LIMITING THE EXTRATERRITORIAL IMPACT OF TITLE VII OF THE DODD-FRANK ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

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CONTENTS

Page

Hearing held on:
  February 8, 2012 1
Appendix:
  February 8, 2012 29

WITNESSES

WEDNESDAY, FEBRUARY 8, 2012

Allen, Chris, Managing Director, Barclays Capital 8
Brummer, Chris, Professor of Law, Georgetown University Law Center 9
Thompson, Don, Managing Director and Associate General Counsel, JPMorgan Chase & Company 11
Zubrod, Luke, Director, Chatham Financial 13

APPENDIX

Prepared statements:
  Allen, Chris 30
  Brummer, Chris 43
  Thompson, Don 56
  Zubrod, Luke 62

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Garrett, Hon. Scott:
  Written statement of The Depository Trust & Clearing Corporation 66
  Letter from the Institute of International Bankers dated February 7, 2012 70
  Letter from the International Swaps and Derivatives Association, Inc., dated February 6, 2012 72
  Letter to Representative Himes from the Securities Industry and Financial Markets Association dated February 7, 2012 74
  Letter to Treasury Secretary Geithner, CFTC Chairman Gensler, Federal Reserve Chairman Bernanke, and SEC Chairman Schapiro from the New Democrat Coalition dated April 15, 2011 76
  Letter to Federal Reserve Chairman Bernanke, CFTC Chairman Gensler, FDIC Chairman Bair, and Acting OCC Comptroller Walsh from various Members of Congress dated May 17, 2011 80
  Letter to FDIC Chairman Bair, Federal Reserve Chairman Bernanke, CFTC Chairman Gensler, Acting OCC Comptroller Walsh, SEC Chairman Schapiro, FHFA Acting Director DeMarco, and Hon. Leland Strom from Senator Stabenow and Representative Lucas dated June 20, 2011 83
  Letter to Treasury Secretary Geithner from Chairman Bachus dated August 2, 2011 87
  Letter to CFTC Chairman Gensler, Federal Reserve Chairman Bernanke, SEC Chairman Schapiro, and FDIC Acting Chairman Gruenberg from Senator Johnson and Representative Frank dated October 4, 2011 90
  Letter to Federal Reserve Chairman Bernanke, SEC Chairman Schapiro, FDIC Acting Chairman Gruenberg, CFTC Chairman Gensler, and Acting OCC Comptroller Walsh from Senators Johanns, Vitter, Crapo, and Toomey dated October 17, 2011 92
Himes, Hon. James:
  Written statement of the ABA Securities Association (ABASA) 94
  Written statement of Representative Gwen Moore 97

LIMITING THE EXTRATERRITORIAL IMPACT OF TITLE VII OF THE DODD-FRANK ACT

Wednesday, February 8, 2012

U.S. House of Representatives,
Subcommittee on Capital Markets and
Government Sponsored Enterprises,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:20 p.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Schweikert, Royce, Biggert, Hensarling, Neugebauer, Pearce, Posey, Hayworth, Hurt, Grimm, Stivers, Dold; Waters, Sherman, Hinojosa, Lynch, Maloney, Moore, Perlmutter, Carson, Himes, Peters, and Green.

Chairman Garrett. The Subcommittee on Capital Markets and Government Sponsored Enterprises is called to order. Today's hearing is titled, "Limiting the Extraterritorial Impact of Title VII of the Dodd-Frank Act."

I welcome the witnesses to the witness table. We will begin our opening statements. I will recognize myself for 3 minutes, and then move to the Minority side. So, good morning to the entire panel. I look forward, as always, to the testimony on this important topic. And today's hearing is important. Why? Because it gets to a broader issue that some of us on both sides of the aisle, quite frankly, have expressed concerns with regarding the Dodd-Frank Act and the issue of uncertainty. Uncertainty hurts growth, and it stifles investment.

In this case, companies are uncertain how to respond to the litany of new rules proposed under Title VII because of the lack of clarity regarding the extent to which U.S. regulators intend to apply Title VII to entities in foreign jurisdictions. So while exact intentions are uncertain, there are indications that the U.S. regulators intend to have some matter of extraterritorial application of these rules.

The legislation that Congressman Himes and I introduced, H.R. 3283, the Swap Jurisdiction Certainty Act, attempts to not only provide certainty on the application of the Dodd-Frank Act Title VII rules, but also aims to avoid the negative consequences that result if Title VII is applied too broadly. The concerns are not only confined to these shores. Foreign regulators have concerns as well. The following is a direct quote from the lead of a Reuters story published earlier this week: "The United States is coming to be seen as a global threat, acting unilaterally and aggressively, with new market rules that critics say will hurt U.S. firms, foreign banks, and international markets in one fell swoop."

Indeed, the list of negative consequences is long if these issues aren't handled carefully and appropriately. First, depending on how this extraterritoriality is applied, the global competitiveness of U.S. firms could be impacted. Non-U.S. firms may determine it is just too costly to serve customers and markets. So the overall health and liquidity of global markets therefore may suffer.

Dual and contradictory regulations will add additional costs or make it impossible to comply with all the jurisdictional rules that are out there. Additional costs will be passed on to whom? The end-users, of course. And that is the real economy at the end of the day.

The sovereignty of foreign countries may be inappropriately infringed upon. It might in turn invite regulatory retaliation. Concerns in this area are bipartisan in nature. Several of my colleagues across the aisle have joined me in cosponsoring this bill. In addition, the ranking member of the full Financial Services Committee joined the Senate Banking Committee chairman in sending a letter to regulators last October directly addressing these issues.

In part, the letter reads, "Congress generally limited the territorial scope of Title VII to activities within the United States. The general rules should not be swallowed by the law's exception which calls for extraterritorial application only when particular international activities of U.S. firms have a direct and significant connection with the effect on U.S. commerce or are designed to evade U.S. rules. We are concerned that the proposed imposition of margin requirements, in addition to provisions relating to clearing, trading, registration, and the treatment of foreign subsidies of U.S. institutions, all raise questions about consistency with congressional intent."

So, H.R. 3283 seeks to answer these questions through clear statutory language in order to provide certainty to market participants and international regulators as well.

Once again, I look forward to the testimony today, and I also look forward to the comments and questions of the sponsor of this legislation as well, who is taking, obviously, a lead interest in this issue, and I look to his leadership on this matter as we go forward.

With that, I yield back my time, and I yield 3 minutes to Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman. I would also like to thank the witnesses for their willingness to help the committee with its work. I must say I have grave concerns about the legislation before us today. This bill before us exempts an alarmingly large portion of the swaps market from many of the important requirements of Title VII of the Dodd-Frank Act, which deals with the over-the-counter derivatives market.

H.R. 3283 would exempt swaps between a U.S. company and a non-U.S. company or an affiliate from almost all transaction-level requirements in Title VII, including margin, clearing, and execution requirements intended to make swaps transactions safer and more secure.

If you need an example of how this bill would increase systemic risk to the American economy, look no further than AIG. AIG Financial Products, which almost single-handedly crashed the American economy, was a non-U.S. affiliate of a U.S. company that entered into subprime mortgage credit default swap transactions with a variety of American and international companies. When these subprime bonds tanked and it became clear that AIG could not honor margin calls required by these contracts, its imminent failure put the entire American economy in mortal peril. As a result, the American taxpayer pumped $85 billion into AIG to keep it afloat.

Under this bill before the committee, the same transactions that doomed AIG would receive less oversight—not more—and create more systemic risk. Even for the standards of this committee, this is an especially bad idea. Moreover, the sponsors of this bill argue that exempting these swaps from Title VII's margin, clearing, and execution provisions will increase America's competitiveness. That is far from the truth. I believe it will have the opposite effect, by encouraging U.S. companies to move their swap business into an overseas affiliate or subsidiary where they can fully enjoy the loopholes that this bill creates. This is a major and unwarranted exception to the carefully crafted Dodd-Frank reforms, and it creates the possibility of regulatory arbitrage.

Finally, this bill creates a regulatory race to the bottom by preventing U.S. regulators from acting until foreign jurisdictions act first. But of course, as we know, foreign regulators are similarly afraid to act unless the United States goes first. America should be the leader in financial regulation, and not allow a "you first" mentality to put Americans' financial security in jeopardy yet again.

Again, this is a bad idea. And I think we are replanting the seeds that caused this economic crisis in the first place. For these reasons, I oppose the bill under consideration today, and I would urge my colleagues to do the same.

Thank you, Mr. Chairman, and I yield back.

Chairman GARRETT. Thank you. The gentleman yields back.

Mr. Schweikert is recognized for 1 minute.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. And to our witnesses, I appreciate you being here. I am hoping, actually—and I have been looking forward to this hearing—we are about to have a discussion of the law of unintended consequences. And as witnesses, as you are speaking, I am hoping I will hear you touch on everything from jobs to capital availability to competitiveness. Also, I would love for you to touch on, as we just heard, AIG, because my understanding is OTS is gone, and under the regulatory framework we are under right now doesn't happen, and that we are living in a very, very different world, and that actually a problem crisis now has already been dealt with.

The other thing I would also love you to touch on is if the rules stay the way they are, and we see much of our swaps and derivative markets move away from us, move to Europe and other places, are we really systemically that much safer in the future?

So thank you, Mr. Chairman. I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Himes, the sponsor of the legislation, is recognized for 3 minutes.

Mr. HIMES. Thank you, Mr. Chairman. Thank you for holding this hearing and for the comity with which we have worked together on this legislation. I am looking forward to hearing from our witnesses today on what is a very complicated and technical topic. I do want to remind all of us that what we are talking about here is actually pretty esoteric. I suspect my co-author on this bill would disagree with that statement, but I actually think Title VII and the dragging of the heretofore unregulated derivatives market into a regulated environment is a significant achievement of Dodd-Frank.

The notion that derivatives will clear through clearinghouses, trade on an exchange when possible, be subject to margin requirements, be subject to capital requirements, are very, very powerful remedies to what we saw happen with AIG. This particular bill does not touch on any of those issues. And I want to be very clear that this bill is designed really to do two things. First, perfectly consistent with the congressional intent of Dodd-Frank, to provide some certainty about which regulatory regimes apply when you are talking about multiple countries. Section 722(d) of Dodd-Frank took a crack at that, at saying that these laws would only apply where there was a direct and significant connection with activities in the United States.

Second, this legislation is important, very important for competitiveness. I will give an example. If prudence would dictate that a particular swap should have a 5 percent margin against it, and the United States believes that, and Germany believes that, we should have a 5 percent margin on that transaction, not 10 percent. Because if both jurisdictions impose 5 percent margins and you have 10 percent, that swap is not getting done. As in so many things related to derivatives, there is an awful lot more discussion than there is understanding.

With all due respect to my friend from Massachusetts, this has absolutely nothing to do with AIG. This bill would preserve all of the entity protections imposed by Title VII, ensuring that the manifest irresponsibility that was shown by AIG would not happen again. Capital requirements for the entity, specific supervisory obligations, and of course the kinds of oversight provided because, presumably, AIG would have been deemed to be systemically important, all that stays in place.

Again, there is an awful lot of misunderstanding here. An organization I usually appreciate, Americans for Financial Reform, says that capital requirements would be eliminated for certain entities abroad. That is not true. Capital requirements would, in nations that are Basel signatories, defer to the capital requirements in that nation.

So in conclusion, I would just say this is about competitiveness, about making sure that banks and nonbanks understand what jurisdiction they are subject to, and in no way weakens Title VII, the regulation of the derivatives industry, or is an effort to roll back Dodd-Frank, something I think would be a significant mistake.

Thank you, Mr. Chairman. I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back.

The gentleman from Texas, Mr. Hensarling, is now recognized for 2 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. This is the second hearing of the Capital Markets Subcommittee dealing with regulatory overreach and its adverse consequences on jobs and economic growth. Again, another data point: When you yield unprecedented, unfettered, historic discretionary powers to the unelected bureaucracy, they will indeed use it.

Ultimately, we all know, notwithstanding a good jobs report last month, that there are still almost 13 million of our fellow countrymen who remain unemployed. Millions more have simply given up and dropped out of the labor force, which is why jobs and economic growth continue to be the number one issue for the American people. So we have to look very carefully at the subject of regulatory overreach.

Allow me to engage in the time-honored tradition of this committee of quoting the Chairman of the Federal Reserve when he agrees with me, and ignoring him when he doesn't: "If those margin rules for foreign operations are maintained, and Europeans and other foreign jurisdictions do not match it, that would be a significant competitive disadvantage." That is a quote from Fed Chairman Bernanke.

We know that prudential oversight already exists for bank overseas swap activities by the Fed, and by the OCC. So again, we don't have any evidence now that international regulators will adopt the more controversial provisions of Title VII, putting us at a competitive disadvantage. We know that prudential regulation already exists, so we must question just what benefit is to be derived from what is arguably duplicative and inconsistent regulations.

Significant sectors of the U.S. economy, including manufacturing, health care, and technology use these derivatives as a tool to manage risk and compete globally. Regulations that miss the mark will have a negative impact on jobs and the economy.

I appreciate the chairman calling this hearing, and I look forward to hearing the testimony of the witnesses. I yield back.

Chairman GARRETT. The gentleman yields back.

Mr. Royce is recognized for 1 minute.

Mr. ROYCE. Thank you, Mr. Chairman. There were three principles put forward in the Pittsburgh G-20 communique in September of 2009: "All standardized OTC derivative contracts should be traded on exchanges and cleared through central counterparties. OTC derivative contracts should be reported to trade repositories. And noncentrally cleared contracts should be subject to higher capital requirements." So that is what the G-20 countries agreed to.

My concern is with the regulatory crusade undertaken by the CFTC, which is not one geared toward making our markets safer, but rather an effort to fit an ideological narrative. The effort led by the CFTC goes against the very idea of international coordination on this. An overly expansive and aggressive implementation of Title VII will make our markets less competitive, and, problematically, they are going to provide justification for retaliation overseas. This approach has to be taken in tandem with our allies, not through a shot across the bow.

Attempting to regulate the global markets from the CFTC headquarters on 21st Street is not a solution that is going to work with our allies. So I think the Himes-Garrett legislation here is the right approach. It brings much needed balance back into the process. And I yield back.

Chairman GARRETT. The gentleman yields back.

The gentlelady from California is recognized for 2 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. As it turns out, we are getting some complaints from some in the industry who are alerting us to changes that could take place that were unanticipated. I don't know, and I have not decided about this or any other legislation. So I want to hear from the witnesses today. I want to hear what they have to tell us. And so, I am going to yield back the balance of my time.

Chairman GARRETT. I appreciate that.

Mrs. Biggert is recognized for 1 minute.

Mrs. BIGGERT. Thank you, Mr. Chairman. I have many concerns about the unintended consequences of U.S. regulators steamrolling ahead with the Dodd-Frank Title VII regulations. Will these regulations introduce more risk into our financial system, particularly for U.S. insurance companies? Will these regulations create an unlevel playing field for U.S. financial institutions with international subsidiaries, putting U.S. businesses at a competitive disadvantage in the global economy? And what will the impact of these regulations be on our U.S. economy? All these issues must be thoroughly vetted before the Federal regulators take action.

I hope that today's hearing will shed light on the need for an internationally agreed upon regulatory regime, especially with our U.S. trading partners. I yield back.

Chairman GARRETT. And the gentlelady yields back.

Mr. Grimm is now recognized for 1 minute.

Mr. GRIMM. Thank you, Mr. Chairman. I appreciate you calling this hearing to examine the efforts and clarify the reach of the derivatives title of Dodd-Frank and what it will do to business conducted outside the United States. I think at a time of both increased global competition and growing regulation, it is imperative that we ensure that new rules being implemented under Dodd-Frank do not subject American firms to double, and, in many cases, redundant regulations on overseas transactions. These redundancies will serve no purpose but to put U.S. firms at an enormous disadvantage in the global marketplace, and possibly encourage regulatory arbitrage, which could put the worldwide financial system at risk.

I look forward to hearing our witnesses' thoughts on the legislation before us, and I truly hope that our regulators are paying attention to the discussions that we are having here today, and take it into account as they move forward with their rulemaking. With that, I yield back the balance of my time.

Chairman GARRETT. Mr. Perlmutter is recognized for 2 minutes.

Mr. PERLMUTTER. Thank you, Mr. Chairman. I am sympathetic to the issues raised by Mr. Himes and the chairman. And I am glad we are highlighting these issues at today's hearing, although legislating, at this point, may be premature. It is important that we do not competitively disadvantage or penalize U.S. financial institutions just because the United States is further along in financial reform than others in Europe and Asia. Our rules should be constructed so foreign businesses still want to conduct business with U.S. financial institutions abroad.

Undoubtedly, imposing strict margin requirements on certain trades done abroad that only apply to U.S. financial institutions would place the U.S. institutions at a disadvantage because foreign businesses will choose to transact business with foreign institutions, where their rules don't apply.

But I feel like there has been some amnesia reflected on the committee because I still have nightmares surrounding the events of 2008 and the financial crisis. I do not want to legislate broad exemptions or carveouts that could potentially bring down our financial system and the economy. If our financial institutions are going to stand behind the trades conducted by their foreign subsidiaries, we must ensure that they are adequately capitalized and protected so taxpayers, depositors, and shareholders are not at risk. With that, I yield back to the Chair.

Chairman GARRETT. I thank the gentleman.

The gentleman yields back. Mr. Dold is recognized for the final 1 minute.

Mr. DOLD. Thank you, Mr. Chairman, and I certainly thank you for calling this important hearing. In listening to my colleague from Colorado, I want to agree that we don't want to have unintended consequences jeopardize American financial institutions abroad. And when we look at the global marketplace today, it is probably flatter than it has ever been. Certainly what we don't need is to make sure that U.S. financial institutions are operating from a disadvantage.

What I can tell you is that when we look at a 2,400-page bill, inevitably in those 2,400 pages there are going to be mistakes that are made, couple with the idea that we are going to have literally thousands of pages of regulation on top of it trying to interpret that law. Inevitably, there are going to be mistakes that will be made.

The task that we have is to try to make sure that we rectify some of those mistakes so that we aren't putting American institutions at a disadvantage. And certainly the CFTC, in terms of its interpretations, may simply be doing that.

So I want to thank my colleagues on the other side of the aisle for this bipartisan piece of legislation and for their leadership, and I look forward to hearing from our witnesses today.

Chairman GARRETT. Thank you. The gentleman yields back.

Now, we will turn to our panel. And as we turn to the panel, you will see that you have a piece of bipartisan legislation before you. And you can see from the opening statements today some supportive positions, but also some concerned positions, and also some open minds as we begin to look into something that is, as Mr. Himes said, a fairly technical piece of legislation before us.

So with that, we will turn to our first witness. And of course, the entire written testimony of all of the witnesses will be made a part of the record. We are looking to you for 5 minutes of testimony.

And the first will be Mr. Chris Allen, managing director over at Barclays. Good afternoon, Mr. Allen.

STATEMENT OF CHRIS ALLEN, MANAGING DIRECTOR, BARCLAYS CAPITAL

Mr. ALLEN. Good afternoon, Chairman Garrett, Ranking Member Waters, and members of the subcommittee. I thank you for the opportunity to testify today. My name is Chris Allen, and I am managing director of Barclays Bank PLC based in London. I head the global markets legal group for the U.K. and Europe, and have been actively involved in Barclays' implementation of global regulatory reform. I would like to start off by thanking the committee for the leadership they have shown in trying to get this right.

We strongly support the proposed bill, and believe the objectives of Title VII would be best served if this measure is enacted. As U.S. financial reform regulations are being finalized, there is concern that U.S. regulators are considering applying Dodd-Frank's swap dealer and other substantive requirements to non-U.S. aspects of a firm's global businesses. If these reforms are not modified, they will subject foreign firms and non-U.S. affiliates of U.S. firms to duplicative, inconsistent, and sometimes contradictory regulatory requirements.

This is best illustrated by example. A firm may be required to execute a trade via a swap execution facility in the United States while simultaneously being under an obligation to execute the same trade via the European concept of an organized trading facility. The European rules are at an early stage of development. But to the extent that the rules end up looking different, firms may be presented with the dilemma of not being able to comply with both sets of regulations at the same time.

Also concerning, an overly expansive application of Title VII could place global firms at material competitive disadvantage. If a firm which is conducting business from for example, Asia, with a client also based in Asia, is required to apply U.S. rules such as the clearing rules, while local competitors are under no such obligation by virtue of not being U.S. registrants, then the firm subjected to the U.S. rules will struggle to compete successfully.

