities and infrastructures based in its jurisdiction.

In the U.S., to the extent that the CFTC's proposed regulations have revealed, the scope of application of substituted compliance can be further extended to a broader set of regulated entities and transaction-level requirements. As a national regulator, we would like to be recognized as the primary regulator of the entities established in Japan, and the CFTC is invited to rely on our supervisory authority and competence as much as possible. Whether a swap dealer qualifies for substituted compliance should be determined on recognition of equivalent regulation on a country-by-country basis, not on an entity-by-entity or rule-by-rule basis. In Japan, with respect to foreign CCPs and trade repositories, they are subject to less onerous requirements compared to CCPs and trade repositories established in Japan, if they are properly supervised by foreign regulators under supervisory cooperation arrangements with FSA Japan.

Fifth, cross-border transactions, by their nature, will be subject to regulations of two or more jurisdictions, if no arrangements are made between the relevant regulators to avoid duplication. If those duplicative requirements are not entirely conflicting or inconsistent, market participants could still cope, although there may still be additional costs involved in ensuring compliance with several different rules, such as in the case of duplicative data reporting requirements. But, if those rules clash with each other, arrangements are needed between regulators to enable the transaction to take place legally. Such cases can arise in the context of central clearing requirements.

In Japan, we have so far deliberately refrained from applying our rules to cross-border transactions in anticipation of an international coordination arrangement on regulation of cross-border transactions which we strongly hope to be developed soon.

When the U.S. and Japan require central clearing for transactions of the same product, such as JPY-denominated IRSs with reference to LIBOR, market participants will not be able to enter into transactions without breaching the regulations of either the U.S. or Japan, unless there is a CCP licensed or registered both in the U.S. and Japan In this regard, a Japanese clearing organization licensed under FIEA (Japan Securities Clearing Corporation (JSCC)) is currently seeking CFTC registration as a derivatives clearing organization (DCO). The challenge for JSCC, however, is that it would need more time than its U.S. counterparts to fully comply with U.S. regulation, and a request is being made to grant some additional time for it to be fully compliant.

Need for Better International Coordination and the Initiatives Underway

As noted above, there are a number of important issues we need to address with respect to cross-border application of OTC derivatives regulations. To address these issues, there is a much greater need for international coordination and cooperation among regulators.

The G20 Ministers of Finance and Central Bank Governors agreed in Mexico City this November to put in place the legislation and regulation for OTC derivatives reforms promptly and act by end-2012 to identify and address conflicts, inconsistencies and gaps in their respective national frameworks, including in the cross-border application of rules. The Financial Stability Board, in its latest report on OTC derivatives market reforms, urged key, high-level OTC derivatives market regulators from G20 jurisdictions to pursue further discussions before the end-2012 deadline to (i) identify the cross-border application of rules to infrastructure, market participants, and products; (ii) identify concrete examples of any overlaps, inconsistencies and conflicts; and (iii) develop options for addressing these issues.

In response to the growing calls, leaders of regulators of major OTC derivatives jurisdictions, including regulators from the U.S., EU and Japan, met in New York City at the end of November, and agreed to a set of high-level operating principles and identified areas for further exploration in the regulation of the cross-border OTC derivatives market. This effort culminated in the joint press statement published last week which I referred to earlier. In pursuing this work, we have appreciated very much the leadership taken by the CFTC and the SEC. Regulators have agreed to regularly meet and consult with one another, going forward. The next meeting is scheduled to be in Brussels early next year.

The joint press statement was intended to address important issues requiring international coordination and cooperation, and to present a useful way forward. This includes (i) an understanding on clearing determinations (prior-consultation when making clearing determinations), (ii) an understanding on sharing of information and supervisory and enforcement cooperation (relevant supervisory authorities enter into supervisory and enforcement cooperation arrangements), (iii) an understanding on timing (an orderly implementation process and a reasonable limited transition period) and (iv) areas of exploration regarding the scope of regulation and recognition or substituted compliance for cross-border compliance (possible approaches to prevent the application of conflicting rules and the desire to minimize the application of inconsistent and duplicative rules).

We found the outcome of this discussion extremely useful in further promoting coordination and cooperation among themselves, and will continue to meet and consult regularly to coordinate in order to address any outstanding issues.

Last but not least, with the deadline of G20 commitment coming near, we will continue to need to push ahead aggressively to put in place the legislation and regulation for OTC derivatives reforms promptly and act to identify and address conflicts, inconsistencies and gaps in our respective national frameworks, including in the cross-border application of rules, so that we can achieve the G20's goals of improving transparency in the derivatives markets, mitigating systemic risk, and protecting against market abuse. We should make use of the opportunity that international forums such as IOSCO and the FSB could provide in supporting the work of OTC derivatives market regulators.

Thank you very much for providing this opportunity to share my views with you today. Let me emphasize once again that, as agreed by international regulators last month, regulators intend to cooperate and coordinate each other much more closely and address the important issues related to cross-border regulation. It is a huge challenge, but one that has to be pursued, if we are to have globally interconnected financial markets that serve well to help growth in the real economies worldwide. Finding sensible, pragmatic cross-border solutions for global OTC derivatives trading is a test case for the global financial reform process. And it is urgent. We would be most grateful if you could provide your insights or suggestions in this regard. Now I will be delighted to respond to any questions you may have.

The CHAIRMAN. Thank you, Mr. Kono.

Mr. Pearson is also recognized as a representative of a foreign organization whose statements are being provided under the terms of the diplomatic immunity given to officials of the European Union. The statements are being given in cooperation and freely for the information of the U.S. House of Representatives and the House Committee on Agriculture.

Mr. Pearson, you are recognized for 5 minutes.

STATEMENT OF PATRICK PEARSON, HEAD, FINANCIAL MARKET INFRASTRUCTURES UNIT, INTERNAL MARKET AND SERVICES DIRECTORATE GENERAL, EUROPEAN COMMISSION, BRUSSELS, BELGIUM

Mr. PEARSON. Thank you, Chairman Conaway, Ranking Member, and Members of the Subcommittee, for inviting me to testify today. My name is Patrick Pearson. I represent the European Commission. We have the rulemaking powers in this specific area together with the European Securities Market Authority (ESMA).

Now, the reason for our work and the reason why we are here today are absolutely persuasive. The financial crisis exposed serious shortcomings to the OTC derivatives markets, it amplified shocks, and it impacted our economies in several ways. Our economies, our companies, our citizens, our taxpayers in the United States as well as in Europe and other parts of the globe are still paying for these shortcomings.

We have reached a global consensus. We have a plan. The United States and European Union have shown genuine leadership in pushing for global regulatory reform. Now, these derivative reforms involve a significant change in regulation to cover both the regulation of firms, legal entities; it covers the regulation of transactions, of contracts, and we have been working in parallel with the United States' agencies over the past 30 months to adopt the legislative reforms to achieve common goals.

The United States adopted the Dodd-Frank Act. Two months later, the European Union made its own proposals—European Market Infrastructure Regulation (EMIR). That legislation entered into force on the 16th of August of this year and, as in the United States, many technical rules will need to enter into force in the coming weeks to enact these requirements. The European Union hopes to enact its technical requirements before this Christmas.

Now, the Commission has worked closely with the CFTC and the SEC over the past years, often successfully. We have tried to align our requirements with your approaches. The Chairman of the CFTC and European Commissioner Michel Barnier, have met in Brussels and in Washington on a number of occasions to discuss derivatives reforms, a very useful process. International regulators, as Mr. Kono has made clear, have met recently in New York. We made some progress, cooperation, info exchange, consultation; but crucially, there is one key area where there is no progress and no agreement, and that is cross-border work.

And why is that crucial? It is because that $640 trillion OTC derivatives market is global. The Euro, the dollar, are the most important underlying currencies for derivatives. And the global nature of OTC markets with the two counterparties to transactions frequently located in different jurisdictions to each other or in a different location to the infrastructure being used makes the effective use of regulation absolutely critical. So we need rules that work not only for a national jurisdiction but also rules that work between jurisdictions. And even reforms that are consistent and coherent within one jurisdiction can have significant adverse impacts applied to cross-border transactions, even if we have apparently similar rules.

We did a recent detailed analysis of the U.S. and European rules and we identified numerous—80 pages—of potential conflicts, inconsistencies, gaps between our rules that have to be addressed. If we don't, many of our collective reform efforts to reduce risk will remain obsolete. Example: it is quite possible that two parties to the same transaction can be required to trade in different venues, clear on different DCOs or CCPs, report to different trade repositories. Trade could be subject to clearing in one jurisdiction and to margin requirements in another, and this is particularly relevant to corporate end-users. Companies will not be able hedge their risks, risks will be concentrated within jurisdictions, and contracts simply will not be cleared. We defeated the objectives we agreed to attack.

So what is the problem? There were three. First, scope. We have significant concerns with the proposals from the CFTC that would extend the territorial reach of its rules to counterparties outside of the United States. This immediately creates conflicts, undue burdens to market participants. Firms and traders will fall under two rules—U.S. rules and foreign rules. The only choice they have is whose rules to break—the United States' rules or European rules?

The scope of persons who are subject to the application of our respective rules and regulations must be defined in a narrow manner. It has to be based on the establishment of the counterparty in the territory of our jurisdictions. And what is really important is that all the counterparties in two jurisdictions are subject to the requirements we all agreed to to ensure global safety. And we believe this is better done by ensuring comparability of rules than by overextending the reach of national rules.

My second point—the principles of recognition of equivalent substituted compliance are critical to a cross-border regulatory regime. We believe that the CFTC is too modest in the way it proposes to use substituted compliance. It should be applied more broadly. It should not only apply to entity requirements but also to transaction requirements. It should apply also to transactions between domestic U.S. and a third country counterparty. The CFTC has the powers to do this. It has done this in the past. Why not here?

Third, registration. Registration might be unavoidable, but if you do it, you need to do it from the beginning with recognition and substituted compliance. Market participants must have absolute possibility and certainty ahead of any registration. Foreign swap dealers are being told to register without knowing the complete set of rules that will bind them as a consequence up front, how they will be applied in an international context, and once registered, you cannot de-register. This isn't Facebook we are talking about. There are some significant issues.

And finally, timing is absolutely essential. We need cross-border rules that are right and not just rapid. We are strongly urging U.S. regulators not to enforce rules that will obstruct cross-border business before solutions for cross-border transactions have been finalized. The CFTC is intent on introducing its rules where the SEC's intentions in the same field are still unknown to us. Regulatory certainty is simply not available internationally. And a well known saying goes if you want to do something fast, you do it alone; if you want to do something right, you do it together.

So concluding, if we don't reach agreement on a sensible cross-border approach, then conflicts, inconsistencies, and gaps will persist. Trades won't take place. It won't be cleared. It will be reported in a fragmented way. Companies in our economies will not be able to hedge risks they have to hedge to do business, commercial or financial. And to quote a historian we all know well, Tacitus, "They created a desert and then called it peace." That is what we want to avoid here. We need to do this together, the right way.

Thank you for listening to me.

[The prepared statement of Mr. Pearson follows:]

PREPARED STATEMENT OF PATRICK PEARSON, HEAD, FINANCIAL MARKET INFRASTRUCTURES UNIT, INTERNAL MARKET AND SERVICES DIRECTORATE GENERAL, EUROPEAN COMMISSION, BRUSSELS, BELGIUM

Chairman Conaway, Ranking Member Boswell, and Members of the Subcommittee, thank you for inviting me to testify at today's hearing.

My name is Patrick Pearson, and I am the Head of the Financial Market Infrastructures Unit at the European Commission. The European Commission is responsible for the preparation and enforcement of legislation in the European Union. The European Parliament and the Council are responsible for the final enactment of that legislation, while the European Commission, together with the European Securities Market Authority (ESMA), has direct rulemaking powers in technical areas and in determining the 'equivalence' of the rules of foreign countries.

The financial crisis exposed serious shortcomings with respect to the OTC derivatives market which amplified shocks and impacted our economies in several ways. Collateral calls generated by sharp movements in the mark-to-market value of the OTC derivative trades drained liquidity buffers and provoked the fire sales of assets. Second, the bilateral nature of the OTC derivatives market—between the two parties to the contract—be it dealer and customer or dealer and dealer-created its own set of difficulties. When counterparties became concerned about the health of a particular dealer, they moved their business and collateral with them, which worsened the funding crunch in the market. Third, when a large counterparty, Lehman Brothers, filed for bankruptcy, it could no longer meet its obligations. Open OTC derivatives positions with its customers were frozen, which created large problems for Lehman's counterparties. Fourth, the opaqueness of the OTC derivatives market made the situation much worse because no one had clear insight into the financial health of their counterparties. Because there was no easy way to know who was in difficulty or not, the incentives were all on the side of assuming the worst—closing out open trades, hoarding liquidity, and retreating to the sidelines.

The crisis made it crystal clear that the regulatory regime had not kept pace with the rapid growth of the global OTC derivatives market. In assessing the shortcomings of the OTC derivatives market after the crisis, a global consensus has been reached. The United States and the European Union showed genuine leadership in pushing for this global consensus.

Standardizing trades improves transparency and price discovery. This mitigates the opaqueness that helped to generate the illiquidity and loss of market function evident during the crisis. Clearing such trades through CCPs reduces the aggregate amount of risk in the system. In a CCP framework, the bilateral exposures of each dealer to one another are replaced by a single set of claims to and from the CCP. Inserting a CCP in between two counterparties to a trade reduces the run risk faced by a potentially troubled dealer. If trades with the dealer are cleared through a CCP, direct exposures to the dealer are eliminated and replaced by exposures to the CCP itself. Mandatory reporting of trades to trade repositories is designed to ensure that the details of each contract are preserved and available to the regulatory authorities. They will have a full overview of risk in the system. Finally, the fact that CCPs will be central to the system dramatically increases their importance. In essence, global CCPs will be systemically important. Thus, for the system to be safer, it is necessary that CCPs be as safe as the United States Bullion Depository. They have to have the ability to perform and meet their obligations regardless of the degree of stress in the financial system and even if one or more of their participants were to fail in a disorderly manner. Hence, there is a compelling need for tougher principles that are broadly enforced.

These derivative reforms involve a significant change in regulation, covering both the regulation of firms (legal entities) and the process for entering into and performing individual derivative transactions.

The U.S. and the EU have been working in parallel over the past 30 months to adopt the necessary legislative reforms to achieve these common goals. The U.S. adopted the Dodd-Frank Wall Street Reform Consumer Protection Act in July 2010, including some 80 pages (Title VII) on derivatives reform. Two months later, in September 2010, the European Commission adopted its legislative proposal to introduce similar reforms in the 27 Member states of the European Union. This legislative proposal—the European Market Infrastructure Regulation (EMIR)—which runs to some 60 pages was adopted by the European Parliament and the Council last July. It entered into force last August. As in the U.S., many detailed implementing rules need to be in place to specify the technical details of the legislation. In the U.S. the CFTC and the SEC are advanced in this process. The EU will adopt its technical implementing rules before the end of this year.

The European Commission has worked closely with the CFTC and the SEC over the past years. Staff have held many meetings, sometimes even on a weekly basis, to understand and discuss the thrust and details of our respective approaches and draft rules. Wherever possible we have attempted, often successfully, to align our approaches to avoid discrepancies. The Chairman of the CFTC and European Commissioner, Michel Barnier, have met in Brussels and Washington to discuss derivatives reform on a number of occasions. This has been a very useful process of international cooperation.

Nevertheless, there remains one key area where we believe further work is required to deliver reforms that will meet our common objectives. Our respective rules must also work on a cross-border basis.

This is important because the $640 TR OTC derivative market is global. The Euro or the U.S. dollar are the most important underlying currencies used for OTC derivatives. The global nature of OTC derivatives markets, with the two counterparties to transactions frequently located in different jurisdictions to each other, or in a different location to the infrastructure being used, makes the effective and consistent regulation of cross-border activity crucial.

We need rules that work not only for regulators and market participants in a national jurisdiction, but also in a cross-border environment and *between* jurisdictions. OTC derivative reforms that are consistent and coherent within a single jurisdiction can have adverse impacts when they apply to cross-border transactions. This is so even where the different jurisdictions involved have apparently similar rules. Cross-border application of multiple rules will inhibit the execution and risk management of cross-border transactions. Recent detailed analysis of U.S. and EU rules has identified numerous potential conflicts, inconsistencies and gaps between our rules that should be addressed through mutually acceptable solutions. Failure to address these issues will render many of our collective reform efforts to reduce risk in the system obsolete.

By way of example, it is possible that two parties to a transaction may be required to trade in different venues, clear on different CCPs or report to different trade repositories. Trades would be subject to mandatory clearing in one jurisdiction and to margining requirements in another jurisdiction—this is particularly relevant for corporate end-users.

In order to achieve the effective and consistent implementation of our objectives, 2 weeks ago international Treasury departments, regulators and central banks meeting in the Financial Stability Board insisted on international coordination on the cross-border scope of regulations and cooperation on implementation in order to avoid unnecessary overlap, conflicting regulations and regulatory arbitrage.

To be more precise, 'scope' is the root cause of many cross-border problems that we have identified. We have significant concerns with proposals from the CFTC that would extend the territorial reach of its rules to counterparties outside the USA. This will create conflicts and undue burdens for market participants. The scope of persons who are subject to the application of our respective rules and regulations should be defined in the most narrow manner possible and be based on the establishment of the counterparty in the territory of our respective jurisdictions, where those jurisdictions have comparable and consistent requirements. What is important is that all the counterparties in two jurisdictions be subject to the requirements we all agreed to in the G20 to ensure global safety. This is better done by ensuring comparability of rules than by over-extending the reach of national rules. What ultimately matters is where the counterparties to a transaction are established, not the location where that transaction is concluded.

The principles of 'recognition', 'equivalence' or 'substituted compliance'—as referred to in our respective jurisdictions—are important underpinnings of a cross-border regulatory system. 'Substituted compliance' will avoid the application of multiple rules to the same entity or the same transaction. Appropriate deference to foreign regulations is the most effective means of achieving our shared goals. We applaud the CFTC for proposing to rely on substituted compliance in the application of its OTC derivative rules. We agree that where different requirements achieve the same objectives market participants, intermediaries and infrastructures should be subject to one set of rules for their cross-border activity. We also believe that the CFTC is too modest in the way it proposes to use substituted compliance; it should be applied more broadly. We believe that the following key points should be applied by the U.S. regulators:

First, regulators should apply substituted compliance between a domestic and a third-country counterparty established in a jurisdiction with comparable and consistent requirements, and should not seek to restrict this only to transactions between two non-domestic counterparties. The former situation reflects the area where the large majority of conflicts and inconsistencies exist between our rules. It is therefore necessary to apply one set of rules to such transactions to ensure legal certainty for cross-border transactions;

Second, substituted compliance should apply to *transaction* level requirements between counterparties in different jurisdictions, and not only to entity level requirements as U.S. regulators have suggested. Where transaction level requirements are comparable, counterparties should e able to discharge their obligations by complying with one set of requirements. We believe that the CFTC has the statutory powers to do this, and has even done this in the past in other areas of its rulemaking.

Third, foreign infrastructure which is subject to comparable requirements in its own jurisdiction should not be required to comply with domestic requirements in order to service the domestic market. Agreement on this is essential to ensuring clearing obligations can be complied with in respect of cross-border transactions.

We also believe that registration should be required only in respect of those jurisdictions that lack comparable and consistent requirements. To the extent that registration is unavoidable, it should be combined, from the very outset, with recognition/substituted compliance in order to limit as far as possible any legal complications and burdens. Market participants must be afforded absolute certainty ahead of any registration in respect of the consequences if they apply for registration. However, the registration approach suggested by the CFTC has serious shortcomings. Foreign Swap Dealers would be required to register without knowing with sufficient certainty the complete set of rules that will bind them as a consequence, and how those rules will be applied in an international context—including how substituted compliance will work. A possible waiver or no action letter could provide solace. However, this will only delay, but not eliminate the problem. Even if registration only triggers certain trade reporting requirements, lack of substituted compliance could immediately create issues in terms of conflicting requirements. For example, conflicts with data privacy and data protection considerations in national and European law may well arise. We cannot put firms in the impossible position where they are forced to choose between breaching either U.S. law or EU law. Applying a registration requirement to EU firms without up-front clarity about whether and how substituted compliance will apply will do precisely this.

Finally, timing is essential. We need the right cross-border rules, and not just rapid rules. We would strongly urge U.S. regulators not to enforce rules that will obstruct cross-border business *before* any solutions for cross-border transactions have been finalised.

If we do not reach agreement on a sensible approach to applying our rules on a cross-border basis, and entities and particularly transactions are not subject to full substituted compliance, then conflicts, inconsistencies and gaps will persist, and we believe that trades will not take place, will not be able to be cleared and will, at best, be reported in a fragmented manner to repositories. In short, firms in our economies will not be able to hedge risks, commercial or financial, and our common objectives agreed in the G20 will not be met.

The European Union is committed to creating an appropriate regulatory framework for OTC derivatives that provides comprehensive oversight, ensures systemic stability and promotes market transparency. The EU, like the U.S., is in the final stage of implementing the rules to achieve these policy objectives. We are also committed to working with you and other market participants to ensure that our rules work on a cross-border basis. We look to the U.S. to work with other jurisdictions to achieve our common objectives.

Thank you, Chairman Conaway and Ranking Member Boswell. I appreciate the opportunity to testify, and look forward to your questions.

The CHAIRMAN. Thank you, Mr. Pearson.

We have been joined by the Chairman of the full Committee, and I would recognize him for 5 minutes.

OPENING STATEMENT OF HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM OKLAHOMA

Mr. LUCAS. Thank you, Mr. Chairman, and I apologize to the Chairman and the Ranking Member and our panel here today, lots of things going on. At various points recently, I sort of feel like a derivatives regulator with all of the stuff swirling around me. That said, I appreciate the Chairman holding this timely and important hearing to examine the real challenges that are facing both the U.S. and international regulators as we attempt to balance the various reforms across the global marketplace. And I hope that we can all agree that reforming the OTC derivatives marketplace is a global effort—as has been alluded to by our panelists—that demands genuine coordination, not the appearance of coordination. If due care is not taken to complement the regulatory structures across foreign jurisdictions, we could seriously jeopardize the efficiencies currently found in the global market whose nominal value well exceeds $600 trillion—yes, trillion dollars.

And Ms. Sommers, I want to congratulate you and thank you for addressing numerous cross-border issues at the Commission's Global Markets Advisory Committee on November 7. I share many of the concerns echoed at that meeting. And Commissioner Chilton, I appreciate you testifying today and look forward to hearing, as we have heard, your views. I also want to echo my thanks to Mr. Kono and Mr. Pearson for taking time out of their extremely busy schedules to travel literally thousands of miles to testify before the Committee. I think that fact alone should demonstrate that the rest of the world is serious about getting derivatives reforms right and the United States should reciprocate that level of concern.

