TESTIMONY OF BARCLAYS CAPITAL

REGARDING

INTERNATIONAL ISSUES RELATED TO THE EXTRATERRITORIAL APPLICATION OF THE

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES

February 8, 2012

Barclays Capital[1] ("Barclays") appreciates this opportunity to offer the Committee its views regarding the territorial application of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). We welcome the Committee's attention to this important issue. Today we have been asked to speak on Title VII of Dodd-Frank, the Wall Street Transparency and Accountability Act ("Title VII"), and other provisions of Dodd-Frank whose extraterritorial application may impact global competitiveness, the stability of U.S. or global financial markets and market liquidity. Barclays operates a global risk management business and supports Title VII's objectives of reducing systemic risk and providing regulators the tools they need to ensure stable, transparent, efficient and liquid global markets.

The swap markets are liquid, global markets that permit investors access to a range of risk management products and investment opportunities across a wide range of international financial markets. Unlike the futures and securities markets, swap markets are not dominated by regional exchanges. The global nature of the swap markets brings important benefits to U.S. end users and other market participants by increasing competition and liquidity.

However, the possibility remains that Title VII could be extensively applied extraterritorially in ways that Congress never intended when it enacted Dodd-Frank. This would lead to the very duplicative and conflicting regulation that the G-20 intended to

[1] Barclays Capital is the investment banking division of Barclays Bank PLC. Barclays Capital provides large corporate, government and institutional clients with a comprehensive set of solutions to their strategic advisory, financing and risk management needs. Barclays Capital has offices around the world and employs over 25,000 people.

avoid. Such duplications and conflicts would place foreign firms with ties to the U.S. – both those firms headquartered abroad that choose to do business in the U.S. and the foreign affiliates of U.S. firms – at a competitive disadvantage as they conduct business around the globe. Furthermore, financial firms – firms headquartered abroad with U.S. operations or foreign affiliates of U.S. firms – with intentions to grow their business footprint in regions where the local swap business has a strong growth potential could be placed at a significant competitive disadvantage to local financial firms with little or no presence in the U.S. or to U.S. clients. To prevent these consequences, global entities may effectively be forced to insulate their U.S. business from the rest of their global activity, significantly increasing costs and risks to firms and their customers. Further, foreign regulators may choose to follow U.S. regulators in this approach, imposing foreign regulations extraterritorially on purely U.S. activities. We have already seen one example of this in recent changes to proposed European swaps legislation. Such duplicative, extraterritorial regulation is in no one's interest: it would burden market participants by increasing costs and fragmenting the markets, and it would burden taxpayers by expanding regulators' oversight mandates beyond those contemplated by Title VII.

Moreover, clear guidance regarding the territorial scope of Title VII is needed well before its swap dealer registration and other substantive requirements become effective. It will be challenging or impossible to design, test and implement the many changes necessary to comply with Title VII until there is greater certainty regarding its territorial application. For this reason, it is of concern that the Commodity Futures Trading Commission ("CFTC") recently finalized rules requiring provisional registration of swap dealers before these issues have been clarified.

These results are not necessary consequences of Dodd-Frank. Title VII includes traditional territorial limitation provisions, and there is no indication Congress intended for those provisions to mandate extraterritorial jurisdiction greater than that already exercised by the CFTC and the Securities and Exchange Commission ("SEC") in the futures and securities markets, respectively. Title VII also includes other provisions that facilitate U.S. regulators' ability to achieve workable solutions that are consistent with the protections and objectives of Title VII, as well as efficient for regulators and market participants. In this regard, U.S. and foreign firms have developed a consensus framework for the appropriate oversight of cross-border activities – a framework that would establish a level playing field, avoids duplicative or inconsistent regulation while maintaining all the protections envisaged by Title VII, with the most efficient utilization of regulatory resources.

Finally, proposed regulations implementing other aspects of Dodd-Frank – most notably last Fall's proposal to implement the "Volcker Rule" – also raise similar concerns of extraterritorial over-reach as Title VII.