Many global firms transact across the world using a single entity structure; i.e., one company throughout the world. U.S. extraterritorial overreach will cause firms to have to reconsider the viability of that model in favor of local subsidiaries in order to avoid regulatory overlap.

Why does that matter? First, it is likely to create hurdles for U.S. end-users seeking direct access to overseas markets, since firms may be concerned with establishing a U.S. connection which would bring them within the scope of Title VII. Also, there would be an increased likelihood of back-to-back transactions within firms offering access to those overseas markets, making such access more expensive for end-users. It is also unlikely that such an approach would enhance global consolidated supervision of firms and their swaps businesses.

We also note that the CFTC is likely to require firms to register as swap dealers prior to finalizing its extraterritoriality guidance; i.e., firms will be registering without knowing the global impact of that registration.

Turning to the proposed bill, we believe that it appropriately reflects the jurisdictional intent of the Dodd-Frank statute and serves the effective and transparent oversight of the global swaps market without having unnecessary negative impact. Specifically, we support the bill's aim of dividing the substantive Dodd-Frank requirements into entity-level requirements, such as those relating to capital or risk management requirements, and then transaction-level requirements such as clearing or public reporting.

Where comparable home company country entity-level requirements exist, such as in relation to capital, compliance with those requirements should satisfy Dodd-Frank. U.S. transaction-level requirements would apply to trades with U.S. customers, but local foreign requirements would apply to trades between foreign entities.

That brings me briefly to the Volcker Rule. In our view, the proposed limitations on proprietary trading and the fund activities go beyond what is required by the statute and would have severe extraterritorial consequences that were not intended by Congress. The various exceptions in Volcker are, in our opinion, insufficient to avoid extraterritorial overreach.

This is not just a case of the rest of the world playing catch-up. In the U.K., the Independent Commission on Banking released a proposal that specifically studied and determined that the Volcker Rule, as passed in the Dodd-Frank Act, was not necessary when evaluated in light of other systemic risk management measures the U.K. is instituting. Without revisions, the Volcker Rule is likely to decrease foreign investments in the United States, reduce investment opportunities for U.S. pension funds, reduce liquidity and market opportunity for issuing companies, and reduce the willingness of international financial institutions to trade with U.S. counterparties. All of this risks encouraging alternative financial centers to develop outside of the United States, and ultimately results in jobs and transactions moving overseas.

In 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, the SEC, and prudential regulators to ensure that Dodd-Frank is implemented in a balanced and orderly manner, making efficient use of supervisory resources and promoting international comity. Thank you, Mr. Chairman.

[The prepared statement of Mr. Allen can be found on page 30 of the appendix.]

Chairman GARRETT. And I thank you.

Next, from Georgetown, we have Dr. Brummer.

STATEMENT OF CHRIS BRUMMER, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. BRUMMER. Chairman Garrett, members of the subcommittee, my name is Chris Brummer, and I am a professor at Georgetown Law School, where I teach international finance—

Mr. PERLMUTTER. Pull that microphone closer.

Mr. BRUMMER. It is very rare that a law professor is ever asked to speak louder or to speak more.

Mr. PERLMUTTER. We are older than most of your students.

Mr. BRUMMER. Indeed. Indeed. My name is Chris Brummer, and I am a law professor at Georgetown. And I teach international finance and securities regulation. I have worked in London with Cravath, Swaine & Moore, and I serve periodically on NASDAQ delisting panels, as well as at the Milken Institute's Center for Financial Market Understanding. But this is the first time I have had the honor, as can you tell, to talk to you today. And thank you for the invitation.

Each great failure of 2008, whether it be Fannie Mae, Freddie Mac, Lehman Brothers, or Countrywide held important lessons for the country, and AIG was no exception. Its tragic downfall illustrated, perhaps above all else, just what happens when complex or opaque transactions fall through the regulatory cracks, even when they take place in far-flung parts of the world.

Regulated by a weak and underfunded OTS, and escaping meaningful oversight in London and France, the insurance giant's affiliates were able to create and write credit default swaps that, when combined with poor lending practices, ultimately toppled the international conglomerate when its bets went wrong, and at a cost of $85 billion for taxpayers.

To plug these gaps made apparent by AIG and other bailed-out institutions, Congress passed the Dodd-Frank Act, which sought to enhance not only entity-level, but also transaction-level credit quality in an effort to help prevent future financial crises. Two key elements of these efforts were: one, to regulate some of the, up to then, largely unregulated derivatives transactions which had caused and contributed to the crisis; and two, to direct supervisory agencies most familiar with the transactions, in this case the SEC and the CFTC, to take a more active role alongside traditional prudential regulators in the oversight of such instruments.

Title VII is an important part of the overall reform package. Essentially, it is designed to move the United States toward a new system of regulation, with margin requirements to enhance the credit quality of swap transactions and provide a buffer against losses. It includes a push towards centralized clearinghouses to reduce counterparty default risk, and to allocate losses and reduce the likelihood of bailouts, and to ensure that credit risk is supported by realtime mark-to-market benchmarking. It also includes a move from over-the-counter trading to centralized exchanges in order to facilitate standardization, ensure price discovery, and increase competition.

And these efforts have not been made in a vacuum. In the wake of 2008, G-20 countries, of course, have directed their attention to the task of reforming the international regulatory system and committed to a variety of goals including increased standardization and trading of over-the-counter derivatives, exchange and electronic platform trading, capital requirements, and reporting to trade repositories. However, up to this point even now, relatively few prescriptive standards have been articulated at the international level.

The Dodd-Frank Act represents an effort to lead by example, but its approach has been in certain notable regards unilateral. We have sought to lead by example, but we have also exported, or at least sought to export, our own regulatory preferences by leveraging our own formidable capital markets.

From the standpoint of financial diplomacy, this particular approach can serve an important purpose, both as a means of cross-border negotiation and to help get the ball rolling on international standards-setting that, as we have all seen, can be quite protracted.

But unilateralism carries risks that have only grown as financial markets have become more globalized. Regulated entities may seek to avoid your shores, creating competitive disadvantages, as I am sure we will hear even more about momentarily. Foreign regulators can, if not retaliate, at least use your own unilateralism as a kind of precedent in their own territorially-based regulation. And in the future, collaborative efforts between regulators can be undermined. So a balance has to be met between financial stability, comity, and pragmatism.

The particular approach in this bill carries the promise of rationalizing internationally the transactions between banks, but it carries the danger of rolling back all of the transaction-based progress that I had mentioned before.

For that reason, in my written testimony I had expressed my own confidence in a more thoughtful and calibrated mutual recognition regime that is in the legislation standards for capital. I think a blanket carte blanche allows an offshore financial center in the future, or a country from Bangalore to Syria to open up its own haven for low-level regulation, and in doing so creates certain kinds of risks that could, unfortunately, bring us back to 2008. I think we do need to engage our international counterparts. It is essential. But we have to do so in a thoughtful way. And part of the bill, I think, moves us in the right direction, and quite frankly, part of the bill does not. Thank you.

[The prepared statement of Dr. Brummer can be found on page 43 of the appendix.]

Chairman GARRETT. Thank you, Professor.

Mr. Thompson is welcomed back and recognized for 5 minutes.

STATEMENT OF DON THOMPSON, MANAGING DIRECTOR AND ASSOCIATE GENERAL COUNSEL, JPMORGAN CHASE & COMPANY

Mr. THOMPSON. Thank you, Chairman Garrett. My name is Don Thompson. As the head of the derivatives legal team at JPMorgan Chase, I am responsible for leading the firm's implementation efforts of Title VII. I would like to thank the committee for inviting me to testify today on the extraterritorial application of Title VII. And I look forward to addressing the concerns addressed by Congressman Lynch and others about AIG.

This is an issue of the highest priority to our firm and to the competitiveness of the American banks internationally. Section 722 of Dodd-Frank states that Title VII should not apply outside the United States unless foreign activity has a direct and significant connection with activities and/or effects on commerce of the United States. The interpretation of this phrase is crucial because swap markets are global.

Since Dodd-Frank passed, bipartisan letters from numerous Members of Congress have clarified that the intent of Congress is to not apply Title VII extraterritorially absent extraordinary circumstances. Notwithstanding these expressions of congressional intent, there are reasons for concern based upon the current state of the regulatory discussion.

Today, I will focus on three important points related to this debate. First, the extraterritorial application of Title VII would create competitive disadvantages for U.S. firms. U.S. banking regulation has long recognized and preserved the ability of U.S. firms to compete on a level playing field in the international markets. If Title VII applies to our overseas operations serving European or Asian clients, but not to our European or Asian competitors, U.S. banks will lose much of this business. This ultimately will have a negative effect on the competitiveness of U.S. banks, U.S. job creation, and economic growth. Significantly, losing many of our non-U.S. customers would also deprive us of valuable diversification in our credit exposures. This would actually be risk-increasing to our firm rather than risk-reducing.

Second, global harmonization is not the answer to this competitive disadvantage problem. We are aware that regulators are attempting to harmonize derivatives rules globally. These efforts are important to ensure against arbitrage and adverse competitive impact, but practical impediments to harmonization make this an unreliable solution to the competitiveness problem. Putting aside for a moment the fact that perfect harmonization will probably never be achieved, even with European regulators, it is reasonable to expect that there will be severe differences in the approach to derivatives regulation in Asia, Latin America, and other important markets around the globe. The timing of harmonization is also a problem. Europe is on a much longer timetable than the United States, and the rest of the world is even further behind. Applying Title VII extraterritorially would put U.S. firms at a significant disadvantage while the rest of the world catches up, and many customer relationships will be damaged or lost in the gap period.

Third, it is important to note that a prudential supervisory framework with respect to U.S. banks already exists and is effective. The stated rationale for an aggressive, expansive application of Title VII to the foreign swap activity of U.S. banks with their foreign clients is the potential to import excessive risk back into the United States. Proponents of this view cite the overseas swap activities of AIG, but this rationale no longer holds true for a number of reasons.

First, the activities of U.S. banks outside the United States, including their swap activities, are already subject to a robust prudential supervisory regime that is administered by the Fed and the OCC. It is important to note that virtually all U.S. swap dealers are banks, or affiliates of banks, or bank holding companies, and are thus subject to this regime.

Second, the regulatory regime for swaps has changed dramatically since 2008 and AIG. Major participants in the market now, because of Title VII, are required to register as swap dealers or major swap participants. This requires them to comply with requirements for sound risk management practices, minimum capital standards, and full regulatory transparency. Under these mandates, AIG would have been subject to this regulatory regime, and would not have been able to incur the exposures that led to the firm's demise. As such, an overreaching application of Title VII is not necessary to protect the U.S. financial system.

Finally, I would like to mention the Himes-Garrett bill. We believe the Himes-Garrett bill is a sensible and workable solution to these problems. By maintaining the tough entity-level regulatory framework for all swap dealer activity, even that outside the United States, it achieves the dual goal of providing important safeguards for the U.S. financial system while ensuring that U.S. firms can compete on a level playing field in the global marketplace.

JPMorgan is committed to working with Congress, regulators, and industry participants to ensure that Title VII is implemented appropriately. I look forward to answering your questions.

[The prepared statement of Mr. Thompson can be found on page 56 of the appendix.]

Chairman GARRETT. All right. Thank you.

From Chatham Financial, Mr. Zubrod, you are recognized for 5 minutes.

STATEMENT OF LUKE ZUBROD, DIRECTOR, CHATHAM FINANCIAL

Mr. ZUBROD. Thank you. Good afternoon, Chairman Garrett, and members of the subcommittee. I thank you for the opportunity to testify today as the subcommittee considers legislation to limit the extraterritorial impact of Title VII of the Dodd-Frank Act.

My name is Luke Zubrod, and I am a director at Chatham Financial. Today, Chatham speaks on behalf of the Coalition for Derivatives End-Users. The Coalition represents thousands of companies across the United States that utilize over-the-counter derivatives to manage day-to-day business risks. Chatham is an independent service provider to businesses that use derivatives to manage interest rate, foreign currency, and commodity risks. A global firm based in Pennsylvania, Chatham serves as a trusted adviser to over a thousand end-user clients ranging from Fortune 100 companies to small businesses. Our clients are located in 46 States, including every State represented by the members of this subcommittee. Many of them operate globally. And we serve them from offices in the United States, Europe, and Asia. The Coalition has long supported the efforts of this subcommittee to mitigate systemic risk and increase transparency in the derivatives market.

Additionally, we have appreciated the bipartisan efforts of this subcommittee to ensure that end-users of derivatives are not unnecessarily burdened by new regulation. Throughout the legislative and regulatory debates, end-users have expressed concerns to Congress and to regulators about a number of issues, most notably, the imposition of government-mandated margin requirements on end-user transactions and the regulation of an end-users inter-affiliate transactions.

In addition to these regulatory requirements that would directly burden end-users, the Coalition has raised concerns about regulatory actions that could indirectly burden end-users by making risk management more expensive.

We have, for example, expressed concerns that certain derivatives-related proposals by the Basel Committee on Banking Supervision could deter end-users from managing their risks or could make it materially less efficient to do so.

Today, we add to these concerns by highlighting the ways in which an expansive extraterritorial application of Title VII could adversely impact end-users. Global companies often manage risks arising from their foreign operations by executing hedges out of the foreign subsidiaries that are actually exposed to those risks. Such entities often have relationships with both foreign and U.S. banks. Having a robust pool of bank counterparties enables end-users to enjoy numerous benefits, including achieving efficient market pricing and diversifying counterparty exposure.

Importantly, and as I elaborate upon in my written testimony, the transactions end-users execute abroad are not designed to evade U.S. law; they are so executed for important business, legal, and strategic reasons. Because it is practically infeasible to perfectly align U.S. and foreign rules, expansive extraterritorial application of Title VII could create structural disincentives for end-users to transact with counterparties that are subject to U.S. law. Such disincentives could lead foreign end-users or the foreign subsidiaries of U.S. end-users to transact with a smaller potential pool of counterparties, thus reducing competition and liquidity, increasing pricing, and concentrating counterparty exposure. Measures banks may take to limit competitive disadvantages that result from expansive extraterritorial application of Title VII would inevitably increase costs for end-users.

Additionally, the expansive application of these same requirements to foreign banks operating in the United States could further impact U.S. end-users operating domestically. U.S. end-users presently transact with a wide array of banking partners, including both U.S. and foreign banks. In order to avoid the duplicative application of U.S. and home-country law to transactions executed with non-U.S. end-users, foreign banks have incentives to spin off their U.S. operations into separately capitalized subsidiaries. This would adversely impact the end-users in numerous ways, which I elaborate upon in my written testimony. In essence, it would likely make hedging risk more expensive and more burdensome. In effect, expansive extraterritorial application of Title VII could undermine end-users' ability to manage risk efficiently, both when they transact domestically and abroad.

We therefore appreciate this subcommittee's consideration of legislation that would clarify the territorial scope of U.S. law. Proposals such as the Himes-Garrett bill will increase certainty for market participants and resolve inevitable conflicts that would result from overlapping regulations in foreign jurisdictions.

We acknowledge the complexity of the task before policymakers in considering the appropriate boundaries of U.S. law, and believe the Himes-Garrett bill thoughtfully recognizes the need to defer entity-level regulations to home-country regulators, while clarifying U.S. transaction-level requirements apply only in circumstances in which there is a U.S. counterparty.

We appreciate your attention to these concerns, and look forward to continuing to support the subcommittee's efforts to ensure that the derivatives markets are both safe and efficient.

Thank you for the opportunity to testify today. And I am happy to address any questions you may have.

[The prepared statement of Mr. Zubrod can be found on page 62 of the appendix.]

Chairman GARRETT. Great. I appreciate your testimony.

I have just been advised that we are going to have votes in a little while, so I am going to try to keep everybody right to their 5-minute time limit so that everybody here gets the best chance possible on their time for questioning. So I will recognize myself, and also abide by the 5 minutes.

Running down the line, thanks, Mr. Zubrod, on this point. You said that companies, investment companies would invest overseas for strategic reasons, and not to avoid foreign law, or in this case U.S. law, right?

Mr. ZUBROD. That is right.

Chairman GARRETT. Okay. They do that now. But your argument would be that if you did have an onerous anticompetitive position, would that change, that they might change from strategic purposes of investment to trying to avoid U.S. law in the future?

Mr. ZUBROD. I think if the law is applied expansively abroad, it would ultimately be a cost issue for end-users.

Chairman GARRETT. So that is part of the strategic decision then at that point. It is cheaper to do it over here than to comply is part of the strategic—okay. A second question on that would be—and anybody else on the panel can chime in on this—when they do do that, without the expansiveness of the regulation, to advocate for a minute for that position, when they do make that strategic position, does that potentially have a direct and significant impact on the United States?

Mr. ZUBROD. I think it does not. I think when end-users transact abroad with, for example, the foreign branches of U.S. banks, those foreign branches of U.S. banks, of course the key concern here is could that activity potentially transmit risk back to the United States? And I think there you have to look at the entity-level requirements that are imposed on that foreign branch.

Chairman GARRETT. Okay.

Mr. ZUBROD. And I think you would look and say those are robust.

Chairman GARRETT. So maybe just moving down, Mr. Thompson, following along that line of thinking then, or that discussion, part of the seminal question is to define—or the understanding of what that term "direct and significant impact" would be, I guess, right, under Dodd-Frank? How would you define that? Would it require that you have a material impact upon the U.S. financial markets, a material impact upon the U.S. economy to fall under that definition? Is that appropriate?

Mr. THOMPSON. Unfortunately, the direct and significant test has no direct analog in any other statute that we have been able to identify. There are some which are similar, but none uses the exact language. So we don't have the benefit of court cases to interpret it.

In my mind, though, it implies something other than a U.S. firm losing money on a particular swap with a particular client because there is no margin associated with that particular transaction. I think it needs to be something that rises to the level where it affects not just the creditworthiness of a particular institution, but there are ripple effects for the financial system as a whole.

Chairman GARRETT. Okay. Great. Dr. Brummer or Mr. Allen, would you like to chime in on that? Dr. Brummer?

Mr. BRUMMER. Sure. It is absolutely true that we don't have any direct analog. However, effects-based regulation, effectively Congress regulating internationally when certain activities have an impact here, that is, at least under international law, quite common. I would say that in this particular instance where you have a parent company perhaps guaranteeing the swaps of a foreign entity, and where those swaps—when bets, quite frankly, go wrong on those swaps and could imperil the financial health of Parentco here in the United States, it is hard for me to imagine a situation where that is not having a direct effect in the United States.

I think it is worthwhile to think about whether or not, in the absence of Title VII's transactional requirements, what we have here in the United States for Parentco would be sufficient under, say, just Regulation K or the OCC, many of which—where you have under Regulation K, sure, you have capital requirements, but even those capital requirements under Reg K were originally envisioned in a world which, if you go through Reg K and 210 and other provisions, there are no references made to, say, derivatives activities. When you look at the permitted activities of a foreign—

Chairman GARRETT. And I am going to have to cut you short since I am going to abide by my own rule.

Mr. Allen, do you want to comment on this? And if there is uncertainty, as we hear from the panel so far as to that terminology, what have you—what is the cost, legal, operational, or otherwise, to that uncertainty for firms such as yours not knowing as far as whether the swap is going to be subject to it or not then?

Mr. ALLEN. I think in order to answer the question, it is useful to go to the issue of the entity-level versus the transactional-level basis of regulation. The reason I say that is that when one looks at the question of the safety and soundness body of regulation embodied most notably through capital, I don't think there is any suggestion under the bill, or more generally, that there should be deference or deferring to overseas regulators in circumstances where those regulations are less robust. And in fact, I have heard members comment that the European regulatory agenda, for example, is somewhat behind the United States in terms of implementation of those reforms. That is not necessarily the case.

In fact, I don't think that is the case at all in relation to capital. When it comes to the transaction-level regulation, I think it is absolutely right that to the extent that there is a U.S. nexus, derived by virtue of the fact that, for example, the one client is based in the United States, then absolutely the CFTC or the SEC rules, as appropriate, should be the ones that apply. But I think the point is that they shouldn't apply in circumstances where the activity is exclusively outside the United States.

Chairman GARRETT. Thank you. Gotcha. I thank the gentleman. Mr. Lynch is recognized for 5 minutes.