And it is my hope that today's hearing will continue to foster genuine dialogue and actual sincere coordination between the U.S. and international regulators. Without proper coordination, American end-users will face higher costs because it will cost more or be impossible for some of them to access the global markets to manage risk.

And finally, we must remember the United States was the first nation in the world to enact derivatives reform legislation, and as the first-mover on reform, we cannot take an approach that is substantially more restrictive than foreign jurisdictions or U.S. institutions will cease to remain competitive around the world. This is a result we cannot and must not allow to happen at any cost.

With that again, I thank the Chairman and the Ranking Member. I yield back and look forward to some fascinating questions.

The CHAIRMAN. I thank the Chairman.

The chair would remind Members that they will be recognized for questioning in the order of seniority for the Members who are here at the start of the hearing. After that, Members will be recognized in the order of arrival. And I appreciate the Members' understanding.

I now recognize myself for 5 minutes.

Again, thank you for coming this morning.

As we talk about trying to harmonize across international borders, I am very troubled by the fact that the SEC and the CFTC can't issue a common *U.S. persons* definition. It is my understanding that you can have the circumstance where you would be a U.S. person for swap dealer standpoint and a non-U.S. person for a securities swap. It makes no sense. Is there some law that prevents the CFTC from issuing a joint rule or joint guidance that would at least harmonize on our side of the various oceans? Either one, Ms. Sommers or Mr. Chilton.

Ms. SOMMERS. I don't think there is anything certainly that prevents us, and I want to stress that we have been coordinating with the SEC all along. There are just fundamental differences in both Commissions' approach to the cross-border issues.

The CHAIRMAN. But do those fundamental differences mean we will in fact have two separate definitions that the world will have to deal with——

Ms. SOMMERS. Right. That is right.

The CHAIRMAN. There is no common ground that you can come to?

Ms. SOMMERS. There is common ground and I believe that the staff is still working to come to a common agreement on those issues, but right now, we are not there.

The CHAIRMAN. Yesterday, Chairman Gensler told the Financial Services Committee to expect to have some additional rules by the end of the year. I am not sure how the Commission works, if the Chairman has unilateral authority and each Commissioner does as well, but are you aware of these pending changes or things that will be done at the end of the year? And will that include a narrowing of the definition of *U.S. persons?*

Mr. CHILTON. I am not sure about the narrowing, Mr. Chairman, but the process is a little different than just a regular rule that we do as part of Dodd-Frank. This is the final exemptive order that we have been sort of talking about, moving things out for some time certain. But it could be narrowed and that is what I called for here in my testimony—ensuring that if you are a U.S. affiliate in a foreign country—so you are U.S. bank XYZ but you are in another country—that you wouldn't have to be required for this time period certain—6 months, 5 months—to register, nor would anybody doing any business with you. A foreign swap dealer, for example, would have to register. So I am hopeful we can narrow this down as you suggest.

And one thing if I might, Mr. Chairman, is that one of the problems that we have had this—and I take Congressman Scott's point—a lot of times this has not been graceful what we have done by any stretch of the imagination. It has been a little messy. But we have tried to accommodate things as we have gone forward. We had some compliance deadlines on October 12 and it was sort of a mess leading up to that. We have all these questions, a couple hundred questions, letters from people. We finally got it dealt with but it was not pretty. So I am hopeful that we don't end up in that circumstance this year, Mr. Chairman, at the end of this year. And certainly, if we haven't given an answer to somebody when they have requested guidance, I cannot imagine and I would not be supportive of the agency taking any action against such a firm.

The CHAIRMAN. The mechanics of a 6 month extension is a blanket extension or each individual entity has to request the extension? What are you contemplating?

Mr. CHILTON. The Commission could do it and we could do it blanket, and what I am suggesting is a 6 month window on compliance so nobody would have to comply for 5, 6 months, whatever the time period would be.

The CHAIRMAN. My professional background as a CPA, we have a similar issue with respect to 54 jurisdictions in the United States, all of them wanting to regulate CPAs differently. The regulatory agencies, all 54 of them and the CPAs, came together and created a Uniform Accountancy Act, which was the standard by which everything would be judged. And if your state laws met the standards of the UAA, then your CPAs could practice wherever they wanted to. Is the International Organisation of Securities Commissions, Mr. Kono, an appropriate body to create that standard, a uniform Act, on which all the jurisdictions could look to when they are putting theirs together so that they would have this substituted equivalency—or we called it substantial equivalency in the accountancy world—to alleviate some of these cross-border things? Is that the organization to do that?

Mr. KONO. Thank you, Mr. Chairman.

First, I should mention that IOSCO has certainly been effective in developing standards in certain areas, and particularly, those standards pertain to, for example, the rules that countries should apply or are recommended to apply with respect to mandatory central clearing, to data reporting, to other aspects of OTC derivatives reform.

Having said that, those are standards that will have to be implemented by national governments and supervisors, each within their powers and within their mandates. And therefore, when it comes to coordination across different implementation schedules, different rules being implemented in countries, this coordination will have to take place amongst the regulators and supervisors. And IOSCO could certainly facilitate that process, but IOSCO is not necessarily a place where we can take decisions that will be enforceable upon governments. I think we have——

The CHAIRMAN. Okay. Yes, I understand that you can't do it on their behalf, but if they had to go by documents that put their rules in place that comported with those, then they would meet the equivalent standards that would allow for the recognition of their regulatory scheme by the U.S.

Thank you.

Mr. Scott for 5 minutes.

Mr. DAVID SCOTT of Georgia. Thank you very much.

Let me start with Mr. Chilton and Ms. Sommers. Again, welcome. But before I do that, let me ask unanimous consent that we submit this statement for the record from the Americans for Financial Reform.

The CHAIRMAN. Without objection.

[The information referred to is located on p. 77.]

Mr. DAVID SCOTT of Georgia. Thank you, sir.

As you know, Commissioner, the temporary relief that you all approved on October 12 will expire on December 31, and that threatens a repeat of the business losses we saw in October. Will the CFTC act well in advance of this date to provide certainty and clarity for market participants and customers? It certainly seems that something definitely needs to be done. The date December 31 is rapidly approaching; it is about 2 weeks away.

Ms. SOMMERS. Unfortunately, as you know, we are already at December 13. I think it is both my hope and Commissioner Chilton's hope that we have something that is clear and that clarifies all of these issues for market participants within the next week.

Mr. DAVID SCOTT of Georgia. All right. And Commissioner Chilton, earlier this year, you gave a speech where you provided an estimated timeline for the implementation of Dodd-Frank rules, and you suggested that cross-border guidance be finalized by June 2013. But is this when you expect the CFTC to vote on the measure?

Mr. CHILTON. I would hope that we could do it now, like ASAP, Congressman, and then have the compliance delayed until June 1 or perhaps July, whatever make sense. I am not a stickler on whether or not it is a month or so. As I said, I am not sure that that makes everything super graceful, but it will help. When I talk with the financial firms, part of the concern is that it is disjointed. It is like Chairman Conaway was saying, people are going at different rates and speeds, and so if we do it at the same time when there is sort of a date certain, that will help at least.

Mr. DAVID SCOTT of Georgia. All right. Mr. Kono, let me ask you. During the SEC's Global Market Advisory Committee meeting on November 7, you stated that some firms outside the United States have started to decline transactions with the United States companies because of the uncertainties in the rules and the apparent lack of coordination between regulators. And indeed, I think this is what we saw in October. But in your current observations, have U.S. regulators taken sufficient action to clarify this uncertainty?

Mr. KONO. Thank you very much for your question. I think that since then, we have been doing our utmost efforts in actually providing more clarity to our market participants, and of course initially, there was this reaction of wait-and-see. But now, I can testify that Japanese financial service providers are able and willing to conduct normal business with their U.S. counterparts once, of course, the rules become a clear and they are made known to them. I think there is still some work to be done in that respect so the uncertainty is being removed, but we still have some more work to do.

Mr. DAVID SCOTT of Georgia. Thank you very much.

Mr. Pearson, I found your testimony to be very revealing and very consequential. I think it would be important to get a reaction from your recommendations from Ms. Sommers and Mr. Chilton in your efforts on this whole issue of cross-border extraterritorial. You stated your recommendations and major concerns were scope, registration, and timing, and you sort of laid the gauntlet down to challenge our regulators. And so Mr. Chilton and Ms. Sommers, how do you react to what he said and do you accept the challenge and the recommendations that he has offered? Or do you find any problems with adhering to those?

Ms. SOMMERS. Congressman, I think that the difficulty for us right now in working with our global counterparts, as I alluded to in my testimony, is not just substance. There are issues with regard to substance that we continue to work on, but because the United States is requiring compliance with the Dodd-Frank rules that we have already finalized, it adds an enormous amount of challenges to firms who are trying to operate. Without knowing how we are going to apply Dodd-Frank extraterritorially, asking people to comply is where the problem is. So we are hopefully going to be able to issue some type of relief to both foreign and domestic swap dealers within the next week, and I think that is where the agreement that at least I have and I believe Commissioner Chilton has with Mr. Pearson's testimony. We do believe that that relief needs to happen for compliance while we are working out all of these details before we can all come to the same place and coordinate on all these rules.

Mr. DAVID SCOTT of Georgia. Thank you very much.

The CHAIRMAN. I thank the gentleman.

I ask the Committee's indulgence to recognize the Chairman of the full Committee for 5 minutes.

Mr. LUCAS. And I appreciate the Chairman and the Committee's indulgence.

Commissioner Sommers, on or before October 12, the CFTC issued a number of staff no-action letters and interpretations to address many of the outstanding concerns and uncertainties surrounding implementation of its new derivative rules. Are the four other Commissioners outside of the Chairman's office consulted by CFTC staff on no-action relief letters or exemptive orders prior to their release?

Ms. SOMMERS. Well, I think this process has been overwhelming for all of us. The answer would be sometimes we are and sometimes we are not. Certainly, before October 12, there were dozens of no-action letters that we issued and we are in the same place now before the end of the year because these compliance statutes are kicking in. We have had dozens of requests for additional pieces of no-action relief. These are issued by staff. The no-action letter is saying that staff has agreed to not take enforcement action against these entities for not complying with issues. Sometimes the Commission is aware of those requests and sometimes we are not.

Mr. LUCAS. But in the aftermath, the Commissioners all see these documents?

Ms. SOMMERS. We do see the no-action letters, yes.

Mr. LUCAS. Yesterday, at the House Financial Services Committee meeting, Chairman Gensler was asked about the cost-benefit analysis performed by the Commission on cross-border guidance, and he asserted that it had in fact been done. Are you aware of any such analysis?

Ms. SOMMERS. There is a cost-benefit analysis within a proposed exemptive order that is circulating within the Commission right now. There is a cost-benefit analysis within that document.

Mr. LUCAS. Well, let me ask this question then. The Chairman asserted that he had approximately 40 different cost-benefit analyses on different rules. How many of those analyses have been shared with you, or Mr. Chilton for that matter?

Ms. SOMMERS. Typically, they are included within the drafts of the rules. There is a cost-benefit analysis included. It differs certainly with regard to how thorough those analyses are.

Mr. LUCAS. Mr. Kono, what do you say to reports that foreign firms stopped doing business with U.S. firms for fear of being swept up in the U.S. regulatory regime?

Mr. KONO. Thank you very much. I think it is fair to say that insofar as the Japanese financial service providers are concerned, they are willing to comply with U.S. rules once they are, of course, made transparent and also that they are given enough time to comply. And I don't think that anything would lead us to think that all of the requirements will be too onerous for foreign providers to comply with; it is just that we need more transparency.

Mr. LUCAS. But it is fair to say that foreign firms are concerned about how this process will evolve?

Mr. KONO. They are reasonably concerned, but at the same time, they do register recent progress and I mention that. Thank you.

Mr. LUCAS. Mr. Pearson, what are some of the potential consequences that would result from conflicting swap dealer regulatory regimes if you would expand on your testimony of course?

Mr. PEARSON. Congressman, the results and consequences that we have been able to analyze is that depending on the conflicts between the rules and requirements of the United States and the 27 countries of Europe, trades will not be able to be cleared. If they can't be cleared, they won't take place. This means that firms, end-users will not hedge their risks; or firms will hedge their risks but they will only take place within one jurisdiction, which means that risk will be concentrated in one jurisdiction on the planet. That could be the United States. If your firms can't hedge their risks outside of the United States, they will have to hedge them here. The consequences of that is obviously a fragmented market and a significant concentration of financial risk in the U.S. system. And this is exactly what we tried to prevent with our global regulatory reform.

Another consequence is that perhaps firms that will be able to conclude a contract but it is not clear which rules apply to that contract. If it is not clear which rules apply to the contract, you run obviously legal risk. Which rules do you apply; which rules do you not apply?

A third consequence is that a contract might be able to be concluded, but the contract is reported for regulatory purposes to different jurisdictions and different swap data repositories. This means that the regulators and the governments will not have that overview of this important and significant market that we wanted to have. A global overview aware of the risks, who is bearing the risks, which financial firms in our economies are exposed to those risks? So that means that none of the objectives we tried to agree on in the G20 will be met.

Mr. LUCAS. Thank you, Mr. Pearson. And I appreciate the indulgence of the Chairman and the Ranking Member and yield back the time I do not have.

The CHAIRMAN. Thank you, Mr. Chairman.

The chair recognizes Mr. Courtney for 5 minutes.

Mr. COURTNEY. Thank you, Mr. Chairman. And I really again appreciate the fact that you have organized this hearing on Dodd-Frank implementation, which unfortunately Congress hasn't been around much the last couple months and a lot of things have been happening. And I apologize to some of our guests here from outside because I did want to focus on another issue which you have been grappling with.

Again, I think the last time the two Commissioners appeared before this Committee, gas prices were about $4.25, $4.30 up in New England. Today, they are about $3.50, $3.40. I think Rhode Island is $3.30. Obviously that is a pretty dramatic drop, about 20 percent. End-users that I talk to, whether it is farmers, oil delivery guys, the cynicism with which they regard this market that is seeing this type of swing—I realize refineries were offline and now are back online. I mean there are some things that actually happened in the real world that might explain some of it, but the fact is is that nobody really believes that that drastic a drop can be explained by real market factors.

And Dodd-Frank had a specific provision, and Commissioner Sommers, the language from Congress, which you eloquently talked about in your remarks, could not have been more crystal clear about the dictate to the Commission to put some position limits in almost a year ago. And obviously the court decision was a big disappointment that came down. Again, I would appreciate it, Commissioner Chilton, if you could give us an update in terms of where we stand regarding the legal case and where the Commission stands in terms of trying to address this.

Mr. CHILTON. Thank you for the question and thank you for your leadership, Congressman, on that particular issue, speculative position limits. The agency has appealed the district court's decision, yet staff is currently working—and we haven't seen a draft yet—on yet another rule. It is a little bit in the weeds. I will try to make it sort of high level. The court said that we have two authorities. We have the Dodd-Frank authority to establish speculative position limits, which we used. The court just said we should have explained why we needed to use that. And the law was pretty clear to me. I mean it said the agency shall establish appropriate position limits. But the case went to the word *appropriate*. What is appropriate? The court said, well, you should say why you are doing it, what is appropriate.

The second authority that the judge said that we have, which we know we have, is a 1936 authority, and so I believe that the rule that we propose, yet another rule—so the appeal is going along at one rate and then the other rule that I hope we will approve sometime in the first quarter of the year—we will use both the 1936 authority and the Dodd-Frank authority. It will have the added benefit, this rule I hope, of doing an improved cost-benefit analysis, which was one of the other challenges in court. When we did the cost-benefit analysis, we did it based upon the information we had from market participants, but it wasn't very detailed because they didn't know. Now, because all of this was supposed to happen October 12, they know how much it costs them, so I am hopeful that our rule will also include a better, more improved cost-benefit analysis.

Mr. COURTNEY. Well, thank you. And I would just say this, again, with two Commissioners here. You know, for people who we go home and try and explain what is going on in Washington to deal with this issue, which again just goes to the heart of our economic recovery. Whether it is a nurse going to work in the morning who is dealing with high gas prices or a small business who is trying to stay ahead of this, the inability of us to even explain what the heck is going on and what is being done about it, again it just puts everyone in an impossible position. And frankly, the fact that the Commission appears to be divided in terms of even a decision of whether to file an appeal is very disappointing because just at some point what we are talking about here is not about sort of your job; it is about people's jobs every single day out there in the real economy. And they are counting on you to do something.

And again, this is one of my last appearances in this Committee because I am going to be moving on in the next Congress, and I just, again, appreciate the Chairman's focus on this issue because it really does go to the heart of whether or not we are going to have a real recovery. And what you do, which is not that well understood out there in the public, is just critical. So please, when you are looking at these issues—Dodd-Frank didn't happen because people just wanted to create some regulatory structure. There was a real need in terms of what happened in 2008 and it is still going on today.

I yield back.

The CHAIRMAN. The gentleman yields.

The gentleman from Iowa, Mr. King, 5 minutes.

Mr. KING. Thank you, Mr. Chairman. And I thank the witnesses for their testimony, especially those that came the furthest to provide that input to us today.

I would first turn to Ms. Sommers. And I noted in your testimony that you referenced Section 722(d) and I believe that you said that the Act shall not apply to activities outside the United States unless those activities have a direct and significant connection. And you referenced that it needs both. And it is the implication that—and I don't know if I heard it clearly—you believe the rules that are being written today are reading that as direct or significant or how would you describe that to me?

Ms. SOMMERS. Congressman, the CFTC put out a proposal for interpretive guidance on cross-border issues in June of this year, and that proposal suggested that if a swap had a direct connection to the United States, it should be regulated under Dodd-Frank. So the significant part of that definition in my opinion was not considered appropriately.

Mr. KING. They interpreted the word significant to be insignificant, then, in other words?

Ms. SOMMERS. Yes.

Mr. KING. Thank you. And Mr. Chilton, I listened to your testimony in your recommendation that we not require compliance for

6 months but it does say they finalize the rule as soon as possible. That is generally how I hear it. And so if that is the case, can you tell me how close we are going to be in conformity with foreign regulators? Do we have a sense of that at this point? I know you said we are within 6 months, but I don't know how far apart the regulations might be.

Mr. CHILTON. On the issues, sir, yes. We are closer than some might think. I mean there are still some differences and I am hopeful that also during that transition period that they actually get closer. Now, when I say that, we will have pretty much done most of ours but we still will have things that we call interpretive guidance and we do Q&A's for people, and we will still work with foreign regulators. I stated earlier that everything we have done hasn't necessarily been graceful—but we have shown that we can sort of turn around and when we make a mistake, we certainly hear about it. You guys hear about it, and then we hear about it from you all. So if we make a mistake, we can fix it. I am committed to doing that, but so far I think that this delay that we have had, Congressman, has actually led us to a place that is much better. I thank you for the guidance to go slow at times. I think you guys were right. And to me, where we are now is much better a place than I thought we would have anticipated even 6 months ago. We still have a ways to go.

Mr. KING. Who needs to move more, foreign regulators or us as regulators?

Mr. CHILTON. Well, I think we have struck a pretty good balance, Congressman, and so I am not so sure that we need to move much. Now, on the compliance we definitely need to do that. And I think Commissioner Sommers and I are in lockstep on that. But I am pretty confident with where we are on the rules right now.

Mr. KING. And you heard Mr. Kono testify that he believes that we can rely on foreign regulators and you are comfortable with that testimony?

Mr. CHILTON. I am, particularly on the major things, the major reasons why Dodd-Frank was created, to avoid systemic risk, I mean, so that we don't have another $400 billion bailout. So if there is some big fish trader in London with a U.S. bank but he is in London and that can come back to haunt us and maybe our taxpayers with the bailout, we either have to ensure that the UK or the EU is regulating them or we have to do it. If they don't have a comparable regulatory regime, we need to protect our taxpayers by doing it.

Mr. KING. Okay, that is if there is a gap. But I will turn to Mr. Pearson and I recall your testimony, Mr. Pearson, that you said sometimes you have to decide which rules to break. What kind of input would you like to provide on the testimony you have heard since you spoke?

Mr. PEARSON. Thank you for the question. I think the knife cuts two ways. It is not really the question whether UK regulators expose U.S. taxpayers; we have faced exactly the same issue when European taxpayers were exposed to U.S. regulatory shortcomings—MF Global, AIG, Bernie Madoff. These are not European companies. So we are all in the same ship here. I think the point we are trying to make is that we have the same objectives. If we have the same rules and requirements, then we should be able to rely on the same rules and requirements. Where we don't want to be is to have the same rules and requirements which are slightly different to apply to the same actors and to the same contracts. That is an unworkable situation. The contracts simply will not take place and everybody will lose. Citizens will lose, companies will lose—they can't hedge their risks—firms will lose because firms will arbitrate and will shift and rebook their trades to other jurisdictions. Nobody wins. And that is where we need to focus our attention on.

Mr. KING. Thank you, Mr. Pearson. And I do think the word *significant* is significant.

And I yield back, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

And the lady from Alabama, Ms. Sewell, is recognized for 5 minutes.

Ms. SEWELL. Thank you, Mr. Chairman. I want to again thank Chairman Conaway as well as Ranking Member Boswell for scheduling this hearing today. You know, this hearing has really given us a chance once again to hear from witnesses and to discuss Dodd-Frank derivatives reform and some of the challenges that we are facing both in the United States and internationally. The 2008 financial crisis made it clear that regulators must have transparency in the global derivatives market in order to make educated policy decisions and to mitigate systemic risks.

As we continue to move forward with the rulemaking in the implementation process provisions of Dodd-Frank, I think we need to be really mindful of the original intent and the original purpose behind the passage of this essential reform. Dodd-Frank was intended to add more transparency and oversight to the financial markets and to ensure that another financial crisis, a meltdown if you will, doesn't happen again.

This is why I stood with a bipartisan group of Congress Members to introduce H.R. 4235, which is the Swap Data Repository and Clearinghouse Indemnification Correction Act of 2012. It was to help ensure regulators continue to have that transparency in the derivatives market needed to make those crucial decisions as to how to mitigate their risk. And it is my hope that this bill will come to the Floor in the very near future and be considered and passed by the entire body.

I want to applaud the diligent work that both the CFTC, as well as the SEC, has had in both drafting and implementing these critical new regulations. I know it is hard. I appreciate all that you all do to take into account all the various parties that are involved in trying to make sure that we have cogent and workable regulations. However, as Members of Congress, we must continue to provide importance guidance and oversight to both the agencies to ensure that there are no unintended consequences to the original purpose and intent of Dodd-Frank.