I. Dangers of Extraterritorial Application of U.S. Swaps Regulation

There is a robust worldwide market for swaps, with regular cross-border transactions between U.S. and foreign entities, including foreign branches and affiliates of U.S. entities and U.S. branches and affiliates of foreign entities. In contrast with the exchange-dominated futures and securities markets, the swap markets have evolved as global, over-the-counter ("OTC") markets. The defining characteristic of these markets is the ability for sophisticated end users and other market participants to execute customized hedges for the risks they face in their global operations.

While swap-specific regulation is largely new in the U.S. under Title VII of Dodd-Frank, many foreign jurisdictions have regulated foreign swap dealers, including branches and affiliates of U.S. firms, for years. The G-20 and other jurisdictions are also working in parallel with U.S. efforts to supplement these existing regulatory regimes with swap-related clearing, transparency and margin reforms to achieve regulatory objectives similar to those sought through Dodd-Frank.

As a result, extraterritorial application of Title VII risks producing duplicative or conflicting regulations resulting in competitive disadvantages for U.S. and U.S.-facing institutions and a "Fragmentation effect" as firms seek to insulate their U.S. businesses from the rest of their global swap activity. Accordingly, as described below, U.S. swap-specific regulations should not apply to swaps between two foreign persons.

A. Risk of Duplicative and Conflicting Regulation

There are a wide range of matters addressed by Title VII of Dodd-Frank which are very similar to measures actively being considered by legislative and regulatory authorities in a number of overseas jurisdictions or regions. To take the European Union

("EU") as an example, there is an active program of regulatory reform which is looking to introduce rules relating to, for example, enhanced pre- and post-trade transparency requirements, an obligation to clear OTC swaps, measures aimed at requiring the segregation of client collateral and draft rules relating to the way in which market activity is conducted through the use of organized trading venues. Existing and proposed EU legislation also broadly address business conduct by market professionals.

Such a degree of international consistency of approach, at least at the thematic level, is to be expected given the agreements reached by the heads of state at the G-20 summit in Pittsburgh in 2009 relating to matters such as clearing. However, several challenges nonetheless arise.

The first, by way of example, is that firms may be subject to an obligation to clear the same OTC swap as a matter of both U.S. and European regulation. Hopefully there will be agreements reached between the CFTC and SEC and authorities in member states of the EU which permit clearing to occur through clearinghouses organized in each other's region – after all, it is impossible to clear the same contract in two different clearinghouses. But those agreements will not necessarily address concerns that may arise where regulators in differing regions implement differing approaches to which products need to be cleared, what exemptions, if any, there will be for any sectors of the markets, and how collateral is to be protected by clearinghouses and clearing members.

These issues become more complex when one takes into account the obligation contemplated by Title VII for certain instruments to be executed via swap execution facilities. The final outcome of the rules relating to the execution of swaps may be different between the U.S. and Europe (which is developing a concept currently referred to as an "organized trading facility"), making mutual recognition of U.S. and European execution regimes far from guaranteed. Absent mutual recognition, firms will face the insoluble difficulty of simultaneously being required to execute a trade via a swap execution facility (as a matter of U.S. regulation) while also being under an obligation to execute the same trade on an organized trading facility (as a matter of European regulation).

Another, similar, issue arises under U.S. swap dealer business conduct regulations, which mandate certain disclosures, representations and duties different from those under existing and proposed European conduct of business requirements. Duplication in this area is likely to create confusion among customers about the risks of the products they are trading and the relationship between the parties, which are precisely the results that the U.S. and European requirements are intended to prevent.

To the extent that the trades in question are between a European-based firm (albeit one which is a registered swap dealer because it chooses to do business in the U.S.) with a European-based client, the advisability of that trade being subject to conflicting U.S. regulations is questionable. This is particularly the case given the limited resources of U.S. regulators. At a time when U.S. regulators already must make difficult trade-offs to regulate domestic markets effectively, making them responsible for ensuring compliance with and enforcement of U.S. rules in the context of wholly foreign transactions and locations raises serious concerns.