Mr. LYNCH. Thank you Mr. Chairman. If I listened closely enough, it seems to me what people are saying is that in order to remove the uncertainty in the regulatory process that Dodd-Frank Title VII, Section 722 creates, in order to remove that uncertainty we are just going to exempt all the stuff from regulation, so there won't be any uncertainty because none of it will apply. That is the solution here. And that exception that you are creating swallows the rule entirely.

Under H.R. 3283, its provision would exempt foreign affiliates of U.S. banks from basically all the major protections against derivative risk contained in Title VII. It doesn't eliminate registration, albeit, but margin, capital requirements, clearing requirements, all that is gone.

What bothers me is looking at the Fed filings, first of all, five U.S. banks control 95 percent of all the derivatives trading that is going on. So it is concentrated in five banks. You look at the filings of these five banks, let's just take right off the top Goldman Sachs, they have 62 percent of their derivatives books in foreign affiliates or subsidiaries for international banking. That is about $134 billion in fair value.

Let's look at Morgan Stanley. They have 77 percent of their derivatives book, $101 billion, in non-U.S. operations. So if you do this, if you say, okay, these—because you have these foreign subsidiaries, if you do your business through them, you can do an end-around of all this regulation. That is what you are doing here. This is a big end-around. This is recklessness. I understand there is a danger here in uncertainty, and we would like to, if not harmonize, using Mr. Thompson's term, if not harmonize, certainly reconcile the regulatory framework between our country and the countries of Europe and Asia. But what you are suggesting here is getting rid of—giving a huge escape hatch for these firms so they don't have to do any of the things that Dodd-Frank has required to minimize the risk. And by doing so, you are again planting the seeds for the next crisis, the next collapse.

This is a return back to the bad old days. That is what is going on here. Dr. Brummer, tell me I am wrong. Tell me that this is not what they are trying to do.

Mr. BRUMMER. Certainly, when you see that most of the derivatives transactions that are currently—

Mr. LYNCH. I am sorry, could you pull your microphone closer? Thank you.

Mr. BRUMMER. Certainly when you see that most derivatives transactions are occurring overseas, this would effectively exempt those transactions. And I think it is an overstatement to say that in the absence of Title VII, the protections that will exist for the U.S. part of the company are going to be robust. I will say that the G-20 process is slowly grinding along.

Mr. LYNCH. Very slowly, right? Facially they have set a deadline of 2012, but do you think that is going to happen?

Mr. BRUMMER. No. It is not going to happen in 2012. And even with the capital requirements, you see Germany and France trying to slow down certain parts of Basel III. But my personal concern is not merely that this encourages a kind of regulatory arbitrage or opportunity, but the way in which the bill is drafted, you can go anywhere. You can go to Syria, you can go to Iran, you can go wherever you want to go, right, set up a financial center. And if you are a country looking to attract transactions that are lowly regulated, at least as I interpret the bill, you can set up that financial center in order to evade—or to appeal to firms seeking to avoid the protections that were fought for under Title VII. And I personally don't understand why one would want that to happen.

I do understand and respect the fact that we want to keep our financial centers here very strong. But it seems like there are better ways to go about engaging our international counterparts.

Mr. LYNCH. Thank you. Thank you, Dr. Brummer. I appreciate that.

Mr. THOMPSON. Might I have a moment, Chairman Garrett?

Chairman GARRETT. I am going to come back to you for that response if we get through this circle. So hold that thought.

We will now turn to the gentleman from Arizona. But before we do, I ask unanimous consent to enter into the record some documents with regard to this issue of intent. They are letters from Senator Schumer pointing out, as we said in the opening statement, with regard to their concerns about inconsistencies with the congressional intent on this matter; a letter from Senator Johnson and Representative Frank with regard to the same concern about unintended consequences from the proposed regulations; a letter from the New Democrat Coalition on this point; and a letter from the chairman of the Financial Services Committee, Chairman Bachus, as well. Without objection, it is so ordered.

Now, to the gentleman from Arizona.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. And we are going to do some bouncing around, so we will get a chance for that.

Mr. Zubrod, help me, just because I want to make sure I am doing the flow. If this portion of Volcker goes forward, how different would a transaction look? Do you have to find a flat in London? What happens here?

Mr. ZUBROD. You said "Volcker," I assume you mean the derivatives?

Mr. SCHWEIKERT. The derivatives portion, I am sorry.

Mr. ZUBROD. I think, again, it is a matter of cost. If there is a foreign firm or a foreign subsidiary of a U.S. firm transacting in Europe, and these requirements have the effect of limiting the number of counterparties who are effectively available to bid on a transaction, that is going to impact my price because I have a smaller, less liquid pool of counterparties. So I think it ultimately just burdens end-users with additional and unnecessary costs.

Mr. SCHWEIKERT. Thank you, Mr. Zubrod. Do you end up moving the book of business somewhere else to execute? What do you do?

Mr. ZUBROD. No, I don't think so. I think you pay a higher price.

Mr. SCHWEIKERT. Mr. Thompson, same question.

Mr. THOMPSON. Sure. I think this talk of being able to move around like you are on a chessboard to evade these requirements is wildly overstated, the example that Dr. Brummer gave of Syria. The reality is we are international because that is where our clients are. That is why we are in London. That is why we are in Paris. That is why we are in Hong Kong. That is why we are in Singapore. That is why we are in Tokyo. We are not going to, and we are not capable of picking up shop and moving to Syria or Iraq, or some other light-touch regulatory jurisdiction, because you don't have the facilities there, you don't have the infrastructure there. In our derivatives trading businesses, every front office person is supported by seven or eight back office and support people. You can't find those people in light-touch jurisdictions. It is simply not possible.

I will also add that the CFTC and the SEC under Title VII have broad anti-evasion authority to impose Title VII requirements upon any registrant who structures his business in a way to avoid the Title VII requirements.

Mr. SCHWEIKERT. You hit on something. You are one of the big shops, correct?

Mr. THOMPSON. Yes, we are. We are a major dealer in all of the asset classes.

Mr. SCHWEIKERT. Just for a reference point, how many employees do you have who actually do interest rate hedging compared to how many employees you have on the regulatory compliance?

Mr. THOMPSON. We are seeing—and this trend is increasing, generally speaking—as I said, the number of front office people who actually do the business are dwarfed by the number of support people, the people who process payments, the people who deal with documents, the people who do regulatory reporting. And our compliance effort around this is vastly increasing. We have a whole Title VII implementation infrastructure in JPMorgan now, and that is between 350 and 400 people.

Mr. SCHWEIKERT. So you have 350, 400, and how many interest rate hedgers?

Mr. THOMPSON. Our number of front office people, certainly in New York, where most of them are, is probably 40 to 50.

Mr. SCHWEIKERT. Okay. So an interesting ratio there.

Mr. THOMPSON. Right.

Mr. SCHWEIKERT. Just tell us and make sure, because I think it is worth an expansion because some of the emails and things that I have gotten keep referring to this as sort of, you are going to allow AIG to happen again. And I am going to ask you, Mr. Thompson, because you started, and then I will ask some solicitation of other people whether they agree or see a hole in your argument, why won't AIG happen again?

Mr. THOMPSON. Great. So there are three reasons why AIG won't happen again under the current regulatory framework. The first is that, as Congressman Lynch noted, the derivatives business in the United States is vastly concentrated among five or six large bank holding companies. All of these entities are subject to a full and robust system of prudential regulation globally where the Fed and the OCC have ample oversight authority on a safety and soundness basis to examine our foreign branches, subsidiaries, and affiliates. That is a robust regime. It is ongoing, and it is quite—

Mr. SCHWEIKERT. Forgive me, I want to live up to my chairman's expectation of having only 30 seconds left.

Does anyone on the panel disagree with that as sort of an explanation? Could I start with Mr. Allen in just the last couple of seconds that we have? When you see what is coming up, particularly in the rules being written and we are moving under Dodd-Frank, do you believe that the regulators are following the way the statute was intended?

Mr. ALLEN. No. It is my belief that they are adopting a very expansive approach to what is written in the statute.

Mr. SCHWEIKERT. Thank you.

Dr. Brummer?

Mr. BRUMMER. All of the examples in Mr. Thompson's testimony were not prudential, but were disclosure-based, and so I would disagree with the idea that our system is robust enough to deal with derivatives transactions.

Mr. SCHWEIKERT. Thank you. And I am over my time.

Thank you, Mr. Chairman.

Chairman GARRETT. And the gentleman yields back.

And before I yield to the gentleman who just came to the panel, also without objection, I would like to offer a statement into the record which was submitted to us by the Depository Trust & Clearing Corporation—that is the DTTC, of course—which has written to us with regard to an important issue dealing with indemnification, which, by the way, I will just add as an aside, is an issue that the regulators have also chimed in on. Last week, Congress got a report from the CFTC and the FTC which stated that a legislative amendment to the indemnification provision is appropriate. So without objection, that letter will also be added to the record.

Mr. Hinojosa is recognized for 5 minutes.

Mr. HINOJOSA. Thank you, Chairman Garrett. I commend you for holding today's hearing on limiting the extraterritorial impact of Title VII of the Dodd-Frank Act. I believe this bill represents an accomplishment in bipartisanship, and I thank Chairman Garrett and Congressman Himes for their efforts on behalf of this legislation.

If there is any financial market that begs for clarity, it is the derivatives market. These financial tools can be used to hedge against risk, or, as we have seen in the subprime lending crisis, they can be used to obscure risk. I believe this market is now transparent, much more transparent than it has ever been, thanks to the Dodd-Frank Act and its implementation by U.S. regulatory agencies.

At this point, U.S. financial firms are asking for clarity in return from this body and from the regulatory agencies. While the Dodd-Frank Act sought to ensure the soundness and transparency of the derivatives markets, its intent was never to overextend its reach in a way that might harm the competitiveness of U.S. financial firms on the global stage. There has been unneeded confusion over the extraterritorial reach of the regulations set forth regarding swaps markets. Regulatory agencies should recognize the intent of this body with regards to Title VII of Dodd-Frank. While I commend the efforts of the CFTC in implementing this Dodd-Frank Act, I also would encourage them to limit the scope of their rules to the United States.

With that, Mr. Chairman, I yield back the remainder of my time.

Chairman GARRETT. Thank you.

The gentleman yields back his time.

Mr. Stivers is now recognized for 5 minutes. Thank you.

Mr. STIVERS. Thank you, Mr. Chairman, I appreciate it. And I appreciate the witnesses' testimony today.

And obviously, we all want to make sure that we don't drive jobs out of America and we don't make it harder for companies that need to manage their risk to do so. And I want all of you to be able to serve your customers wherever they are, obviously.

So I guess I would like to start by asking a couple of questions about the big nature of Title VII. Do you think that Title VII is, as written—if the regulators would implement it the way it was written by Congress, would cause a problem for—I will start with Mr. Allen—for firms like yours that are foreign based, but doing business here in America?

Mr. ALLEN. I believe the answer is no, not as written by Congress, and not as we interpret the relevant sections of the Act, principally Sections 722 and 772. I see those sections as fundamentally limiting the extraterritorial scope of the Act subject to, obviously, the well-known caveats from that. Our concern is that a regulatory approach which takes a different view and views those provisions as the foundational basis for an expansive application of regulation is where the problem starts to arise.

Mr. STIVERS. Right. And so you have answered the second part of the question. Obviously, those regulators have extended their reach beyond what Congress intended.

What do you think the choices for you will be you, Mr. Allen, in the long run for Barclays and firms like yourselves that are foreign based if that extraterritoriality continues and expands? What will your choice be for jobs in the United States?

Mr. ALLEN. It is important to stress that Barclays is very much in favor of an enhanced and enriched regulatory marketplace, regulatory-enforced marketplace, but the concern is where we find ourselves faced with regulations which we cannot comply with, as a matter of, say, U.S. regulation on the one hand and European, or specifically U.K., regulation on the other, but forces us into the position of potentially having to walk away from that business because, of course, we cannot be noncompliant with CFTC rules on the one hand, U.K. FSA rules on the other.

Mr. STIVERS. Right. And what does that mean for jobs in America?

Mr. ALLEN. It means that we have to look at our U.S. businesses and consider whether or not we need to try and insulate that business in some way. The United States is a very important market for Barclays, and Barclays has no intention of walking away from that business. It is a core part of our business.

Mr. STIVERS. But it is bad for jobs in America. Is it good or bad?

Mr. ALLEN. It makes it more difficult for us to do that business.

Mr. STIVERS. Thank you. I really just wanted it that simple.

And, Mr. Thompson, you have the other extreme. You are an American company trying to compete with foreign companies and trying to follow your customers and clients around the world.

Mr. THOMPSON. Correct.

Mr. STIVERS. Tell me about how extraterritoriality would complicate American firms, and what it means for your ability to serve your clients and compete internationally with those that might not have to have the same regulations.

Mr. THOMPSON. In the worst case, it severely disadvantages our overseas business because we would have to apply Title VII requirements to business with our non-U.S. customers out of our non-U.S. operations in a way that our competitors would not have to do so.

It is important to note that this affects not just our derivatives business, but a lot of our other businesses, such as investment banking, debt underwriting, and equity underwriting, also have a symbiotic relationship with our derivatives business, so being unable to compete with respect to the derivative has an adverse impact on your entire investment-banking franchise.

Mr. STIVERS. And as your competitiveness, Mr. Thompson, decreases internationally, what does that do to your profits of, obviously, an American company that you might be able to repatriate some of those profits?

Mr. THOMPSON. Yes. It would be a significant impact to our revenues. We are a very international firm. It varies from quarter to quarter, but in some quarters we derive more revenue from our investment-banking business overseas than we do in the United States.

I would also point out that it would have a perverse effect on the ability—and regulators are united on this, and we believe that by and large it is true—the industry needs to become better capitalized. Especially in the current environment for bank equity, the only way for banks to add capital is through retained earnings. So impairing our ability to earn significant revenue from our European and Asian and Latin American franchises will hinder our effort to build our capital cushion.

Mr. STIVERS. Thank you.

So the bottom line for jobs and profits—

Mr. THOMPSON. Simply phrased, it would be bad.

Mr. STIVERS. If the bill is not passed, it is bad. Kind of simple, getting to the point.

Thank you. I yield back the balance of my time, Mr. Chairman.

Chairman GARRETT. Thank you.

The gentleman yields back, and before I yield back, without objection, I have three other letters to enter into the record.

Again, these are in support of the underlying legislation, and also raise the question of the uncertainty under the proposed rules. They are from SIFMA and ISDA, and the last one is from the Institute of International Bankers. And the reason why I left that for last is because I just want to make one point, and this goes to what Dr. Brummer was saying before. They raise the point, the fact that this can be satisfied for those countries that are signatories to the Basel Capital Accords, which is, in other words, their protection in that area. And when we have more time, I will probably allow Dr. Brummer to address that.

But with that, Mr. Carson is recognized for 5 minutes.

Mr. CARSON. Thank you, Mr. Chairman.

Thank you, witnesses, for appearing before us.

This question is for Professor Brummer. The CFTC has indicated that it plans to work on clarifying guidance on this issue by April. It is not clear whether this will be a formal regulatory proposal, or if they will utilize a less formal guidance procedure.

Please give me, Professor, your assessment of the need for legislative action now versus waiting to review the guidance we anticipate from the regulators. Do you think more legislative action now could make the regulators' work more difficult? Or do you think it will be more timely and even useful in some instances?

Mr. BRUMMER. Yes, that question, is in part very difficult, because it is not just a question of the CFTC, it is also a question as to what our European counterparts are doing and the schedule with which they are moving with reforms.

Certainly we are ahead of time, and particularly with regards to our implementation of something like the Volcker Rule, that is a question that has to be addressed sooner, quite frankly, rather than later. But I think that we certainly have the time for most of the Title VII, as opposed to Title VI Volcker Rule, to—we have the luxury to see whether or not—see precisely what the CFTC and their Office of International Affairs and other folks are doing with regard to accommodating other regulatory programs in other parts of the world.

Mr. CARSON. I yield back. Thank you, Mr. Chairman.

Chairman GARRETT. The gentleman yields back.

Mr. Hurt is recognized.

Mr. HURT. Thank you, Mr. Chairman. Just kind of a general question, and I, first of all, thank the witnesses, and I apologize that I wasn't able to hear your statements, but I have reviewed them. And again, thank you for your appearance.

I come from Virginia's Fifth District, which is a rural southern Virginia district, and over the years we have—over the last 10, 20, 30 years, we have been really hit hard by the loss of our manufacturing sector, textiles and furniture in particular. As you look at the loss of jobs in our area, one can't help but be struck by the fact that our inability to compete in the global marketplace has contributed a lot to the decline of those sectors. And when you look at the barriers that we in Washington over the years have put up to make it more and more difficult for American companies to succeed, I think that we have to be extremely sensitive to the issue that we are discussing today.

When you think about the Tax Code, when you think about the environmental regulations and the labor regulations, all of the litigation, and the accounting that has to go along with all of the different regulations, I think that our American companies have a steep challenge. And I hope that, whether we as a Congress or the regulators that are implementing our legislation, it seems to me that it is more important than ever that we be sensitive to those challenges and those—and, frankly, those burdens that we put on our American companies.

So, I guess my question would be when you—and this would be for everyone. I would love to start with Mr. Allen and then just go down the line. When you look at the importance of harmonizing our regulatory and legislative structure as it relates to other countries, can you think of examples that jump out where we have done that successfully, and can you think of examples, the worst-case scenario, where we haven't done that successfully? I would think that certainly manufacturing might be one of those, but if you could speak just generally to that topic, because at the end of the day, as my colleague from Ohio Mr. Stivers said, at the end of the day, this is about jobs for us.

Mr. ALLEN. If I may cite an example which actually resides within Title VII itself, if we think about the position that Europe is currently heading in regarding the clearing of derivatives, the proposals there are substantially the same as those that we see under Title VII. There is a timing question there, there is a timing delay, that is unquestionably the case, but there has already been a pretty much arrived-at political consensus in Europe as to what the shape of that statute should look like. And it is intended that that statute be on the statute books by the end of 2012 of this year.

When one looks at the substantive regulation that sits in that clearing framework, it is very substantially aligned to what we see in the United States. There are other areas where that is not the case, admittedly, potentially around execution through SEFs and things of that nature, as I mentioned before. But clearing is a good example of where there is a reasonable—reasonably high prospects of a degree of international harmonization and convergence around how that is going to work, which, of course, should not be surprising given that it is embedded within the G-20 commitments articulated at Pittsburgh.

Mr. HURT. Thank you.

Mr. BRUMMER. I would agree.

Mr. HURT. Mr. Thompson?

Mr. THOMPSON. There clearly are some areas where harmonization is working, and I agree that clearing is one of them, but it is important to note that there are many where harmonization does not seem to be working. I will give a couple of examples.

The swaps push-out rule of Section 716, which is a feature of Title VII, no other jurisdiction of commercial importance has indicated any interest in adopting it soever.

A second example with respect to the margin rules for uncleared swaps, the U.S. approach is very proscriptive and significantly varies from current market practice. The indications of the approach in Europe will be quite different, and that you can deal with the risk relating to uncleared swaps by either capital or margin, but not both, as is in the case in the United States.

Finally, the approach to the execution mandate on electronic trading platforms will probably be quite different in Europe as opposed to the United States.

So it is important to note that although there are some successes on the harmonization front, there are many areas where the global regulatory framework will not harmonize.

Mr. HURT. Thank you.

Mr. Zubrod?

Mr. ZUBROD. I would echo some of those comments. In particular, among the most salient aspects of regulation that will impact end-users, both financial and nonfinancial, is the imposition of margin requirements. The U.S. prudential regulator's rule on margin does impose margin requirements on all market participants, albeit to varying degrees, depending on the type of participant. It is not clear that the world will follow that approach. Indeed, that approach isn't aligned with congressional intent here in the United States, but even globally foreign regulators have given signals that they have questions about the U.S. approach and whether or not capital requirements are sufficient to address the risks associated with noncleared swaps. And I think that whether or not harmonization is possible on that front is a question that will be answered in time.

Chairman GARRETT. The gentleman yields back.

The gentleman who sponsored the legislation is recognized for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman. Just to start, I would like to seek unanimous consent to submit two statements for the record, one from my colleague Gwen Moore, and one from the ABASA. Thank you.

Chairman GARRETT. Without objection, it is so ordered.

Mr. HIMES. I guess I would like to explore—I hear two criticisms of the bill that the chairman and I have written. One is the whole AIG thing, which I think is faulty, to say the least, and if I have time, I will come back to that. But I would also like to explore the concept that this bill would lead to a race to the bottom. And to do that, I guess I am very interested in currently.