Additionally, many market participants, along with their regulators, continue to voice concerns over the very lack of rules and sufficient time to implement them. So this Subcommittee's hearing today is critically important.

I am a former lawyer. I worked on Wall Street for the first part of my career at Davis Polk & Wardwell and did securities law. I think that the indemnification issue is an important one. And given all the significant extraterritorial issues, my question really is to either one of the Commissioners. The CFTC, is it ever going to really support striking the indemnification requirement and promote a passage of H.R. 4235?

Ms. SOMMERS. Thank you, Congresswoman. I have supported that legislation publicly in the past, and I do think that the only way to really solve the problems with regard to those issues is a legislative fix. We have done everything we can in our rule to address the issue as far as our rulemaking ability, but I do think it needs a legislative fix.

Mr. CHILTON. Yes, I agree, Congresswoman. Thank you for your leadership on the issue.

Ms. SEWELL. There have been considerable debates around the intent of the Section 722 of the Dodd-Frank and the aggressive approach being taken by the CFTC to apply derivatives rules to the U.S. banks doing business overseas with foreign clients. I am concerned that the CFTC's application of section 722 and its expansive view of what is direct and significant connections with activities in and effect on commerce in the United States, what that means. And the proposed cross-border guidance misses the mark in many ways in really explaining and ameliorating that problem with the CFTC moving ahead to apply the Dodd-Frank rules abroad without real clear harmonization. And many international regulators are quite concerned about the conflicting laws for those entities. And I really wanted to ask you whether you thought that it would lead to greater conflict if not resolved, specifically Section 722?

Mr. CHILTON. Thanks, Congresswoman.

I think the issue really comes down to, ideally, what we would all like, is to allow for comparable regulation by foreign regulators, but we have no desire to have little CFTC deputy agents running around Brussels. It is just a matter of everybody coming together, which is why this timing delay is so critical so that we are all doing it sort of together.

There can be some sort of disagreement about what is significant. The Dodd-Frank Act was trying to get at the big things that were systemic risks that can bring down our economy, so I am hopeful that ultimately everybody will have their own regulations on the big things like systemic risk, capital, margin, those things, transparency like swaps data repositories. Those things, they need to be pretty close on the language—not identical but pretty close. And then there is a whole list of other things where they don't necessarily have to be so close. But on the key fundamental things, the things that impacted the entire global economy, those have to be fairly close together, at least that is my view.

Ms. SEWELL. Thank you. Thank you all for your participation in the hearing.

The CHAIRMAN. Mr. Scott for 5 minutes.

Mr. AUSTIN SCOTT of Georgia. Thank you, Mr. Chairman.

And I, like you, come from one of those highly regulated industries, and Mr. Chilton, I can't help but laugh when you say if the regulators make a mistake, they will fix it. And I wonder is being one of the regulators, at what cost to the regulated does that come?

But we are here today because this has an important impact on global trade. And 80 percent of the world trade is outside of the United States. Our trade partners, our global trade partners in general are also our allies when it comes to, in many cases, more difficult issues, and we need to make sure that this is implemented in a manner that doesn't hinder commerce.

I listened as Mr. Pearson talked about scope, registration, timing, and other challenges that still remain with regard to the rules. And I have listened to you, Mr. Chilton, say that we need to have these timing delays so that we are able to get on some of the same page if you will. Is that correct? Yet you contradict yourself when you say we are going to go ahead and pass our rule in the United States—this month as I understand it—but we are going to delay the implementation for 6 months essentially to give the rest of the world 6 months to come in compliance with the U.S.

Mr. CHILTON. Well, there may be a little minutiæ there that will save my potential contradiction, and that is we put out a proposal, Congressman. I believe it is fairly well done. It strikes a fairly good balance. But we do have an interpretive guidance and it does allow us to continue this dialogue, which Commissioner Sommers has been engaged in through the GMAC and the Chairman has been engaged in, so it doesn't mean that we can't move. It doesn't mean that this is it and there is nothing else that can be done. But look, in fairness, we were first. We have had some time to do this and the EU has been sort of playing catch-up and they have done a remarkable job. But we have a proposal out there and I hope people will continue to look at it and ultimately we will have comparable regulations across the globe.

Mr. AUSTIN SCOTT of Georgia. Mr. Chilton, with due respect, once it becomes a rule, it is no longer a proposal. It is no longer a proposal once you adopt it in December. Now, compliance with it, you can delay compliance for 6 months, but the bottom line is once you adopt that rule, firms must start to come into compliance with your rule, because when you turn on the compliance of it, they don't get 6 months from the date you turn it on; they get 6 months from the date you implement it to the date you turn it on. And if they are out of compliance on day two, then they are in trouble. And if you have made a mistake, you said you can fix it, but with all due respect, it will come at a tremendous cost to the people who are regulated and maybe to the U.S. economy because we——

Mr. CHILTON. Yes, I hope I am not talking past you, Congressman——

Mr. AUSTIN SCOTT of Georgia. You are not talking past me, I can assure you.

Mr. CHILTON. Okay. I didn't mean it as an insult. I meant that maybe I am not expressing myself correctly. So we have interpretive guidance. We are doing that all the time. I mean we are doing it on rules that were done a year ago. We continue to do that. And so my only point is not that the rule is not the rule when it is done, but there are things that can be done after the process and sometimes they will actually require amending a rule. A lot of times they can do it on a staff level. That was my only point, sir.

Mr. AUSTIN SCOTT of Georgia. Mr. Chilton, it is better to get it right the first time.

And Mr. Pearson, if I understand you, we still have scope, registration, timing, other things that are still to be discussed. And Mr. Kono, do you agree that those three things have not been resolved?

Mr. KONO. Thank you for your question. I think we are still very much in the process of addressing those issues. And in fact, I did talk about reliance on foreign regulators on this point. Of course, we are quite aware that we need to build an element of mutual trust before this can be done, particularly since we do understand the concerns that you have of those risks flowing back to the U.S. from abroad. On the other hand, to build this trust, we are determined to move forward and we would like to have some time for it.

Mr. AUSTIN SCOTT of Georgia. Yes, sir. And that is in the best interest of global trade is to give you that time. And my concern with the CFTC is they are going to do what they want to do regardless of whether this Committee says no or our trade partners, which are also our allies in military affairs, think that that is bad for global commerce.

And I guess I would ask one last question, Mr. Pearson. Would it make sense—and it may or may not; just think out of the box—that a trade that was placed in Euros that the European Union be the primary regulator of that trade since it was placed in Euros? In other words, should the currency that the trade is placed in matter with regard to who regulates it?

Mr. PEARSON. Thank you. The currency is a key issue but there are other leading points as well, and that is where are the counterparties established? U.S. counterparties between themselves can have Euro-denominated trades.

Mr. AUSTIN SCOTT of Georgia. Sure.

Mr. PEARSON. It would be out of the question—out of the question—for that very reason only that the European Union would seek to regulate that contract. And the problem is, well, that is exactly what the CFTC attempts to do with its June cross-border guidance. We do not believe that it is the right thing to do the moment that one U.S. party is a counterparty to a trade, then U.S. rules apply. It makes no sense and it is not in line with international comity, as Mr. Kono has said.

Mr. AUSTIN SCOTT of Georgia. Thank you, sir.

Mr. Chairman, I yield the time that I don't have.

The CHAIRMAN. I thank the gentleman.

Mr. McGovern for 5 minutes.

Mr. MCGOVERN. Thank you, Mr. Chairman. I apologize for being late.

I have a question, Ms. Sommers. I know it is a bit off-topic but it has been awhile since you were here to talk about MF Global and your investigation. When you testified here more than a year ago, you said in response to a question by my colleague Mr. Cardoza, "there will be policy changes that we will want to come to this Committee for your consideration." You also told Mr. Cuellar and Mr. Gibson that you would get back to the Committee with a comprehensive list of lessons learned from MF Global. Can we expect any policy changes or lessons learned from you before the end of this year?

Ms. SOMMERS. Congressman, thank you for that question. My delegation with regard to MF Global is solely with regard to the enforcement investigation. Chairman Gensler has taken a lead on the lessons learned from MF Global. We did issue earlier this year a package of rule changes to our own internal CFTC rules that had to do with customer protection, and many of those were part of the package of lessons learned from MF Global and were directly related to the incident that happened through MF Global. So I do think that the Commission has moved forward on that, but as far as lessons learned being submitted to the Committee, I am not sure if the Chairman intends to do that.

Mr. MCGOVERN. So is the enforcement investigation concluded?

Ms. SOMMERS. No, sir, it is not.

Mr. MCGOVERN. And do you think it will be concluded before the end of 2013 or——

Ms. SOMMERS. There is no way for me to speculate on when the enforcement investigation will end. I can assure you that we are working diligently on that investigation.

Mr. MCGOVERN. A few weeks ago our colleagues on the Financial Services Subcommittee on Oversight issued a report on MF Global.

Ms. SOMMERS. Yes.

Mr. MCGOVERN. Do you have any comments or thoughts on that report, and do you think its characterization of the CFTC's performance during the MF Global crisis is accurate or fair?

Ms. SOMMERS. I certainly do. It did reflect many of the important issues that we all, in hindsight, realized after MF Global happened.

Mr. MCGOVERN. Thank you, Mr. Chairman. I don't have any further questions.

Mr. CRAWFORD [presiding.] The gentleman yields back.

I am going to recognize myself for 5 minutes.

Mr. Pearson, yesterday, at House Financial Services, Chairman Gensler stated, "We are comfortable with substituted compliance if there are real rules over there." We seem to be speaking specifically about Europe, Japan, Australia, and Canada. And that is interesting for a couple of reasons. One, his words call into question his repeated assurances that he has given the U.S. Congress that he is coordinating abroad; and second, it raises the logical question of what are the standards by which the CFTC and Chairman Gensler will judge as a *real rule?* Your thoughts?

Mr. PEARSON. Thank you for the question. We went through the process of comparing 500 pages of Dodd-Frank and CFTC draft implementing rules with 642 pages of European rules. We have real rules, both jurisdictions, and we have worked closely with Chairman Gensler and the staff on this. The rules are there. The question is also are they comparable? In many cases they are. In many cases U.S. rules and European rules are comparable; in a lot of cases European rules are tougher than American rules. Example: DCOs or CCPs. This is where the risk will be concentrated on OTC derivatives, the handful of them on the planet: $640 trillion of risk will be concentrated in five entities. We believe that they have to be able to stand financial Armageddon. They need to be stronger than the U.S. bullion depository, Fort Knox.

The European rules are tougher, stricter than the U.S. CFTC rules on these CCPs, DCOs. Does that mean they are incomparable? No. It means we are following the same objective. We have differences in rules. We need to make sure that these rules work together. We need to make sure that U.S. firms, U.S. companies, U.S. financial firms can clear their trades in U.S. or in European DCOs, even if, as Mr. Chilton says, the rules are not identical, even if we go a bit further than the United States of America.

We have been working on this. The question is not what do the rules say? The question is are we willing to defer to each other's rules? And as I said before, Congressman, we believe the CFTC needs to defer more in the field of transaction requirements than they are prepared to do at this point in time. Otherwise, the system simply will not work.

Mr. CRAWFORD Okay. Let me follow up on that. You recently talked about the inconsistencies between European rules and the CFTC approach. You stated that "trying to regulate the cross-border rules verges almost on rocket science" and I can tell you this is a potential *Apollo 13* situation. The message is, "Washington, we have a problem." Do still think that Washington, or maybe better stated, the CFTC has a problem, and what would the major issues be that are unresolved?

Mr. PEARSON. Thank you. Absolutely. When I refer to Washington, I refer to *Apollo 13*. My knowledge of Hollywood films is not as extensive as those of Mr. Chilton. I will quote the Roman historians or Shakespeare, but that is where it stops.

Yes, we do believe we have a problem. We tried to resolve that problem as Mr. Kono made clear. Two weeks to the day we had a meeting in New York with international regulators. The problem is absolutely clear. There is no issue on the table that nobody understands. The question is to what extent are we prepared to accept that our rules are the same and to what extent are we prepared to defer to the rules of another jurisdiction where we have the same or similar rules and the same objectives? That is the problem. And the question is simply scope. Are we prepared to limit the scope of the extraterritorial application of our rules and requirements? In Europe we are.

In Europe we have a rule on the table that our parliament, our Congress has accepted. As it is said, we are prepared to defer European rules entirely and apply Dodd-Frank entirely in European Union if it works both ways. We need the CFTC to understand that we need, too, to go down that route. We cannot do it on our own. And that is where we need further work and further discussions, Congressmen.

Mr. CRAWFORD Thank you, Mr. Pearson. I am going to yield the balance of my time and recognize the gentleman from California, Mr. Garamendi, for 5 minutes.

Mr. GARAMENDI. Thank you. And since this is my first day in a Committee hearing on the Agriculture Committee, I will try to quickly catch up. And so if I cover some areas that have already been covered, my apologies to all.

I am trying to understand the territorial thing. It seems to me it can be worked out and is likely to get worked out here in the very near future. It is certainly in all of our interests to do so.

Mr. Chilton, in your testimony, you blew past an issue that I know that you are concerned about and that is high-frequency trading. Is there any information available today that high-frequency trading causes disruptions or inappropriate directions in the marketplace?

Mr. CHILTON. Thank you for the question and I look forward to working with you, Congressman, on the Committee.

The CFTC recently put out a report last week or the week before that showed that when high-frequency traders—these traders that I call cheetah traders because they go fast, fast, fast—that when they are in the market they tend to gain more when they are trading with a smaller trader or a passive trader. A lot of these guys are sort of commercial ag folks because these high speed traders are very, very quick. The argument on their behalf—on the cheetah's behalf—is that they provide liquidity to the markets, and that is obviously a good thing in general, but it is fleeting liquidity in that they are not there to hedge your bean or rice or corn crop for the season; they are there for 5 seconds and they are in and out of the market.

So there have been a lot of examples, Congressman, where we have seen extreme volatility where these cheetah traders are in the market. You can go back to a few months ago when we saw crude oil go down $3 in 60 seconds. That was in part because cheetahs were heavily in the market. So there are many examples. We have seen it. We have seen it in India recently. We see it in the stock market as you know. You have followed that very often when Kraft shifted to NASDAQ.

So I am concerned that there are some basic, prudent steps that need to be taken. They are not even required to be registered with us now, which means that we can't request their books and records. They are not required to test their programs. They are not required to have kill switches, and importantly, they are not required or we don't mandate that they stop what they call wash trading. That is when their trades bump into each other. They trade with themselves. And that is a big problem in my view. I can't really talk about the extent to which they do this cross trading, but I don't think that is good for markets. It is illegal and we need to do a better job of enforcing it, Congressman.

Mr. GARAMENDI. A quick question, maybe a quick answer. Does the Commission have the authority to deal with these issues?

Mr. CHILTON. We have a lot of authority to deal with it, but quite frankly, it has been like drinking out of a fire hose with Dodd-Frank. So it is one of the reasons that I raised this earlier as an issue for reauthorization because we still have another 20 rules to finish, and so I think that we haven't been able to focus on it like we should.

Mr. GARAMENDI. Excuse me for interrupting but I try to be obedient here as with regard to the clock.

Mr. Pearson, how about the view from the European Union on high-frequency trading?

Mr. PEARSON. Thank you for the question, Congressman.

Yes, we have seen the concerns expressed by Mr. Chilton. Our rules are currently in the making. They are not yet on the statute book, but the concerns express all the underlying issues that Mr.

Chilton has made. And again there is another example that we need to work on this together. We need similar rules in the United States as we would have in the European Union. It makes no sense to regulate these rules in this jurisdiction in a slightly different manner than in the European Union or any other jurisdiction.

Mr. GARAMENDI. So you are moving forward in the European Union——

Mr. PEARSON. Certainly, we are.

Mr. GARAMENDI.—to deal with these sets of issues?

Mr. PEARSON. We certainly are moving forward.

Mr. GARAMENDI. And perhaps the volume of the fire hose will diminish and the Commission can get to it here.

Mr. PEARSON. Mr. Chilton drinks from one fire hose; I have to drink from 27 at the same time, so——

Mr. GARAMENDI. I yield back my time. Thank you.

Mr. CRAWFORD The gentleman yields back.

Just real quick, Mr. Chilton, high-frequency traders, you referred to them as cheetahs.

Mr. CHILTON. Yes.

Mr. CRAWFORD Can I suggest maybe another name? That really kind of sounds bad. I know that you are making——

Mr. CHILTON. You can suggest it but it is in the lexicon now I am afraid, Congressman.

Mr. CRAWFORD Yes, that is too bad.

Mr. CHILTON. I am not saying cheaters, not like Boston card cheaters. I am saying cheetahs because they are fast——

Mr. CRAWFORD I understand.

Mr. CHILTON.—and scooping up micro dollars in milliseconds.

Mr. CRAWFORD I get it completely, but I just thought that might be an unfortunate choice of words, particularly in this environment, but that is another subject.

The chair recognizes the gentleman from New York, Mr. Gibson, for 5 minutes.

Mr. GIBSON. Well, thanks, Mr. Chairman, and I appreciate the panelists. It has been an illuminating dialogue here this morning. And I thought I would take advantage of this opportunity to perhaps get to a finer point on recommendations, hearing from Mr. Kono and Mr. Pearson. It certainly has been encouraging to hear that we share that we want to have more collaboration, going forward. I am interested in your recommendation, specifically with regard to process, what recommendations you have so that we achieve this goal of closer coordination. Mr. Kono first.

Mr. KONO. Thank you very much for your question.

First, we do have now a group of regulators from the major markets of OTC derivatives and we have agreed to have regular meetings and also to coordinate as quickly as possible on all of the aspects that have been discussed today. On the other hand, IOSCO, where I am now chairing the Board, can certainly provide its support to this process, and in the past, IOSCO has been developing related standards with respect to cooperation and enforcement. There is what we call an MMOU, a Multilateral Memorandum of Understanding, which enables regulators to exchange information when necessary in the course of their enforcement actions. I think this can be further extended and we also should have more signatories to this MMOU in all those respects. So certainly regulators can do better in terms of making use of such international forums and also working closely together.

Mr. PEARSON. Thank you, sir. I will process three points. The first is that we actually need to agree that there is a problem. It doesn't make a lot of sense sitting around the table if some of or one of the counterparties is in denial and says there is no problem because either I disagree or I don't have the time to work through the problem with you.

The second thing is to work through what the problem actually is, and that means time. This is very, very, very complex. And if we get it wrong, we will get it horribly wrong. And we are drafting history here for the global market so we need the time to work it through and accept that there is a problem. If there is a problem, there is a solution and that is a solution that has to work for everybody around the table.

The third point is registration. A delay of the impact of registration doesn't help. You simply delay the problem but you don't eliminate the problem. If anybody thinks we can eliminate the problem of registration within 6 months, I am happy to sign up to that. But what sense does it make to require firms around the planet to register if you can't tell them what the consequences of registration will be and this gamble on solving this within 6 months. I dearly hope you will be able to solve it in 6 months but I sure would like to have some up-front clarity about that for our firms outside of the United States of America, sir.

Mr. GIBSON. I appreciate that. And I would like to hear Mr. Chilton and Ms. Sommers' reactions specifically to those points.

Mr. CHILTON. Thanks, Congressman.

And let me just restate with a dialogue I was having a little bit earlier. I am not suggesting that our proposal was perfect or shouldn't be tweaked in some manner. I am just saying that I think we will get to it before the end of the year. So when I was having this conversation about what we can do, guidance, *et cetera,* I am not suggesting we shouldn't make some changes and we are working on that right now on some of the changes internally. But I don't disagree with Mr. Pearson at all. I think it makes a lot of sense and I agree with about everything he says, that it could go horribly wrong if we don't coordinate. We don't want regulatory arbitrage. That is the big negative to me of us going too far too fast is that companies will migrate to nations with the thinnest of rule books, with less rules. That is not what Dodd-Frank wanted. Congress wanted to make sure that we protected the U.S. economy from a big bailout, from systemic risk, to add the transparency. So that is the main goal. We have to keep our eyes focused on that and realize that if it is going to take a few more months to get it right, that is certainly worth the wait.

Mr. GIBSON. Okay, so just to make sure I heard you correctly, with regard to problem, definition, time, and registration, and notwithstanding earlier comments about ballpark figures in terms of when you would publish, you feel it is important to address these points and to get that right before you publish?

Mr. CHILTON. Absolutely, Congressman. Now, when I talk about guidance, there may be things that we don't anticipate because we didn't understand this, as Mr. Pearson says, $639 trillion OTC market. We never viewed it. So we are actually learning things as we go along. So I agree. We should get it right the first time. I hope we do. We are trying. But the important point is if we do make a mistake that we can remedy it. And so I am hopeful we change our proposed exemptive order in the next couple of weeks, that we provide this relief for another time certain, perhaps a 6 month time horizon, and then we work with our colleagues across the world to try to make sure that we have a global harmonized system of regulatory regimes.

Ms. SOMMERS. Thank you, Congressman. I think certainly the most important part of both what Mr. Pearson and Commissioner Chilton has said is that we are working together with our global counterparts. I think we are all very hopeful that we will come to a mutually agreeable solution but that it is important that the CFTC in the meantime does not impose our regulations on those entities until we know how this framework is going to work out.

Mr. GIBSON. I appreciate all that testimony and sorry to go over, Chairman. I yield back.

Mr. CRAWFORD The gentleman's time has expired.

The chair recognizes the gentleman from Texas, Mr. Neugebauer, for 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Chilton used a holiday movie, *It's a Wonderful Life.* As I am talking to the market participants, particularly in the swaps area, they think the Grinch has stolen Christmas. And one of the things Mr. Gensler testified yesterday and one of the things that was brought out is that over the last couple of years, we have cautioned you, and some of you mentioned it in your testimony about making sure that we understand what we are trying to regulate and what the consequences of that regulation are and making sure that we don't disrupt these markets. And so then, if that was the goal, and we look at the swaps market, for example, right now where ICE has just announced that they are moving trillions of dollars worth of transactions to the futures area, the market is telling you something here.

And I also talked to some folks the other day and said they are having trouble and said some of their customers are reluctant to trade with them until some of these issues are worked out, particularly on the registration issue and the cross-border issue. And so some of the businesses are moving to foreign countries because they are not sure whether they are going to be dragged into this regulation, and then they don't know what the regulation is actually going to be and what the consequences of dealing with those firms are.

And so one of the things that is a very troubling to me is that, yes, we talk about, well, we had cost-benefit analyses. I have seen some of those cost-benefit analyses and they are marginal at best.

Commissioner Sommers, what should we be doing different here? I am not sure that we are moving in a direction that is—I mean the whole original plan, for example, for the derivatives in the OTC was just to bring transparency. It appears we have moved pass transparency into we are almost trying to micromanage those markets. Would you agree with that?

