Testimony of Samara Cohen

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Subcommittee on Capital Markets and Government Sponsored Enterprises

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Executive Summary

The approach regulators adopt to the cross-border application of Title VII of the Dodd-Frank Act will have profound effects on the U.S. and international swap markets. To ensure that this regulatory action achieves the objectives reflected in the G-20 commitments and does not have a negative impact on capital markets or liquidity, we believe it is necessary to clarify and limit the scope of cross-border applicability and to adopt a considered approach to phasing in Title VII outside the United States. The breadth of cross-border applicability reflected in the CFTC's proposed guidance is without precedent. Key parts of the guidance, such as the definition of "U.S. Person" and the methodology for determining whether a non-U.S. entity may be subject to having to register as a swap dealer, lack the clarity necessary to enable market participants to make informed business plans. Finally, the guidance fails to provide a clear implementation sequencing scheme that accords with the work being done to implement the G-20 commitments by regulators and legislators in other jurisdictions. These problems will discourage customers from transacting with U.S. financial institutions and further move that business offshore, decrease efficiency in the swap market and increase systemic risk. A long-term solution is only possible through the CFTC avoiding assertions of jurisdiction beyond what is contemplated under Dodd-Frank, as well as close coordination on both timing and substance with the SEC and regulators in other G-20 jurisdictions. Reports of recent meetings among regulators appear promising. In the short term, with the current implementation date looming on December 31, it is imperative that the CFTC act to limit the application of Title VII requirements to non-U.S. counterparties until an international consensus and solution can be achieved.

Testimony

Chairman Garrett, Ranking Member Waters, and members of the subcommittee. My name is Samara Cohen and I am a Managing Director in the securities division of Goldman Sachs. Having spent 13 years working with a range of market participants to facilitate their access to capital markets and various risk management and investment products, I transitioned in May to focus exclusively on assisting clients and Goldman Sachs prepare for the advent of Dodd-Frank Title VII requirements. In my current role, I interact regularly with market participants that transact in swaps with Goldman Sachs to manage risk, access liquidity and improve returns. As a result, I speak frequently with these market participants about their views and concerns related to the effect of Dodd-Frank on their relationship with U.S. financial institutions. Thank you for inviting me to testify at today's hearing to share those views and concerns with you and answer any questions you may have. We value the Committee's careful and bipartisan examination of the rules implementing Dodd-Frank.

Our Global Business and Support for Dodd-Frank's Goals

Goldman Sachs supports the overarching goals of Dodd-Frank's derivatives provisions, including decreasing systemic risk and increasing transparency. We believe that it is possible to achieve these goals while preserving robust and efficient international swap markets that allow our customers to, among other things, manage their risks. We are committed to effectively and expeditiously implementing Dodd-Frank and have, since its passage, been engaged in an active implementation process that has included creating new technological, operational and compliance systems, devoting substantial resources to build, implement and monitor these systems and educating our clients regarding the effects of global regulatory reform.

While we are a U.S.-based financial institution, our swap business is global. We have swap customers throughout the world and intend to register both U.S.-based and non-U.S.-based entities as swap dealers with the CFTC.[1] Given the significant potential business impact, we and our customers have been carefully monitoring the way that the CFTC and SEC view the cross-border reach of Dodd-Frank's derivatives provisions, including how the U.S. regime compares to and will interact with the regulatory reform efforts underway in other G-20 jurisdictions. As part of this process, over the past several months, we and our clients have identified a number of issues in the CFTC's proposed cross-border guidance and exemptive order that raise significant concerns.

Concerns and Solutions

We encourage G-20 policy makers to strive to achieve a convergence of cross-border regulatory approaches that reflects a common understanding of the desired regulatory outcomes. Applied consistently, a measured and global approach will be a vital tool in safeguarding global financial stability and minimizing opportunities for regulatory arbitrage. If the steps we recommend are not taken, we fear that swap business will migrate, in the short term, away from U.S. financial institutions to other jurisdictions that are putting in place similar regulatory reform initiatives but are not as far advanced in doing so as the United States. We believe that once customers move their business outside the United States, due to this timing mismatch, they may not move the business back, even when other G-20 jurisdictions have put clearing, reporting and other similar mandates in place.

It is important to emphasize that these concerns are not theoretical. The international interdealer swap market felt major disruptions around October 12, 2012, the date on which market participants that engage in swap dealing activity began counting swap dealing transactions to determine whether they would need to register as swap dealers. In the days leading up to Friday, October 12, U.S. financial institutions—including Goldman Sachs—received numerous calls from clients in Europe, Asia, Latin America and other places around the globe informing them that their trading activities with U.S.