In addition, there is a danger that foreign regulators might follow suit and also seek to apply their requirements extraterritorially to purely U.S. activities. The current ongoing EU negotiations on swaps regulation presents an example of retaliatory measures EU regulators could employ in reaction to U.S. regulators' extraterritorial reach. Specifically, recent drafts of EU swap-related legislation contain language that substantively mirrors a provision of Dodd-Frank which the CFTC – wrongly in our view – appears to be interpreting as requiring an extraterritorial application of its rules.[2] Depending how the U.S. regulators ultimately interpret statutory territorial reach this could result in reciprocal foreign regulatory oversight in U.S. markets.

These examples are illustrative only and cite the proposed European approach, but the concept would be applicable across a range of rules and global regulatory regimes.

B. <u>Resulting Competitive Disadvantages and Fragmentation Risks</u>

Firms subject to U.S. regulation of their foreign business face the risk of potentially material competitive disadvantage.

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[2] As an example, Article 3 of the European Council's 4th October draft European Market Infrastructure Regulation contains the following text:

> "…Counterparties shall clear all OTC derivatives…if those contracts….have been concluded…between third country entities that would be subject to the clearing obligation if they were established in the EU, provided that the contract has a direct, substantial and foreseeable effect within the EU or where such obligation is necessary or appropriate to prevent the evasion of any provisions of this Regulation".

This risk is also best illustrated by an example. If a firm which is conducting business from Asia, with a client based in Asia, is required to apply U.S. clearing or other rules to a trade with its client, but other financial firms competing for the same business are under no such obligations, then it is highly unlikely that the firm subject to the U.S. rules will be able to compete successfully. Competitor firms which are not materially active in the U.S., and which are therefore not subject to a U.S. obligation to register as a swap dealer or a major swap participant, may be able to compete without the pressure derived from compliance with the U.S. requirements. These firms would, of course, be subject to applicable domestic regulations.

One of the ways in which international firms may look to mitigate this risk is to insulate their U.S.-facing business. Many large foreign banks currently operate their swap businesses on a global basis through a "central booking location." In other words, regardless of their location, a bank operating under this model transacts with its swap counterparties through a single legal entity, usually the headquarters of its parent bank. This model benefits customers by reducing credit risk by allowing them to transact with the most well-capitalized, most creditworthy legal entity and to reduce their net exposure to the bank by centralizing their relationship across different products and asset classes. It also ensures that clients face global counterparties with proper centralized risk management and efficient employment of capital. For regulators, it assures that the bank's swap business is subject to consistent prudential regulation globally and reduces the need for the bank to operate through multiple interconnected subsidiaries that might impede effective cross-border regulatory coordination during a market disruption.

However, if Dodd-Frank is applied extraterritorially too broadly, banks will be compelled to evaluate whether to set up companies geared towards the regions into which they face and dismantle the global booking model which many foreign banks use to cost-efficiently operate businesses around the world, including in the U.S.

This silo or "Fragmentation" risk is concerning for a number of reasons:

- U.S. end users may find that accessing overseas markets directly is difficult because overseas firms may be concerned with establishing the kind of U.S. nexus which would trigger a U.S. registration obligation;

- For U.S. end users to be able to access overseas markets, the U.S. firm through which the U.S. investor trades is likely to have to enter into a series of back-to-back trades with group affiliates to access those markets. Over and above the question as to whether that intra-group activity would be required to be cleared or subject to non-cleared margin rules from multiple jurisdictions, there are frequently capital-derived limits on the amount of exposure that can be permitted between intra-group entities which could ultimately restrict U.S. end-user access to overseas markets;

- Global banks often have global clients. To the extent the global activity of both a bank and its internationally active clients are fragmented into local silos and local entities, there is likely to be a reduction in the availability of portfolio netting available to both the bank and its clients. For the end user, it is likely to increase the overall cost of access to a range of markets; and