Ms. SOMMERS. I do. Congressman, I think that one of the things that we could have done that we chose not to do, we could have taken the lead of the SEC on these issues in implementing the Title VII reform in that they are passing their rules and not requiring compliance until all of the rules are finished so they can look holistically at how the regime is going to be set up before they require compliance. And where we have run into trouble and where we have had to issue dozens of no-action letters to market participants because they can't comply is because our rule set isn't finished. In requiring compliance before we are finished has created problems.

Mr. NEUGEBAUER. And so why aren't we doing that?

Ms. SOMMERS. That decision was made that we would not do that and I am not sure why. I would have been supportive of that.

Mr. NEUGEBAUER. Was that something that was voted on or was that just——

Ms. SOMMERS. No, it was not.

Mr. NEUGEBAUER.—unilaterally determined by Mr. Gensler?

Ms. SOMMERS. It was determined by the Chairman.

Mr. NEUGEBAUER. Yes. And so we are seeing some consequences of that?

Ms. SOMMERS. Yes, sir.

Mr. NEUGEBAUER. Mr. Chilton, do you have some response to that?

Mr. CHILTON. Yes, and I hate disagreeing with Members of Congress, particularly people that I have worked with before and I really don't like to disagree with my colleague. I think Congress was pretty clear that it wasn't just transparency, sir, in the OTC market. Congress wanted us to guard against systemic risk so that if—look, risk is part of these markets. Everybody understands that. But if you go down, you shouldn't take—to risk another analogy—all the Whos in Whoville with you. I mean we don't want to have another bailout. I think that is really an important part of Dodd-Frank, not just the transparency.

Mr. NEUGEBAUER. Well, the thing about the over-the-counter market was that people didn't quite understand—they felt like that there could be systemic risk because they weren't quite sure what kind of space is out there. I am not sure how much of a systemic risk that that market actually was and I am not sure that we have done anything that has reduced if it is a systemic risk at this particular point in time.

But what I do understand is that those are very important pieces of capital formation in our country and very important risk management tools, as far as you know, one of the gentlemen was talking about a while ago about keeping the cost of energy down for Americans. And if we have these markets who are trying to move away, market participants not wanting to participate, then we obviously are doing something that is not positive.

Mr. CHILTON. I don't disagree with you on the latter part, Congressman. I know your time is up so I will be very brief, but Bear Stearns, Lehman Brothers, those are a direct result of OTC trading. There wasn't a requirement that they value their OTC trades with the counterparty. They valued it at whatever they wanted it. Lehman Brothers in their final statement before they went down was leveraged 30 to 1. That is the type of systemic risk stuff that we are trying to address at least.

Mr. CRAWFORD The gentleman's time has expired.

The chair recognizes the gentleman from Kansas, Mr. Huelskamp, for 5 minutes.

Mr. HUELSKAMP. Thank you, Mr. Chairman. A lot of Hollywood themes, Mr. Commissioner, I appreciate that.

I would like to follow up on a related theme. Congressman McGovern had mentioned the MF Global situation. In your opening comments you talked about folks in that particular movie that you referenced, someone is going to serve time in jail. It has been quite a few months and I have yet to see anything, anybody really punished, or certainly nobody in jail for the MF Global situation. And so I wonder if you might indicate what is happening on that front and we can talk about what happened 4 years ago. I am worried about something that is impacting constituents in my district yet today.

Ms. SOMMERS. Congressman, as I said before, our enforcement investigation is ongoing and we continue to make significant progress on that case, but I am unable to discuss any of the specifics of our enforcement investigation.

Mr. HUELSKAMP. Mr. Gensler is still not participating in that investigation? What is the latest of his status in there given his role?

Ms. SOMMERS. He is not participating in the enforcement investigation but he is in charge of any type of lessons learned or our policy changes with regard to customer protection.

Mr. HUELSKAMP. And Commissioner, I appreciate the difficulties or inability to say what is going on there, but can anyone say when we might have some information? My constituents see the gentleman—I mean Mr. Corzine, he was directly responsible and he is still walking around and we don't know if he is being investigated. Folks haven't been made whole. I mean we can talk about Lehman Brothers and talk about that, but clearly, when are we going to find out what is going on and when are we going to hold someone accountable here?

And I am going to have a follow-up question with Mr. Pearson because there is a connection apparently with cross-border with MF Global and I am curious what connection is going on, what investigations are going on over here. And we are talking about trying to solve a future problem; I am trying to make some constituents whole today. They are still waiting. And to just be able to tell them, well, we don't know yet after a year. And then maybe Mr. Chilton has some information on that.

Mr. CHILTON. Well, I know that it is frustrating when people don't know and I hate to speak for her but it is frustrating for us to not be able to explain certain things. But when these are investigations, they are very difficult for us to talk publicly. There is always the option, Mr. Chairman, of calling an executive session and more information could be provided. I am not suggesting that; if you are really concerned and you really want to find out more about it, that is one way that you can find out some more about it that we can't discuss in public.

Mr. HUELSKAMP. I appreciate that. And one follow-up on Mr. McGovern's line of questions as well—I mean waiting for some proposals—what immediate things were done to prevent that in the future?

Mr. CHILTON. Several things: first, that we are requiring actual 24/7, 365 electronic access to the bank records instead of just relying on them telling us it is the case. Second, when they reach sort of these things that I call liquidity levels—they are called something more complicated in our rule—but when they are running low on liquidity, they have to transfer the customers' funds to another entity. And then finally, the third point is that if they don't transfer the customer funds to somebody else, we can mandate that it be done. So those are three things. There are others, too, Congressman, but those are the three key things for me.

Mr. HUELSKAMP. Have they been fully implemented?

Mr. CHILTON. No, they are proposals. They are not fully implemented yet.

Mr. HUELSKAMP. And do we know when those might be implemented to provide protections to——

Mr. CHILTON. A couple of months, maybe the end of the year is it? No, next several months, Congressman.

Mr. HUELSKAMP. Okay. And Mr. Pearson, if I might, what is happening on your front? I mean do you have these particular regulations in effect for your traders in the EU and can you describe how MF Global participates in those or did participate in that?

Mr. PEARSON. The situation is slightly different. We have a different approach to segregation of client funds and protection of funds, and that is a different legal approach, which goes somewhat further than the one that you are discussing over here. So we acknowledge the issue. We are also regulating the issue that has already been laid out in European regulation. We end up in more or less the same space. So we are absolutely cognizant and we have worked together with the CFTC very much to test whether our systems are comparable to yours and whether they are stress-resistant on a cross-border basis. And I am happy to say that so far that does appear to be the case.

Mr. HUELSKAMP. So do you think there are more or less protections under your regimen *versus* ours?

Mr. PEARSON. It is a different set of protections, Congressman. The protection is different in that we have a more direct set of protections and less indirect set of getting there as you have in the United States of America. The end result is the same but the way we get there is slightly different.

Mr. HUELSKAMP. Okay. Well, thank you, Mr. Pearson. I appreciate the questions and look forward to actual implementation of where we are heading. I am actually a little more nervous than when I started that we have some things out there in a few months we might fully implement them and I will have some follow-up questions of what exactly are the risks that remain in the system then. Thank you. I appreciate it.

I yield back.

Mr. CRAWFORD The gentleman's time has expired.

The chair recognizes the gentlelady from North Carolina, Mrs. Ellmers, for 5 minutes.

Mrs. ELLMERS. Thank you. And it looks like I am probably the last questioning. And I just want to say thank you, too, to our panel. I really like this system of bringing everyone together at the table at the same time so that everyone can hear the information being exchanged, and I think that is very helpful for us.

Mr. Kono, I have a question for you. The analogy of risk spilling over into and onto U.S. shores in times of crisis has been used a lot recently. And certainly, we want to avoid such a scenario. How can that scenario be avoided without adopting an overly strict regime that does not respect the ability of foreign regulators?

Mr. KONO. Thank you very much for your question, Congresswoman.

And in fact my point was that certainly we understand those risks. And in fact if I may mention this, I was at the frontlines of supervision when the Lehman affair did occur. And in fact we have basically the same problem still today. We are still in the course of fixing that in the sense that we do not have enough flow of information plus enough tools to deal with such cross-border issues effectively in coordination with foreign regulators. And once that is established, a close cooperation, close exchange of information is established, we will do much better in preventing such risks from flowing from shore to shore.

Mrs. ELLMERS. Thank you, Mr. Kono.

Mr. Pearson, in Chairman Gensler's testimony yesterday, he stated, "I think if we do not cover the guaranteed affiliates offshore that you can basically blow a hole out from the bottom of Title VII and all of what Congress intended on transparency and risk." It doesn't appear that he has much faith in foreign governments being able to properly regulate their own affiliations and jurisdictions. How do you feel about this and do you see this as being very problematic?

Mr. PEARSON. Thank you, Congresswoman Ellmers. We take a slightly different view on this.

There are a couple of points here and that is it cuts both ways. If the U.S. affiliate abroad is guaranteed by the U.S. parent and the U.S. taxpayers, the same applies to our affiliates here in the United States of America. Why is it that we do not apply the same approach as proposed by the CFTC? Why is it that we do not trust the United States' regulators to regulate our firms here and the U.S. regulators would not trust the European regulators to regulate your affiliates in Europe? It is about trust. It is about not understanding the level and the degree of rules that apply on both sides of the Atlantic. And as I have tried to explain earlier on, they are actually very comparable, very consistent, and in a number of cases, our rules are actually a lot stricter than the United States' rules.

The next point is how do you enforce this? If the European Union were to try to enforce its rules on all of its affiliates in the United States of America, we would be doing two things that are horribly wrong. We would be trying to enforce something we cannot enforce in practice; even worse, we would be giving the impression that we will be able to enforce this. And if something goes wrong, where will the plane land? Will it land here in the United States or with a regulator in Europe? So that is the thing that we are trying to avoid. We do not afford ourselves a luxury of putting in place a regulatory system that we know we cannot enforce.

Mrs. ELLMERS. Yes. Well, thank you very much. And again, thank you to the panel.

And I yield back the remainder of my time.

Mr. CRAWFORD Thank you. The gentlelady yields.

And with no further comments from the Ranking Member, I do have some written testimony to enter into the record with unanimous consent, written testimony for the record from Mark Boleat from the City of London, and written testimony for the record from Steven Maijoor, Chairman of ESMA.

Without objection, so ordered.

[The information referred to is located on p. 49.]

Mr. CRAWFORD And we also have letters for the record. These were letters written to Chairman Gensler and CFTC, letters from the chief financial administrators from UK, France, Japan, and European Union, a letter from the Swiss regulator FINMA, a letter from Hong Kong Secretary of the Treasury, a letter from French financial regulators, a letter from British FSA, a letter from the FSA of Japan, and the Bank of Japan, a letter from the European Securities and Market Authority, a letter from the European Commission, a letter from the Brazilian CVM, and a joint letter from the Asian regulators from Hong Kong, Singapore, and Australia.

Without objection, so ordered.

[The information referred to is located on p. 52.]

Mr. CRAWFORD Under the rules of the Committee, the record of today's hearing will remain open for 10 calendar days to receive additional, material, and supplementary written responses from the witnesses to any question posed by a Member. I thank the participants for being here today.

This hearing of the Subcommittee on General Farm Commodities and Risk Management is adjourned.

[Whereupon, at 10:55 a.m., the Subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

SUBMITTED STATEMENT BY HON. ERIC A. "RICK" CRAWFORD, A REPRESENTATIVE IN CONGRESS FROM ARKANSAS; ON BEHALF OF STEVEN MAIJOOR, CHAIR, EUROPEAN SECURITIES AND MARKETS AUTHORITY

Dear Chairman Conaway, Ranking Member Boswell, and Members of the Committee,

I would like to thank you on behalf of ESMA for your invitation to testify before this Committee on the important topic of derivatives reform. Unfortunately, due to other urgent obligations I am unable to be physically present at today's hearing. ESMA is submitting this statement to highlight, in particular, some issues in relation to the application of the Dodd-Frank Act to non-U.S. persons. I know that the European Commission, with which we have worked very closely in this process, is attending the hearing and will be able to expand on some of these points.

I will now briefly introduce ESMA to you. As an independent agency of the European Union (EU) our mission is to enhance the protection of investors and reinforce stable and well-functioning financial markets in the EU. ESMA achieves this mission by building the single rule book for EU financial markets and ensuring its consistent application and supervision across the EU. ESMA also contributes to the supervision of financial services firms with a pan-European reach, either through direct supervision or through the active coordination of national supervisory activity.

ESMA is deeply committed to finding convergent regulatory solutions to ensure there is an internationally coordinated application of the G20 commitments. The Dodd-Frank Act in the United States and the EMIR Regulation in the EU have many similarities, and both regimes are broadly aligned on many substantial points. However, there are some differences that require joint action and mutual understanding by regulators, like the CFTC and ESMA, which are tasked with drafting the secondary regulation that will allow the implementation of the respective Act and Regulation.

One of the differences between our respective regulatory frameworks relates to the registration of foreign entities, such as swap dealers (when they fall above the relevant threshold), which is required under U.S. rules but not under EU rules. This registration requirement will apply to entities that are already authorised as dealers (investment firms or banks) under EU rules, and the U.S. regime will therefore apply to entities and transactions that are also subject to EU rules. As the two sets of rules are similar in substance, there is a clear case for avoiding the situation where a particular entity or transaction is simultaneously subject to two sets of rules. The application of two sets of rules to a single entity or transaction will lead to legal uncertainty and will be unnecessarily burdensome for firms.

The main relevant international regulators have been working together to seek ways to achieve convergence on the application of the rules that legislators in our respective jurisdictions enacted to reform OTC derivatives markets. ESMA has cooperated with its peers in other jurisdictions and found many points in common, including with the CFTC. As highlighted in the statement issued by the OTC Derivatives Market Regulators following their meeting on 28 November, a number of conflicting, duplicative and inconsistent requirements have been identified when analysing the simultaneous application of different national regulations. These requirements, if applied on a cross-border basis to the same entities and transactions, would, in certain cases, impede a transaction from taking place or might impede an entity from operating with U.S. counterparties. This would have serious consequences for global market liquidity and might even have financial stability consequences.

These conflicting and duplicative requirements are, amongst others:

(1) different applications of the clearing obligation;

(2) different bilateral margin requirements;

(3) privacy and data protection constraints;

(4) different scope and exemptions (non-financial counterparties, inter-affiliates, pension funds, small banks, *etc.*);

(5) different requirements for CCPs and trade repositories; and

(6) indemnification requirements in the U.S.

The group of international OTC Derivatives Market Regulators reached some common understanding of the problems that these conflicting and duplicative requirements may give rise to. They have also agreed to carry out further work to identify mutually acceptable solutions to address these problems, but more work is needed.

ESMA considers that it is of fundamental importance to avoid the application of two or more sets of rules to the same entities or transactions, if those entities and transactions are subject to appropriate requirements in their home jurisdiction. Therefore, we would urge U.S. regulators to rely to the maximum extent on equivalent requirements enshrined in EU law, instead of imposing U.S. requirements when those non-U.S. entities are dealing with U.S. persons. When a duplicative application of rules cannot be avoided, we believe it is essential to identify and mitigate any possible conflict that might arise from that situation.

ESMA has welcomed as a workable solution, the use of mechanisms like "substituted compliance", which would allow U.S.-registered foreign swap dealers to apply their home jurisdiction rules, to the extent that they are producing the same result as the corresponding U.S. rules. However, while this is moving in the right direction, we remain concerned about the fact that in its current version it would not be applicable to transactions in which one of the counterparties is a person established or domiciled in the U.S. We remain confident that, through common work, we will reach an agreement to allow the maximum possible use of mutual recognition and substituted compliance as ways to minimise conflicts and overlaps between different sets of laws.

Pending any such agreement, and until a framework for dealing with the above issues is finalised, we are of the view that registration and other requirements should be suspended for foreign entities. In this vein, ESMA would like to express its strong concerns about maintaining the deadline for the registration of foreign swap dealers by the end of 2012, despite a possible temporary waiver from some related obligations. This is due to the three reasons outlined below.

Firstly, the registration requirement that EU swap dealers face is required at a stage when several associated rules that they will have to comply with in the future are not yet final. In addition, international coordination efforts are still under development and subject to the dialogue between international OTC Derivatives Market regulators. Therefore, foreign swap dealers would be required to register without knowing with sufficient certainty the complete set of rules that will bind them as a consequence of their registration, and how those rules will be applied in an international context—including how substituted compliance will work.

Secondly, ESMA remains concerned about the fact that the registration application grants access to the U.S. supervisors and the U.S. Department of Justice to the books and records of registered swap dealers. It is important to reconcile this with the privacy or blocking laws that in many jurisdictions restrict the type of data that banks and investment firms can share with anyone except their national supervisors with a statutory power to require those data.

Thirdly, while we have achieved some progress on reaching an agreed approach to resolving cross-border issues, our international dialogue has not yet been exhausted and, therefore, fixing the registration requirement ahead of the conclusion of that dialogue could undermine the above-mentioned cooperation process.

I would like to thank you again for the opportunity to submit ESMA's views on this important matter to your Committee.

Yours sincerely,

STEVEN MAIJOOR,
Chair,
European Securities and Markets Authority.

SUBMITTED STATEMENT BY HON. ERIC A. "RICK" CRAWFORD, A REPRESENTATIVE IN CONGRESS FROM ARKANSAS; ON BEHALF OF MARK BOLEAT, CHAIRMAN, POLICY AND RESOURCES COMMITTEE, CITY OF LONDON

Chairman Conway, Ranking Member Boswell, and Members of the Subcommittee:

Thank you for inviting me to testify before you today, I welcome this opportunity and apologise that I cannot be there with you to attend this hearing in person. In my absence, I have prepared the following testimony, which outlines my views on the topic of "Dodd-Frank Derivatives Reform: Challenges Facing U.S. and International Markets".

I am Policy Chairman at the City of London Corporation, which is the local government authority for the City of London. In the role of Policy Chairman, I am responsible for overseeing and coordinating the agenda of the City of London and this includes a remit for strategy, resource allocation and engagement with legislators and regulators in the UK, Europe and across the world on policy issues affecting London as a global financial centre.

In my written testimony I would like to focus on three key challenges that I see facing U.S. and international markets because of Dodd-Frank derivatives reform and explain what action I think could be taken in order to resolve these challenges.

I appreciate this Subcommittee's attention on the international dimension at this hearing because the past few years have demonstrated both the highly global nature of the financial markets and the need, where possible, to find international solutions especially through the G20. I support the efforts of the U.S. regulatory agencies to provide transparency and lower risk through increased clearing and swap dealer oversight but I have particular concerns regarding the extraterritorial application of some of the rules that form part of Dodd-Frank derivatives reform and the implications for the U.S. and international markets. I also strongly welcome the recent joint press statement of leaders on Operating Principles and Areas of Exploration in the Regulation of the Cross-Border OTC Derivatives Market [1] and their identification of the areas that would be further explored in order to address the concerns that have been raised around extraterritorial requirements. However, I fear that given the scope of what is to be explored and the timescales for implementation and the difficulty inherent in jurisdictions moving at different speeds, much more needs to be done to better coordinate international regulatory regimes.

In my consideration of challenges facing the U.S. and international markets, I will firstly discuss conflicting, inconsistent and duplicative rules. Secondly, I will explain my concerns about the gaps in guidance and clarification that need to be addressed given the sequencing and timing of Dodd-Frank derivatives reform. Thirdly and finally, I will discuss the need for consistent margin requirements across G20 regimes. On all of these issues, I will outline the problem facing U.S. and international markets, the potential impact and what could be done to address these problems.

1. The Challenge of Conflicting, Inconsistent and Duplicative Rules

I am concerned that under Dodd-Frank derivatives reform, cross-border transactions could be subject to duplicative, inconsistent and even conflicting rules. The proposed cross-border guidance from the Commodity Futures Trading Commission (CFTC) does not guarantee "substitute compliance" for countries with equivalent regulatory regimes and instead allows the CFTC to determine which elements of a foreign jurisdiction's regulatory regime it will recognise.

Having two sets of rules to comply with could increase compliance costs for the entities registered with the CFTC as swaps dealers, including non-U.S. branches and foreign subsidiaries of U.S. banks as well as foreign dealers, and end-users. Many end-users, whether based in the UK, U.S. or elsewhere, have operations in multiple jurisdictions, through numerous affiliates. These companies often manage risks arising from their foreign operations by executing hedges out of foreign subsidiaries, as part of their overall efforts to manage the risks inherent in their global commercial and business operations. Their ability to do so effectively and efficiently improves their ability to plan for the future, reduce volatility in their business, and offer more stable prices to their customers. It facilitates the flow of goods and services in a global economy, and enhances their role as drivers of economic growth and job creation in communities across the globe.

Failure to address inconsistent, duplicative or conflicting requirements for cross-border transactions could create strong disincentives for both non-U.S. end-users to trade with U.S. counterparties, or for non-U.S. dealers to trade with U.S. end-users. Having a smaller pool of potential counterparties could reduce liquidity and the efficient pricing that having wide selection of counterparties provides. At the same time, a reduced pool of counterparties may inhibit an end-user's ability to diversify its exposures to counterparties, increasing the concentration of exposure, for example, to counterparties in certain regions.

I would therefore ask that these inconsistent, duplicative or conflicting rules for cross-border transactions are resolved with "substitute compliance" (allowing them to be referred to the home regulator) to ensure that international regulatory regimes are more closely aligned. Further clarification around the broad definition of a U.S. person would also help address some of the duplication.

2. The Challenge of Gaps in Guidance and Clarification Given the Sequencing and Timing of Dodd-Frank Derivatives Reform

In terms of the sequencing and timing of Dodd-Frank derivatives reform, important elements remain unclear and there are areas where insufficient clarification and guidance on cross-border rules has been provided, given the impending implementation timeline. The finalised cross-border guidance is yet to be released, caus-

[1] *http://www.cftc.gov/PressRoom/PressReleases/pr6439-12*.

ing uncertainty for non-U.S. entities over the need to register as a swap dealer, the designation of Commodity Pool Operators as well as the aforementioned scope of "substitute compliance".

The lack of clarity and guidance on these issues is causing considerable uncertainty in U.S. and international markets. This could result in a shift in transactions, particularly from the U.S. to other markets, as firms attempt to comply with the regulations being implemented despite the uncertainty and it could reduce global liquidity. It has also caused confusion as to whether the cross-border rules within Dodd-Frank derivatives reform will be consistent with other national regulatory regimes.

In order to address this problem, more guidance and clarification is of course needed, but a sufficient transition period should also be given so that parties have adequate time to comply with regulations. I believe that the application of CFTC rules with respect to non-U.S. persons should also be deferred to allow for better alignment with other national regulatory regimes and the potential for regulatory arbitrage.