[1] The entities we intend to register represent over 90% of our global OTC swap business (as of September 30 measured by notional value, excluding affiliate positions) and virtually 100% of our swap business with U.S. clients and counterparties.

financial institutions would cease that coming Monday due to the uncertainty. Understanding the urgency of such messages, the CFTC issued a series of no-action relief letters on and slightly before October 12, 2012. We appreciate the CFTC's effort in doing so and believe that these no-action letters were able to alleviate the immediate market distress. The key take-away from this experience is that without rules that are clear and implemented on a consistent basis across jurisdictions, market disruptions are possible, if not likely, and market access will be constrained.

Therefore, while a coordinated international approach is being developed it is imperative that the CFTC ensure that it extends the reach of its regulations only to instances that bear a "direct" and "significant" impact to U.S. commerce as contemplated by Dodd-Frank, and that the CFTC take a few key steps to minimize potential disruptions to the swap markets that would undermine liquidity and confidence in the capital markets. First, from now until a final "U.S. person" definition has been finalized and implemented, the CFTC should employ the "U.S. person" definition used in its October 12 no-action relief and apply Dodd-Frank requirements to transactions between registered swap dealers and U.S. person customers. Under this approach, swap regulation involving U.S. customers would commence on December 31 as planned, but would be targeted to the primary U.S. counterparties Title VII was designed to address. Complex provisions currently proposed by the CFTC that differentiate treatment of transactions as having a U.S. nexus based on the location of the swap dealer may not only be unnecessary and duplicative as swap regulation is implemented abroad, but may also have the unintended consequence of creating confusion and uncertainty among market participants, potentially motivating both U.S. and non-U.S. customers to move their business outside the United States.

Concerns with the CFTC's Cross-Border Approach

We have a number of specific concerns around the new and unprecedented concepts included in the CFTC's proposed cross-border guidance, including the regulation of "non-U.S. affiliate conduits," regulation of inter-company booking models, aggregation of positions across affiliates, the impact of parent guarantees and the extremely limited recognition of foreign regulatory regimes through substituted compliance. We have provided detailed descriptions of these concerns and our proposed solutions in our August 27 comment letter to the CFTC. However, I would like to describe in my testimony today four problems we and our clients see with the CFTC's general approach to the cross-border application of the Dodd-Frank Act and the consequences that might result from such an approach.

Jurisdictional Breadth Without Precedent

First, the CFTC has taken a sweeping approach to its jurisdiction beyond U.S. shores that is without precedent. In Dodd-Frank Section 722, Congress limited Title VII's cross-border reach by providing that its CFTC-related derivatives provisions "**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 are evasive.[2] Recent public meetings held by the CFTC and others have made it clear that swap market participants and non-U.S. regulators have substantial concerns about this expansive approach. These concerns will inform the ways in which swap market participants operate. For example, local banks in Asia, Europe and South America have expressed concerns directly to U.S. financial institutions that they will have to stop trading with U.S. dealers to avoid CFTC swap dealer registration. The approach may also encourage foreign regulators to be similarly expansive as they craft their own regulatory reform regimes.[3] For example, in recent meetings with the CFTC, foreign regulators have indicated that these proposed rules would not be workable in an international environment.[4]

[2] Dodd-Frank Section 722(d)(i) (emphasis added).

[3] As CFTC Commissioner Scott O'Malia stated, "Unfortunately, the Proposed Guidance overreaches in many respects and, as a result, steps on the toes of other sovereign nations. Today's Proposed Guidance will likely provoke these nations to develop strict swap rules in retaliation that unfairly and unnecessarily burden U.S. firms." Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, O'Malia Concurring Statement, 77 Fed. Reg. 41214, 41241 (July 12, 2012)

[4] As Fabrizio Planta, Senior Officer, Post-Trading European Securities and Market Authority, said at the CFTC's recent Global Markets Advisory Committee Meeting, "Basically if I may make a parallel to a sport situation, it's like asking a player to be at the same on two different fields, or if we consider the global derivatives market as a baseball field, it's like deciding which rules apply depending on the player that hits the ball. This is not workable, and we as international regulators have the responsibility to find (….continued)

U.S. Person Definition

Our second concern is that the CFTC's definition of "U.S. person" is overly broad and unclear. The CFTC's proposed cross-border guidance and exemptive order condition the application of Title VII requirements on whether a swap counterparty is a "U.S. person." As a result, market participants throughout the world must be able to determine, easily and with consistency and certainty, whether they and their counterparties are or are not U.S. persons. Unfortunately, the CFTC has not yet finalized a definition of U.S. person, and the definition that has been proposed is vague and problematic in a number of ways described in our comment letter. In addition, the breadth of the definition makes it nearly certain that some market participants will be both a U.S. person for the purpose of U.S. regulation and an "E.U. person," or its equivalent, for the purpose of E.U. regulation, causing unnecessary overlap and potential conflicts in regulation.