- Breaking up a firm's legal entity structure into a series of separate subsidiaries is likely to be highly capital inefficient. It is not simply the case that capital moves from the parent entity to the new subsidiary in what is effectively a zero sum game. Minimum capitalization requirements, funding demands and the risk of increased direction in trading books as it becomes more difficult to manage well-balanced market neutral books within local entities, are all likely to drive a decrease in the efficiency of capital deployment by firms. Should a firm's legal entity structure be broken up to isolate its U.S. facing business, it may expose financial firms with U.S. operations to the potential of similar nationalistic treatment by other jurisdictions. Other jurisdictions may request similar treatment of entities operating in their local markets. If this occurs, firms with U.S. operations will be at a severe competitive disadvantage. Local competitors will not be facing the same pressure of higher capital requirements if these firms have limited or non-existent exposure to the U.S. or U.S. based clients.

C. Implementation Challenges of Title VII

The industry has been engaged in ongoing dialogue with the CFTC, SEC and other regulators, and has sought guidance on the territorial scope of Dodd-Frank from the inception of the rulemaking process. Nevertheless, nearly every question on this topic and related issues, such as the treatment of inter-affiliate transactions, guarantees and branches, remains open.

Against this backdrop, it is challenging that the CFTC finalized rules on January 11, 2012 requiring companies to register provisionally as swap dealers or major swap participants as soon as the CFTC's definitional rules under Dodd-Frank go into effect. All indications are, however, that the CFTC will not have finalized its extraterritoriality guidance by that time, and possibly without a sufficient transition period for companies to come into compliance.

II. Territorial Application of Title VII and Related Provisions

Congress, through Dodd-Frank, established the territorial scope of the jurisdiction of the CFTC and the SEC with respect to swap activities. For the CFTC, Section 722 of Dodd-Frank provides that Title VII "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 [CFTC anti-evasion rules]." For the SEC, Section 772 of Dodd-Frank provides that "[n]o provision" of Title VII "shall apply to any person insofar as such person transacts a business in security-based swaps without the jurisdiction of the United States, unless such person transacts such business in contravention of [SEC anti-evasion rules]."

These provisions are consistent with existing interpretations and statutory provisions setting forth each of the Commissions' jurisdictions. In the context of financial market regulation, U.S. jurisdiction over conduct outside the U.S. has typically been limited to cases involving fraud and manipulation. Courts have generally rejected application of substantive U.S. requirements to activities conducted abroad.[3] And, although Section 722 does contain an exception for "direct and significant" connections with or effects on U.S. commerce, that exception is very similar to exceptions in other

[3] See, e.g., Plessey Co. PLC v. General Electric Co. PLC, 628 F.Supp. 477 (D. Del. 1986) (rejecting application of U.S. tender offer disclosure and filing requirements to a British tender offer even though some of the target's voting shares were held in the U.S.).

statutes that U.S. courts have interpreted narrowly.[4] There is thus no reason to believe Congress intended for the Commissions to exercise broader extraterritorial jurisdiction than they have in the past.

Dodd-Frank also empowered the SEC and CFTC to limit registration of foreign entities (including foreign banks and foreign affiliates of U.S. banks) to a branch, department or division engaged in their U.S. swaps activities. Specifically, Dodd-Frank contemplates designation of a person as a swap dealer for a "single type or single class or category of swap or activities." Under this limited designation authority, if a financial institution registers in the U.S. as a swap dealer, the registration and regulation of that institution should be limited to only the branch or separately identifiable department or division specifically engaged in the swap activity giving rise to the U.S. registration requirement. The branch, department or division of a registrant involved in the U.S.-regulated swap activity should be responsible for compliance with Dodd-Frank's requirements, but those requirements should not be imposed more generally on offices or operations of foreign-regulated entities that are not connected, or only tangentially connected, to U.S.-regulated swap activity.