3. The Challenge of Implementing Consistent Margin Requirements Across G20 Regimes

The final challenge I would like to highlight to the Subcommittee is the need for consistent margin requirements across G20 regulatory regimes. The inconsistencies between proposed margin requirements in the U.S. and the EU are of particular concern in this regard.

As they stand, the proposed margin requirements under Dodd-Frank derivatives reform could result in an unlevel playing field between U.S. and European banks and possible regulatory arbitrage. The different requirements would also be difficult to apply cross-border and significant differences in collateral requirements among regulatory regimes would undermine G20 objectives to have consistent global standards for these margin requirements.

I would therefore call on regulators to work together further on consistency. Even if convergence between the EU and the U.S. regulatory schemes on this issue is not possible in the near term, equal treatment within each scheme should be sought.

In summary, I ask the Subcommittee to consider my concerns about firstly, duplicative, incompatible or conflicting requirements; secondly, regulatory uncertainty caused by lack of sufficient clarification and guidance; and thirdly, inconsistencies in proposed margin requirements. Fragmented or conflicting regulation, even when the policy objectives are the same, would have a negative impact on competition and consumer choice and on the ability of market users and participants to raise capital, manage risk and contribute to economic growth. We should work collectively to avoid the risk of impeding or disrupting the efficient functioning of our global financial markets as a result of regulatory fragmentation, which would be to the detriment of consumers, investors and other market participants. I would also urge the authorities involved to strengthen international regulatory dialogue and cooperation further to ensure a consistent approach that meets the needs of market users, without major unintended consequences, and avoids unilateral action by either side, or both.

Thank you again for this opportunity to submit a testimony to this hearing. I appreciate the Subcommittee's attention to these issues and remain at your disposal to discuss them in further detail should you wish to follow up on them.

Yours sincerely,

Mark Boleat

MARK BOLEAT,
Chairman of the Policy and Resources Committee.

SUBMITTED CORRESPONDENCE BY HON. ERIC A. "RICK" CRAWFORD, A REPRESENTATIVE IN CONGRESS FROM ARKANSAS

16 July 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Swap Dealers Registration under Dodd-Frank Act

Dear Chairman Gensler,

We are writing to express our concerns about the potential extraterritorial effects of registration rules for swap dealers.

We understand that the implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of July 2010 requires substantial rule-making and have followed the related regulatory developments with interest. We share the view that closer monitoring of the derivatives business may, contribute to higher market confidence and mitigate systemic risks in highly interconnected markets. As regards the CFTC regulations, it is our understanding that the final rules adopted so far only address registration issues, while details of specific requirements remain pending.

According to our information, registration with the CFTC is required by September, probably before the exact reach and scope of the U.S. swap dealer regulatory regime will have been clarified. The CFTC released a Proposed Interpretive Guidance and Policy Statement on 29 June 2012 for public consultation to address—among other issues—the cross-border application of U.S. swap dealer requirements. The principle of substituted compliance may thereby only be recognized for certain entity level requirements of non-U.S. swap dealers and if the CFTC concludes that the foreign jurisdiction's laws and regulations are comparably robust and comprehensive. Beyond that the demand for direct extraterritorial access to transaction data and books and records as well as to entity level information on capital, compliance, risk management is not addressed in the guidance. The potential extraterritorial reach of the requirements still remains unclear to us. Hence, for the time being, we are not in a position to fully assess the consequences of a registration with the CFTC and whether these can be reconciled with Swiss regulatory standards, domestic laws, and supervisory practice. Nonetheless, we have serious doubts as to whether the registration as a swap dealer of a Switzerland-domiciled bank as a whole can be reconciled with Swiss practice.

We are particularly concerned about potential CFTC margin requirements for swap deals that are not cleared by a central counterparty. If such margin requirements are applied to a Swiss-based entity, this may duplicate the requirements and may possibly conflict with international and domestic capital adequacy rules, thereby leading to prudential inefficiencies. Furthermore, certain of the proposed reporting requirements, in particular those regarding trade data and end-customer data, and access requirements may raise Swiss privacy and data protection issues as well as enforcement difficulties. Due to these concerns, we cannot exclude that FINMA may have to deny financial institutions permission to supply certain information or grant direct access to U.S. supervisors.

We are conscious that UBS and Credit Suisse are planning to register as swap dealers with the CFTC. In this context, the registration of UBS's swap business may be particularly challenging. Contrary to other swap market participants, UBS does not book its derivative transactions through foreign affiliates of the group, but carries these out largely through a branch network. Most of the derivatives traded with U.S. counterparties are currently booked in the UBS London or Stamford branches. The bank is currently working on shifting its derivatives business to a standalone legal entity (UBS Limited London). This process is expected to take several years.

Based on our current understanding, we are not comfortable with the idea of a Swiss-based bank as a whole registering with the National Futures Association (NFA) and the CFTC while the extraterritorial effects of the registration remain unclear.

We are confident, however, that viable alternatives which comply with both of our prudential mandates can be found. Such alternatives could include the provisional registration of those foreign branches of Swiss-based banks in which swap transactions with U.S. persons are booked until a separate legal entity has been set up, or the registration of a U.S. incorporated entity acting as information transfer agent for the bank.

We thank you for your consideration and look forward to discussing these issues with you in more detail. Our office will contact you to schedule a telephone call.

Yours sincerely,

PATRICK RAAFLAUB,
Chief Executive Officer,

MARK BRANSON,
Head of Banks Division,

Swiss Financial Market Supervisory Authority FINMA;

Swiss Financial Market Supervisory Authority FINMA.

CC:

Hon. MARY SCHAPIRO, *Chairperson,* Securities and Exchange Commission.

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27 July 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Subject: CFTC International Guidance and phased compliance program

Dear Chairman,

As Minister of Economy and Finance and as Chairmen of the *Autorité de contrôle prudentiel* ("ACP") and the *Autorité des marchés financiers* ("AMF"), we are writing to share our strong concerns regarding extraterritorial effects of the cross-border application of the swaps provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

This issue was raised last month in an open Letter published by Michel Barnier, the EU Commissioner in charge of the Internal Market and Services.[1] In February 2011, we also drew your attention as regards to credit institutions located in France that may have to register as Swap dealers or, from case to case, as Major Swap Participants, in the U.S.[2]

In such a context, we welcome the CFTC's initiative aiming at defining through an Interpretative Guidance, the scope and the boundaries of the U.S. legislation in a cross-border context, as well as the proposal for a phased compliance program. In particular, we support the concept of "substituted compliance" related to non-U.S. Swap Dealers or non-U.S. Major Swap Participants. We are firmly convinced that the equivalence system is the best way to prevent overlaps and to achieve an efficient regulation and oversight of OTC de1ivatives markets. Other upcoming European financial regulations propose to adopt a similar cross-border equivalence approach. As fertile as such the concept of "substituted compliance" may be, based on the EU legislation (EMIR)[3] and from a very practical point of view, we wish to emphasise that any entity-by-entity approach should be articulated with and complemented by the assessment, in a comprehensive perspective, of the rules applicable on both sides of the Atlantic. Indeed, such general approach, combined with an appropriate temporary exemptive relief (particularly for transactions between a non-U.S. and a U.S. entity and provided for an extended period of time), should facilitate the processing of the files (and reduce the costs for the firms) and avoid any distortion or discrepancies between the entities located in the same jurisdiction (*i.e.,* EU or EEA).

Generally speaking, the mere extension of the scope of registration for Swap Dealers or Major Swap Participants to non-U.S. entities would create regulatory and oversight overlaps which cause serious concerns for us and our industry.

In addition, we would like to point out the main legal impediments we will face, namely the professional secrecy rules and the protection of strategic data ("Blocking Law") which may prevent French entities from freely displaying information you may request (such concern should dully be considered, in particular, regarding Form 7–R). Similarly, you must consider clarifying the scope of the activities which would be concerned by the application of the Volcker rule in order to prevent significant extraterritorial consequences for the non-resident banking entities (*i.e.,* functional and/or structural reorganization) that could induce unexpected impact for both U.S. and EU economies.

Furthermore, we understand that the financial statements of EU Swap Dealers and Major Swap Participants which are prepared under IFRS, should be reconciled under U.S. GAAP. Such requirements would be contrary to the process of reconciliation initiated a few years ago between the U.S. and the EU accounting standards and inconsistent with mutual recognition commitments already taken on both sides of the Atlantic.[4]

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[1] See *Financial Times,* 21 June 2012.
[2] See *Annnex I.*
[3] See *Annex II.*
[4] Since 15 November 2007, the SEC has decided to remove the requirement for non-U.S. companies reporting under International Financial Reporting Standards (IFRSs) as issued by the

Finally, we consider that the specific issue related to the cross-border transactions should also be explicitly covered in the interpretative guidance, especially when such transactions occur between an EU and a U.S. counterparty: according to the recognition of equivalence and, if appropriate, following the substituted compliance decision, authorities should be able to rely on each other, regardless of the type of rules concerned. Given the importance of these requirements for market participants, we would also strongly encourage you to adopt a strict and objective definition of the concept of "U.S. person" without criteria that would be excessively subtle and difficult to implement and that could finally undermine the effectiveness of our common action to regulate OTC derivatives.

We believe our objectives are the same and are fully convinced that we will succeed in building a sound and coherent global framework leading to improve the transparency, the efficiency and the robustness of the OTC derivatives market, in accordance with the G20 commitments and based upon a sound transatlantic level playing field. We are aware of the current efforts undertaken by U.S. authorities and are supportive on pursuing a constructive dialogue between our respective institutions.

Yours sincerely,

PIERRE MOSCOVICI,
Minister,
Ministère de l'économic et des finances;

CHRISTIAN NOYER,
Chairman,
Autorité de contrôle prudentiel (ACP)

JACQUES DELMAS-MARSALET,
Interim Chairman,
Autorité des marchés financiers (AMF)

CC:

Mrs. MARY L. SCHAPIRO, *Chairman* of the Securities and Exchange Commission.
Mr. TIMOTHY GEITHNER, *Secretary* of the Treasury.

ANNEX I: JOINT LETTER FROM THE ACP AND THE AMF RELATED TO TITLE VII OF THE DODD-FRANK ACT OF 11 FEBRUARY 2011

11 February 2011

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Re: Title VII of the Dodd-Frank Act

Dear Chairman,

As Chairmen of the *Autorité de contrôle prudentiel* ("ACP") and of the *Autorité des marchés financiers* ("AMF") we take the opportunity of the public consultation on your proposed rulemaking to raise specific concerns on the proposed rules related to Section 712(d)(1), Section 721(c) and Section 761(b) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). Although this is not a formal contribution to your consultations we would like to draw your attention specifically to the case of foreign-headquartered financial organizations and in particular French entities.

We understand that the CFTC and the SEC, in consultation with the Board of Governors of the Federal Reserve System ("Fed"), are proposing rules and interpretative guidance to further define the terms "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible contract participant" which would not specifically take into account the case of the non-resident entities and, therefore, could have non-desirable extraterritorial effects on such entities.

Based on our common experience, especially in a cross-border prudential supervision and market regulation perspective, we believe that such unilateral approach could lead to regulatory overlaps and inconsistencies and therefore be counterproductive. Indeed, the articulation between the different legal and regulatory

IASB to reconcile their financial statements to U.S. Generally Accepted Accounting Principles (GAAP). In the same way, since December 2008, the European Commission has identified as equivalent to IFRS the U.S. GAAPs for listed companies.

frameworks is an international challenge and is undoubtedly a corner stone for the achievement of G20's commitments.

Therefore, from a practical point of view, we strongly support for foreign banking organizations and other financial institutions (such as asset management companies, investment advisers, private equity funds and other entities that might qualify as major swap participants) a mutual recognition regime built around an adequate and balanced symmetrical system taking into account the home and the host country regulatory regimes. Thus, without calling into question the registration of non-resident entities as "swap dealer", "security-based swap dealer", "major swap participant" or "major security-based swap participant", we expect that such registration will be limited to activities in relation with U.S. counterparties and/or clients and will not involve similar obligations to the financial organizations as a whole. The obligations for non-resident entities should indeed be proportionate and take into equivalent requirements in their home jurisdiction. In this perspective, in order to prevent double and recursive regulation, Memoranda of Understanding (MOUs) signed between the regulatory authorities concerned could be very useful instruments. Having regard to Section 752 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, we understand that such an approach could be relevant.

Consequently, taking into consideration the short timeframe of the proposed rulemakings, we would be happy to explore with you various options in a constructive approach and we would be pleased to further discuss on this very important subject.

We look forward to our continued co-operation in this field.

With our best regards,

CHRISTIAN NOYER, *Chairman,* Autorité de contrôle prudentiel (ACP)	JEAN-PIERRE JOUYET, *Chairman,* Autorité des marchés financiers (AMF)

CC:

Mrs. MARY L. SCHAPIRO, *Chairman* of the Securities and Exchange Commission.
Mr. WILLIAM DUDLEY, *Chairman* of the Federal Reserve Bank of New York

ANNEX II: ARTICLE 13 OF EMIR—MECHANISM TO AVOID DUPLICATIVE OR CONFLICTING RULES

1. The Commission shall be assisted by ESMA in monitoring and preparing reports to the European Parliament and to the Council on the international application of principles laid clown in Articles 4 [clearing obligation]*, 9* [reporting obligation]*, 10* [non-financial counterparties] *and 11* [Risk-mitigation techniques for OTC derivative contracts not cleared by a CCP]*, in particular with regard to potential duplicative or conflicting requirements on market participants, and recommend possible action.*

2. The Commission may adopt implementing acts declaring that the legal, supervisory and enforcement arrangements of a third country:

(a) are equivalent to the requirements laid down in this regulation under Articles 4, 9, 10 and 11;

(b) ensure protection of professional secrecy that is equivalent to that set out in this Regulation; and

(c) are being effectively applied and enforced in an equitable and non-distortive manner so as to ensure effective supervision and enforcement in that third country.

Those implementing acts shall be adopted in accordance with the examination procedure referred to in Article 86(2).

3. An implementing act on equivalence as referred to in paragraph 2 shall imply that counterparties entering into a transaction subject to this Regulation shall be deemed to have fulfilled the obligations contained in Articles 4, 9, 10 and 11 where at least one of the counterparties is established in that third country.

4. The Commission shall, in cooperation with ESMA, monitor the effective implementation by third countries, for which an implementing act on equivalence has been adopted, of the requirements equivalent to those laid down in Articles 4, 9, 10 and 11 and regularly report, at least on an annual basis, to the European Parliament and the Council. Where the report reveals an insufficient or inconsistent application of the equivalent requirements by third country authorities, the Commission shall, within 30 calendar days of the presentation of the report, withdraw the recognition as equivalent of the third country legal framework in question. Where an implementing act on equivalence is withdrawn, counterparties shall automatically be subject again to all requirements laid down in this Regulation".

August 13, 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Re: Proposed CFTC Cross-Border Releases on Swap Regulations

Dear Gary,

We appreciate the opportunity to comment on the proposed CFTC cross-border interpretative guidance and exemptive order regarding compliance with certain swap regulations. We are writing to ask the Commission's consideration of our concerns about these proposals, in particular about the application of registration and transaction requirements to operations of foreign financial institutions established outside the U.S.

As to the extraterritorial application of OTC derivatives regulation of the Dodd-Frank Act, we can understand your concern that risks emanating from an overseas entity of a financial group could directly flow back to the whole group, and this should be avoided. We believe, however, that such extraterritorial application will need to be consistent with the principles of international comity between jurisdictions, as noted in the CFTC proposal. A number of jurisdictions, including Japan, have been making significant progress in implementing the G20 commitments, including mandatory clearing and trade reporting, in an internationally consistent and coordinated manner toward the agreed deadline of end-2012. The regulations which Japan will be implementing from November this year are not identical with U.S. regulations, but are consistent with the objectives of the G20 countries to improve transparency in the derivatives markets, mitigate systemic risk and protect against market abuse, and in this regard share the same goals with the Dodd-Frank Act.

Against this backdrop, we have two overarching concerns and three specific requests to amend the CFTC proposals as follows.

I. Overarching Concerns

Avoidance of Overlapping or Conflicting Regulation

First, to the extent that U.S. law subjects Japanese financial institutions established and conducting businesses in Japan to U.S. regulation, then this would inevitably lead to overlapping or conflicting regulation, thus placing undue burden not only on the financial institution itself but also on other market participants as well.

In this regard, FSA Japan has the primary responsibility in determining and implementing appropriate regulation of OTC derivatives market participants and their transactions in Japan. Therefore, we would like to ask the Commission to reconsider the necessity of extraterritorial application of U.S. derivative regulations, including swap dealer registration requirements to Japanese financial institutions established and conducting businesses in Japan.

Need for International Coordination in Cross-Border Regulation

Second, if the scope and timing of application of OTC derivatives regulations to cross-border transactions would be different and inconsistent among jurisdictions, there are risks that the application of a country's regulations to cross-border transactions without proper international coordination would unduly impose additional costs on those transactions and thereby reduce the liquidity of OTC derivatives markets. For example, where the scope of mandatory clearing in terms of products is not identical between jurisdictions and no single CCP is available for clearing the transactions of both counterparties, market participants will not be able to enter into a transaction for fear of finding themselves in breach of either of the two sets of regulations. In this context, FSA Japan intends to address this issue by limiting the scope of mandatory clearing to transactions between large domestic market players at the initial stage of implementation of OTC derivative regulations to enter into force in November this year.

Therefore, we urge the Commission to consider deferring the application of its regulations on cross-border transactions until an internationally consistent approach on how to address cross-border regulation of OTC derivatives would be developed (*e.g.,* for at least 1 year and renewable, if necessary).

II. Specific Requests

In addition to the overarching concerns above, we have the following three specific requests to amend the CFTC proposals:

1. Further extension of application of substituted compliance, and making clear its details, including due process and timing
2. Deferral of application of CFTC regulations with respect to non-U.S. persons
3. Exclusion of certain transactions from the calculation of swap transactions in regard to the *de minimis* threshold for non-U.S. persons

1. Further Extension of Application of Substituted Compliance, and Making Clear Its Details, Including Due Process and Timing

In the proposed CFTC guidance, we recognize that the Commission intends to introduce the concept of substituted compliance for the purpose of avoiding duplicative application of regulation. While we welcome this step, we have two concerns in this regard.

(i) The first concern is that the scope of application of substituted compliance is too narrow. We request it to be further extended, so that overlap or conflict with Japanese regulation could be avoided as much as possible.

As for entity-level regulations, substituted compliance should apply to all types of foreign affiliates of U.S.-based swap dealers, including those with swaps booked in the U.S. Substituted compliance should also be extended to a broader set of transaction-level requirements. For example, transactions conducted in Japan between Japanese financial institutions and Japanese affiliates of U.S.-based swap dealers (swaps booked in the U.S.) should be subject to substituted compliance. In addition, cross-border transactions between the head offices of Japanese financial institutions and U.S.-based swap dealers should be able to benefit from substituted compliance.

(ii) The second concern is that the details, including the procedure and implementation timeline of "substituted compliance" are not clear in the proposal. The Commission proposes that it would make comparability determinations on an individual requirement basis, such as mandatory clearing and trade execution facility, rather than the foreign legislative/regulatory regime as a whole. We believe this determination should be made on a country-by-country basis, and in a comprehensive manner, from the viewpoint of whether or not foreign regulation is broadly in alignment with U.S. regulation and consistent with the overall objectives of the G20 commitments. The determination should also take into account such elements as further regulations to be introduced in a phased manner and the necessity of different regulation in light of divergent practices in non-U.S. markets.

Furthermore, when certain requirements under Japanese regulations are not identical to those of the U.S. at a particular point in time, it would not be acceptable for us that the Commission applies its regulations in addition to Japanese regulations in place to address the differences. In other words, substituted compliance should respect foreign regulations as a set, not on a piecemeal basis.

2. Deferral of Application of CFTC Regulations With Respect to Non-U.S. Persons

As noted above, we believe that CFTC regulations, including swap dealer registration should, as a matter of principle, not be applied to Japanese financial institutions established and conducting businesses in Japan. Even if Japanese financial institutions would be required to register as swap dealers under limited circumstances, these requirements should be the least onerous, and a sufficient preparation period needs to be ensured.

In this regard, according to the CFTC rule, the application for registration as swap dealer will need to be filed within 60 days after the final rule on the definition of swaps is published in the U.S. *Federal Register.* Although this deadline is applied to non-U.S. persons, as well as U.S. persons, we request that the swap dealer registration requirement (along with other obligations that registration entails) should not apply to non-U.S. persons before (i) the details, including the procedure and implementation timeline of substituted compliance become clear, and (ii) the assessment by the Commission for substituted compliance is completed and agreed with interested parties.

3. Exclusion of Certain Transactions From the Calculation of Swap Transactions in Regard to the *De Minimis* Threshold for Non-U.S. Persons

Third, the following types of swap transactions should be excluded from the calculation of swap transactions in regard to the *de minimis* threshold in determining the need for swap dealer registration for non-U.S. persons, if non-U.S. persons are required to register under limited circumstances.

(i) Transactions between non-U.S. affiliates of non-U.S. persons under common control and U.S. persons

We believe that only transactions with U.S. persons conducted by Japanese financial institutions established in Japan should be included in determining the need for registration as swap dealer. In other words, transactions with U.S. persons conducted by entities under common control of Japanese financial institutions established outside Japan (*e.g.,* in the UK and Hong Kong) should not be included in the calculation of swap transactions in regard to the *de minimis* threshold, with respect to the Japanese financial institutions established in Japan.

Furthermore, even if Japanese financial institutions are to be registered as swap dealers, their subsidiaries, sister companies or parent companies which conduct transactions with U.S. persons below the *de minimis* threshold should not be required to register as swap dealers.

(ii) Transactions between U.S. branches of non-U.S. persons and U.S. persons

According to the proposed guidance, we understand Japanese financial institutions established in Japan do not need to include the notional value of swap transactions with U.S. persons in which their U.S. affiliates engage, when calculating the swap transactions in regard to the *de minimis* threshold. In parallel with this, we believe that transactions between U.S. branches of Japanese financial institutions and U.S. persons should also be excluded from the *de minimis* threshold calculation for Japanese financial institutions.

We would Like to kindly request that the Commission take into account the above and amend the proposed guidance and order in accordance with our requests. Should you have any questions concerning the above, please do not hesitate to contact us.

Sincerely yours,

河野正道 M.K.

MASAMICHI KONO,
Vice Commissioner for International Affairs,
Financial Services Agency,
Government of Japan;

Hideo Hayakawa

HIDEO HAYAKAWA,
Executive Director,
Bank of Japan.