My understanding is that the vast bulk of the swaps market occurs within the G-20, and, in fact, specifically trades largely in New York, London, Hong Kong, Tokyo and Germany. Can somebody just ballpark for me what percentage of the swaps market happens in those five jurisdictions?

Mr. THOMPSON. I will give you my guess. I would say north of 90 percent, probably closer to 95.

Mr. HIMES. Okay. So just for shorthand, let me say that all of the trading in these instruments happens in those five or six jurisdictions. If I listen to some of my friends on the other side, and some of my friends in the banking industry, I would hear that the efforts that were made to address the financial meltdown, whether it was Dodd-Frank, or transaction taxes being discussed in Europe, compensation limits imposed in the U.K., that we have unleashed the four horsemen of the apocalypse on the industry. And I wonder, in these last 3 years in which we have done this, how much of the swaps market has migrated away from these five or six entities to low regulation—Dr. Brummer talks about Syria and Iran. How much of that market, in the face of this assault on the industry, has migrated away from those jurisdictions?

Mr. THOMPSON. Certainly at JPMorgan the answer is zero, and the reason is we are in those jurisdictions because that is where the clients are, that is where the business is, that is where the infrastructure is.

As a practical matter, we can't pick up and move to Syria. Even aside from the anti-evasion authority that the CFTC has under the statute, we simply can't do it as a practical matter.

Mr. HIMES. So my colleague from Massachusetts says that if we enact this, that effectively we will lift all regulations on the transactions. Do any of these jurisdictions, London, Hong Kong, Tokyo, Germany, that effectively are all of the swaps market—do any of the witnesses want to characterize the transactional level requirements in those jurisdictions in which all of these transactions occur? And I am talking about margin, registration, reporting. Does anybody want to characterize the regulations in those markets where these transactions occur as lax?

Yes, Dr. Brummer?

Mr. BRUMMER. I would certainly not characterize them as lax, in part because we don't really know what they are. And they are yet on the books yet, which creates its own problems.

Mr. HIMES. But in each of those markets, there are currently clear regulations subject to evolution.

Mr. BRUMMER. We have proposals, right. And I would also want to emphasize, as I said in my report, when you look at the European Union—and I would agree with Mr. Allen—that there are some broad levels of consensus. We are different countries with different histories; we are going to come up with different approaches. I am not for trying to find a way to accommodate those differences.

Mr. HIMES. But if I could just interrupt you there. Regulations exist currently in those jurisdictions. It is probably fair to assume that they will get through Basel III or through other mechanisms probably more regulatory, probably fair to assume that. So, again, I just—my question is is the status quo in any of those jurisdictions currently—can you characterize the status quo as lax?

Mr. BRUMMER. I don't think so.

Mr. HIMES. Okay. I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back, and the gentleman from California is recognized for 1 minute, and then we will close since we have votes that were already called.

Mr. SHERMAN. Thank you.

Mr. Brummer, given the sizable derivative exposures of foreign branches of some of our major U.S. banks, how can we ensure that such exposures do not contribute to the systemic risk here in the United States? And is it typical for the U.S.-based corporate entity to guarantee or otherwise expose themselves to the risk of these foreign branches?

Mr. ALLEN. If I may—

Mr. SHERMAN. I guess, Dr. Brummer, although—

Mr. ALLEN. My apologies, of course.

I was just going to say that when it comes to the safety and soundness regulation which underpins the prudential approach to the activities of the non-U.S. branches of the U.S. firms, and this is true internationally as well, they are subject to considerable regulatory oversight—in the case of the United States, by the Federal Reserve, and in the case of the U.K., by the likes of the FSA—which goes to the safety and soundness of the activities which those institutions undertake.

Much of what we are talking about around Title VII relates far more to the transactional level-type regulation, where there is more of a fragmentation in terms of the international approach to the regulation of those issues, but far less the case when it comes to fundamental principles of prudential safety and soundness.

Mr. BRUMMER. I agree. That is certainly the case. But it is also useful to understand that many of our prudential regulations are created with certain expectations as to what kinds of activities our entities are permitted to do. So therefore, if you have capital requirements, say, under Reg K that is not necessarily anticipating foreign banking organizations from engaging heavily in derivatives and swaps transactions, and if you also have, say, under Dodd-Frank provisions that say we are not going to bail out dealers in derivatives and swaps, then you have to think very hard about whether or not preexisting capital standards sufficiently account for the additional risk not only at the entity-level, but also at the transactional level.

Chairman GARRETT. I thank the gentleman for his answers. I thank the sponsor and all of the members of the subcommittee. I thank the panel as well.

The Chair notes that some Members may have additional questions for the panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their response in the record.

And with that, this hearing is adjourned. Again, thanks to the panel.

[Whereupon, at 3:43 p.m., the hearing was adjourned.]

A P P E N D I X

February 8, 2012

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

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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. Resulting Competitive Disadvantages and Fragmentation Risks

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

[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.

Written Testimony of
Chris Brummer, Professor of Law, Georgetown University Law Center
Before the House Financial Services Committee, Subcommittee on Capital Markets and Government Sponsored Entities
"Curbing the Extraterritoriality of Dodd-Frank's Derivatives Regulation: An Examination of the Swap Jurisdiction Certainty Act"

February 8, 2012 2:00 pm

Summary: The Swap Jurisdiction Certainty Act embraces the worthy objective of improving certainty, efficiency and competitiveness in the cross-border derivatives market. However, the breadth of the proposed carve out would profoundly increase the potential vulnerability of U.S. financial institutions to regulatory lapses abroad. Instead, a more narrowly tailored exemption or mutual recognition program is needed to engage regulatory partners and facilitate cross-border financial transactions.

I. AIG and The Necessity of "International" Derivatives Regulation

Financial products, swaps and other derivative products largely escaped robust regulation by financial authorities prior to the financial crisis. For the most part, swaps were considered to be relatively low risk instruments. They originated as means for evading foreign exchange controls, and later evolved into insurance-like instruments offering institutions a means of spreading risk. As such, many experts viewed swaps as valuable tools for enhancing financial stability.[1] Indeed, swaps and other instruments associated with hedging activities were excluded from the kinds of prudential regulation to which other sectors of the financial economy were routinely subject.[2]

The myth of "fail-safe" swap products—as well as the potentially disastrous implications of an unregulated cross-border derivatives market—was largely revealed in the failure of AIG in 2008. Leading up to the crisis, AIG's London affiliate had sold credit protection for financial firms around the world in the form of credit default swaps on collateralized debt that had by 2008 declined in value. Due to its AAA status, it had not been required to post collateral for its positions; but as its rating fell in September 2008, AIG was required to post ever more frequent collateral with counterparties, especially in the wake of the failure of Lehman Brothers and the government takeovers of Fannie Mae and Freddie Mac.

AIG's increasing exposure was amplified by associated problems arising under its U.S.-based securities lending unit. Under the firm's securities lending program, AIG's

[1] E.g., Alan Greenspan.
[2] *Commodity Futures Modernization Act of 2000*, H.R. 5660, 106th Cong. (2000).

subsidiaries extended loans in exchange for cash collateral. To increase yield on the transaction, the collateral would then be reinvested. Usually, companies would invest their cash in highly liquid risk free assets. AIG, however, invested in the U.S. subprime mortgage market via mortgage-backed securities. When the U.S. real estate market plunged and borrowers returned their securities demanding the repayment of collateral, the firm was unable to meet the resulting call. As the firm teetered, the Fed offered AIG up to 85 billion at rates 8.5% above the rates banks were charging one another, and said the government would take 79.9% interest in the company in exchange, facilitating a government funded takeover of the firm.[3]

The AIG debacle was unique in severable notable ways. Unlike other firms like Lehman Brothers and Bear Stearns, its businesses also touched hundreds of millions of American companies and households. In addition to credit default swaps, upon which scores of financial institutions depended, it also sold insurance to hundreds of thousands of companies, pension plans and Americans.[4] Yet despite this diversity of economic stakeholders, AIG failed to net its exposure through matched books that balanced bought and sold protection to minimize its exposure. Instead, its business model and book focused on sold credit protection, even as it leveraged its rating to escape cash collateral requirements.

But AIG did reveal the extent to which unfettered swap and other complex financial product transactions could undermine international financial markets, especially as insurance objectives morphed into ones driven by speculation. AIG also highlighted the degree to which strong domestic and international oversight was needed. Perhaps ironically, the problem with AIG's regulation was not so much that of international regulators, but of U.S. regulators. AIG's default swaps business was handled by its London subsidiary, AIG Financial Products Corp., which had itself been formed by Banque AIG in France, which itself was the product of a federal savings bank subsidiary subject to federal oversight by the Office of Thrift Supervision (OTS). The French banking regulator then recognized OTS as comparable—in part because of its own weak regulation of swaps—and in doing so allowed the United States to act as the primary regulator for AIG's worldwide operations. Poor oversight by an understaffed OTS demonstrated, however, how delocalized risk associated with credit default swaps could eventually become. Regulatory lapses in one region (in this case the United States) could undermine financial stability in other parts of the world as financial institutions in far-flung parts of the world, as diverse as Banco Santander, the Bank of Montreal, Société Générale, entered into contracts with AIG that, if not honored, could have exposed them to possible insolvency.

[3] David Wessel, In Fed We Trust 193-95 (2009).
[4] *Id.* at 192.

II. The G-20 Global Agenda

In the wake of the outbreak of the 2008 global financial crisis, G-20 countries directed their attention to the task of reforming the international regulatory system and providing guidance for a range of financial entities and transactions, including derivatives products. Specifically, leaders have committed to a variety of goals, including the increased standardization and trading of over the counter (OTC) derivatives, exchange and electronic platform trading, capital requirements and reporting to trade repositories. The Basel Committee, in particular, has developed new capital weightings to better account for risk exposures generated by complex financial instruments.[5] However, relatively few prescriptive standards have been articulated by standard setters at the international level. Although a general consensus exists that OTC derivatives should be increasingly standardized and traded on exchanges or cleared through clearinghouses, there has been limited explicit agreement as to just how such objectives should be achieved, or even what kinds of granular, descriptive rules should be applied to clearinghouse ownership and membership.[6]

III. The Potential Extraterritorial Scope of Dodd-Frank

Yet even in the absence of clear prescriptive rules, most G-20 countries have set about working toward achieving the broad policy objectives expressed by the group, the United States included. The Dodd-Frank Act embodies Congressional efforts to curb, among other things, the risks generated by the expanding international derivatives markets. Among its relevant provisions, Title VII prohibits any person from acting as a swap dealer unless that person is recognized as a swap dealer. Additionally, Title VIII imposes a range of reporting, mandatory clearing, and mandatory trading requirements, including rules relating to conflicts of interest and business conduct standards. The Dodd-Frank Act has also enabled the Commodity Futures Trading Commission (CFTC) to propose capital requirements for dealers and major swap participants that would otherwise escape such requirements by prudential regulators.

The extraterritorial scope of Title VII lies in both the drafting and implications of Section 722. As a general matter, it is worth emphasizing that, as the Supreme Court noted in *Morrison v. National Australia Bank*, American law has espoused the principle that in the absence of explicit Congressional intent to the contrary, U.S. statutes are presumed to apply primarily with domestic actors.[7] But in Dodd-Frank, there is a clear intent to tackle, if necessary, regulatory challenges extraterritorially. Section 722 provides that US regulation should not apply unless activities have a significant effect on commerce in the United States or when they contravene CFTC rulemaking. Similarly, under 772, Title VII provisions do not apply unless a swap-based security transaction is conducted in

[5] *See* Chris Brummer, Soft Law and the Global Financial System 238 (2012).
[6] *See id.* at 248-49 for a more in depth discussion.
[7] Morrison v. Nat'l Austl. Bank Ltd., 130 S. Ct. 2869 (2010).

contravention of SEC rulemaking. Although these provisions were drafted as limitations on CFTC and SEC authority, they permit, at least in principle, considerable discretion for regulatory agencies to potentially engage in extraterritorial rulemaking where a "direct" connection with the United States is established. Necessarily, the provisions are operationalized via CFTC and SEC rulemaking authority, providing considerable room for both agencies to apply, interpret and implement Title VII provisions. These decisions would also enjoy considerable deference by judges under longstanding administrative law.

That said, extraterritorial exertions of regulatory power can be difficult to successfully execute. Even when domestic legislatures empower regulatory agencies to conduct extraterritorial regulation, the unilateral "exportation" of regulation by national authorities to other jurisdictions can be difficult. Regulators do not act in a vacuum, and when their actions have negative consequences for foreign regulators, they may be punished by similar actions in the future.[8] Additionally, financial globalization has made extraterritorial regulation more difficult insofar as enforcement is often dependent at least in part on cooperation with foreign regulators.

One of the most significant challenges with extraterritoriality in the derivatives space is that extraterritorial regulation can create not only onerous burdens on firms, but also potentially irreconcilable compliance obligations where foreign regulators adopt different or even *similar* obligations. For example, Section 723(a)(3) of Dodd-Frank requires that swaps entered into between parties be submitted to a clearinghouse registered with the CFTC or be exempt from registration. At the same time, the European Commission has forwarded its own Proposal on OTC Derivatives, Central Counterparties and Trade Repositories, also known as the European Market Infrastructure Regulation, which would require local clearing. If both rules were to be applied extraterritorially, a cross-border swap between a U.S. person and an EU counterparty would trigger both jurisdictions' clearing requirements, and the swap may have to be cleared twice, at both clearinghouses, if neither is registered with U.S. or EU authorities.[9] As a consequence, swap participants would potentially have to comply with potentially duplicative or even contradictory reporting, margin and even capital requirements.

Similar potential conflicts lie in the area of trade repositories. Generally, under the rules of both the CFTC and SEC, if there is at least one U.S. person participating in a swap, the swap must be reported. However, pending EU legislation also requires financial and certain non-financial counterparties established in the EU to report OTC trades to an EU-registered repository. As in the case of clearing, a swap between U.S. and EU counterparties could fall under both jurisdictions' reporting requirements, and as such require reporting to two different trade repositories, itself a duplicative and likely inefficient policy outcome.[10]

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[8] Brummer, *supra note 5*, at 41-42.

[9] Robert Colby and Andrew Fei, *Potential Extraterritorial Application of Regulations Issued Under Title VII of the Dodd-Frank Act*, J. ON THE LAW OF INV. AND RISK MGMT. PROD., FUTURES AND DERIVATIVES LAW REPORT, June-July 2001.

[10] *Id.*

IV. Title VII Exemptions for Swaps Entered Into by Registered Non-U.S. Persons

The Swap Jurisdiction Certainty Act is envisioned to minimize such conflicts. Under the first major operative provision of the proposed bill, U.S. registered swap dealers engaging in swap transactions with a non-U.S. person would not be subject to the Dodd-Frank derivatives rules if each party reports the swap to an SEC registered swap repository. Meanwhile, under the second avenue, a non-U.S. person that registers as a swap dealer or security-based swap dealer with the CFTC or SEC, respectively, can be deemed to have satisfied Dodd-Frank capital requirements by complying with comparable regulatory requirements in the firm's home country, so long as such home country is a signatory to the Basel Accords. The first provision thus constitutes a carve out, and the second, a gateway for future greater regulatory acknowledgement and deference through a mutual recognition regime.

The first exclusion is rather straightforward. In short, the reforms would create a blanket exemption from Title VII in that a non-U.S. swap dealer that registers with the Commission shall only be subject to Title VII requirements with respect to swaps entered into with a U.S. person who is not a U.S. subsidiary, branch or affiliate. By implication, this indicates that a range of transactions will not be subject to Title VII. The bill would lift the requirements of Dodd-Frank for U.S. swap dealers when they engage in inter-affiliate transactions with U.S. or non-U.S. affiliates or with any non-U.S. person that is not registered as a swap dealer. The bill would also exempt a non-U.S. person registered as a swap dealer from all Dodd-Frank rules except with respect to transactions entered into with a U.S. person (but not its affiliates).

Adopting this approach achieves several noteworthy policy objectives. First, it levels the playing field for U.S. banks. A non-U.S. person facing the choice of a trade with a European bank and the foreign branch of a U.S. bank would not face the pricing incentives to deal with the European bank if in an extraterritorial regime U.S. regulations were more severe than on the European side. Second, it potentially promotes economic efficiency insofar as international subsidiaries of U.S. firms can avoid duplicative, and even potentially contradictory, rules that may in themselves undermine cross-border relationships with other regulators. Finally, it is administratively easy to apply. Even where regulators in different countries agree on standards, the timeline for implementation may differ, creating temporary distortions or competitive disadvantages for regimes in certain jurisdictions. A bright line avoids these types of logistical problems and provides clear indications as to the application of U.S. law.

There are also, however, serious risks. The only requirements for non-U.S. companies are registration and reporting. These are not, however, prudential requirements aimed at shoring up financial stability. At best, they facilitate surveillance by supervisors. This is problematic because a U.S. parent guaranteeing a trade done by a foreign subsidiary could expose itself to considerable losses in the absence of sound regulatory framework.

Indeed, under the current bill, no mechanism is available to insulate (or prohibit) a U.S. parent from trading losses of a subsidiary, even though such exposure would comprise by definition a "direct connection" to the U.S. economy. The policy rationale behind such flexibility is that foreign supervision of operations abroad is sufficient to oversee risk to both the U.S. and global financial system when coupled with sound U.S. regulation. This assumption has merit insofar as the most of the major liquid derivatives markets are located in countries participating in the G-20 process of derivatives reform, and among these countries broad conceptual agreement has been reached. However, implementation by standard setters such as the International Organization of Securities Commissions (IOSCO) and the Committee on Payment and Settlement Systems (CPSS) are not complete, much less efforts by national regulators. Thus providing a broad carve out exposes potential vulnerabilities in cross-border regulation.

Moreover, even assuming that all G-20 countries come to the same prescriptive regulatory conclusions, the exemption could nevertheless permit outlier countries to adopt weaker standards in order to draw business to their shores, much as one sees with off-shore financial centers in money laundering, tax and terrorist financing. As a result, the exemption might provide incentives for structuring transactions in ways that funnel them through foreign affiliates in order to evade U.S. law. And if a subsidiary or affiliate was free to write unregulated contracts, it could, as in the case of AIG, bring down the parent company and affiliates. Of course, the same incentives could well be at play if no flexibility was granted to U.S. persons and their overseas affiliates, and in the process additionally disadvantage U.S. firms operating abroad. And a blunt extraterritorial application of U.S. law could be difficult to enforce, or subject our firms to a variety of duplicative or even incompatible foreign regulations. Nonetheless, it is quite possible that a more narrowly tailored exemption, perhaps even a mutual recognition regime with responsible partners like the European Union, would better balance competition and financial stability objectives.

V. Mutual Recognition for Capital Requirements

The second, administratively more complicated approach applies to capital requirements and comprises what can be considered authorization for a "mutual recognition" regime for foreign swaps dealers. In its simplest form, mutual recognition means that one country recognizes the other's regulatory oversight as equivalent and thus allows the market participants of the partner country to conduct business with no additional regulatory hurdles beyond compliance with the partner's regulatory regime.

Mutual recognition is not new to the SEC. The SEC, for its part, has adopted both nationally tailored and broader-based mutual recognition programs in other fields. As early as 1990, the SEC established the Multijurisdictional Disclosure System (MJDS) program, a mutual recognition scheme adopted by the United States and Canada. Under the MJDS, Canadian foreign private issuers that meet eligibility criteria qualifying them as large, established companies are viewed as meeting certain of the SEC's securities registration and reporting requirements if they provide disclosure documents prepared according to the requirements of the relevant Canadian securities authorities. [11] Conversely, U.S. issuers also enjoy expedited access to Canadian markets, though only a fraction have chosen to do so, given the immediate advantages of U.S. markets. The program is thus largely viewed as a boon to Canadian issuers seeking to raise capital in the United States. And as late as 2008, the SEC introduced a new mutual recognition program for exchanges and broker-dealers whereby market participants from select countries became eligible to enjoy preferential access to U.S. investors if they demonstrate compliance with foreign regulations that are comparable to those of the United States. Finally, and perhaps most broadly, Regulation S excludes any agency or branch of a U.S. person located outside the United States if the agency or branch engaged in the business of insurance or banking and is subject to substantive insurance or banking regulation in the jurisdiction where it is located.