In addition, Dodd-Frank contemplated that the U.S. branches of foreign banks, as well as foreign banks themselves, might register as swap dealers. It provided that the Federal Reserve would be the prudential regulator of such swap dealers. The Federal Reserve has long permitted foreign banks to establish U.S. branches and bank subsidiaries without directly supervising the activities of those banks outside the U.S. It also has a well-established policy of deferring to the comparable capital requirements and supervision of foreign banks' home-country supervisors.

Consistent with the regulatory structure contemplated by the foregoing provisions, Congress has sought to ensure that swaps regulation be implemented in coordination with

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[4] See Republic of Argentina v. Weltover, 112 S.Ct. 2160 (1992); U.S. v. LSL Biotechnologies, 379 F.3d 672 (9th Cir. 2004); United Phosphorus, Ltd. v. Angus Chem. Co., 131 F.Supp.2d 1003 (N.D. Ill. 2001); In re Intel Corp. Microprocessor Antitrust Litig. (Intel II), 476 F.Supp.2d 452 (D.Del. 2007). See also F. Hoffman-La Roche Ltd. et al. v. Empagran S.A. et al., 124 S.Ct. 2359, 2361 and 2369 (2004) (rejecting the notion that the Foreign Trade Antitrust Improvements Act exception for "direct" effects expanded U.S. antitrust jurisdiction, noting that "if America's antitrust policies could not win their own way in the international market place for such ideas, Congress, we must assume, would not have tried to impose them, in an act of legal imperialism, through legislative fiat.").

foreign regulators. Section 752 of Dodd-Frank expressly requires the SEC and CFTC to seek harmonization with regulators in other countries by consulting and coordinating "with foreign regulatory authorities on the establishment of consistent international standards" for swaps regulation. Taken together, these provisions provide the statutory framework for effective and efficient solutions that are consistent with international law and time-honored principles of international comity and deference.

III. Workable Solutions under Title VII

As noted above, U.S. and foreign market participants have developed a consensus framework for the appropriate oversight of cross-border activities. Our goals have been to establish a level playing field, avoid duplicative or inconsistent regulation, and maintain the protections envisaged by Title VII, with the most efficient utilization of regulatory resources.

In the case of entities organized or established outside the U.S., Dodd-Frank contemplates regulation of U.S. customer-facing swap activities. General principles of international law together with the limited designation and territorial scope provisions of Dodd-Frank support U.S. regulation of transactions with U.S. customers. As a result, U.S. regulators should not seek to regulate transactions between foreign entities and their foreign customers, and should limit regulation of foreign registrants with respect to the branches or separately identifiable departments or divisions specifically engaged in the U.S.-facing swap activity giving rise to U.S. registration.

Additionally, an important and useful distinction exists between "transaction level" and "entity level" requirements.

U.S. regulation of transactions between a foreign entity and a U.S. customer should focus on requirements applicable at the level of the individual transaction or trading relationship, or "transaction-level" requirements. Such requirements include U.S. customer protections, such as business conduct rules. However, where transactions take place between foreign entities, local foreign regulation should apply.

For "entity-level" requirements, which are those requirements that apply on an entity or group-wide basis, compliance with comparable home-country regulation should be deemed sufficient under Dodd-Frank. As noted above, Dodd-Frank contemplates that foreign banks will have the Federal Reserve as their prudential regulator, and the Federal

Reserve has proposed to defer to comparable capital oversight by home-country supervisors. The SEC and CFTC should leverage this prudential supervision as well as the existence of substantially comparable entity-level foreign regulation for requirements related to capital, such as Dodd-Frank's requirements for a risk management program and financial recordkeeping. In addition, foreign prudential supervisors generally require a rigorous compliance program and policies and procedures to address some of the types of conflicts of interest that Dodd-Frank addresses. These requirements should provide a basis for deference on some, if not all, of Dodd-Frank's requirements relating to chief compliance officers and conflicts of interest procedures.