CC:

Commissioner Ms. JILL E. SOMMERS, CFTC
Commissioner Mr. BART CHILTON, CFTC
Commissioner Mr. SCOTT D. O'MALIA, CFTC
Commissioner Mr. MARK P. WETJEN, CFTC
Chairman MARY L. SCHAPIRO, SEC
Under Secretary for International Affairs LAEL BRAINARD, U.S. Department of the Treasury

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24 August 2012

DAVID A. STAWICK,
Secretary,

Commodity Futures Trading Commission,
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 U.S. 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 'U.S. Person'

The European Commission understands the CFTC's concern about exposing the U.S. financial system to significant risks through connections with a foreign entity which is not resident or established in the U.S. To this end the CFTC proposes a wide definition of a 'U.S. 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 U.S. regulatory requirements with those of other jurisdictions, including the EU. An EU and a U.S. firm that conclude an OTC derivatives contract will be simultaneously subject to EU and U.S. 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 U.S. persons would be subject to regulatory requirements in the EU and to Dodd-Frank in the U.S.

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 U.S. rules to non-U.S. firms implies that they would need to be enforced by U.S. 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-U.S. firms would be supervised by both the CFTC as well as their home regulators. A duplicative application of EU and U.S. 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 U.S. firms could face permanent legal uncertainty if this issue is not resolved. We therefore suggest that the definition of a 'U.S. person' should be qualified and should not apply to a person or entity that is not resident or established in the U.S. 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 U.S. 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 'U.S. person' proposed by the CFTC the registration requirement for non-U.S. 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 'U.S. 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 U.S. 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 U.S. branch of an EU entity trades only with other non-U.S. persons, there would seem to be no question of exposing the U.S. financial system to significant risks. Second, in response to the excessively wide scope of U.S. rules, EU banks might consider converting their U.S. 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 U.S., as an affiliate of a non-U.S. bank will be a fully legally incorporated U.S. 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 U.S. 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 U.S. 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 U.S. law compared to the treatment granted to U.S. 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-U.S. firms' transactions with U.S. 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-U.S. legal persons. Substituted compliance would not apply to trades involving one U.S. legal person and a non-U.S. 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 U.S. counterparties would always be subject to Dodd-Frank, while U.S. firms dealing with EU counterparties could not be subject to EU rules if the EU decides to grant equivalence to the U.S. Although the need for U.S. authorities to have certainty about the proper regulation of trades entered into by subsidiaries of U.S. 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 U.S. 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 U.S. 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 U.S. 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 U.S. 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 U.S. affiliates of EU firms would be subject to EMIR thus leading to the application of multiple rules to U.S. 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 U.S. 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 U.S. 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 U.S. 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,

JONATHAN FAULL,
Director General, Internal Market and Services,
European Commission.

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24 August 2012

DAVID A. STAWICK,
Secretary,
Commodity Futures Trading Commission,
Washington, D.C.

FSA Comment on *Proposed Interpretive Guidance and Policy Statement on Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act ("Proposed Cross-Border Guidance")* and *Proposed Exemptive Order Regarding Compliance With Certain Swap Regulations ("Proposed Exemptive Order")*

Dear Mr. Stawick,

We appreciate the ongoing dialogue between the CFTC and FSA in relation to the cross-border application of the U.S. Dodd-Frank legislation, and we would like to take this opportunity to provide comments on behalf of the FSA on the two papers released by the CFTC last month.

Our comments focus on a few areas of concern the FSA has with the proposed cross-border guidance and proposed exemptive order.

Deadline for Registration of Non-U.S. Swap Dealers ("SDs") and Major Swap Participants ("MSPs")

We understand that, in accordance with previous CFTC Dodd-Frank rulemakings. those SDs and MSPs required to register with the CFTC will be required to do so within 60 days of the publication in the U.S. *Federal Register* of a joint final rule with the SEC providing further definitions of "swap" and related terms.[1] We understand that this means that SDs and MSPs will need to register with the CFTC by 12 October 2012.

The CFTC acknowledges in its proposed cross-border guidance that there is uncertainty over whether a non-U.S. person's swap dealing activities will be sufficient to require registration as an SD. The proposed guidance is designed, in part, to provide clarity on this issue. Non-U.S. firms will therefore not be in a position to determine whether they are required to register as an SD or MSP before the final cross-border guidance is published. If this is close to, or after 12 October 2012, there is a risk

[1] CFTC/SEC Joint Final Rule and Interpretation: *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping.*

that firms will incorrectly register (or conversely. not register when they should), which exposes them to regulatory risk.

We therefore suggest that the CFTC delays imposing the registration requirement on non-U.S. persons until a defined period (perhaps 6 months) after the CFTC has finalised its cross-border guidance. This would allow firms time to interpret the guidance and make an informed and considered decision on the appropriate entities to register.

Application of Transaction-Level Requirements To All Registered SDs and MSPs

Section III.B.S of the proposed cross-border guidance outlines the application of Dodd-Frank transaction-level requirements, specifically "*to require non-U.S. swap dealers and non-U.S. MSPs to comply with Transaction-Level Requirements for all of their swaps with U.S. persons, other than foreign branches of U.S. persons, as counterparties*".

The corresponding European Union legislation (the Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories—"EMIR") takes a fundamentally different approach. Under EMIR, where a foreign regime is deemed to be equivalent, "counterparties entering into a transaction subject to this Regulation shall be deemed to have fulfilled the obligations contained in [*relevant articles*] where at least one of the counterparties is established in that third country." [2]

We are concerned that the proposed cross-border guidance does not allow for a similar equivalence-based process, and will instead require firms to meet Dodd-Frank transaction-level requirements where one of the counterparties is a U.S. person. In our view this has the potential to have a real impact on trades between UK and U.S. firms. For example, it is likely to result in the Dodd-Frank requirements being exported to a wide range of UK (and other EU) firms, for example resulting in any UK firm doing business with a U.S. firm needing to trade on a CFTC-registered Swap Execution Facility and clear the trade on a CFTC-registered clearing organisation. Were any non-U.S. legislation/regulation to take a similar approach to the proposed cross-border guidance. then a real risk of regulatory conflict for cross-border trades, potentially prohibiting such business, would exist.

We would therefore encourage the CFTC to take an approach similar to that taken in EMIR. This would build on the substantial work done at an international level to ensure a consistently strong level of regulation of global derivatives markets, enabling each jurisdiction to determine independently which other jurisdictions it considers equivalent, to ensure there is no dilution in the strength of local regulations.

Impact of Proposed Exemptive Order on Non-U.S. Persons

The proposed exemptive order would "*allow non-U.S. SDs and non-U.S. MSPs to delay compliance with certain Entity-Level Requirements*".[3] We believe this is appropriate as it will provide time for those firms for whom substituted compliance is possible to make an application to meet CFTC requirements through that route.

However, the proposed exemptive order only provides limited relief in relation to transaction-level requirements. Related to the previous point on the general application of transaction-level requirements to non-U.S. SDs and MSPs, we believe that the delays in required compliance in the proposed exemptive order should extend to also cover transaction-level requirements for non-U.S. SDs and MSPs. This would provide time for the CFTC to undertake determinations of substituted compliance before the requirements become binding on firms.

Substituted Compliance Process

We broadly support the process outlined in Section V of the proposed cross-border guidance for the determination of substituted compliance for an individual jurisdiction. We do however believe there are a number of additional points or changes that could be made in the proposed cross-border guidance that would help provide clarity to market participants on the process for determining substituted compliance.

- EU entities will be subject to highly harmonised regulation on derivatives issues, with the EMIR regime for OTC derivatives clearing, reporting and margining, the Markets in Financial Instruments Directive (soon to be updated) for trading-related issues and the Capital Requirements Directive for banking and investment firm solvency. It would therefore seem duplicative to require each EU entity seeking to benefit from substituted compliance to separately dem-

[2] Regulation (EU) No. 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories, Article 13(3).

[3] Proposed Exemptive Order, Section III.

onstrate the equivalence of these EU rules with Dodd-Frank. In the EU, assessments of equivalence will be undertaken at a jurisdictional level. As far as possible, we believe it would be beneficial, and more efficient, if the CFTC were to take a jurisdictional rather than firm-by-firm approach.

- In our view, the guidance could also outline more clearly in what circumstances a particular foreign jurisdiction will be acceptable for substituted compliance, and where substituted compliance will only be able to be determined for specific requirements as opposed to the entire set of CFTC swap requirements.
- As a further point we would encourage you to consider outlining in the guidance how the CFTC will make a determination of substituted compliance when regulatory reform in another jurisdiction is underway but not yet complete. For example, it remains unclear whether the CFTC could deem another jurisdiction to be acceptable for substituted compliance on the basis that a jurisdiction has rules entering shortly into force.
- We also believe it would be beneficial for the guidance to outline the anticipated timing of the CFTC's substituted compliance assessments, so that firms can have some certainly around whether there will be a gap between the expiry of the exemptive order and the relevant substituted compliance determinations.
- Finally on this point, we would encourage the CFTC to take into consideration compliance with relevant international standards in the determination of acceptability for substituted compliance. In general, compliance with relevant international standards (such as the CPSS–IOSCO Principles for Financial Markets Infrastructure or various reports of IOSCO) should be an important factor in determining if a jurisdiction has a regime acceptable for substituted compliance.

Treatment of U.S. Branches of Non-U.S. Persons

We are concerned there is a lack of clarity about the treatment of U.S. branches of non-U.S. persons in the proposed cross-border guidance.

Section II.D.3 of the proposed cross-border guidance suggests that, in certain circumstances, a U.S. branch of a non-U.S. person could be required to register with and be subject to oversight by the CFTC. We are particularly concerned that a non-U.S. person, who may trade only with other non-U.S. persons, could become subject to CFTC registration and oversight due only to the activities of a U.S. branch of the non-U.S. person.

As an example, it appears under the proposed cross-border guidance that a New York branch of a UK bank that is facilitating trades between the UK bank and another non-U.S. bank could result in the New York branch, or the UK bank itself, being required to register with the CFTC despite the legal person being located outside the U.S. and trading only with non-U.S. persons. We believe in this scenario that the transaction entered into by the non-U.S. person through a U.S. branch is unlikely to introduce any risk into the U.S.

We therefore believe the guidance could be clarified to make clear that the presence of a branch in the U.S. should not, in itself, result in the branch or parent entity becoming subject to CFTC registration and prudential requirements, unless they are required to do so on some other basis.

Definition of a U.S. Person

We understand the CFTC's desire to avoid a situation where the U.S. financial system is exposed to undue risks through links to a foreign entity. However, defining an entity which is not resident or established in the U.S. as a U.S. person comes with a risk of conflict of laws, particularly where that person is resident or established in a jurisdiction with a highly developed regulatory system. For example, a collective investment vehicle managed from the EU, but with a majority ownership by U.S. persons, would be subject to the Alternative Investment Fund Managers Directive and EMIR in the EU and to Dodd-Frank in the U.S., and the multiple registration requirements could present a significant possibility of conflict of laws. We would encourage a qualification to be added to the definition of U.S. person to state that an entity which is neither established nor resident in the U.S. will not be classed as a U.S. person where it is established or resident in a jurisdiction which has in force regulations with equivalent effect to Dodd-Frank.

We thank you again for providing the opportunity to comment on these important releases, and we look forward to continued strong engagement between the CFTC and the FSA. We would be happy to discuss any of these issues raised with you further.

Yours sincerely,

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DAVID LAWTON,
Director of Markets, Financial Services Authority;

STEPHEN BLAND,
Director of Investment Banks and Overseas Banks, Financial Services Authority.

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27 August 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Dear Gary,

1. We appreciate an opportunity to comment on the Commodity Futures Trading Commission ("CFTC")'s draft interpretative guidance on the "Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act" (the "Proposed Guidance") in July 2012. We are writing to express our concerns and to seek clarification on various aspects of the Proposed Guidance as raised by our regulators and the industry.

2. The Proposed Guidance indicates that the CFTC intends to regard non-U.S. persons as being subject to the CFTC registration requirements under certain conditions. We are concerned that such an approach to extend the CFTC's jurisdiction to the operation of foreign financial institutions would result in such institutions having to meet overlapping, and possibly conflicting, regulations in the U.S. and their home jurisdictions, and would undermine regulatory reform efforts currently under way in other jurisdictions including Hong Kong. Moreover, the proposed extension of the CFTC's jurisdictional reach would increase compliance costs for global market participants and more importantly, may discourage market participants from entering into Over-the-counter ("OTC") derivatives transactions with U.S. persons, resulting in market fragmentation and liquidity withdrawal. Particularly for those provisions that may be in conflict with local legislation, enforceability is called into question.

Defining "U.S. Persons"

3. Regulators in Hong Kong, the Securities and Futures Commission ("SFC") and the Hong Kong Monetary Authority ("HKMA"), have examined the Proposed Guidance with market participants operating in Hong Kong with the view to assessing the impact that such guidance may have on them and their operations here. The general feedback is that there is insufficient clarity as to how the U.S. rules and regulations will be applied to non-U.S. based swap dealers ("SDs") and non-U.S. major swap participants ("MSPs"), leading to concerns about the practical implementation issues arising from the Proposed Guidance. A major area of concern is how the term "U.S. person" will be construed. As you will agree, it is critical for a non-U.S. person to be able to independently determine if it falls within the registration requirements of the CFTC rules. As we understand it, this hinges on whether the non-U.S. person's counterparty is a "U.S. person". In this regard, our market participants are concerned that the Proposed Guidance does not provide sufficient clarity or specificity to enable them to ascertain whether their counterparties will be construed by the CFTC as U.S. persons. Consequently, it is also difficult for them to assess the full impact of the registration requirements on them and their operations. This also hampers the ability of global players in the OTC derivatives market to streamline their structure and operations when dealing with both U.S. and non-U.S. counterparties.

Enforceability Issues

4. Besides, financial institutions registered as non-U.S. based SDs are required to report all OTC derivatives transactions to a Swap Data Repository ("SDR"). Market participants are concerned about whether they could legally transfer customer data to the foreign SDRs to meet CFTC's reporting requirements, given that the client account opening documents are governed by the local laws and in the context of ful-

filling the reporting obligations, the U.S. authorities are neither the banks' home or host regulators. Therefore, for the avoidance of legal risk, non-U.S. based SDs may be unable to continue dealing with non-U.S. customers in the OTC derivatives market unless these customers provide explicit consent to release their data to meet the U.S. reporting requirements or substituted compliance is permitted. This places them at competitive disadvantage *versus* peers which are not subject to the same restriction.

"Substituted Compliance"

5. The Proposed Guidance indicates that the CFTC will allow for "substituted compliance", *i.e.,* compliance with local laws and regulations will be regarded as sufficient if such laws and regulations are comparable to U.S. rules and regulations. In the extreme cases, such requirements may force financial institutions to refrain from certain OTC derivatives activities, thus hampering liquidity in the global markets. However, it isn't clear how the CFTC will assess comparability for the purposes of allowing "substituted compliance", making it rather difficult for market participants and foreign regulators to understand how comparability will be applied in practice.

Regulatory Cooperation on Cross-Border Transactions

6. We believe the international community should work together to build a cooperative framework for the regulation of OTC derivatives market on the global basis. As the OTC derivatives market is a global one, it is important that regulators adopt comparable rules based on guidance and standards set by international standard setting bodies. International standards and principles serve to harmonise regulatory standards and minimise regulatory arbitrage, while also respecting jurisdictional authority. Regulators in major markets have been working together through international standard setting bodies (such as the International Organisation of Securities Commissions and the Committee on Payment and Settlement Systems of the Bank for International Settlements) to agree on common standards and principles for regulating the OTC derivatives market. Reform efforts in individual markets, including Hong Kong, have also been progressing by reference to these international standards and principles.

7. As foreign jurisdictions would have primary responsibilities in developing and implementing the regulatory frameworks for the OTC derivatives market participants and their transactions in their own jurisdictions. To avoid regulatory overlap and in the spirit of international comity, we propose that foreign jurisdictions be responsible for the regulation of OTC derivatives activities in their home jurisdictions in accordance to international standards. Under this framework, the application of the CFTC's rules to non-U.S. persons, *e.g.,* foreign banks, should only be confined to their legal entities based in the U.S. (*i.e.,* U.S. branch or subsidiary). In this connection, we would like to request the CFTC to reconsider the need and the implication of the extraterritorial application of the U.S. derivative regulations, including swap dealer registration requirement for non-U.S. persons (including Hong Kong financial institutions).

8. We understand and appreciate CFTC's concerns over the activities of U.S. persons and their overseas branches and subsidiaries conducted outside the U.S. that may have a significant connection and impact on the U.S. markets and thus giving rise to CFTC's proposal for cross-border application of their regulations. We should continue to explore how foreign subsidiaries of U.S. entities could meet the CFTC's rules on swap without coming into conflict with local regulations. Before international consensus is reached on this important matter, we would like to propose that CFTC defers application of its regulation with respect to non-U.S. person so that regulators in international forum could work out the arrangement for regulating cross-border OTC transactions in a coordinated manner.

Central Clearing of OTC Derivatives

9. Furthermore, under the Proposed Guidance, non-U.S. based SDs in order to comply with CFTC requirements, will be compelled to clear their OTC derivatives transactions through a U.S. regulated central counterparty ("CCP") in certain cases. Specifically, non-U.S. based SDs who transact with U.S. counterparties, or counterparties guaranteed by U.S. persons, will have to clear their OTC derivatives transaction through a CCP that is either registered in the U.S. as a Derivatives Clearing Organization ("DCO"), or exempted from having to be registered as a DCO. This requirement has significant implications because it means non-U.S. based SDs who want to clear through their local (non-U.S.) CCPs, some of which provide service for unique local products, could do so only if such CCPs would have been registered (or exempted from being registered) as DCOs before the implementation of the clearing obligations under the Dodd-Frank Act. If the CCPs fail to obtain such

registration or exemption status in good time, there will be significant disruption to the global OTC derivatives market. For example, many market participants will need to establish in short time new clearing arrangements with CCPs which are U.S.-regulated DCOs, or already registered as such. Otherwise, they may have no choice but stop transacting with U.S. persons at all to avoid risking non-compliance. Either way, the consequences for market participants will be significant.

10. It is believed that the above unintended and undesirable consequences can be avoided or minimised. In this regard, I urge the U.S. authorities to consider the following:

i. **Transitional arrangement.** Allow OTC derivatives transactions conducted outside the U.S. to carry on as usual during the processing period for a DCO application or a "substituted compliance" application;

ii. **Exempting foreign CCPs.** Provide exemption from the DCO registration if a foreign CCP is not systemically important to the U.S. market. For example, a *de minimis* exemption could be provided (similar to the *de minimis* threshold for the SD registration) such that foreign CCPs that clear OTC derivatives transactions for U.S. persons below a certain threshold, may be exempted from the DCO registration; and

iii. **Recognising foreign CCPs.** Develop a simplified process for recognising foreign CCPs that are regulated by competent authorities subscribing to international standards.

11. In conclusion, we call for greater coordination internationally on implementation of OTC regulations, particularly those with cross-border implications. We hope that the CFTC, SEC and the U.S. Treasury will defer the application of the U.S. rules and regulations over non-U.S. persons and work with the international community on a coordinated framework on regulatory cooperation in cross-border OTC transactions. We also hope that U.S. authorities would provide greater clarity to the Proposed Guidance and to recognize the OTC derivatives regulatory regimes of overseas jurisdictions on the basis of international standard.

Yours sincerely,

Professor K.C. CHAN, *Secretary for Financial Services and the Treasury.*

CC:

Secretary of the Treasury, USA, (Mr. Timothy Geithner)
Chairman, U.S. Securities and Exchange Commission (Ms. Mary L. Schapiro)
Consul General of the United States of America in Hong Kong (Mr. Stephen Young)
Chief Executive, Hong Kong Monetary Authority (Mr. Norman Chan)
Chief Executive Officer, Securities and Futures Commission (Mr. Ashley Alder)
Hong Kong Commissioner for Economic and Trade Affairs, USA (Mr. Donald Tong)

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27 August 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

CFTC's Proposed Guidance on Cross-Border Application of Certain Swap Provisions of Commodity Exchange Act ("Proposed Guidance")

Dear Chairman Gensler,

1. We, the undersigned, are a group of financial regulators in the Asia Pacific region with a mutual interest in ensuring the smooth and effective implementation of the G20-agreed reforms of OTC derivatives markets in our jurisdictions. We welcome the release of the Proposed Guidance by the CFTC to clarify how it intends to apply the Commodity Exchange Act to cross-border swap dealing activities involving non-U.S. persons, and acknowledge the CFTC's efforts to consider the impact of the swap provisions on non-U.S. markets and participants. However, we are concerned that some of the proposed requirements as they currently stand may have significant effects on financial markets and institutions outside of the U.S. We believe a failure to address these concerns could have unintended consequences, including increasing market fragmentation and, potentially, systemic risk in these

markets, as well as unduly increasing the compliance burden on industry and regulators. We therefore think it necessary to share with you our specific concerns, as well as some suggestions to mitigate these concerns, so that any unintended and adverse consequences for global markets and institutions can be averted.

Major Issues and Suggestions

2. Currently, various national authorities around the globe (including those represented in this letter) are taking active steps to implement in their jurisdictions the reform measures endorsed by the G20 leaders in respect of OTC derivatives markets, with a view to promoting transparency and confidence in derivatives markets and reducing systemic risks arising from activities in such markets.

3. However, the CFTC Proposed Guidance, that subjects non-U.S. persons to the swap dealer ("SD") or major swap participant ("MSP") registration requirements as well as entity-level and transaction-level requirements, may have the following consequences:

- Affected non-U.S. persons will have to comply with two sets of regulations, which may be overlapping and conflicting, imposed by the U.S. and individual non-U.S. regimes. This is compounded by the lack of clarity and specificity in a number of areas of the Proposed Guidance.
- Potential market disruption or fragmentation, with consequently increased risks to systemic stability and market liquidity in our markets, may arise as market participants may have to change their business models or even withdraw from certain businesses, all within a relatively short period of time. The impact from any resulting (likely significant) increase in compliance costs and the potential reduction in liquidity of OTC derivatives markets should not be under-estimated.

4. In our view, while the approach proposed by the CFTC is a useful first step, further changes are needed to the Proposed Guidance to achieve an internationally harmonised approach and avoid creating frictions in the international market place, given the cross-border nature of OTC derivative markets and the concerns expressed in this letter and also by other regulators.

5. We would thus urge the CFTC to consider the following suggestions:

(i) ***Re-assess scope and timing for implementing the Proposed Guidance:*** We suggest that a re-assessment of the CFTC's proposed approach should be made to avoid any unintended and adverse implications for global markets and institutions. This should preferably be done together with engagement with affected jurisdictions (including ourselves) to address their concerns before finalising the Proposed Guidance. We seek further dialogue with the CFTC to do so. Consideration should also be given to deferring the application of the relevant requirements until there is international consensus on how such cross-border transactions should be regulated.