Mutual recognition is not new to the CFTC, either. Indeed, the CFTC was the first financial supervisor to originate such a program of cross-border recognition, with the Part 30 rules adopted in 1987, effective in 1988, and the first 30.10 order issued to Australia in November 1988.[12] CFTC Regulation 30.10 permits a person affected by any of the requirements contained in Part 30 governing the offer and sale of foreign futures and options contracts to petition the CFTC for an exemption from such requirements. A petition for exemption pursuant to CFTC Regulation 30.10 is typically filed on behalf of persons located and doing business outside the U.S. that seek access to U.S. customers by a governmental agency or self-regulatory organization responsible for implementing and enforcing the foreign regulatory program. If after its review the CFTC determines that compliance with the foreign jurisdiction's regulatory program would offer comparable protection as that which would be available domestically, and the CFTC is able to memorialize an information sharing agreement with the firm's home country regulator, the CFTC may issue an order to the foreign regulator or self-regulatory organization granting general relief, subject to certain conditions. [13] As implemented, orders issued under rule 30.10 have exempted foreign brokers from registering as futures commission merchants based on their "substituted compliance" with foreign regulatory regimes that have been found to be "comparable" with the CFTC's regulations.

In light of these earlier mutual recognition regimes, H.R. 3283 would constitute another step in an increasingly established process for creating an institutional framework for negotiating and mediating jurisdiction for cross-border transactions, and in doing so, elides some of the negative consequences of unilateralism. The difference here, however,

[11] Once the Canadian securities regulator grants approval, a wrap-around document is attached to the prospectus. This document provides certain information required by the United States securities regulators such as taxes, civil liability, and GAAP reconciliation in certain circumstances. Ruth O. Kuras, *Harmonization of Securities Regulation Standards Between Canada and the United States*, 81 U. DET. MERCY L. REV. 465, 469 (2004).

[12] 17 C.F.R §30 (1988).

[13] Foreign Markets, Products, and Intermediaries, http://www.cftc.gov/international/foreignmarketsandproducts/foreignprodsales.

is that a mutual recognition regime concerns not so much registration exemptions, but capital requirements.

VI. Mutual Recognition as a Means of Extraterritorial Export

Mutual recognition programs are viewed as largely deregulatory programs because they entail reciprocal (and simultaneous) changes in national-level hard law governance structures. This means a loss of national regulatory control and authority for participating regulatory agencies. It also potentially empowers international firms to engage in forum shopping, depending on the final rules adopted by national authorities.[14]

However, mutual recognition programs can and do periodically constitute a means of regulatory export, at least insofar as they may encourage foreign countries to adopt U.S.-style regulations. In the case of the MJDS, Canadian regulators were required to institute a range of changes associated with both issuance rules and supervisory activities as a condition for participating in the program. The SEC eked out additional concessions from Canadian regulators over time. In 2000, for example, the SEC publicly considered abandoning the program outright. The agency considered two matters inadequate—the reconciliations between Canadian companies' financial statements and generally accepted U.S. accounting principles, and the oversight that Canadian regulators, particularly the Ontario Securities Commission, had exercised over prospectuses filed under the MJDS. The deliberations prompted several important reforms in the supervision of issuances, including the allocation of increased resources for that purpose. When Sarbanes Oxley was passed by the U.S. Congress, questions arose as to whether Canadian firms would be required to abide by the new U.S. legislation, which imposed a range of additional (and costly) requirements on issuers. Canadian firms and regulators felt that compliance was not warranted and resisted prospective application of such rules to Canadian firms making offerings in the United States. Partly in response to this resistance, the SEC formally considered various policy changes that would, among other things, dismantle the MJDS. After further negotiations with the United States, Canadian regulators eventually conceded to the SEC and implemented key Sarbanes Oxley provisions at home, which ultimately bolstered the cross-border arrangement.

Sarbanes Oxley's repercussions on the MJDS illustrate an important limitation of regulatory export through mutual recognition. Because mutual recognition is not legal convergence, it does not create a level playing field across borders. If the legal regimes are sufficiently similar when entering into an agreement, this lack of convergence may not be a problem. National regulatory frameworks are never static, however; they change continually with regard to their substantive intensity and breadth. This dynamism can challenge the robustness of mutual recognition when one party makes a significant change to its national regulatory regime.

[14] Chris Brummer, *Post-American Securities Regulation*, 98 CAL. L. REV. 327, 369 (2010).

Such change need not take the shape of enhanced regulatory stringency. Having entered into a substantive mutual recognition arrangement, one of the parties may decide to dramatically lower its domestic standards. By lowering its standards, it acquires a duel benefit: it can become a more attractive jurisdiction for issuers seeking low-cost regulation, and it can act as a backdoor to the partner jurisdiction when foreign issuers from a third country decide to submit to its local (weaker) regulatory jurisdiction. This type of conduct not only deflates the trust and understanding on which mutual recognition arrangements are based, but also clashes with the partner jurisdiction's regulatory philosophy and undermines the supervision of its markets and protection of investors.

Seeking to avoid the earlier shortcomings of the MJDS, the SEC modified mutual recognition strategies have been employed by the SEC—in particular, to incentivize change and liberalize markets. The most high-profile strategy has been the "substituted compliance" program (later renamed "mutual recognition") introduced by SEC officials in 2008, just before the financial crisis. Under this initiative, foreign exchanges and foreign broker-dealers from select countries are eligible to enjoy preferential access to US investors if they comply with foreign regulations that are comparable to those of the United States. The SEC must therefore seek partners that, as in typical mutual recognition arrangements, recognize one another's institutions and procedures governing market regulation as "comparable," thereby allowing market participants or products in the market segment covered by the recognition regime to operate freely in the host market. Substituted compliance departed from the earlier MJDS insofar as it required an actual application for exemptive relief from national regulatory authorities for the mutual recognition scheme to become effective, thereby creating a multi-tiered process of granting market access.[15] Among other things, "eligible market participants would need to apply for, be vetted and finally granted an exemption on a case by case basis. Thus while the home country supervisors retain ultimate authority over foreign players active in their jurisdiction, the host country, the SEC, would grant individual exemptions to market participants."[16]

To establish a framework for such exemptions, substituted compliance entails that the SEC and its chosen foreign counterpart sign a nonbinding mutual recognition "arrangement" laying out their intent to liberalize market integration. At the same time, bilateral memoranda of understanding would be signed allowing for enhanced enforcement cooperation and information sharing. This arrangement would also contain an undertaking by the foreign regulators to describe "in detail how certain regulatory preconditions required by the SEC are met, and a similar undertaking by the SEC providing for reciprocity." US regulators would then evaluate the country's regulations, determining whether they were comparable to those in the United States. Once the SEC had blessed the laws of their home jurisdictions, stock exchanges and broker-dealers in those countries would be able to apply for exemption from SEC registration based on compliance with their home countries' laws. Consequently, shares traded on or through

15 Steffen Kern, *EU-US Financial Market Integration: A Work in Progress*, 56 EU MONITOR 1 (2008).
16 *Id.*

those countries could be marketed and sold to US investors without compliance with US disclosure and corporate governance rules.

The first mutual recognition agreement for exchanges was signed on August 25, 2008, between the United States and the Australian financial authorities. The program has yet to be implemented in the wake of the financial crisis, and most commentators are unsure whether U.S. regulators will proceed with the initiative. Indeed, there is widespread concern that a consequence of the initiative could be regulatory arbitrage: companies could list on Australian exchanges to access U.S. investors. This concern is exacerbated by the ostensible failings of earlier deregulatory initiatives that contributed to the crisis. The program's regulatory architects nevertheless believe that it provides key incentives for foreign counterparts to adopt more U.S.-style regulatory features: although convergence might be costly or involve the adoption of rules contrary to a regulator's traditions or philosophy; the regulator's domestic market participants could benefit from a range of competitive advantages, especially over other market players in nonparticipating jurisdictions; under the initiative, securities do not have to be registered in the United States in order to access capital markets there (since compliance only with the home state regulator is required); exchanges in the complying jurisdiction could potentially enjoy greater liquidity; and foreign regulators that secure agreements could receive political payoffs (for example, raises or promotions from agency executives and political elites, or jobs in the private sector). Regulators that are supportive of the initiative hope that advantages such as these might increase regulators' net payoffs. Of course, the optimal outcome would be the importation of U.S. law, and as common or more closely related standards are adopted, positive network effects may stimulate better consensus between market participants and their regulators.

VII. Limitations of Mutual Recognition Regime for Cross-Border Derivatives Regulation

Mutual recognition is most likely to be effective as a means of raising regulatory standards in two circumstances. First, preferential market access may provide sufficient incentive for adopting new standards when a regulator of a big, capital-rich market enters into a mutual recognition policy with the regulator of a significantly smaller capital market with hungry investors. In this situation, all else being equal, the big market regulator would be reluctant to coordinate at the smaller regulator's standards since adjustment would entail high costs (more of its firms would have to make compliance changes). By contrast, the regulator of the smaller market would have greater incentive to make concessions in order to enable its firms to access clients, customers, and investors on terms that are more competitive than those available to firms in other countries.

Second, mutual recognition programs are most feasible when adjustment costs in the target jurisdiction are low.[17] That may happen, for example, when few conditions are placed on a prospective counterparty to a mutual recognition agreement (such an agreement almost entirely facilitates market access or a deregulatory program). Another example involves countries that share similar regulatory approaches, philosophies, administrative techniques, or enforcement intensity—such as the substituted compliance initiative between the United States and Australia. In these instances, regimes are comparable or even equivalent, and few adjustments are needed unless one regulator seeks convergence at a higher, more intense level than is currently the case in either jurisdiction.

Third, and this is particularly relevant for a capital regime in the derivatives space—mutual recognition programs will be most successful where the transaction costs and indeed ability to establish a comparability regime are high. Establishing an assessment usually requiring the existence of a 1) mature regulatory framework along with 2) a proven supervisory regime in both countries. At that point, an adequate assessment of regimes' strengths and weaknesses is possible.

When applied to the derivatives space, these observations suggest that mutual recognition faces an uphill battle as a means of regulatory suasion. A regulator must wield a considerable amount of market power to be able to single-handedly achieve significant regulatory change in another jurisdiction through a mutual recognition agreement. But in today's international swaps market, other jurisdictions have equally comparable and liquid derivatives markets. Today, Europe is the most important region in the global derivatives market, with 44 percent of the global outstanding volume–significantly higher than its share in equities and bonds.[18] Meanwhile, Asian derivative markets today account for one third of worldwide foreign exchange and over 40 percent of equity derivatives trading. Korea is hosting the world's largest derivatives exchange and India has the world's fastest growing exchange.[19] The United States, quite simply, is not in the position of dictating terms to the European Union.

Meanwhile, the issue of adjustment is highly uncertain, in part because even in light of the delays in the rulemaking process that have stymied regulators since Dodd-Frank, the U.S. is further along than other countries with regards to instituting rules for derivatives transactions. The European Union, importantly, has only proposed rules for derivatives transactions, and has yet to pass a comprehensive derivatives regime. Asia is even further behind. In November 2010, Singapore Exchange launched the first central-clearing platform for OTC financial derivatives in Asia. However, clearing is not yet a

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[17] Pierre-Hugues Verdier, *Transnational Regulatory Networks and Their Limits*, 34 YALE J. INT'L L. 113, 148 (2009).

[18] Deutsche Börse Group, *The Global Derivatives Market: An Introduction* (April 2008), http://math.nyu.edu/faculty/avellane/global_derivatives_market.pdf.

[19] Oliver Fratzscher, *Emerging Derivatives Markets in Asia*, ASIAN FINANCIAL MARKET DEVELOPMENT (March 2006), http://siteresources.worldbank.org/INTEAPREGTOPFINFINSECDEV/Resources/589748-1144293317827/EAFinance_bkgrnd_Derivative_Markets.pdf.

mandatory requirement for swaps transactions, and the platform currently only covers interest-rate swaps. The G-20's recommendations are, however, being examined and the Monetary Authority of Singapore will conduct a consultation by the end of this year on all aspects of the Financial Stability Board's recommendations with regard to implementing its G-20 commitments. Similarly, the Hong Kong Monetary Authority and the Hong Kong Securities and Futures Commission have only issued consultation papers on proposals for the regulation of the OTC derivatives market in Hong Kong, and these rules will likely not be given effect for at least a year. Thus although there is progress towards the creation and implementation of international standards in the derivatives space, reforms have only started, and are far from robust programs. Consequently, there is precious little data for building a robust "assessment" capable of comparing disparate regulatory regimes.

Importantly, the additional reference to the Basel Accords provides an important backstop. The Basel Accords do not comprise formal international "treaties", though a variety of disciplines are in place to help monitor countries' commitment to the various capital and prudential requirements.[20] And to be sure, G-20 countries are further in their devising of capital standards than derivatives regulation. But implementation can and will be different, from definitions of Tier 1 capital to application of various supplemental ratios. As such, the Basel Accord, though a potent means of coordination, may not definitively ensure that firms have the specific type of capital structure necessary for providing the kind of cushion optimal for firms dealing in swaps.

This is not to say, however, that mutual recognition cannot serve as a useful means of financial statecraft, or even the promotion of U.S. regulatory interests. A mutual recognition regime, when properly crafted, helps establish three conditions precedent for realizing a cross-border regulatory regime:

- First, it provides an opportunity for learning about other regimes and improving domestic regimes. Advantages and lapses of regulatory approaches can be digested and dissected, and from that learning process, domestic regimes themselves can be potentially improved, both with regard to removing inefficient regulatory burdens and implementing stronger, smarter safeguards.
- Second, it provides an opportunity to shape common approaches to regulatory challenges. Comparability assessments are generally not only means of "checking the box"; they also help forge common views and strategies with regard to standard-setting in international forums.
- Finally, as discussed above, mutual recognition can provide the incentives—at times on the margins and at times more significantly—to reform domestic practice and export U.S. policy preferences.

For this reason, a mutual recognition arrangement might be useful and even preferable for not only capital requirements, but also Title VII more generally. In this way, Congress could empower U.S. regulators to abide by and respect longstanding principles of comity,

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[20] *See generally* Brummer, *supra note 5*.

but in ways that would not necessarily potentially exempt transactions taking place in regulatory environments that have eschewed regulatory reform. But mutual recognition is no magic bullet. In many cases, time and experience will be needed to determine just what kind of flexibility is warranted as other jurisdictions undertake not only the legislative and regulatory tasks of rulemaking, but also the equally important activities of supervision and oversight. Yet space for regulatory innovation is always possible even within the ambit of mutual recognition to help facilitate cross-border transactions—from pilot programs, parole periods, and framework agreements. Such efforts at "first in time cooperation" with partners will be necessary, and ultimately essential, in order to better navigate the distinctly international nature of today's financial marketplace.[21]

[21] *See generally* Brummer, *supra note 5,* at Chapter 6.

Testimony of Don Thompson
JPMorgan Chase & Co.
Subcommittee on Capital Markets and
Government Sponsored Enterprises
House Financial Services Committee
February 8, 2012

Chairman Garrett, Ranking Member Waters, and Members of the Committee, my name is Don Thompson and I am a Managing Director and Associate General Counsel at JPMorgan Chase & Co. I provide legal advice with respect to the full range of J.P. Morgan's OTC derivatives businesses and have been leading J.P. Morgan's implementation of Title VII of the Dodd-Frank Act. Thank you for inviting me to testify at today's hearing.

The extraterritorial application of Title VII to JPMorgan Chase's swaps activity is an issue of critical importance to our firm, American banks' competitiveness internationally and market integrity. Simply put, the unnecessary harm cannot be overstated. An overreaching application of Dodd-Frank would severely impact U.S. competitiveness and actually increase risk when a robust regulatory framework already exists and there are other safeguards that could be adopted without creating an unlevel playing field for our banks.

Background

The question of the degree to which the many reforms affected by Title VII will apply to activities outside the United States is an essential one. Congress addressed the issue in Section 722 of Dodd Frank, which states that Title VII should not apply outside the United States unless foreign activity has a "direct and significant connection with activities in, or effect on, commerce of the United States." If an expansive approach to extraterritorial application is part of the Title VII framework, the effect on U.S. financial institutions would be to put those firms at a severe competitive disadvantage relative to their overseas competitors.

Since Dodd Frank passed in July of 2010, the question of how this provision would be applied has loomed as one of the most important issues facing the OTC swaps markets. The reason this issue is so important is that swap markets and the activities of swap dealers are global, as I describe below. Although there has been no definitive pronouncement on this issue by the CFTC or SEC to date, there are reasons for concern.

Statements by Chairman Gensler and CFTC staff in public forums have indicated that the CFTC intends to take an expansive, aggressive approach in applying Title VII's provisions to the overseas activities of U.S. swap dealers. These views have been confirmed in meetings in which many market participants have participated. In particular, the CFTC has indicated that for firms that conduct swap activity through their foreign branches, such as J.P. Morgan, they will likely consider the firm as a single legal entity and will apply all of Title VII's requirements to all of the foreign activity of the firm, even those activities with entities that have no nexus to the United States.

The CFTC has indicated that it will propose a rulemaking or interpretation on the extraterritorial application of Title VII at some point in the regulation writing process, but it has not yet indicated when it will be published.

Competitive Disadvantage

J.P. Morgan is a diversified financial institution that competes with other investment banks in all markets around the world. When we compete outside the United States, a big part of the value we provide to our clients is that we bring global capabilities and scale. Equally important is being able to compete on a level basis with local competitors in local markets. The importance of U.S. firms to compete on a level playing field in the global marketplace has been long recognized in U.S. banking regulation (Regulation K of the Federal Reserve Board is an example), which has generally provided financial institutions with powers sufficiently broad to enable them to compete effectively with their foreign competitors outside the U.S.

A good example of this is our securities powers. Historically our ability to transact in debt and equity securities through bank entities was circumscribed by regulation in the U.S., but outside the U.S. we are authorized to engage in securities underwriting and trading. This approach works because, among other things, the banking regulators, the Federal Reserve Board (the "Fed") and the Office of the Comptroller of the Currency (the "OCC"), have broad powers to regulate our foreign branches, subsidiaries and affiliates to ensure that all of their activities, including derivatives activities, are conducted in a safe and sound manner, which I describe later.

Applying all of the Title VII provisions to all our foreign activities would (1) violate this longstanding principle of competitive equality, (2) would directly conflict with the requirement that overseas application is only warranted when the "direct and significant effects" test is met and (3) would place U.S. firms at a severe competitive disadvantage to foreign banks.

The best example of how extraterritorial application of Title VII will place U.S. firms at a competitive disadvantage in the global marketplace is contained in the proposed margin rules for uncleared swaps. If a French pension fund, a Dutch company or an Asian sovereign wealth fund wishes to enter into a derivatives transaction, European or Asian banks will not require them to post margin; if Dodd-Frank is read to require U.S. banks to do so, we will simply lose this business, which will ultimately have a negative impact on U.S. jobs and the economy. Furthermore, since most companies seeking debt underwriting require a derivative as part of their funding plan – for example, a German firm may wish to issue debt in dollars and swap to euros – we would also be unable to compete in those markets.

The competitive impact of applying the margin rules to our swap activities overseas is exacerbated by very prescriptive and restrictive rules governing what types of margin are eligible under the proposed regime. By restricting eligible margin to U.S. dollar cash, Treasuries and Agencies, the proposed rules will not only put U.S. banks in the position of demanding margin from our overseas clients when our competitors do not, but we would not even be permitted to accept margin in the form of, for example, Euro Cash and G7 Sovereign Debt, which are common forms of permitted collateral in European markets. The effect of this will be to eviscerate our ability to serve clients overseas and cede the global market to foreign competitors, who would not be subject to these rules.

Congress could have passed a law prohibiting U.S. banks from operating an overseas derivatives business, but it did not. In fact, it has never even considered doing so, given the vital importance of this business to U.S. financial firms and their ability to serve U.S. multinational corporations. And yet the interplay of a CFTC/SEC registration requirement and a margin proposal from the bank regulators risks the same result. Under the terms of Dodd Frank, which include a specific mandate against extraterritorial application of rules in this area, the CFTC should not require a foreign branch or subsidiary of a U.S. bank to register as a U.S. swap dealer unless it is doing business in the United States.

In fact, in gauging Congressional intent on this issue, many Members of Congress, including those who supported and led the passage of Dodd-Frank, have subsequently expressed concerns about such an approach. Chairmen and Ranking Members of the House and Senate Agriculture and Financial Services Committees, the New Democrat Coalition, bipartisan members of the New York Delegation and many others have expressed concerns that the needle be threaded carefully given the negative impact on American competitiveness.