Sequencing

Our third concern relates to the approach the CFTC has taken to sequencing its rules. As SIFMA has noted, cross-border jurisdictional rules are part of the foundation of the Dodd-Frank swap regime – they determine to whom Title VII will apply. However, the CFTC has chosen to finalize its substantive Title VII rules and require compliance with them before specifying to which entities they will apply. As a result, market participants face significant uncertainty as to how swap dealer rules that will begin to go into effect shortly will apply to them. In contrast, the SEC's approach recognizes the need for cross-border clarity as a precondition for firms to make informed decisions about how to implement the new rules and has stated that it will specify the cross-border application of its rules well before requiring compliance.[5]

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mutually acceptable, workable solutions to solve these issues." Global Markets Advisory Committee Meeting, Nov. 7, 2012. Transcript available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/gmac_110712_transcript.pdf.

[5] The SEC has indicated that it "does not expect to require compliance by participants in the U.S. [security-based swap] market with the final rules arising under the Exchange Act before addressing the cross-border aspects of such rules." Statement of General Policy on the Sequencing of Compliance Dates

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While the CFTC's requirements will incur substantial cost, no cost-benefit analysis has been done, as the CFTC chose to propose cross-border interpretations as guidance rather than as a rule subject to the CFTC rulemaking process and a full cost-benefit analysis. In addition, since the cross-border rules were sequenced after the substantive Title VII rules, the cost-benefit analyses of those substantive rules do not take into account the cost of applying the regulations to customers outside the United States. The SEC has indicated it will undertake formal rulemaking, including the requisite cost-benefit analysis, to determine the cross-border application of its security-based swap activity. We strongly believe the CFTC should do the same.

Coordination

Our final concern relates to the fact that the CFTC's cross-border approach has not been developed with a view towards allowing it to operate alongside other non-U.S. regulatory regimes, as is necessary in a global derivatives market. Indeed, we do not anticipate that the CFTC's rules will necessarily reconcile even with those of the SEC. Overlapping regulation will lead to higher costs for firms and the clients they serve, as well as confusion in terms of which rules apply, without any public policy value. To the contrary, this confusion will likely have an adverse impact on the effectiveness of regulation generally. While the CFTC's cross-border guidance makes reference to the possibility that non-U.S. firms that are otherwise subject to Title VII requirements may have the ability to satisfy such requirements through "substituted compliance" with comparable local regulation, the approach to substituted compliance described by the CFTC appears to be quite limited in scope and inconsistent with the practices that the CFTC has observed for decades in its regulation of cross-border futures markets.

We were encouraged by the recent meeting of market regulators from across the globe and were particularly pleased to see those regulators, including representatives of both

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for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act, 77 Fed. Reg. 35625, 35631 (June 14, 2012).

the CFTC and SEC, recognizing the necessity of cross-border coordination in the regulation of OTC derivatives. The joint statement issued following that meeting indicated regulatory commitment to cross-border harmonization of particularly problematic requirements, including clearing determinations, cross-border information sharing and enforcement and compliance timing.[6] We urge the CFTC to embrace those commitments and reflect them in future no-action letters, policy statements and rulemakings.

In the short term, the timing mismatch between the CFTC's rulemaking and that of other G-20 jurisdictions will cause swap customers to move their business to jurisdictions where regulations do not yet govern swap transactions. In general, we believe that such business will move to jurisdictions that are planning to implement requirements similar to those in the United States, but on later timetables, because derivatives business needs operational support and legal certainty that is available only in the most developed jurisdictions. That is why most derivatives trading occurs in financial centers such as New York, London, Hong Kong, Tokyo, Germany and Singapore. As a result, we think it is possible for the G-20 and similar jurisdictions to come together and oversee the derivatives market in a comprehensive way without worrying about the business migrating to less regulated jurisdictions. However, for the United States to be part of that solution, it is critical that our regulators avoid unnecessary overreach in asserting jurisdiction in foreign markets and that they coordinate with the G-20 and similar nations to implement comparable rules on the same timeframe.