Rather than a rule-by-rule or case-by-case approach as it is currently proposed, an approach that looks at substantive regulatory outcomes (where appropriate) or an expansion to place greater reliance on the regulatory and supervisory regimes of other regulators would better achieve the concept of international comity which the CFTC is seeking.

(ii) ***Provide more guidance and clarity on assessment of substituted compliance and definition of U.S. person:*** Notwithstanding the suggestions in Paragraph 5(i), we believe the Proposed Guidance would benefit from greater clarity and detail regarding the application of the swap provisions. In particular, (a) the definition of "U.S. person"; and (b) the criteria, procedures and implementation timeline for "substituted compliance" in respect of each of the CFTC's entity-level requirements and transaction-level requirements could each be further clarified. We would welcome dialogue with the CFTC on these areas.

We note that the proposed definition of "U.S. person" is high-level and different from that used in other regulations (*e.g.,* Reg S.). Market practitioners have also highlighted that it is not easy to identify if a counterparty is a U.S. person. Uncertainty will increase the risk for, and costs of, market participants in assessing the full impact of the Proposed Guidance (*e.g.,* the registration requirements).

On substituted compliance, the Proposed Guidance contains broad language to the effect that the CFTC would determine comparability for the purposes of "substituted compliance".[1] However, it is unclear on how comparability will be assessed and whether there will be interim measures prior to finalising the assessment as no further details or elaboration are provided in the Proposed Guidance.

We are of the view that one useful point of reference for substituted compliance assessment would be the foreign regime's compliance with applicable global standards set by international standard-setting bodies like the CPSS, IOSCO and the Basel Committee on Banking Supervision. Moreover, just as the CFTC has proposed requirements which are tailored to the U.S. market, there is also a need for other regulators to cater for special characteristics of their local markets. For example, in the case of Hong Kong, Australia and Singapore, we are studying whether local market liquidity can justify implementation of mandatory trading of OTC derivatives products on exchanges or electronic trading platforms, and the form of trading venue which will best suit the purpose of improving pre-trade price transparency. This will affect our timing for implementing mandatory trading in practice (although the powers for imposing such trading obligation will be in place). In addition, the CFTC has recognised that the pace of implementation of OTC derivatives reforms by different jurisdictions may vary, and we suggest that the approval for "substituted compliance" should take into account, among other things, the proposed regulations, and the progress in introducing these regulations, in "potentially comparable" jurisdictions.

(iii) ***Allow transitional arrangements for application of Proposed Guidance to non-U.S. entities:*** To minimise the risk of market disruption and fragmentation in respect of the conduct of OTC derivatives transactions outside the U.S. that will likely be captured under the Proposed Guidance, we strongly recommend the CFTC to consider more flexible transitional arrangements that will allow market participants to carry on such transactions as usual as it reviews jurisdictions for the purpose of "substituted compliance", in line with the spirit of international comity.

(iv) ***Consider further temporary exemptive relief for non-U.S. SDs and MSPs:*** We note that certain requirements, *e.g.,* capital and margin rules, the SEF rules, may not be finalised before the swap dealer registration deadline. It is thus strange for non U.S.-based entities to register without having certainty on the full implications of the registration.

In addition, certain SD requirements may conflict with domestic requirements. For example, non-U.S. SDs that are regulated as banks may be prohibited by local privacy laws from transferring customer data to the U.S. for reporting swap transactions. To avoid legal risk, non-U.S. SDs may be unable to continue dealing with non-U.S. customers in the OTC derivatives market unless (a) their customers provide explicit consent to the release of their data in order to meet the U.S. reporting requirements; or (b) "substituted compliance" is permitted.

As such, we request that the CFTC considers delaying the registration requirement for non-U.S. SDs until there is clarity of the above issues.

Furthermore, we have two comments with respect to the proposed granting of temporary exemptive relief order, to allow non-U.S. SDs and MSPs to delay compliance with certain entity-level and transaction-level requirements. First, *we suggest that the "non-affiliate" condition is removed or modified* as it will capture foreign affiliates that operate independently from the U.S. SD (and are not under the SD's majority control) and whose swaps with non-U.S. counterparties are unlikely to have significant systemic risk implications for the U.S. Second, while we appreciate the intent of this temporary relief, it is subject to progress made on operationalising "substituted compliance" as well as more clarity on the conditions to which the relief is subject.

(v) ***Consider proportional regulatory approach to central counterparties ("CCPs") in non-U.S. jurisdictions with relatively small OTC derivatives markets:*** We would strongly encourage the U.S. authorities to develop a simplified and pragmatic process for (a) recognising or exempting non-U.S. CCPs (including those that operate in relatively small OTC derivatives markets) that are regulated by competent authorities subscribing to relevant CPSS/IOSCO standards; and (b) handling applications for "substituted compliance" with pri-

[1] Considerations include (i) the "scope and objectives" of the regulatory requirements imposed by a non-U.S. regulator; (ii) the comprehensiveness of the regulator's supervisory compliance programme; and (iii) the regulator's power to support and enforce its oversight of non-U.S. SDs and MSPs operating in its jurisdiction.

ority (provided that clear guidance on application criteria and procedures is available to potential applicants). In formulating this process, the CFTC is also requested to have regard to the potential impact on non-U.S. CCPs and markets as explained below.

Under the Proposed Guidance, non-U.S. SDs, which may be significant liquidity providers in foreign jurisdictions, will be required to centrally clear their OTC derivatives transactions with (a) U.S. counterparties or (b) non-U.S. counterparties that are guaranteed by U.S. persons (although "substituted compliance" may be permitted for transactions described in (ii)) through registered or registration-exempted Derivatives Clearing Organisations ("DCOs"). If the CFTC mandates clearing for products that are also traded in our markets, it will be critical that CCPs operating in those markets be able to obtain approval from the CFTC as a registered DCO (or be exempted from registration) in good time, to allow participants to clear mandated transactions.

Failure of a CCP to obtain approval as a registered DCO (or be exempted from registration) in time may lead to the following consequences:

- The mandated transactions may be channelled to registered DCOs which are now global facilities. This raises concerns over the potential over-concentration of risks in such CCPs.
- Certain U.S. SDs operating in the Asia Pacific region are major liquidity providers in local markets. If they are not allowed to use clearing platforms other than DCOs that are U.S.-registered or exempt from registration, and other smaller local/regional players can only access central clearing indirectly, the overall capacity of these players to further provide liquidity in local/regional OTC derivatives markets may be curtailed.
- This development may also undermine the financial viability of local/regional CCPs, in turn resulting in such CCPs ceasing to provide important clearing services for products that are unique to our financial markets and not cleared through foreign CCPs registered as DCOs, potentially increasing systemic risk in such markets and impacting the stability of U.S. markets and/or major participants as well.
- Lastly, local and regional market participants who do not have direct access to global CCPs may have to face the credit risk of a small group of clearing agents who are likely to be the same global dealers with whom they are dealing, potentially restricting their counterparty risk management capacity. This also adds to, and further concentrates, the risks at the major clearing members.

6. We appreciate the opportunity to provide our comments to the Proposed Guidance and look forward to our continued cooperation and engagement with the CFTC and other regulators to provide globally harmonised regulations for an efficient and robust OTC derivatives market.

Yours sincerely,

BELINDA GIBSON,
Deputy Chairman,
Australian Securities and Investments Commission;

ARTHUR YUEN,
Deputy Chief Executive,
Hong Kong Monetary Authority;

TEO SWEE LIAN,
Deputy Managing Director,
(Financial Supervision),
Monetary Authority of Singapore;

MALCOLM EDEY,
Assistant Governor
(Financial System),
Reserve Bank of Australia;

KEITH LUI,
Executive Director
Supervision of Markets,
Securities and Futures Commission, Hong Kong.

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27 August 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Ref: Answer to the Proposed Interpretative Guidance and Policy Statement on Cross-Border application of Certain Swaps provisions of the Commodity Exchange Act—RIN number 3038–AD57

Dear Gary,

On 12 July 2012, the Commodity Futures Trading Commission (CFTC) published a proposed interpretative guidance and policy statement regarding the Cross-Border application of Certain Swaps provisions of the Commodity Exchange Act.

This consultation is of particular relevance to ESMA which is tasked with drafting technical standards under EMIR, including determining derivative contracts that are considered to have a direct, substantial and foreseeable effect within the European Union, as well as assisting the European Commission in its own task of adopting decisions on equivalence of the legal, supervisory and enforcement framework in third countries. We have maintained an open and fruitful dialogue with the CFTC in the past on these matters and we will continue to do so, in the interest of regulatory convergence at international level.

In a market which is global in nature, it is particularly important that regulations in the different jurisdictions converge. Convergence and, consequently, avoidance of gaps and overlaps, will contribute to a safe and efficient global derivatives market.

In order to prevent overlaps, it is important that regulators in different jurisdictions rely on each other especially when an equivalent regulation is implemented in the relevant jurisdiction. Indeed it is of paramount importance to strictly limit, if not eliminate, any overlap that could jeopardise both safety and efficiency of the derivatives market and that could negatively impact on the implementation of the G20 commitments.

We would like to comment as follows:

U.S. Person and Registration

The proposed interpretation of the scope of what has a "*direct and significant connection with activities in, or effect on, commerce of the United States*" is broad.

The CFTC proposes that non-U.S. persons who engage in more than a *de minimis* level of swap dealing with a U.S. person are required to register as a swap dealer (SD). In addition, non-U.S. persons who hold swap positions above the Major Swap Participants (MSP) specified thresholds with a U.S. counterparty are required to register as MSP.

In practice, this would mean that European entities (whether or not affiliates or subsidiaries of U.S. entities) would be subject to CFTC registration requirements if they enter into transactions (above the SD or MSP thresholds) with U.S. persons. This means that these European entities will be subject at the same time to Dodd-Frank and EMIR requirements.

We believe that the scope of the derivative transactions to be considered for the purpose of determining the registration requirement of SD or MSP should be limited to relevant transactions and to those other activities which could be carried out with the purpose of circumventing any relevant obligation. Indeed, it would be appropriate to consider that only transactions that might result in a significant exposure for a U.S. person should be deemed to have a direct and significant impact in the U.S.

Far-reaching entity level registration requirements imposed on European entities as well as a limited scope for substituted compliance (as discussed below), contributes to dual regulatory compliance requirements. This is why we ask the CFTC to reconsider the need for European entities to register as SD or MSP to the extent they are fully subject to EU legislation on OTC derivatives.

In addition, CFTC registration requirements would apply to European entities irrespective of whether they would solicit the counterparty in the U.S. or whether the transaction would be concluded at the initiative of the U.S. person. Moreover, in the case of U.S. branches, registration of the European head office is required even though the transactions would be legally entered into by the parent entity outside the U.S., with no additional risk for the U.S. compared to similar entities operating without U.S. branches.

In Europe, under the MiFID proposal, the EU regime would be applicable to third country investment firms only if the latter promote their services or solicit clients in the EU. Such regime would not apply in the case of the provision of services by the third country investment firm at the exclusive initiative of the EU clients.

Under the MiFID proposal, third country entities would also remain subject to their home country legislation if deemed equivalent by the European Commission.

The broad scope of the definitions of a U.S. person, SD and MSP, and the resulting registration requirements could have a serious impact on the current business model of European and U.S. firms which may not be proportionate to the benefits being sought. Alternative approaches should be envisaged to ensure that the objectives of U.S. regulations are satisfied.

Substituted Compliance

We appreciate the introduction of the concept of substituted compliance in the CFTC's proposal. However, we see two limitations in the concept, apart from its application (commented below):

- We have always been of the view that when equivalence or substituted compliance is granted for an entire jurisdiction, registration of entities located in that jurisdiction, including affiliates or subsidiaries of U.S. entities, should not be required. However, in the U.S. proposed regime, registration is a pre-requisite before substituted compliance could apply.
- We believe that the proposed use of substituted compliance is still very limited. It would apply on a chapter by chapter basis, and in some instances, on a case by case basis. It would also only apply to transactions between non-U.S. persons and not to cross-border transactions. If applied in this form, such an approach would be far away from the concepts of equivalence, mutual recognition and avoidance of duplicative or conflicting rules included in EMIR.

We understand that substituted compliance would apply for entity level requirements on a firm by firm basis but with provisions for applications by groups or by whole jurisdictions. It is important to note that EMIR is a regulation directly applicable in the 27 EU Members States. This will also be the case for the technical standards developed by ESMA that will take the form of a European Commission Regulation. Other entity-level requirements have already been introduced in Europe through either MiFID or the Capital Requirements Directive (CRD). Under this EU regime, firms established in European countries will apply these rules without any option to apply different rules. Because there is one set of rules that applies across the EU, and in order to facilitate the assessment and to limit the burden on European firms, substituted compliance should apply to all EU firms rather than at firm specific level. This is also the case for ensuring a consistent application of enforcement and supervision across EU firms. In this respect, there are several ESMA mechanisms to ensure that supervision and enforcement are convergent and comparable across the EU. Against this background, the European approach on equivalence is based on an overall assessment of the regulatory and supervisory regime in a particular jurisdiction and we encourage the CFTC to adopt a similar approach for substituted compliance for the entire EU.

Concerning the application of substituted compliance to transaction level requirements, we believe that its application is too narrow. We understand that substituted compliance would apply to transactions between two non-U.S. counterparties but, for cross-border transactions (*e.g.,* between a U.S. and a European counterparty) substituted compliance is not allowed. This would mean that both the European and U.S. regulations would apply to a transaction. We believe it would be essential to consider the application of substituted compliance for transactions between European and U.S. firms.

Under Article 13 of EMIR, the European Commission, assisted by ESMA, will monitor the international application of requirements for OTC derivatives in particular with regard to potential, duplicative or conflicting requirements. In addition, the European Commission may take an equivalence decision to allow for the application of an equivalent third country regime for transactions between European and third country firms. Therefore, in order to allow for an equivalence decision and positive monitoring, it is important that the third country rules do not duplicate or conflict with the European regime. We urge the CFTC to extend the scope of substituted compliance to ensure a smooth adoption of a mutual recognition approach, to avoid an unacceptable situation for both market participants and regulators.

In addition to Article 13 of EMIR, ESMA (under Articles 4 and 11) has to draft regulatory technical standards specifying the contracts that are considered to have a direct, substantial and foreseeable effect within the Union or the cases where it is necessary or appropriate to prevent the evasion of any provisions in EMIR. We are working on the development of this draft technical standard. In that context, the broad scope of a U.S. person definition and the limited use of substituted compliance might make this work complex in view of the objective to avoid duplications and potentially conflicting provisions which could have serious consequences for both U.S. and European firms.

We believe that we will succeed in building a sound and coherent global framework leading to improved transparency, efficiency and robustness of the OTC derivatives market, in accordance with the G20 commitments. To that end, although we welcome the introduction of the concept of substituted compliance, we are convinced that it will not be possible to achieve our common objective without changing significantly its scope to a regime where true reliance on the EU regulatory and supervisory regime is achieved. This could be done by expanding the number of cases where it can be applied (especially transaction level requirements) and by applying it EU-wide, instead of firm by firm or country by country.

ESMA stands ready to assist the CFTC in assessing the conditions for substituted compliance in a EU-wide approach.

I hope that these comments will help and look forward to continued cooperation with the CFTC with the aim to deliver convergent regulation for a safe and efficient OTC derivatives market.

Yours sincerely,

STEVEN MAIJOOR, *Chair,* European Securities and Markets Authority.

August 27, 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Re: Proposed CFTC Cross-Border Releases on Swap Regulations

Dear Chairman Gensler,

We would like to share our views and concerns regarding the impacts of cross-border application of certain swaps provisions of the Commodity Exchange Act (CEA). as a result of our assessment of the proposed interpretive guidance issued by the CFTC.

(1) Registration as a Swap Dealer or as a Major Swap Participant

According to preliminary data, some Brazilian financial entities will exceed the *de minimis* threshold and be required to register as swap dealers (SD) or as a major swap participants (MSP) and, therefore, to comply with the relevant rules.

The additional regulatory burden, associated with the CFTC oversight of activities already regulated in Brazil, as we have been told, might discourage Brazilian institutions from trading swaps with many active U.S. persons in our market, with potential impact on market liquidity.

The regulatory overlap might not only make it more difficult for Brazilian authorities to address local market problems or to deal with troubled institutions, but also create a burdensome environment in a time of slow global growth.

(2) Substituted Compliance

The proposed approach for a substituted compliance mechanism has several limitations.

Rather than acknowledging the comparability of the foreign regime as a whole, applications for substituted compliance must be submitted by any individual firm registered as a SD or as a MSP. This approach is likely to impose unnecessary costs and burdens on individual firms in complying with the rules under the CEA. Also. it remains unclear whether the foreign applicant will be able to dispute any of the Commission's findings in terms of comparability assessments.

With regard to G20 members, an alternative to the proposed substituted compliance approach would be a CFTC presumption that countries that have implemented the G20 commitments have an adequate regulatory regime for the purposes of "substitute compliance" or "equivalence". The various implementation reviews that the FSB, IOSCO and other bodies have set up could be used as an input in this process.

It is worthy to mention that Brazilian rules are stricter and provide more protection to stability than the requirements set forth in other jurisdictions. To mention some examples, we could point out the fact that, in Brazil:

(i) the final beneficial owner is identifiable at all levels of the holding chain, allowing for accurate and up-to-date monitoring of exposures per market participant, on a daily basis; and that

(ii) over 90% of all derivatives are exchange-traded and cleared at a central counterparty clearing, providing unparalleled systemic risk mitigation.

Last, the "transaction-level requirements", as we understood, are not eligible for substituted compliance. In our opinion, the relevant rules. along with the features pertaining to other jurisdictions (such as mandatory central counterparty clearing and margin requirements), can lead to inefficient results. In this sense, we find it relevant that the particularities of a foreign regime be taken into consideration also in relation to the "transaction-level requirements".

(3) Privacy and Data Protection Issues

Another area of concern relates to privacy and data protection issues, since substituted compliance relative to Swap Data Repository (SDR) reporting is only permitted if the CFTC is able to access the required information stored in the SDR. This approach may conflict with Brazilian bank secrecy rules set out in Law 105 of 2001. The Market Authority (CVM) has powers to share information protected by bank secrecy rules in cases of enforcement, but there are no previous cases of information sharing in cases of market supervision. In this context, Brazilian entities may be prevented from providing more detailed information requested by the CFTC.

Even in the cases of market participants that are exempt from the registration as a SD or as a MSP, our concerns relative to bank secrecy rules remain, since SDR reporting rules also apply in such cases.

We thank you for your consideration and should you have any questions concerning the issues we have raised, please do not hesitate to contact us.

Yours sincerely,

OTAVIO YAZBEK, *Chairman,* Comissão de Valores Mobiiários.

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17 October 2012

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

U.S. Cross Border Swaps Rules

Dear Chairman Gensler,

We, the undersigned, would like to share our concerns with you about the implementation of the current phase of post-crisis regulatory reform, as you reflect on the final shape of the CFTC cross-border rules for swaps.

Faithfully implementing the reforms adopted by the G20 in 2009 in Pittsburgh on the clearing and electronic trading of standardised OTC derivatives in a non-discriminatory way remains of the utmost importance. As you know, Europe has adopted legislation on clearing and is in the final stages of negotiation on the trading aspect of the G20 Pittsburgh reforms. In Japan, clearing requirements will be effective in November and legislation on trading platforms was recently approved by the Diet. While there may be differences in some areas of detail, we believe the U.S., the Member States of the EU and Japan are now set to implement these historic reforms in a broadly consistent way in our respective jurisdictions.

This is a significant achievement, capturing the large majority of the global swaps market. But as has been continuously stressed by G20 leaders since 2009, domestic legislation alone does not fulfil the political aim that was agreed in Pittsburgh and reaffirmed in Toronto in 2010. Regulation across the G20 needs to be carefully implemented in a harmonised way that does not risk fragmenting vital global financial markets.

For all its past faults, the derivatives market has allowed financial counterparties across the globe to come together to conduct more effective risk management and, as a result support economic development. Done properly this should be of benefit to all. At a time of highly fragile economic growth, we believe that it is critical to avoid taking steps that risk a withdrawal from global financial markets into inevitably less efficient regional or national markets.

We of course recognise and understand the need for U.S. and other regulators to satisfy themselves on the adequacy of regulation in other jurisdictions. But we would urge you before finalising any rules, or enforcing any deadlines, to take the time to ensure that U.S. rulemaking works not just domestically but also globally. We should collectively adopt cross-border rules consistent with the principle that equivalence or substituted compliance with respect to partner jurisdictions, and consequential reliance on the regulation and supervision within those jurisdictions, should be used as far as possible to avoid fragmentation of global markets. Specifically, this principle needs to be enshrined in CFTC cross-border rules, so that all U.S. persons wherever they are located can transact with non-U.S. entities using a proportionate substituted compliance regime.

We assure you our regulatory authorities stand ready to work closely with you to ensure an effective cross-border regime is implemented at the earliest possible opportunity and provide you with the necessary information and reassurance regarding our respective regulatory frameworks.

Yours sincerely,

GEORGE OSBORNE,
Chancellor of the Exchequer,
European Commission;
UK Government;

MICHEL BARNIER,
Commissioner for Internal Market and Services,

中塚 一宏

IKKO NAKATSUKA,
Minister of State for Financial Services,
Government of Japan;

PIERRE MOSCOVICI
Minister of Finance,
Government of France.

SUBMITTED LETTER BY HON. RANDY NEUGEBAUER, A REPRESENTATIVE IN CONGRESS FROM TEXAS

December 20, 2012

Hon. K. MICHAEL CONAWAY,
Chairman,
Subcommittee on General Farm Commodities and Risk Management,
House Committee on Agriculture,
Washington, D.C.

Dear Chairman Conaway,

Last week, the Subcommittee on General Farm Commodities and Risk Management held a hearing titled "Dodd-Frank Derivatives Reform: Challenges Facing U.S. and International Markets." During the hearing, one of the CFTC witnesses indicated that the CFTC is drafting a new position limits rule and will appeal the D.C. District Court's decision vacating a previous version of the rule.

I am concerned that the rule fails to distinguish between speculators on the one hand and certain broadly diversified, passive index funds on the other. Inappropriately applying position limits to such funds could significantly reduce investor access to commodity markets, shrink market liquidity, impede price discovery, and destabilize the market.

The potential for such unintended consequences is so significant that the then-Chairwoman of the Senate Agriculture Committee, Blanche Lincoln, a primary author of what became Title VII of the Dodd-Frank Act, was compelled to send the enclosed letter to the CFTC. This letter constitutes the clearest expression of legislative history in this area, and I therefore ask that it be made a part of the official hearing record.