In short, if Title VII applies only to international branches of U.S. banks serving European or Asian clients, but not to our European or Asian competitors, we will lose much of this business. The impact on J.P. Morgan would be severe; although this varies from quarter to quarter, we often derive as much of our revenues from our global operations as from those in the United States. Moreover, losing our non-U.S. customers would deprive us of valuable diversification in our credit exposures and would increase risk to our firm rather than reduce it.

Harmonization Isn't the Answer

As one would expect, we have raised the problem of competitive disadvantage to regulators and policy makers whenever we have the opportunity to discuss this issue. The answer that we often hear is that global harmonization of rules will solve the problem. While we understand that various groups of regulators are attempting to harmonize the rules relating to derivatives globally, and we agree that these efforts are important to ensure against regulatory arbitrage and adverse competitive impacts, practical impediments to harmonization will make it unreliable as a solution.

First is that most harmonization efforts are focused on harmonizing U.S. regulation with that in Europe. While this is of course critically important, it is equally important to recognize that we operate globally, in every non-U.S. jurisdiction of commercial importance. Even if U.S. regulation relating to derivatives were to be perfectly harmonized with Europe's (which we think is highly unlikely as we will explain in the succeeding paragraph), the issue of competitive disadvantage would still be a problem for us in Asia, Latin America and many other important markets around the globe.

As experience with other attempts to harmonize commercial law shows, it is likely that only the broadest set of principles can be adopted on a global basis. There still will be the need to implement and interpret those principles at the national level, and it is likely that differences will arise in such implementation and interpretation, highlighting the need for regulations that enable entities to compete locally on a level playing field.

Second, we think it is highly unlikely that harmonization of derivatives regulation between the United States and Europe will be perfect: it is much more likely to result in significant differences on many important issues.

The CFTC and SEC acknowledge this in their Joint Report on International Swap Regulation, published last week, in which they stated that with respect to harmonization efforts "it is still too early to determine precisely where there is alignment internationally and where there may be gaps or inconsistencies."

For example, it is not at all clear whether other G20 regulators will adopt either the Volcker rule prohibition on proprietary trading or the so-called "Swaps Pushout" rule contained in Section 716 of Dodd Frank. To date, global regulators are taking a significantly different approach to the rules relating to requiring margin for uncleared swaps than the approach taken in the U.S. by the CFTC and the prudential regulators.

Harmonization with Europe will be at best imperfect, and thus extraterritorial application of U.S. rules to U.S. swap dealers' activity in Europe – which we believe Congress never intended in the first place – will leave U.S. swap dealers at a significant competitive disadvantage compared to European competitors.

Third, harmonization will not fix the timing problem. The U.S. Congress and regulators have made needed reforms to the OTC swaps markets much more quickly than their counterparts in Europe and Asia. The U.S. regulatory framework will be largely set and in the process of being implemented in 2012. In contrast, the European approach is on a much longer timetable and may not be concluded until 2014 or even later, and the rest of the world is even further behind. If harmonization is used as the solution to the extraterritorial application of U.S. rules, there will be a period of at least two years where U.S. firms will be operating at a significant competitive disadvantage to their overseas competitors, and during that time many customer relationships will be lost.

The Existing Prudential Supervision Framework for Bank Activity Outside the U.S.

The stated rationale for an aggressive, expansive application of the Title VII framework to the foreign activities of U.S. banks with non U.S. clients is that this activity has the potential to import excessive risk back into the United States, much as the swap activity of AIG's London based financial products subsidiary did. There are a number of reasons why this rationale is not valid with respect to U.S. banks in the current regulatory environment.

- **First, it is important to note that the activities of U.S. banks outside the U.S, including their swap activities, are already subject to a robust prudential supervisory regime that is administered by the Fed and the OCC.** For example, every national bank that operates foreign branches must furnish information concerning the financial condition of those branches upon demand by the OCC. These prudential regulators already have broad supervisory authority over the foreign activities of banks (including foreign branches), their subsidiaries and their affiliates. U.S. banks conducting international operations under Regulation K are required to supervise and administer their foreign branches and subsidiaries in such a manner as to ensure that their operations conform to high standards of banking and financial prudence. Branches must have effective systems of records, controls and reports to keep management informed of their activities. The systems must provide, in particular, information on risk assets, exposure to market risk, liquidity management, operations, internal controls, legal and operational risk, and conformance to management policies. All such reports, as well as any additional reports required by the Fed, must be available to Fed examiners. Moreover, Fed and OCC examiners can and do regularly examine the foreign branches and subsidiaries of U.S. banks. Unlike the case with AIG Financial Products, the foreign swap activities of U.S. banks, affiliates and subsidiaries are already subject to a comprehensive regulatory regime that is designed to ensure that those activities are conducted in a safe and sound manner. Pursuant to this authority, for example, prudential regulators could require branches or subsidiaries of U.S. banks operating overseas to provide periodic reporting of their significant credit and market risk exposures.

- **Second, the regulatory regime for swaps has dramatically and fundamentally changed since AIG.** Under Title VII, major participants in the swaps market are now required to register as swap dealers or major swap participants. Once registered, they are subject to a comprehensive, "entity level" regulatory framework that includes requirements for sound risk management practices and minimum capital standards. Had these entity level regulatory requirements been applicable to AIG Financial Products, it would not have been able to incur the exposures that it did and would not have had to be bailed out.

Proposed solutions, such as the Himes-Garrett Bill discussed below would maintain these aggressive new Dodd-Frank mandates, while keeping U.S. banks subject to the comprehensive entity level regulatory regime of Title VII with respect to all foreign swap activities of swap dealers and major swap participants.

The Himes-Garrett Bill is a Sensible Solution

The application of the entire Title VII regime to all the foreign activities of U.S. banks, creating a severe competitive disadvantage for U.S. banks, is not necessary to achieve the protection of the U.S. financial system. The Himes-Garrett bill is a sensible and workable bipartisan solution that protects the U.S. financial system without making U.S. banks uncompetitive in the global marketplace.

The Himes-Garrett Bill, by recognizing that there are two types of regulation imposed by Title VII, achieves this dual goal of protecting the U.S. financial system and placing U.S. firms on a competitive footing for global business:

- "Entity Level" regulation, which applies to the totality of entities' swap activities, include the requirement to register as a swap dealer, to maintain minimum capital standards, to have in place sound risk management practices and a robust compliance program.

- "Transaction Level" regulation, which applies to each individual swap entered into by an entity, includes the requirement to submit a swap for mandatory clearing, to execute swaps on a Swap Execution Facility under certain circumstances and to provide certain risk disclosures in connection with certain types of swaps. The bill redefines the term "swap" to exclude transactions between foreign branches, subsidiaries or affiliates of U.S. banks and their non-U.S. clients, but permits regulators to require those foreign entities to register as swap dealers or major swap participants.

The Himes-Garrett structure—by maintaining the tough "entity level" regulation imposed on these entities under Title VII but exempting individual transactions from Title VII requirements, such as margin requirements—removes the competitive disadvantage aspect of applying Title VII to foreign activities but continues to protect the U.S. financial system against the importation of excessive risk from that foreign activity.

Conclusion

In conclusion, J.P. Morgan is committed to working with Congress, regulators and industry participants to ensure that Title VII is implemented appropriately. The consequences of getting it wrong are very significant for the competitiveness of U.S. banking institutions and the effective functioning of U.S. and global markets. I appreciate the opportunity to testify before this Committee and look forward to answering any questions you may have.

Testimony of Luke Zubrod
Chatham Financial

Hearing on Limiting the Extraterritorial Impact of Title VII of the Dodd-Frank Act Before the Capital Markets and Government Sponsored Enterprises Subcommittee of the House Committee on Financial Services

February 8, 2012

Good afternoon Chairman Garrett, Ranking Member Waters, and members of the subcommittee. I thank you for the opportunity to testify today as the subcommittee considers legislation to limit the extraterritorial impact of Title VII of the Dodd-Frank Act. My name is Luke Zubrod and I am a Director at Chatham Financial ("Chatham"). Today, Chatham speaks on behalf of the Coalition for Derivatives End-Users ("Coalition"). The Coalition represents thousands of companies across the U.S. that utilize over-the-counter ("OTC") derivatives to manage day-to-day business risks. The companies represented by the Coalition use derivatives to reduce risks in their businesses – not to take on risk through speculation.

Chatham is an independent advisor and service provider to businesses that use derivatives to manage interest rate, foreign currency and commodity risks. A global firm based in Pennsylvania, Chatham serves as a trusted advisor to over 1,000 end-user clients, ranging from Fortune 100 companies to small businesses. Our clients are geographically diverse. In the U.S., we have clients in 46 states, including every state represented by Members of this subcommittee. Many of our clients invest and operate globally, and we serve them from offices in the U.S., Europe and Asia.

The Coalition has long supported the efforts of this subcommittee to mitigate systemic risk and increase transparency in the derivatives market. Additionally, we have appreciated the bipartisan efforts of this subcommittee to ensure that end users of derivatives are not unnecessarily burdened by new regulations. Throughout the legislative and regulatory debates, end users have expressed concerns to Congress and to regulators about a number of issues – most notably, the imposition of government-mandated margin requirements on end-user transactions and the regulation of an end user's inter-affiliate transactions. We appreciated the recent efforts of this subcommittee to pass legislation targeted at these concerns.

In addition to these regulatory requirements that would directly burden end users, the Coalition has raised concerns about regulatory actions that could indirectly burden end users by making risk management more expensive or effectively unavailable. We have, for example, expressed concerns that certain derivatives-related proposals by the Basel Committee on Banking Supervision could deter end users from managing their risks or could make it materially less efficient to do so. We have expressed concern about regulatory requirements that might adversely impact liquidity and make it more difficult to efficiently hedge risk.

Today, we add to these concerns by highlighting the ways in which an expansive extraterritorial application of Title VII could adversely impact end users. Global companies often manage risks arising from their foreign operations by executing hedges out of the foreign subsidiaries that are actually exposed to those risks. Such entities often have relationships with both foreign and U.S. banks, including the foreign divisions of U.S. banks. Having a robust pool of bank counterparties enables end users to enjoy numerous benefits, including achieving efficient market pricing and diversifying counterparty exposure. Importantly, the transactions end users execute abroad are not designed to evade U.S. law; they are so executed for important business, legal, and strategic reasons. For example, a foreign subsidiary of a US company may finance its operations with foreign-denominated debt. Financing its foreign operations in this way protects the company from currency risk that would otherwise arise from servicing US-denominated debt with foreign-denominated revenue. However, such debt may expose the subsidiary to the risk that rising interest rates threaten the subsidiary's financial health. In order to mitigate this risk, the foreign subsidiary may execute an interest rate swap, which effectively locks the subsidiary's interest expense and immunizes it from rising rates. In such a case, the end user executes the swap in the foreign subsidiary because that subsidiary is exposed to risk by virtue of its foreign borrowing.

Because it is practically infeasible to perfectly align U.S. and foreign rules, expansive extraterritorial application of Title VII could create structural disincentives for end users to transact with counterparties that are subject to U.S. law, including foreign branches of U.S. banks and foreign banks that centrally book swaps with U.S. persons. Such disincentives could lead foreign end users or the foreign subsidiaries of U.S. end users to transact with a smaller potential pool of counterparties, thus reducing competition and liquidity, increasing pricing and concentrating counterparty exposure. Indeed, end users have experienced such consequences in recent years as a result of the dissolutions and/or acquisitions of Bear Stearns, Lehman Brothers, Merrill Lynch and Wachovia. Measures banks may take to limit competitive disadvantages that result from expansive extraterritorial application of Title VII would inevitably increase cost for end users, further exacerbating these adverse impacts.

Additionally, the expansive application of these same requirements to foreign banks operating in the U.S. could further impact U.S. end users operating domestically. U.S. end users presently transact with a wide array of banking partners, including both U.S. and foreign banks. In order to avoid the duplicative application of U.S. and home country law to transactions executed with non-U.S. end users, foreign banks may have incentives to spin off their U.S. operations into separately capitalized subsidiaries. This would adversely impact end users in several ways, including the following: (1) end-user transaction costs would increase in order to compensate foreign dealers for the additional capital likely needed for the U.S. subsidiary entities, (2) end users may be precluded from netting their exposures across global financial institution counterparties, and (3) end users may incur additional administrative and legal expenses associated with, for example, collateral management and documentation. Further, the spun-off U.S. subsidiaries of foreign banks may have lower credit quality than the global financial institutions that the end users previously faced. The accumulation of these adverse effects could serve to prevent certain investments from occurring.

In effect, expansive extraterritorial application of Title VII could undermine end users' ability to manage risk efficiently, both when they transact domestically and abroad.

We therefore appreciate this subcommittee's consideration of legislation that would clarify the territorial scope of U.S. law. Proposals such as H.R. 3283 will increase certainty for market participants and resolve inevitable conflicts that would result from overlapping regulations in foreign jurisdictions. We acknowledge the complexity of the task before policy makers in considering the appropriate boundaries of U.S. law, and believe H.R. 3283 thoughtfully recognizes the need to defer entity-level regulations to home country regulators while clarifying US regulators' transaction-level requirements apply only in circumstances in which there is a US counterparty.

As regulators go about the important work of finalizing rules intended to address problems revealed by the financial crisis, it is critical that well-functioning aspects of the derivatives markets not be harmed. It is essential to preserve end users' efficient access to these important risk management tools.

We appreciate your attention to these concerns and look forward to continuing to support the subcommittee's efforts to ensure that the derivatives markets are both safe and efficient. Thank you for the opportunity to testify today and I am happy to address any questions you may have.

House Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises

Hearing on "Limiting the Extraterritorial Impact of Title VII of the Dodd-Frank Act"
Statement for the Record

Larry Thompson
Managing Director and General Counsel
The Depository Trust & Clearing Corporation

February 8, 2012

Chairman Garrett and Ranking Member Waters,

Thank you for the opportunity to submit a statement for the record on the issue of information sharing by U.S.-based swap data repositories (SDRs) and non-U.S. regulators pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA). The Depository Trust & Clearing Corporation (DTCC) remains concerned about the combined impact of the DFA's broad extraterritorial reach and the confidentiality and indemnification agreement provisions. These provisions are fundamentally unworkable, as they do not recognize either foreign legal systems, or the inability of the U.S. to accept reciprocal demands from foreign entities. For reasons set forth in this statement, these provisions risk fragmenting the global data for over-the-counter (OTC) derivatives and undermining efforts to increase market transparency and to mitigate risk in this market. These provisions risk putting U.S. regulators in a position of having less complete information on swaps available to them in the future than they have today.

DTCC currently operates two subsidiaries specifically responsible for providing repository services to the global derivatives community: the Trade Information Warehouse (TIW) operated by The Warehouse Trust Company LLC for credit derivatives, a U.S. regulated entity; and DTCC Derivatives Repository Limited (DDRL) for equity derivatives, a U.K. regulated entity. In response to the G20 commitments made at the September 2009 Pittsburgh Summit, the Financial Stability Board (FSB) Report on OTC Derivatives Market Reform, and forthcoming statutory legislation in various jurisdictions, the international financial community recently selected DTCC's DDRL entity to provide global repository services for interest rates and FX swaps. DTCC also was selected to operate the commodities repository (together with the European Federation of Energy Traders) under its newly established Netherlands entity, Global Trade Repository for Commodities B.V.

DTCC is working closely with global partners and asset class experts to design repositories to meet the regulatory reporting requirements identified in the respective regional or national jurisdictions. DTCC has completed its first phase of creating and operating the new Global Trade Repository for Interest Rates (GTR for Rates) and Commodities (GTR for Commodities). DTCC expects the GTR for Rates regulatory reporting to commence in late February 2012. DTCC is currently in discussions with industry and regulatory authorities, developing consensus on the right framework for the GTR for Commodities' reporting.

DTCC has extensive experience operating as a trade repository and meeting transparency needs. In November 2008, in response to mounting concerns and speculation regarding the size of the credit default swaps (CDS) market following the collapse of Lehman Brothers, DTCC began public aggregate reporting of the CDS open position inventory. Today, this reporting includes open positions and volume turnover, providing aggregate information that is extremely beneficial to both the public and regulators in understanding the size of the market and activity. Further, following the OTC Derivatives Regulators Forum (ODRF)[1] data access guidelines for the TIW, DTCC launched a regulatory portal in January 2011, which provides automated counterparty exposure reports and query capability for market and prudential supervisors and transaction data for central banks with aggregate report views by currency and concentration. Nearly 40 regulators world-wide have signed up to the portal. DTCC plans to expand on this portal as it launches its global trade repository services for the other asset classes.

Two Important DFA Provisions Require Congressional Action

Two key extraterritorial concerns in the Swap Data Repository area of the DFA need further examination by the Congress and legislative resolution:

1) Plenary Access: Under the DFA, any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps must register in the United States as a SDR. The law also requires SDRs to provide data prescribed by the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) to the CFTC and the SEC for each swap collected and maintained by the registered SDR.

2) Indemnity: The DFA requires U.S.-based SDRs to receive a written indemnification agreement from non-U.S. regulators confirming (1) that they will abide by confidentiality requirements and (2) that they will indemnify the SDR and the regulating U.S. Commission(s) for any expenses arising from litigation relating to the information.

The combined impact of the plenary access and indemnification provisions on a global trade repository operating in the U.S. will mean, for example, that U.S. regulators could have the legal right to review data on a trade between two British banks transacting in the U.K. involving a British underlying entity even though such a transaction falls outside the scope of U.S. jurisdiction. Compounding the issue and using this same example, the British regulator would be required to indemnify the U.S. SDR to gain access to that same data – data that is within its jurisdiction.

Many regulators worldwide have expressed deep concerns about the reach and scope of the indemnity provision and have stated it creates an environment for data fragmentation. Taken together, the DFA requirements will (1) impede global regulatory cooperation, (2) risk fragmentation of a global data set for OTC derivatives, and (3) undermine efforts to increase market transparency and mitigate risk in this market.

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[1] The ODRF consists of over 50 international financial regulators, including the SEC and CFTC.

Plenary Access, Indemnification Risk Regulators' Ability to Monitor and Mitigate Systemic Risk

As a result of the DFA requirements, and because many foreign regulators have indicated that they will be unable or unwilling to grant U.S.-based SDRs indemnification in exchange for access to information, DTCC has applied to remove the global repository function from the TIW and has applied to establish a distinct and separate regulatory portal only for U.S. data.

We welcome that the SEC and the CFTC highlighted the concern of data fragmentation in the recently published Joint Report on International Swap Regulation.[2] By precluding SDRs from providing data to non-U.S. regulators unless an indemnification agreement exists, jurisdictions are likely to establish their own "national" repositories, such as has already occurred in Hong Kong, to ensure they have access to the data they need. The application to remove the global repository function from the TIW was a logically required step to avoid the proliferation of "national" repositories which would fragment the current global data set into multiple local sets and limit global regulators' ability to have a comprehensive view of market activity.

Asian, European Regulators Opposed to Indemnification Requirement, Plenary Access

The DFA approach to ensuring data safety and confidentiality has not been welcomed by Asian and European regulators. The European Market Infrastructure Regulation (EMIR), which is anticipated to reach its final legislative phase and be adopted shortly, considered and rejected an indemnification requirement.

Moreover, the confidentiality concerns can be addressed without imposing both the DFA indemnification requirement and plenary access provisions. Under the ODRF data access guidelines, regulators must maintain the confidentiality of information they obtain from DTCC's trade repositories and must affirm that information obtained is of material interest to their oversight.

With respect to plenary access, regulators expect to have appropriate access to an SDR registered in their jurisdiction for direct oversight. This access is necessary to ensure thorough examination of the SDRs operations, guaranteeing the completeness and accuracy of the data published by an SDR. This access is distinct from that required by non-supervisory regulators who rely upon the SDR's data for market oversight. The level of access to an SDR's data should reflect the purpose for which a regulator seeks to review the SDR's information. Regardless, regulators internationally require that appropriate privacy safeguards are in place to protect the data.

[2] ("The DFA requires that foreign authorities provide a written agreement to indemnify a Swaps data repository and the CFTC or SEC, as applicable, for any litigation expenses as a condition to obtaining Swaps data maintained by the Swaps data repository. This requirement has caused concern among foreign regulators, some of which have expressed unwillingness to register or recognize an SDR unless able to have direct access to necessary information. Some regulators also are considering the imposition of a similar requirement that would restrict the CFTC's and SEC's access to information at TRs abroad. The CFTC and SEC are working to develop solutions that provide access to foreign regulators in a manner consistent with the DFA and to ensure access to foreign-based information. Congress may determine that a legislative amendment to the indemnification provision is appropriate.")