It is not necessary or realistic to subject foreign entities (including affiliates of U.S.-headquartered banks) to duplicative oversight where adequate comparable regulation exists. Neither would it be efficient for the SEC and CFTC to conduct comprehensive examination abroad of foreign registrants with respect to matters already subject to home-country oversight that is substantially comparable. Where applicable home-country entity-wide requirements are reasonably designed to achieve the same policy objectives as otherwise applicable U.S. requirements, such compliance should be deemed sufficient for purposes of Dodd-Frank, and any violation of any such comparable home-country requirements would, as in the case of violations of comparable capital and other prudential requirements, constitute a violation of U.S. requirements.

For these reasons, we support the recent Garrett-Himes bill (H.R. 3283, 112th Congress). The bill would provide much needed legal certainty and establish a level playing field between U.S. and foreign banks consistent with the consensus industry proposal outlined above, while still preventing evasion of Dodd-Frank and assuring transparency to regulators through transaction reporting requirements.

IV. Volcker Rule

We would also like to take this opportunity to say a few words about the extraterritorial effects of another provision of Dodd-Frank, the so-called "Volcker Rule."[5] In our view, the current notice of proposed rulemaking to implement the Volcker Rule incorrectly interprets the plain meaning and purpose of the statutory language by restricting a broad range of trading and fund activities conducted outside of the U.S.

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[5] Section 619 of Dodd-Frank.

Consistent with international comity, international regulators traditionally give due regard to home country regulation and regulators to provide the necessary local oversight to provide safe and stable global markets. In the UK, the Independent Commission on Banking released a report that specifically determined that a prohibition on proprietary trading along the lines established by the Volcker Rule was not necessary when evaluated in the context of other systemic risk management measures the UK is instituting.

As drafted, the proposal's extraterritorial application would have significant adverse and unintended consequences for the U.S. economy and the economies of other countries. Specifically, we believe that:

- The proposed limitations on proprietary trading and fund activities conducted "solely outside of the United States" go beyond what is required by the statute, and would have severe extraterritorial consequences that were not intended by Congress and are not supported by the policies behind the Volcker Rule;

- Without modifications, the proposed rules will result in decreased liquidity, increased transaction costs, widened spreads, and increased volatility, leading to an overall deterioration in global market quality and an increase in the cost of capital, and for some issuers eliminate the capital markets as a funding source;

- The proposed regulations will cause significant damage to foreign government bond markets unless they are revised to provide an exemption for trading in foreign government securities comparable to the exemption for U.S. government securities;

- To avoid triggering a Volcker violation or having to impose a very costly Volcker compliance framework on customer-facing trading desks globally, some international banks are likely to be dissuaded from transacting with U.S. customers and counterparties from their non-U.S. offices, further disrupting U.S. investor and corporate client access to international markets; and

- Application of the Volcker Rule's substantive restrictions, proposed compliance regime and reporting requirements to the foreign operations of international banks such as Barclays would be an unwarranted extraterritorial expansion of U.S. financial regulation and would potentially undermine home-country regulatory efforts.

The approach taken in the proposed rule will require significant rethinking to ensure that it does not create unintended negative effects both inside and outside of the U.S. and inappropriately impose U.S. regulation on the foreign activities of international banks. Unless the proposal is significantly revised, it is likely to decrease foreign investment in the U.S., reduce investment opportunities for U.S. pension funds, mutual funds, issuing companies, U.S. banks and other institutional investors, reduce the willingness of international financial institutions to trade with U.S. counterparties and lend into the U.S., encourage alternative financial centers to develop outside of the U.S., and ultimately result in jobs and transactions moving overseas.

V. Conclusion

Barclays appreciates the opportunity to testify today and your attention to these important issues under Dodd-Frank. We encourage you to continue to work with the CFTC, SEC and prudential regulators to assure that Dodd-Frank is implemented in a balanced and orderly manner, making efficient use of supervisory resources and promoting international comity and harmonization.

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	**2. Organization or organizations you are representing:**
Christopher John Allen	Barclays Bank PLC

3. Business Address and telephone number:

[redacted]

4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	**5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?**
☐ Yes ☑ No	☐ Yes ☑ No

6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.

7. Signature:

C J Allen

Please attach a copy of this form to your written testimony.