Best regards,

Randy

Hon. RANDY NEUGEBAUER.

ATTACHMENT

December 16, 2010

Hon. GARY GENSLER,
Chairman,
Commodity Futures Trading Commission,
Washington, D.C.

Re: CFTC's Implementation of Position Limits

Dear Chairman Gensler:

I am writing in regard to the expanded powers granted by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to the Commodity Futures Trading Commission ("CFTC") with respect to position limits. As you know, the CFTC is authorized to set aggregate position limits "as appropriate" across all markets. In the past, the CFTC has examined position limits as a means of preventing excessive speculation or sudden price fluctuations in the commodities markets. I support this authority. Going forward, I urge the CFTC to continue to keep these important twin goals in mind as it considers and initially sets position limits, so that investors who are fully collateralized and may pose little or no systemic risk are not arbitrarily limited and that we do not negatively impact valuable market liquidity.

I am mindful of the CFTC's discretion to set aggregate position limits by "group or class of traders." Further, Dodd-Frank encourages the CFTC to consider how position limits may impact particular classes of persons or swaps. As the CFTC seeks to implement position limits, I urge the CFTC not to unnecessarily disadvantage market participants that invest in diversified and unleveraged commodity indices. These investors often serve as an important, fully collateralized source of liquidity. At the same time, they are natural counterparties to producers who are seeking to reduce their commodity price risk. In this vein, as I have said previously, it is "my expectation that the CFTC will address the soundness of prudential investing by pension funds, index funds and other institutional investors in unleveraged indices of commodities that may also serve to provide agricultural and other commodity contracts with the necessary liquidity to assist in price discovery and hedging for the commercial users of such contracts."

In addition to enhancing liquidity and facilitating greater price discovery for commercial end-users, diversified, unleveraged index funds are an effective way to diversify their portfolios and hedge against inflation. Unnecessary position limits placed on mutual fund investors could limit their investment options, potentially substantially reduce market liquidity, and impede price discovery. Such limits might also have the unintended consequence of forcing investors to rely on higher-cost managers with little experience, insufficient compliance and trade flow infrastructure, and limited risk management capabilities associated with effectively managing commodity index risk.

Such a comprehensive approach to setting position limits would not be contrary to the public interest or to the purposes of the Commodity Exchange Act and Dodd-Frank. In drafting the position limits provision, Congress sought to eliminate excessive speculation and market manipulation while protecting the efficiency of the markets. Consequently, as Chairman of the Senate Committee on Agriculture, Nutrition, and Forestry, I encouraged the CFTC to differentiate between "trading activity that is unleveraged or fully collateralized, solely exchange-traded, fully transparent, clearinghouse guaranteed, and poses no systemic risk" and highly leveraged swaps trading in its implementation of position limits.

I repeat my request again today. As it contemplates position limits, I encourage the CFTC to carefully consider how such limits may impact particular types of investment vehicles and classes of investors. I hope that the CFTC will implement position limits in a manner that protects ordinary investors and ensures that the commodity markets continue to benefit from the liquidity and price stability provided by unleveraged broad-based index investments.

Sincerely,

Senator BLANCHE L. LINCOLN,
Chairman,
Committee on Agriculture, Nutrition, and Forestry.

SUBMITTED STATEMENT BY HON. DAVID SCOTT, A REPRESENTATIVE IN CONGRESS FROM GEORGIA; ON BEHALF OF AMERICANS FOR FINANCIAL REFORM

Today's hearing deals with the question of the cross-border or extra-territorial application of the Dodd-Frank Act's derivatives provisions. Americans for Financial Reform has previously commented on this issue in detail to the Commodity Futures Trading Commission (CFTC).[1] However, for the purposes of the hearing AFR would like to provide a summary of key points.[2]

Strong extra-territorial enforcement of derivatives reforms is absolutely central to protecting the U.S. economy and U.S. taxpayers from the risks of unregulated derivatives markets. In recent months, large international banks and in some cases foreign regulators have opposed effective cross-border application of U.S. derivatives regulation. In evaluating this opposition, several key points must be kept in mind:

- The largest global banks can shift derivatives risks and funding between thousands of international subsidiaries at the touch of a computer keyboard. It is therefore impossible to effectively regulate derivatives markets without applying rules to transactions conducted through foreign subsidiaries. Without cross-border applicability, there is no effective regulation of derivatives.
- Many non-U.S. jurisdictions, particularly in Europe, lag years behind the United States in implementing derivatives protections. Delaying the application of derivatives rules until they are completed in every jurisdiction could create an open-ended delay of multiple years in regulating U.S. derivatives markets. Four years after the financial crisis and 2 years after the passage of the Dodd-Frank Act, we cannot afford further multi-year delays in effectively regulating our financial markets.
- The application of derivatives safeguards to the global operations of U.S. banks does not represent a competitive threat to the U.S. economy. Indeed, these safeguards will benefit the economy and taxpayers by preserving financial stability, and will reduce incentives for the outsourcing of U.S. jobs to foreign regulatory havens. The profits of Wall Street subsidiaries in London or Singapore must not be prioritized over the interests of U.S. taxpayers.

None of these points mean that regulators should not take reasonable and responsible steps to accommodate differences in international regulatory regimes. But cross-border issues must not become an excuse for disguised deregulation.

Without Cross-Border Applicability, There is No Effective Derivatives Regulation

Modern financial markets are inherently global in scope. Profits and losses experienced in overseas affiliates return to affect the parent company and the U.S. economy.

We have learned this lesson in many crises, most recently in the massive derivatives losses experienced at JP Morgan's London office, and most painfully in the world financial collapse of 2008. Nowhere is the globalization of financial markets more evident than in the derivatives market. As CFTC Chair Gary Gensler has stated with respect to the extraterritoriality issue:

> "Swaps executed offshore by U.S. financial institutions can send risk straight back to our shores. It was true with the London and Cayman Islands affiliates

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[1] See Americans for Financial Reform, "Comment Letter On The Cross-Border Applications of Certain Provisions of the Dodd-Frank Act", August 27, 2012. Available at *http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2012/08/AFR-CFTC-Cross-Border-Comment-letter-8-27-12.pdf.*

[2] AFR is a coalition of more than 250 national, state, local groups who have come together to advocate for reform of the financial sector. Members of the AFR include consumer, civil rights, investor, retiree, labor, religious and business groups along with prominent independent experts.

of AIG, Lehman Brothers, Citigroup and Bear Stearns. A decade earlier, it was true, as well, with Long-Term Capital Management. The nature of modern finance is that large financial institutions set up hundreds, if not thousands of 'legal entities' around the globe . . . Many of these far-flung legal entities, however, are still highly connected back to their U.S. affiliates."

Chairman Gensler's statements are confirmed by extensive experience and data. Bloomberg News has documented that large Wall Street banks routinely transact well over ½ of their swaps business through foreign subsidiaries.[3] Furthermore, these large institutions manage their revenues as integrated global entities, making little distinction based on the locations of gains and losses. As Professor Richard Herring of the Wharton School has stated:[4]

"Despite their corporate complexity, LCFIs [Large Complex Financial Institutions] tend to be managed in an integrated fashion along lines of business with only minimal regard for legal entities, national borders or functional regulatory authorities. Moreover, there are often substantial interconnections among the separate entities within the financial group."

Exempting derivatives transactions conducted through international subsidiaries from Dodd-Frank requirements would make central derivatives reforms unenforceable. U.S. companies could simply route their derivatives transactions through foreign subsidiaries, evading regulation, and then transfer cash flows back to the U.S. parent company. Such transfers would be simple for the institutions, because as the above quote points out, major Wall Street banks are managed as global entities. It is well known and well documented that major banks, like other international corporations, manage liquidity on a global scale and freely move funding across borders in response to the needs of various subsidiaries and the home office.[5] Revenues from global subsidiaries are generally swept back to the central corporate treasury for distribution, often on a daily basis. Professor Herring has described how this process worked at Lehmann Brothers, and how it complicated attempts at resolution of the bank:[6]

"But the fundamental problem was that LB [Lehman Brothers] was managed as an integrated entity with minimal regard for the legal entities that would need to be taken through the bankruptcy process. LBHI [Lehman Brothers Holdings, Incorporated] issued the vast majority of unsecured debt and invested the funds in most of its regulated and unregulated subsidiaries. This is a common approach to managing a global corporation, designed to facilitate control over global operations, while reducing funding, capital and tax costs . . . LBHI lent to its operating subsidiaries at the beginning of each day and then swept the cash back to LBHI at the end of each day."

Exempting any of the subsidiaries of a global bank from derivatives oversight could thus effectively allow banks to avoid regulation on any derivatives transactions they chose. This would perpetuate the unregulated derivatives markets that were at the heart of the financial crisis, and undermine the core purposes of Title VII of the Dodd-Frank Act. The failure to properly enforce derivatives reforms internationally would expose U.S. taxpayers to the risks of a financial crisis triggered by unregulated derivatives activities conducted in foreign regulatory havens.

U.S. Rules Must Not Be Delayed Until The Rest of the World Has Equivalent Rules

All of the G20 nations have agreed in principle to a similar set of derivatives reforms, including requirements for central clearing, transparency, and exchange trading. In 2009 the G20 nations jointly committed to implementing these reforms by

[3] See Brush, Silla, "Goldman Sachs Among Banks Lobbying To Exempt Half of Swaps From Dodd Frank" (*http://www.bloomberg.com/news/2012-01-30/goldman-sachs-among-banks-lobbying-to-exempt-half-of-swaps-from-dodd-frank.html*), *Bloomberg News,* January 30, 2012.

[4] Page 217, Herring, R. and J. Carmassi, "The Structure of International Financial Conglomerates: Complexity and Its Implications for Systemic Risk," Chapter 8 in the *Oxford Handbook of Banking,* edited by A. Berger, D. Molyneux, and J. Wilson, Oxford University Press, 2010.

[5] For one of many recent studies documenting this, *see e.g.,* Cetorelli, N. and Goldberg, L., "Banking Globalization, Monetary Transmission, and the Lending Channel" (*http://www.newyorkfed.org/research/economists/cetorelli/Cetorelli__Goldberg__final.pdf*), Forthcoming, *Journal of Finance.*

[6] Page 225, Herring, R. and J. Carmassi, "The Structure of International Financial Conglomerates: Complexity and Its Implications for Systemic Risk," Chapter 8 in the *Oxford Handbook of Banking,* edited by A. Berger, D. Molyneux, and J. Wilson, Oxford University Press, 2010.

the close of 2012.[7] Unfortunately, other countries lag well behind the United States in meeting that deadline. The latest reports from Europe are that implementation of European Union derivatives rules will be delayed until at least mid-2014.[8]

The CFTC has already proposed to delay extraterritorial application of many U.S. derivatives rules through mid-2013 in order to accommodate the concerns of foreign regulators. But creating further open-ended delays in U.S. derivatives rules will leave U.S. taxpayers exposed to risks taken in foreign subsidiaries of Wall Street banks for many years to come. Over 2 years have passed since the Dodd-Frank Act became law, and further delays in implementing derivatives rules are unacceptable. The effort to postpone full implementation of U.S. derivatives reforms until some indefinite date when other nations complete their rules is just the latest of a set of delaying tactics that have been used by large banks to prevent completion of financial reforms.

Timely Implementation of Derivatives Reforms Is Not a Threat to U.S. Competitiveness

Some in the financial industry have argued that U.S. implementation of derivatives reforms is a threat to competitiveness. The claim is that foreign entities will refuse to engage in derivatives business with the foreign subsidiaries of U.S. banks if they know that such transactions will subject them to new requirements such as clearing, exchange trading, and capital requirements. In addition, foreign banks in Europe and other jurisdictions may refuse to do derivatives transactions with U.S. commercial counterparties if this would subject them to registration as a swaps dealer in U.S. markets.

These arguments are deeply misguided, for several reasons. First, they appear to prioritize the profits of financial entities located in foreign countries over the creation of U.S. jobs and the stability of the U.S. economy. It would be a grave error to expose the U.S. economy to the risk of financial instability simply so that the Singapore or London subsidiary of a Wall Street bank can do unregulated derivatives transactions with foreign counterparties. This is especially true since an exemption for foreign subsidiaries would tend to benefit the economy of the foreign jurisdiction where those subsidiaries are located at the expense of the United States. Likewise, creating exemptions that permit U.S. commercial counterparties to perform unregulated derivatives transactions with foreign banks would privilege those foreign banks above regulated U.S. institutions.

Industry arguments also ignore the benefits of global leadership in derivatives reform. As discussed above, the major G20 nations have all agreed to implement derivatives reforms similar to those proposed in the Dodd-Frank Act. While these reforms have been delayed in other nations, in the long term we can expect that they will eventually be implemented in most jurisdictions. As the global derivatives market transitions toward greater oversight, ensuring that U.S. companies have a head start and greater experience in complying with the rules should eventually result in a competitive advantage for U.S. firms. And in the case of any foreign jurisdictions which defy the G20 consensus and refuse to implement derivatives reform, we should clearly act to prevent exposure of the U.S. financial system to unregulated transactions in these jurisdictions.

Finally, the argument ignores the potential competitive advantages to be gained by improving the stability and reliability of U.S. derivatives markets through new reforms. Derivatives reforms require better risk management and greater loss reserves. These changes will mean that U.S. banks will provide more protection and stability for derivatives counterparties and customers, which is a competitive advantage. The U.S. financial sector has gained its international reputation due to our global leadership in creating stable and transparent markets. Indeed, it was over 150 years ago that the U.S. pioneered the derivatives clearinghouse. This was a major positive innovation in establishing robust and valuable marketplaces for commodities as well as key financial markets. Although permitting regulatory loopholes such as extra-territorial exemptions may create short-term profits, in the long run the greatest threat to the U.S. competitive edge is a repetition of the deregulation that led to the disastrous financial crisis of 2008.

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[7] See Financial Stability Board, "Progress of Financial Regulatory Reforms" (*http://www.financialstabilityboard.org/publications/r__120420a.pdf*), April 16, 2012.

[8] Stafford, Phillip, "Europe Dallies on Derivatives Regulation" (*http://www.ft.com/intl/cms/s/0/8ff948ec-3e10-11e2-93cb-00144feabdc0.html*), *Financial Times,* December 4, 2012.

Any 'Substituted Compliance' Regime Must Ensure That Foreign Rules Are Truly Comparable To U.S. Rules

The CFTC has indicated that it will permit 'substituted compliance' with U.S. derivatives rules. Under substituted compliance, foreign subsidiaries of U.S. banks (and in some cases subsidiaries of foreign banks dealing with U.S. persons) will be able to satisfy U.S. requirements by complying with the rules in their local jurisdiction.

The danger raised by substituted compliance is that banks may seek out locations where regulation is weak and then attempt to use the inadequate foreign regulations to satisfy U.S. requirements. This means that it is crucial that any substituted compliance regime be strictly limited to jurisdictions that have genuinely comparable rules to the U.S. both in nature and in enforcement. Otherwise, we will see the emergence of regulatory havens that play a role similar to the role the Cayman Islands and other offshore jurisdictions have played as tax havens. Unless it is backed up by a real and thorough process to determine genuine comparability between regulatory regimes, substituted compliance is simply a form of disguised deregulation.

Regulators must maintain a commitment to genuine comparability determination using a thorough process that carefully compares both the nature and enforcement of rules in foreign jurisdictions to those of the United States. Some in industry have called for a 'principles based' comparability procedure, where substituted compliance is permitted in any jurisdiction that has agreed in principle to oversee derivatives markets. Such calls for 'principle based' comparability are simply an effort at backdoor deregulation, as they do not ensure that regulations are genuinely equivalent.

Clearly there can be no substituted compliance until foreign jurisdictions actually complete and implement their rules. Foreign rules cannot be substituted for U.S. rules where foreign rules do not yet exist. As discussed above, foreign jurisdictions lag years behind the U.S. in implementing derivatives rules. The U.S. must therefore be prepared to implement derivatives reforms rapidly and institute any substituted compliance at a later date, once foreign governments have fully implemented their rules.

ATTACHMENT

Following are the Partners of Americans for Financial Reform

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

A New Way Forward
AFL–CIO
AFSCME
Alliance For Justice
American Income Life Insurance
American Sustainable Business Council
Americans for Democratic Action, Inc
Americans United for Change
Campaign for America's Future
Campaign Money
Center for Digital Democracy
Center for Economic and Policy Research
Center for Economic Progress
Center for Media and Democracy
Center for Responsible Lending
Center for Justice and Democracy
Center of Concern
Change to Win
Clean Yield Asset Management
Coastal Enterprises Inc.
Color of Change
Common Cause
Communications Workers of America
Community Development Transportation Lending Services
Consumer Action
Consumer Association Council
Consumers for Auto Safety and Reliability
Consumer Federation of America
Consumer Watchdog

Consumers Union
Corporation for Enterprise Development
CREDO Mobile
CTW Investment Group
Demos
Economic Policy Institute
Essential Action
Greenlining Institute
Good Business International
HNMA Funding Company
Home Actions
Housing Counseling Services
Home Defender's League
Information Press
Institute for Global Communications
Institute for Policy Studies: Global Economy Project
International Brotherhood of Teamsters
Institute of Women's Policy Research
Krull & Company
Laborers' International Union of North America
Lake Research Partners
Lawyers' Committee for Civil Rights Under Law
Move On
NAACP
NASCAT
National Association of Consumer Advocates
National Association of Neighborhoods
National Community Reinvestment Coalition
National Consumer Law Center (on behalf of its low-income clients)
National Consumers League
National Council of La Raza
National Fair Housing Alliance
National Federation of Community Development Credit Unions
National Housing Resource Center
National Housing Trust
National Housing Trust Community Development Fund
National NeighborWorks Association
National Nurses United
National People's Action
National Council of Women's Organizations
Next Step
OMB Watch
OpenTheGovernment.org
Opportunity Finance Network
Partners for the Common Good
PICO National Network
Progress Now Action
Progressive States Network
Poverty and Race Research Action Council
Public Citizen
Sargent Shriver Center on Poverty Law
SEIU
State Voices
Taxpayer's for Common Sense
The Association for Housing and Neighborhood Development
The Fuel Savers Club
The Leadership Conference on Civil and Human Rights
The Seminal
TICAS
U.S. Public Interest Research Group
UNITE HERE
United Food and Commercial Workers
United States Student Association
USAction
Veris Wealth Partners
Western States Center
We the People Now
Woodstock Institute

World Privacy Forum
UNET
Union Plus
Unitarian Universalist for a Just Economic Community

List of State and Local Affiliates

Alaska PIRG
Arizona PIRG
Arizona Advocacy Network
Arizonans For Responsible Lending
Association for Neighborhood and Housing Development NY
Audubon Partnership for Economic Development LDC, New York NY
BAC Funding Consortium Inc., Miami FL
Beech Capital Venture Corporation, Philadelphia PA
California PIRG
California Reinvestment Coalition
Century Housing Corporation, Culver City CA
CHANGER NY
Chautauqua Home Rehabilitation and Improvement Corporation (NY)
Chicago Community Loan Fund, Chicago IL
Chicago Community Ventures, Chicago IL
Chicago Consumer Coalition
Citizen Potawatomi CDC, Shawnee OK
Colorado PIRG
Coalition on Homeless Housing in Ohio
Community Capital Fund, Bridgeport CT
Community Capital of Maryland, Baltimore MD
Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
Community Redevelopment Loan and Investment Fund, Atlanta GA
Community Reinvestment Association of North Carolina
Community Resource Group, Fayetteville A
Connecticut PIRG
Consumer Assistance Council
Cooper Square Committee (NYC)
Cooperative Fund of New England, Wilmington NC
Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
Delta Foundation, Inc., Greenville MS
Economic Opportunity Fund (EOF), Philadelphia PA
Empire Justice Center NY
Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
Enterprises, Inc., Berea KY
Fair Housing Contact Service OH
Federation of Appalachian Housing
Fitness and Praise Youth Development, Inc., Baton Rouge LA
Florida Consumer Action Network
Florida PIRG
Funding Partners for Housing Solutions, Ft. Collins CO
Georgia PIRG
Grow Iowa Foundation, Greenfield IA
Homewise, Inc., Santa Fe NM
Idaho Nevada CDFI, Pocatello ID
Idaho Chapter, National Association of Social Workers
Illinois PIRG
Impact Capital, Seattle WA
Indiana PIRG
Iowa PIRG
Iowa Citizens for Community Improvement
JobStart Chautauqua, Inc., Mayville NY
La Casa Federal Credit Union, Newark NJ
Low Income Investment Fund, San Francisco CA
Long Island Housing Services NY
MaineStream Finance, Bangor ME
Maryland PIRG
Massachusetts Consumers' Coalition
MASSPIRG
Massachusetts Fair Housing Center
Michigan PIRG

Midland Community Development Corporation, Midland TX
Midwest Minnesota Community Development Corporation, Detroit Lakes MN
Mile High Community Loan Fund, Denver CO
Missouri PIRG
Mortgage Recovery Service Center of L.A.
Montana Community Development Corporation, Missoula MT
Montana PIRG
Neighborhood Economic Development Advocacy Project
New Hampshire PIRG
New Jersey Community Capital, Trenton NJ
New Jersey Citizen Action
New Jersey PIRG
New Mexico PIRG
New York PIRG
New York City Aids Housing Network
New Yorkers for Responsible Lending
NOAH Community Development Fund, Inc., Boston MA
Nonprofit Finance Fund, New York NY
Nonprofits Assistance Fund, Minneapolis M
North Carolina PIRG
Northside Community Development Fund, Pittsburgh PA
Ohio Capital Corporation for Housing, Columbus OH
Ohio PIRG
OligarchyUSA
Oregon State PIRG
Our Oregon
PennPIRG
Piedmont Housing Alliance, Charlottesville VA
Michigan PIRG
Rocky Mountain Peace and Justice Center, CO
Rhode Island PIRG
Rural Community Assistance Corporation, West Sacramento CA
Rural Organizing Project OR
San Francisco Municipal Transportation Authority
Seattle Economic Development Fund
Community Capital Development
TexPIRG
The Fair Housing Council of Central New York
The Loan Fund, Albuquerque NM
Third Reconstruction Institute NC
Vermont PIRG
Village Capital Corporation, Cleveland OH
Virginia Citizens Consumer Council
Virginia Poverty Law Center
War on Poverty—Florida
WashPIRG
Westchester Residential Opportunities Inc.
Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
WISPIRG

Small Businesses

Blu
Bowden-Gill Environmental
Community MedPAC
Diversified Environmental Planning
Hayden & Craig, PLLC
Mid City Animal Hospital, Pheonix AZ
The Holographic Repatterning Institute at Austin
UNET