Potential Legislative Solutions to Indemnification

The Indemnification provisions, which are contained in Sections 728 and 763 of DFA, were added to the legislation during the final hours of the "Conference Committee" and were not subject to the hearing process. Now that the unintended consequences of these provisions have been brought to light, there is bicameral, bipartisan support to resolve the consequences of indemnification. Last year, Senator Agriculture Committee Chairwoman Debbie Stabenow (D-MI) and Ranking Member Pat Roberts (R-KS), and House Appropriations Agriculture Subcommittee Congressman Jack Kingston (R-GA) and Ranking Member Sam Farr (D-CA) authored separate letters to their counterparts in the European Parliament expressing interest in working together on a solution to the issue. In addition, several other Members of Congress have also publicly declared their support for a technical correction to the provision. CFTC Chairman Gensler and SEC Chairman Schapiro have written to European Commissioner Michel Barnier regarding the indemnification provisions of the DFA. The SEC and CFTC recently indicated that any remedy must originate in the legislature.

DTCC has developed several potential approaches to resolving the issues posed by indemnification provisions of the DFA. There exist options for a technical legislative correction to avoid the unintended consequences of the DFA indemnification provision. Congress could eliminate, or modify the statutory language and incorporate a technical correction to the legislation by including a mutual "memorandum of understanding" (MOU) option for regulatory compliance with the indemnification requirement if a foreign regulator is carrying out its responsibilities in a manner consistent with ODRF, or other agreed upon international policy forums. Congress also could include a "reciprocal equivalence" provision in the legislation in a manner consistent with the European Union draft EMIR legislation.

Ultimately, Congress must act to avoid further unintended consequences of the DFA indemnification provision. Correcting the DFA indemnification requirement is imperative not only to prevent the potential repercussions of a non-equivalency determination by E.U. regulators, but also to ensure market transparency and risk mitigation of global financial markets.

Potential Legislative Solutions to Plenary Access

Absent clarification by the CFTC and the SEC on the extraterritorial application of the SDR provisions of the DFA, Congress should consider a technical correction to the DFA that clarifies the purpose of the direct access provision is to allow for direct regulation of the SDR, and is not intended to grant regulatory authorities access to information that otherwise the regulator would not be entitled for its market surveillance activities.

The SDR framework should not establish a conflict in reporting rules that frustrates the global development of trade repositories to meet the G20 commitment. To ensure complete and accurate information to SDRs in multiple jurisdictions, in addition to swaps reporting to U.S.-based SDRs, additional reporting of these trades should be permitted to a non-U.S. SDR without the non-U.S. SDR being required to register with U.S. regulators.

Thank you for your time and attention this afternoon.

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Sarah A. Miller
Chief Executive Officer
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February 7, 2012

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets
and Government Sponsored Enterprises
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Garrett:

We appreciate the Subcommittee holding a hearing on *Limiting the Extraterritorial Impact of Title VII of the Dodd-Frank Act*, and applaud the leadership of both you and Representative Himes in introducing H.R. 3283, *The Swap Jurisdiction Certainty Act*, which we strongly support. The Institute of International Bankers ("IIB") has previously raised before the Congress and the regulators a number of concerns with respect to the extraterritorial application of Title VII of the Dodd-Frank Act (DFA). The DFA, as well as the commitment of the G-20 leaders, recognizes the need for international coordination with respect to cross-border swaps transactions. In this spirit, Sections 722(d) and 772(c) of the DFA generally exclude from regulation under Title VII "activities outside of the United States" or those conducted "without the jurisdiction of the United States."

To date, neither the Commodity Futures Trading Commission nor the Securities and Exchange Commission has clarified the extraterritorial application of Title VII. Nevertheless, in mid-January of this year, the CFTC issued a final rule requiring swap dealers to register. Consequently, firms engaged in cross-border swap activities—both those headquartered in the U.S. and those headquartered outside the U.S.—are at a lost to determine how Title VII's requirements might apply to their non-U.S. operations and whether these requirements might duplicate and possibly conflict with the laws and regulations of foreign jurisdictions with respect to key matters as capital, margin, clearing and exchange trading.

These unanswered questions have created great uncertainty for global swap dealers and the markets. H.R. 3283 will bring much needed certainty to the markets by making clear, among other things, that home offices of internationally headquartered firms that register as U.S. swap dealers will be subject to the requirements of Title VII only with respect to swaps that they enter

INSTITUTE OF INTERNATIONAL BANKERS

into with non-affiliated U.S. persons and, consistent with long-standing U.S. policy, they may rely on their home country capital requirements to satisfy the capital requirements under Title VII, provided that the home country capital requirements are comparable to the Title VII requirements and the home country is a signatory to the Basel Capital Accords.

Again, we applaud you and Representative Himes for your leadership on this important issue and we strongly support H.R. 3283.

Sincerely,

Sarah A. Miller

Sarah A. Miller
Chief Executive Officer

cc: The Honorable Spencer Bachus
The Honorable Barney Frank
The Honorable Maxine Waters
The Honorable Jim Himes

ISDA | Safe, Efficient Markets

February 6, 2012

The Honorable Scott Garrett
Chairman
Subcommittee on Capital Markets & Government Sponsored Enterprises
Committee on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Garrett:

The International Swaps and Derivatives Association, Inc. ("ISDA") is writing to express its support for H.R. 3283, the Swap Jurisdiction Certainty Act, which is being discussed by the Subcommittee on Wednesday, February 8.

ISDA's mission is to foster safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products. ISDA has more than 800 members from 58 countries on six continents. These members include a broad range of OTC derivatives market participants: global, international and regional banks, asset managers, energy and commodities firms, government and supranational entities, insurers and diversified financial institutions, corporations, law firms, exchanges, clearinghouses and other service providers.

ISDA fully supports regulatory reform that mitigates systemic risk by reducing counterparty credit risk and increasing regulatory transparency. Portions of the recently-proposed regulatory framework for the OTC derivatives markets, however, do not support or work against this important goal.

International Swaps and Derivatives Association, Inc.
1101 Pennsylvania Avenue, Suite 600
Washington, DC 20004
P 202 756 2980 F 202 756 0271
www.isda.org

NEW YORK WASHINGTON
LONDON BRUSSELS
HONG KONG SINGAPORE
TOKYO

ISDA

ISDA believes that H.R. 3283 will help to ensure the continued competitiveness of the U.S. financial markets by limiting the extraterritorial application of the Dodd-Frank Act. Importantly, H.R. 3283 will do nothing to restrict the ability of the regulators to identify and respond to potential systemic risks.

ISDA appreciates the attention that you, Congressman Himes and the other co-sponsors of H.R. 3283 have given to this important issue.

Sincerely,

Robert G. Pickel

Robert Pickel
Chairman

Cc:

The Honorable Spencer Bachus
The Honorable Barney Frank
The Honorable Maxine Waters
The Honorable Jim A. Himes

sifma
Invested in America

February 7, 2012

The Honorable James A. Himes
119 Cannon House Office Building
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Himes:

The Securities Industry and Financial Markets Association (SIFMA) strongly supports H.R. 3283, the Swap Jurisdiction Certainty Act, which provides necessary clarity about congressional intent related to the treatment of certain swap contracts.

We believe that this clarification is necessary because the Commodity Futures Trading Commission (CFTC), the Securities and Exchange Commission (SEC) and prudential regulators have not yet clarified the extraterritorial application of their proposed and final Dodd-Frank-related rulemakings. Without this clarity, it will be very difficult for market participants to comply with these rules. H.R. 3283 would ensure consistency with existing Federal policy that registered swaps dealers that are foreign banks or foreign affiliates of U.S. banks are not subject to U.S. capital requirements when already subject to comparable supervision in their home or foreign jurisdiction. H.R. 3283 would also ensure that the entity level regulatory regime of Title VII would continue to apply to all foreign swap activities of registered swap entities which include requirements for sound risk management practices and minimum capital standards.

H.R. 3283 would also ensure a level playing field and protect against duplicative regulations for market participants. The swap market is a truly global market, requiring cooperation by regulators worldwide to avoid duplicative and contradictory regulation. For instance, Japan's Financial Services Agency recently wrote to the CFTC expressing concern about the extraterritorial application of Title VII rules, stating that the proposed framework "will create an undesirable and redundant effect" on Japanese institutions. In addition, a lack of certainty over what activities may trigger regulation by U.S. authorities may cause firms to cease or scale back business with foreign affiliates of U.S. firms. Finally, foreign counterparties may be subject to two distinct sets of regulations for similar contracts that will provide for disparate treatment of similar swaps. Every effort should be made to clearly determine which swaps are subject to U.S. jurisdiction and which swaps are subject to foreign jurisdiction.

Market participants face many operational problems related to the implementation of Dodd-Frank Act. As an example, the CFTC recently approved final rules related to the registration of swap dealers and major swap participants. However, the CFTC has not finalized rules on product or swap entity definitions, nor has it addressed the extraterritorial application of any rules finalized to date. Without clarity on definitions and extraterritorial application, it is impossible for market participations to determine with certainty who will be subject to registration and other requirements. Market participants will be required to restructure their corporate operations, register these entities, build out new operations and technology, conduct additional training, and modify existing and new client agreements and legal documentation. All of these changes will require significant time and cost and regulators should work to ensure that these final regulations are not in conflict and do not result in unnecessary burdens.

Thank you for your consideration of our views.

Sincerely yours,

Kenneth E. Bentsen, Jr.
EVP, Public Policy and Advocacy
SIFMA

cc: The Honorable Scott Garrett
The Honorable Gwen Moore
The Honorable Carolyn McCarthy
The Honorable Robert J. Dold

Members of Subcommittee on Capital Markets and Government Sponsored Enterprises

NEW DEMS

New Democrat Coalition

Rep. Joseph Crowley, Chair
Rep. Jim Himes, Vice-Chair
Rep. Ron Kind, Vice-Chair
Rep. Rick Larsen, Vice-Chair
Rep. Allyson Schwartz, Vice-Chair

April 15, 2011

The Honorable Timothy Geithner
Secretary
The U.S. Department of Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220

The Honorable Ben Bernanke
Chairman
The Federal Reserve Board
20th Street and Constitution Avenue, NW
Washington, DC 20429

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Mary Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairmen Gensler, Schapiro, Bernanke and Secretary Geithner:

During debate of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the New Democrat Coalition played a critical role in advocating for an approach that would reduce systemic risk and increase transparency in the derivatives market. Given the significant role that New Democrats played in authoring many key provisions in the derivatives title, we want to ensure that the rules are promulgated in a way that adheres to Congressional intent.

The new law puts in place strong protections for taxpayers in the event of a default. By encouraging clearing and the imposition of margin, the Dodd-Frank Act will mutualize the risk among the participants in a swap deal and ensure that enough capital is on hand to cover any losses. For many U.S. companies swaps are important tools to responsibly manage risk, stabilize prices, and, in turn, the entire economy. That is why when crafting the language on margin, Congress intended to ensure end users of derivatives who are responsibly hedging their ordinary business risk would not be subject to prohibitive cost increases. The new margin rules must exempt end users from margin requirements and should not have the effect of discouraging these sound risk management practices.

Another goal of the Dodd-Frank Act is to provide regulators with detailed real-time information needed to protect and monitor swap activity. That is why the new law encourages as much trading activity as possible to occur on regulated transparent exchanges. Congress also recognized, however, that there is not always sufficient liquidity in the exchanges to support all types of swaps. Swap Execution Facilities (SEFs) were designed by Congress to act as an alternative mechanism for bringing transparency and disclosure to the derivatives markets. The rules implementing these provisions should provide SEFs with the flexibility to operate distinctly from exchanges. We believe the SEC's proposed rule on SEFs is consistent with this goal and the CFTC's final rule should mirror the SEC's approach.

Real time reporting of swap transactions and block trades will also help infuse transparency into the market and provide regulators important data to monitor systemic risk. The market relies on data repositories to function without delay to ensure liquidity while allowing market participants to meet the requirements of the law. When writing reporting rules, your agency should protect liquidity in the markets for businesses looking to hedge risk and ensure the infrastructure and technology is in place for the derivatives market to function without delay and at a minimal cost.

Considering the interconnected nature of financial markets and the sizeable role derivatives play within the global economy, international harmonization of the regulations should be a major priority during the rulemaking process. A coordinated regulatory approach with our global counterparts will provide for the seamless flow of information and help target and eliminate systemic problems before they occur. The new regulatory regime, however, must be achieved in a way that prevents regulatory arbitrage and limits unintended consequences that could increase systemic risk. For example, the requirements for banks to push-out their swap desks into separately capitalized entities may make it more challenging for U.S. regulators to monitor swap activity and exposure at these institutions on a net basis which could increase systemic risk and costs. In turn, this could drive derivatives trading into less regulated international markets and will inevitably make it more difficult for U.S. counterparties to manage risks in the swaps market. We ask that your agency consider these implications when constructing rules to ensure the U.S. market can continue to operate on a level, and more stable, playing field.

Lastly, the sequencing of the rules is an important element to avoid market disruptions and provide certainty that market participants can adjust their operations to meet the new requirements. The regulatory gaps that contributed to the financial crisis developed over many decades, and the new framework we've created is designed to protect the markets for many years to come. Regulatory certainty is urgently needed in the markets, but it is just as important that the rulemaking process be thorough so that we end up with the right result. Please consider appropriately phasing-in the final rules and implementation guidelines to ensure acceptable rulemaking with minimal disruptions to the market.

For too long, the derivatives market has lacked a regulatory apparatus that has made it susceptible to opaque transactions posing unwarranted risk to the economy. The New Democrats, together with our colleagues in the House and Senate, devised a regulatory structure in the Dodd-Frank Act that will enhance transparency and improve accountability in the derivatives market. While your agency continues the complicated rulemaking process, the New Democrats ask that the rules promulgated balance the needs to reduce systemic risk, promote transparency, and encourage growth in the economy.

Sincerely,

Rep. Jim Himes
Member of Congress

Rep. Gary Peters
Member of Congress

Rep. Joseph Crowley
Member of Congress

Rep. Ron Kind
Member of Congress

Rep. Allyson Schwartz
Member of Congress

Rep. Rick Larsen
Member of Congress

Rep. Jason Altmire
Member of Congress

Rep. John Carney
Member of Congress

Rep. André Carson
Member of Congress

Rep. Gerry Connolly
Member of Congress

Rep. Carolyn McCarthy
Member of Congress

Rep. Gregory Meeks
Member of Congress

Rep. Jim Moran
Member of Congress

Rep. Chris Murphy
Member of Congress

Rep. Bill Owens
Member of Congress

Rep. Ed Perlmutter
Member of Congress

Rep. Jared Polis
Member of Congress

Rep. Laura Richardson
Member of Congress

Rep. Cedric Richmond
Member of Congress

Rep. Loretta Sanchez
Member of Congress

Rep. Terri Sewell
Member of Congress

Rep. Adam Smith
Member of Congress

Rep. David Scott
Member of Congress

Rep. Pedro Pierluisi
Member of Congress

Congress of the United States
Washington, DC 20510

May 17, 2011

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429

Mr. John Walsh
Acting Comptroller
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

Dear Chairman Bair, Chairman Bernanke, Chairman Gensler, and Acting Comptroller Walsh,

We are writing with respect to your proposed regulations applying margin requirements under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") to derivatives between non-U.S. subsidiaries of U.S. entities and non-U.S. counterparties. We are concerned that these proposals will inevitably result in significant competitive disadvantages for U.S. firms operating globally. Moreover, the proposals are inconsistent with Congressional intent regarding the territorial scope of the new regulatory framework for derivatives.

As you know, rewriting the regulatory framework for derivatives trading in the U.S. is an important step in making our financial system more resilient and more transparent. But absent harmonization between new rules here and abroad, disparate treatment of U.S. firms will only encourage participants in the derivatives markets to do business with non-U.S. firms. Accordingly, it is important to strike a balance between implementing the new safeguards and harming the competitiveness of U.S. financial institutions vis-à-vis their international counterparts.

Congress was cognizant of the need to strike this balance, and included provisions in Dodd-Frank that explicitly instruct regulators to guard against evasion of the law as well to impose the regulations extraterritorially beyond the U.S. only if there is a "direct and significant connection" with U.S. activities or commerce. These provisions are intended to protect both the safety of the financial system, by preventing regulatory arbitrage for the purpose of evading the law, and the competitiveness of U.S. institutions, which is necessary for a healthy U.S. banking system. We are concerned that your respective rule proposals would disrupt that balance and could have significant negative effects on the competitiveness of U.S. institutions. Under the proposals, margin requirements do not apply to non-U.S. banks doing business with non-US clients, but they do apply to non-U.S. subsidiaries and affiliates of U.S. institutions doing business with non-

US clients outside the U.S. This disparity in treatment creates a severe disincentive for non-U.S. companies to do business with overseas affiliates or subsidiaries of U.S. financial institutions.

In light of these concerns, we ask that you reconsider the extraterritorial application of these requirements. The application of new margin requirements to activity taking place wholly outside the U.S. must be coordinated with international regulators. We urge you to work closely with your international counterparts to ensure that they adopt as rigorous a regulatory regime for the over-the-counter swaps markets in their countries as we will have in ours. Ideally, those rules would perfectly mirror the U.S. rules. This would minimize the opportunity for regulatory arbitrage by non-U.S. customers of U.S. entities.

We certainly cannot afford a "race to the bottom" in regulatory standards, but, absent a comparable margin regime in other jurisdictions, adopting these rules would accomplish little more than reducing the competitiveness of U.S. financial institutions vis-à-vis their international counterparts and causing them to lose business to foreign entities through regulatory arbitrage by their non-U.S. customers.

Thank you for your consideration.

Sincerely,

Eliot L. Engel

Yvette D. Clarke

Congress of the United States
Washington, DC 20515

June 20, 2011

Honorable Sheila C. Blair
Chairman
Federal Deposit Insurance Corp.
550 17th Street, NW
Washington, DC 20429

Mr. John G. Walsh
Acting Comptroller
Office of the Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

The Honorable Ben S. Bernanke
Chairman
The Federal Reserve System
20th & Constitution Avenue, NW
Washington, DC 20551

Honorable Leland A. Strom
Chairman and CEO
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102

Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Mr. Edward J. Demarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Chairmen, Acting Comptroller and Acting Director:

Thank you for your continued efforts to implement Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). We greatly appreciate the hard work put forth by you and your staff.

In crafting Title VII of Dodd-Frank, Congress was explicit in providing exemptions from mandatory clearing, exchange trading and margin for end-users hedging commercial risks. We are concerned that recent rule proposals may undermine these exemptions, substantially increasing the cost of hedging for end-users, and needlessly tying up capital that would otherwise be used to create jobs and grow the economy. Additionally, we are concerned about the territorial scope of certain rule proposals that could put U.S. firms and U.S. markets at a competitive disadvantage.

Application of Margin Requirements on End-users

On April 12, both the Commodity Futures Trading Commission ("CFTC") and the prudential regulators issued Notices of Proposed Rulemaking ("NPR") to govern margin and capital requirements for Swap Dealers and Major Swap Participants ("MSPs") (and in the case of the prudential regulators' proposal, Security-based Swap Dealers and Major Security-based Swap Participants). Despite clear congressional intent to the contrary, the proposal issued by the prudential regulators could require Swap Dealers and MSPs to collect margin from nonfinancial end-users. Further, despite a statutory directive to permit the use of noncash collateral, the prudential regulators' proposal is overly restrictive when it comes to requiring and valuing highly liquid assets such as cash, treasuries and GSE securities, and does not provide sufficient clarity that the use of other forms of noncash collateral is permitted.