In the long term, without a more measured approach and close coordination on substance and timing, we fear that derivatives markets will regionalize. Corporations and other

[6] Joint Press Statement of Leaders on Operating Principles and Areas of Exploration in the Regulation of the Cross-border OTC Derivatives Market, *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6439-12. We note that the concerns expressed by participants at the November 28 meeting, including particularly the risks to the markets posed by inconsistent or duplicative rules across jurisdictions, the risk of regulatory arbitrage posed by out-of-sync compliance timing and the need to clarify and harmonize the recognition of other jurisdictions' regulations, including the scope and nature of substituted compliance, are precisely those concerns we wish to emphasize here. We are encouraged by the global recognition of these same concerns and we urge the CFTC to work with its co-regulators across the globe to assuage these identified risks.

customers will choose to transact only in their local jurisdictions to avoid duplicative and conflicting regulatory requirements. Regionalization would result in a number of negative consequences. First, regionalization would cause a significant amount of U.S. swap market business to move offshore, threatening U.S. revenues and jobs. Second, regionalization would make it harder for customers to find inexpensive and efficient ways to access markets and manage the risks that they incur as part of their ordinary businesses. Third, regionalization has the potential to increase, rather than decrease, systemic risk, as market participants will not be able to manage their risks globally.

The Solution

The problems described above are not easy to solve, nor can they be solved unilaterally or quickly. Instead, a solution that satisfies Dodd-Frank's goals but maintains a robust and competitive international swap market in which customers can efficiently hedge risks, access liquidity and deliver sound returns to their shareholders will require continued close coordination between the U.S. regulators, and among the U.S. regulators and their foreign counterparts. This coordination will need to relate to both the substance of the rules and their timing. The solution will need to provide clarity to market participants as to which rules apply to any specific transaction, avoid overlapping jurisdiction and be respectful of the jurisdictional limitations embodied in the Dodd-Frank Act, as well as in the commitments of the G-20 leaders to global regulatory reform.

We understand that the development of such a cross-border approach may take time. As a result, we recommend against the CFTC unilaterally finalizing cross-border guidance in advance of December 31. However, in the interim, it is critical that the CFTC address the industry's immediate concerns to avoid harmful and potentially permanent disruptions to the swap markets on and around December 31. Importantly, our recommendation is limited to the cross-border application of the Dodd-Frank Act; we fully support the application of Title VII's requirements to trading with U.S. persons effective on December 31.

Potential Short-Term Problems

Without prompt action, the market disruptions and dislocations around December 31 could be more permanent and significant than those leading up to October 12. October 12 was a date relevant to the financial community in determining whether dealers would have to register with the CFTC. December 31, however, relates to the application of Title VII requirements to customers, including corporations, mutual funds, pension plans and the other investment advisors. Unlike the dealers subject to the October 12 date, last minute no-action relief may not mitigate these concerns from customers that are not as willing or able to move business back to U.S. based financial institutions once they have left.

Solutions

There are a number of steps the CFTC should take immediately to avoid further movement of swap business away from U.S. financial institutions as December 31 approaches:

- **U.S. Person Definition and Application to Customers.** First, the CFTC should, as requested by industry representatives such as SIFMA, permit market participants to use for all Title VII compliance obligations the simplified form of the "U.S. person" definition in the CFTC's October 12 registration no-action letter. This definition is simple and clear, but still captures the vast majority of entities that market participants generally consider "U.S. persons." To give market participants time to understand the final definition and determine their status, this interim definition should govern until 90 days after the CFTC has been able to coordinate with U.S. and foreign regulators and final guidance, including a final definition of U.S. person, is published. During this period, and while a coordinated international approach is being developed, the CFTC should apply Dodd-Frank requirements to transactions between registered swap dealers and U.S. person customers.

- **No-Action Requests.** Second, the CFTC should take prompt action on a number of no-action requests that industry groups have submitted in response to specific problems that have been identified by the industry and customers. As I have mentioned, we greatly appreciated the October 12 no-action relief, which was a great help to the affected market participants. We also greatly appreciate other no-action relief that has recently been issued by the CFTC. The anticipated effects of December 31 will be much greater, however, and will reach a much larger range of market participants with less flexible business models. To avoid the permanent loss of business in the United States, we believe early and comprehensive action is required. Non-dealer market participants need to understand what Dodd-Frank requirements pertain to them, and once they do, be given time to comply.[7]

Conclusion

Goldman Sachs is committed to working with Congress, regulators and industry participants to ensure that extraterritoriality concerns with respect to Title VII regulation and implementation are addressed appropriately, both with respect to the immediate problems that may arise around December 31 and the more permanent issues that U.S. and international regulators need to solve. I appreciate the opportunity to testify and look forward to answering any questions you may have.

[7] The documentation requirements related to the CFTC's external business conduct rule set provide a good example. About 40% of our clients are organized outside the United States but may be subject to the Dodd-Frank rules depending on the definition of "U.S. Person." Their expectation is that they will not be subject but, absent further clarity, we may not be able offer market access to those clients on January 2 if they have not come into compliance.