In addition, there is uncertainty regarding which entities will be deemed "financial end-users." Captive finance affiliates of manufacturing companies that exist to facilitate the sale of the parent company's goods should not be deemed "high risk financial end-users." Such a designation would subject these affiliates to significant and substantial cash burdens that would reduce their ability to provide financing to businesses and consumers. The definition of "financial entity" in Title VII explicitly excludes captive finance affiliates of manufacturers and grants them a full exemption from clearing requirements. The NPR appears to recognize this distinction, classifying captive finance affiliates as nonfinancial end-users:

> *Although the term "commercial end-user" is not defined in the Dodd-Frank Act, it is generally understood to mean a company that is eligible for the exception to the mandatory clearing requirement for swaps and security-based swaps under section 2(h)(7) of the Commodity Exchange Act and section 3C(g) of the Securities Exchange Act, respectively. This exception is generally available to a person that (i) is not a financial entity, (ii) is using the swap to hedge or mitigate commercial risk, and (iii) has notified the CFTC or SEC how it generally meets its financial obligations with respect to non-cleared swaps or security-based swaps, respectively. See 7 U.S.C. 2(h)(7) and 15 U.S.C. 78c-3(g). (Footnote 35).*

We request that you clarify that transactions involving nonfinancial end-users that meet the above statutory requirements are exempt from margin, consistent with congressional intent. Additionally, we ask that you clarify that captive finance affiliates of manufacturing companies are classified as "nonfinancial end-users." Lastly, we urge regulators to ensure that any new capital requirements are carefully linked to the risk associated with the uncleared transactions, and not used as a means to deter over-the-counter derivatives trading.

Exemption from Clearing for Captive Finance Affiliates

As noted above, Congress specifically clarified that captive finance affiliates, "whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, 90 percent or more of which arise from financing that facilitates the purchase or lease of products, 90 percent or more of which are manufactured by the parent company or another subsidiary of the parent company" should be exempt from the clearing requirement.

The CFTC's proposed rule "End-User Exception to Mandatory Clearing" did not clarify the calculation of this exemption, creating uncertainty regarding the eligibility of many captive finance affiliates. In order to facilitate the sale of the parent company's manufactured goods, captive finance affiliates often finance the sale or lease of products that are connected to the underlying product. Examples include the financing of an implement or accessory for farming equipment, the purchase of a used car to facilitate the sale of a new one, or the financing of a marine vessel to facilitate the sale of the vessel's engines. Financing offered by the captive finance affiliate facilitates the sale of the parent or subsidiary's manufactured goods. If the CFTC were to require that 90 percent or more of a particular package of equipment be manufactured by the parent company or a subsidiary, the test itself would be an enormous burden to calculate and impractical to apply.

We ask that the CFTC provide further guidance with regard to the calculation of this exemption and its application, and to do so in a way that is flexible and responsive to the general practices and operational realities of captive finance affiliates. We would also ask that this clarification be provided for the identical provisions providing an exemption for captive finance affiliates from designation as MSPs.

Extraterritorial Application of Dodd-Frank

There continues to be a lack of clarity regarding the territorial scope of Dodd-Frank. Section 722(d) of Dodd-Frank specifically directed the regulatory agencies not to apply new requirements 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. This is consistent with the historical practice by U.S. regulators of recognizing and deferring to foreign regulatory authorities when registered entities engage in activities outside the U.S. and are subject to comparable foreign regulatory oversight.

Despite the statute and historical practice, the CFTC has proposed the possibility of treating foreign subsidiaries of U.S. persons as a U.S. person for purposes of swap dealer registration and, if it does so, prudential regulators' margin proposals would apply margin requirements to all of a U.S. financial institution's transactions – even between a non-U.S. subsidiary of a financial institution and non-U.S. customers that are conducted wholly outside the U.S. While robust oversight is necessary, this proposal could put U.S. firms at a direct and significant competitive disadvantage to their foreign competitors when dealing with non-U.S. counterparties outside the United States. In addition, extraterritorial application of Dodd-Frank to non-U.S. activities, particularly if it engenders reciprocal foreign regulatory treatment, could deter cross-border participation in markets, fragmenting them and making them less liquid and efficient.

We recommend that all of the agencies implementing Dodd-Frank be mindful of recognized principles of international law and provide further guidance and clarification regarding the territorial scope of the proposed rules with enough time for stakeholders to comment.

Thank you for your consideration of this letter. We appreciate and look forward to your response.

Sincerely,

Senator Debbie Stabenow
Chairman
Senate Committee on Agriculture, Nutrition and Forestry

Frank D. Lucas

Representative Frank D. Lucas
Chairman
House Committee on Agriculture

SPENCER BACHUS, AL, CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

BARNEY FRANK, MA, RANKING MEMBER

August 2, 2011

The Honorable Timothy F. Geithner
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW

Dear Mr. Secretary:

Both in your capacity as Treasury Secretary and as the Chairman of the Financial Stability Oversight Council (FSOC), you have responsibility for ensuring that the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) does not jeopardize the health of the United States economy or threaten the ability of the U.S. financial services sector to deliver a broad array of products to consumers, investors, and companies.

Despite numerous assurances from you and other regulators, that the international community will follow the United States' lead on derivatives reforms, there is no indication that is happening. Specifically, there is no concrete evidence that international regulators or policymakers will in fact adopt the more controversial provisions in Title VII of the Dodd-Frank Act, such as Section 716, commonly known as the "swap push-out rule."

Moreover, it is undisputed that foreign regulators are moving at a slower pace in implementing derivatives reforms, which will inevitably lead to capital and liquidity flowing out of the United States to more hospitable regulatory environments. Unfortunately, concerns about the negative competitive consequences of Title VII are only heightened by the fact that some U.S. regulators apparently intend to advocate for an extremely broad extraterritorial application of the U.S. derivatives rules.

Title VII prohibits the extraterritorial application of the derivatives rules unless the offshore activity to be regulated has a "direct and significant" connection with or effect on U.S. commerce or when extraterritorial application is "necessary or appropriate" to prevent evasion of the Dodd-Frank Act. The language of Title VII clearly indicates it is to be applied outside the United States in only limited circumstances. None-the-less, there have been comments made by U.S. regulators that regulations implementing Title VII may apply to an offshore entity solely because it is a subsidiary or affiliate of a U.S. company. The prudential regulators seemingly took this approach in their recent margin proposal that explicitly exempts foreign dealers from margin requirements if they conduct swaps with other foreign counterparties, but does not allow off-shore subsidiaries of U.S. companies to avail themselves of this same exemption.

The mere fact that a non-U.S. entity is an affiliate or subsidiary of a U.S. company does not create a "direct and significant" impact on the U.S. and should therefore not be determinative as to whether such a non-U.S. entity should be subject to Title VII's requirements. Subjecting a non-U.S. entity to Dodd-Frank regulatory requirements solely because of its affiliation will create an unequal competitive environment for U.S. and non-U.S. institutions. Similarly, providing exceptions from regulation solely for non-U.S. entities not controlled by U.S. companies will disadvantage U.S. companies and their non-

The Honorable Timothy Geithner
Page 2
August 2, 2011

U.S. operations. The Dodd-Frank Act already contains provisions that threaten to create a seriously uneven playing field, and the regulators should not further disadvantage U.S. companies through broad extraterritorial application of the derivatives rules. The U.S. should not extend its regulations to cover activities or entities which are or will be the subject of comprehensive supervision by a comparable non-U.S. regulator.

The timing, substance, and extraterritorial reach of Title VII of the Dodd-Frank Act have broad and extensive competitive consequences and raise a number of important public policy questions. Accordingly, I respectfully request that you provide a detailed response to the following questions by August 15, 2011.

- What is the Treasury Department doing to coordinate both the substance and timeframe for implementation of derivatives reforms with your non-U.S. counterparts?

- If the Treasury Department believes, as it has asserted, that international harmonization of derivatives reforms can be achieved, what is the timeline for such an agreement, and how will Treasury ensure that there are no implementation gaps that could contribute to competitive disparities?

- What analysis has Treasury and/or the FSOC conducted to measure the competitive effect of Title VII on U.S. financial markets and derivatives end-users?

- Why is the existing prudential regulatory regime and consolidated supervision of U.S. bank holding companies, further enhanced by modifications enacted pursuant to the Dodd-Frank Act, insufficient to ensure the safety and soundness of U.S. parents of non-U.S. swaps entities transacting abroad, such that extraterritorial imposition of swaps margin rules is necessary?

- Is the extraterritorial application of margin rules necessary if, as you have previously indicated, other countries plan to harmonize their rules in coordination with the United States?

- Do you believe that the mere fact that a non-U.S. entity is an affiliate or subsidiary of a U.S. company is a sufficient statutory basis for extraterritorial application of Title VII requirements? If so, please explain how every transaction between a non-U.S. subsidiary (with a U.S. parent) and a foreign counterparty affects U.S. commerce in a "direct" and "significant" manner, or in the alternative, is designed to evade U.S. rules.

- The Treasury Department did not include Section 716 in its submission of draft derivatives legislative text to the Congress in 2009. Neither the Securities and Exchange Commission (SEC) nor the Commodity Futures Trading Commission (CFTC) provided Section 716 to the Congress. Federal Reserve Chairman Bernanke, SEC Chairman Schapiro, former Federal Deposit Insurance Corporation Chairman Sheila Bair and you all expressed serious concerns or outright opposition to the provision during the Dodd-Frank conference committee's deliberations. As Chairman of the FSOC, do you believe that Section 716 is necessary to ensure the safety and soundness of the U.S. financial system?

The Honorable Timothy Geithner
Page 3
August 2, 2011

- As non-U.S. jurisdictions will not be enacting a provision similar to Section 716, what are you doing as FSOC Chairman to ensure that the SEC and CFTC will implement the rule so as to mitigate its impact on U.S. institutions' ability to compete against their foreign counterparts?

Thank you for your consideration of this important request. I look forward to your prompt response.

Sincerely,

SPENCER BACHUS
Chairman

Congress of the United States
Washington, DC 20515

October 4, 2011

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Ben S. Bernanke
Chairman of the Board of Governors
Federal Reserve System
2001 C Street, NW
Washington, DC 20001

The Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairmen Gensler, Schapiro, Bernanke and Acting Chairman Gruenberg:

As authors of the Wall Street Reform and Consumer Protection Act (P.L. 111-203) (Wall Street Reform Act), we commend your work implementing Title VII of this important new law. We have an enormous opportunity to set a new global standard for the operation of an efficient, transparent and well-regulated derivatives market. It is in a spirit of support for your efforts that we write with suggestions for how to avoid some unintended consequences that could undermine this objective.

As you know, the existing $600 trillion derivatives market operates as an integrated global market, despite the jurisdictional determinations made in Title VII between the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC). It is our hope that the two agencies will work closely and collaboratively together and that the new swap regulations can be sequenced and implemented in a logical, coordinated manner that encourages compliance and market competition.

Given the global nature of this market, U.S. regulators should avoid creating opportunities for international regulatory arbitrage that could increase systemic risk and reduce the competitiveness of U.S. firms abroad. Congress generally limited the territorial scope of Title VII to activities within the United States. This general rule should not be swallowed by the law's exceptions, which call for extraterritorial application only when particular international activities of U.S. firms have a direct and significant connection with or effect on U.S. commerce, or are designed to evade U.S. rules. We are concerned that the proposed imposition of margin requirements, in addition to provisions related to clearing, trading, registration, and the treatment of foreign subsidiaries of U.S. institutions, all raise questions about consistency with Congressional intent regarding Title VII.

Moreover, U.S. regulators should work with other international regulators to seek broad harmonization of appropriately tough and effective standards. This can be accomplished by an appropriate staging of the adoption or implementation of our rules abroad. Should current harmonization efforts ultimately fail or prove a race to the bottom that would undermine effective regulation, the U.S. would of course reserve the right to proceed to extend the application of its standards to overseas operations.

In addition, as you proceed through the rule-making process, we urge you to respect Congress' intent to protect the ability of end users and pension plans to use swaps in a cost-effective manner. In particular, Congress recognized the need to allow pension funds, states, municipalities and other "special entities" to continue to use swaps by expressly rejecting the imposition of a fiduciary duty for swap dealers that is legally incompatible with their legitimate role as market-makers. The withdrawal of the Department of Labor's rules on a fiduciary duty under ERISA gives the agencies an opportunity to work together to prevent such adverse results. We urge you to work to revise the proposed rules in a way that avoids unintended consequences.

As one of the first countries to propose new financial rules following the 2008 crisis, the world is closely watching what we do. As you revise and finalize the proposed rules, we look forward to working together to support your important work in a way that keeps our financial markets the envy of the world.

Sincerely,

Tim Johnson

Senator Tim Johnson
Chairman
U.S. Senate Committee on
Banking, Housing, and Urban Affairs

Barney Frank

Congressman Barney Frank
Ranking Member
U.S. House Committee on
Financial Services

cc: The Hon. Timothy Geithner, Secretary, U.S. Department of the Treasury
The Hon. Hilda Solis, Secretary, U.S. Department of Labor
The Hon. John Walsh, Acting Comptroller of the Currency
The Hon. Edward DeMarco, Acting Director, Federal Housing Finance Agency
The Hon. Leland A. Strom, Chairman and CEO, Farm Credit Administration

United States Senate

WASHINGTON, DC 20510

October 17, 2011

The Honorable Ben Bernanke
Chairman
Board of Governors of the
Federal Reserve System
Twentieth and Constitution Avenue, NW
Washington, DC 20551

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

The Honorable Mary Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable John Walsh
Acting Comptroller
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

The Honorable Martin Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Chairman Bernanke, Chairman Gensler, Chairman Schapiro, Acting Comptroller Walsh, and Acting Chairman Gruenberg:

We are writing regarding potential implications of extending the application of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank") to jurisdictions outside the United States. We are concerned that your recent proposals do not realistically address potential issues this could raise for the global swaps markets.

The swaps market has developed with a recognition by regulators that individual countries have regulatory jurisdiction over the activities within their borders. Given recent statements and actions by U.S. regulatory agencies, we are concerned about proposals that could create uncertainty as to how the additional regulations could apply across borders and alter regulatory precedent. Nor do the proposals take into account the emerging regulation of swaps in Europe and other countries in response to the G-20 agreement to strengthen the regulation of swaps globally.

Problems for global swaps arise in many contexts under the proposals. Requiring swap dealer registration of off-shore swap dealers would subject these swap dealers to capital and margin regulation for their worldwide businesses, which give no credit to requirements in their home jurisdictions and in fact may be inconsistent with these developing requirements. U.S. clearing and exchange trading requirements apparently would apply to cross-border transactions, which may directly conflict with requirements in other countries. In addition, the proposals on their face would regulate swaps between global affiliates and cross-border guarantees, which are key means of reducing risk and raise few regulatory issues.

Letter to Chairman Bernanke, Chairman Gensler, Chairman Schapiro, Acting Comptroller Walsh, and Acting Chairman Gruenberg
October 17, 2011
Page 2

The potential ramifications of rules being applied extraterritorially are of key importance to institutions when determining how and where to conduct business. Even Chairman Bernanke at a recent Senate Banking Committee appearance observed, with respect to the prudential supervisors' proposed margin rule, that if other jurisdictions don't follow the U.S. margin rule, then it could place U.S. headquartered firms at a "significant competitive disadvantage."

Clearly, the final rules should limit their scope and take into account the developing regulation of derivatives in other countries, pursuant to G-20 commitments. The fluid nature of the derivatives markets underscores the need for the international framework for derivatives rules to be as consistent as possible between major financial jurisdictions. Harmonized rules will decrease the risk of regulatory arbitrage and help ensure that America's capital markets remain vibrant and competitive in the new global framework.

Given these concerns, we ask the regulators to clearly address cross-border issues in their rules and to avoid unnecessarily impeding global swaps operations by harmonizing the substance and timing of your proposals with your international counterparts. To this end, the prudential regulators should reconsider the proposed margin rule referenced above and its application to non-U.S. based affiliates of U.S. institutions.

In addition, we request that each of you respond in writing to this letter by November 15th explaining in detail how you will apply your rules to transactions across borders and to non-U.S. swap market participants that register in the U.S., including regulation of these entities, and treatment of interaffiliate swaps and guaranties. As part of that response, please indicate in detail what requests for comment you will publish on extraterritorial issues, including the approaches to regulating cross-border activities on which you will request comment.

We look forward to working with you as you continue with your implementation efforts under Dodd-Frank.

Sincerely,

Mike Johanns
United States Senator

Mike Crapo
United States Senator

David Vitter
United States Senator

Pat Toomey
United States Senator

February 8, 2012

Statement for the Record

On behalf of the

ABA Securities Association (ABASA)

before the

Subcommittee on Capital Markets and Government Sponsored Enterprises

of the

Committee on Financial Services

United States House of Representatives

American Bankers Association

Statement for the Record

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United States House of Representatives

February 8, 2012

Chairman Garrett, Ranking Member Waters, and members of the Subcommittee, the ABA Securities Association (ABASA) appreciates the opportunity to submit this statement for the record on limiting the extraterritorial impact of Title VII of the Dodd-Frank Act. ABASA is a separately chartered affiliate of the American Bankers Association (ABA) that represents those holding company members of the ABA that are actively engaged in capital markets, investment banking, and broker-dealer activities.

ABASA is grateful to this subcommittee for its leadership in addressing the many concerns that have arisen regarding Title VII, the derivatives title of Dodd-Frank. Although Title VII includes provisions that generally limit its extraterritorial reach, the language does not clearly delineate a standard for determining which cross border activities should be subject to U.S. jurisdiction. Nor does it address the competitive imbalances that might arise if swaps regulations apply differently to banks depending on the country where they are headquartered. Furthermore, Dodd-Frank does not address the jurisdictional scope with regard to cross-border swaps between bank affiliates.

Title VII of Dodd-Frank tasks the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) with promulgating regulations that do not apply to activities outside of the United States except in limited circumstances. Both agencies have indicated that they intend to issue something to solicit public comment on the proper scope of the derivatives regulation with regard to cross border activities, but neither has done so to date. ***In the meantime, banks operating globally are uncertain about which U.S. regulatory requirements may or may not apply to some of their derivatives activities and whether the jurisdictional scope may***

differ depending on whether the country is headquartered in the United States or in another country.

ABASA's members are also concerned that subjecting cross-border inter-affiliate swaps to U.S. swap requirements would subject those transactions to multiple regulatory regimes. For certain financial institutions, inter-affiliate swaps are an important tool for accommodating customer preferences and managing interest rate, currency exchange, or other balance sheet risks that arise from the normal course of business. Inter-affiliate trades reduce systemic risk by making it possible to increase the use of netting with clients and, by bringing together a diversified portfolio in one entity (e.g., the risk-managing entity), to use more offsets to manage and reduce risk. Inter-affiliate swaps do not create additional counterparty exposure outside of the corporate group and do not increase interconnectedness between third parties.

For all of these reasons, banks have consistently argued that inter-affiliate swaps should not be subject to the same rules intended for swaps entered into with a third party. Subjecting these risk-reducing transactions with regulatory requirements from multiple regulators could not only result in duplicative or inconsistent regulation but also would reduce market liquidity and potentially increase systemic risk. Cross-border inter-affiliate swaps should not, therefore, trigger U.S. swap regulatory requirements.

H.R. 3283, The Swap Jurisdiction Certainty Act, introduced by Congressman Himes and Chairman Garrett, would address all of the jurisdictional issues discussed above. It would also, however, require reporting of inter-affiliate swaps. ABASA is concerned that applying the same reporting standards to both inter-affiliate and other swaps transactions would duplicate and distort market information that will otherwise be available. ABASA would like to continue to work with the Committee on this reporting provision to ensure it accomplishes the goal of transparency without causing confusion to those using the reported information.

Conclusion

ABASA thanks the Committee for its strong leadership in this area. The Committee's efforts will provide much-needed clarity about the application of the swaps regulations. H.R. 3283 will also help ensure that the jurisdictional reach of the swaps regulations does not create competitive imbalances between banks solely because they may be headquartered in the United States or in another country.

House Financials Services Subcommittee on Capital Markets and Government Sponsored Enterprises Hearing on "the Limitation the Extraterritorial Impact of Title VII of Dodd-Frank"
Wednesday, February 8, 2012
One-Minute Opening Statement

I want to thank you Chairman Garrett and Ranking Member Waters for holding this important hearing. I look forward to hearing the testimony from our witnesses.

As a proud supporter of the Dodd-Frank law including the Title VII of the Act which covers over-counter-derivatives; I believe Dodd-Frank provides a great opportunity to set a new standard for an efficient, transparent, and well-regulated derivatives market.

Today's hearing is important because I think it is critical that we send a strong signal to the regulators about our intent when it comes to the extraterritorial application of Title VII.

It was not our intent when we enacted Dodd-Frank to put US financial institutions on an uneven playing field.

I believe such an aggressive application of Title VII could disadvantage US firms. That is why I cosponsored H.R. 3283, a bill authored by my Colleague

Representative Jim Himes, to clarify the scope of the of Title VII.

I look forward to hearing from our witnesses today and to working with my colleagues to address this important issue.

Thank you and I yield back the balance of my time.

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