May 1, 2013

The Honorable Debbie Stabenow
Chairman
U.S. Senate Committee on Agriculture
328A Russell Senate Office Building
Washington, DC, 20510

The Honorable Thad Cochran
Ranking Member
U.S. Senate Committee on Agriculture
328A Russell Senate Office Building
Washington, DC, 20510

Re: CFTC Reauthorization

Dear Chairwoman Stabenow and Ranking Member Cochran,

My name is Ken Bentsen and I am Acting President and CEO of the Securities Industry and Financial Markets Association ("SIFMA").[1] SIFMA appreciates the opportunity to provide input on the reauthorization of the Commodity Futures Trading Commission (the "CFTC"). Should Congress support Commodity Exchange Act ("CEA") reauthorization, we encourage consideration of the following issues, as discussed below.

As you know, the Dodd-Frank Act ("Dodd-Frank" or the "Act") created a new regulatory regime for derivative products commonly referred to as swaps. Dodd-Frank seeks to reduce systemic risk by mandating central clearing for standardized swaps through clearinghouses, capital requirements, and the collection of margin for uncleared swaps; to protect customers through business conduct requirements; and to promote transparency through reporting requirements and required trading of swaps on exchanges or swap execution facilities. To date, there have been significant reforms put in place that market participants have implemented. Late last year, firms engaged in significant swap dealing activities were required to register with the CFTC as swap dealers and became subject to reporting, recordkeeping and other requirements, many more of which will be phased in over time. Recently, the first swap

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

transactions were required to be cleared at central clearinghouses, in an effort to decrease systemic risk in the swap markets.

SIFMA supports the goals of Dodd-Frank with respect to most of Title VII. However, we remain concerned about how regulators, especially the CFTC, are interpreting and proposing to implement many of provisions. Indeed, in a few instances we also believe it is necessary that Congress amend the Act, as some provisions are duplicative and, at times, counterproductive. Poor implementation of Title VII has the potential to detrimentally limit the availability and increase the cost of derivatives, which are a valuable risk management tool for American businesses, including manufacturers and the agricultural industry.

We recognize the tremendous undertaking required by regulators in their efforts to implement derivatives reform. Throughout this process, SIFMA has frequently sought to engage with regulators in a constructive way.

As an overarching matter, it is our belief that the appropriate sequencing of Title VII rules and coordination between the various regulators responsible for them is critical to the successful implementation of the Dodd-Frank Act. In order to adapt to the new swap regulatory regime, our member firms are making dramatic changes to their business, operational, legal, and compliance systems. We continue to work closely with the CFTC on developing an appropriate implementation timeline to avoid a rushed process that would raise unnecessary complications and risk. The implementation of these new rules is not as simple as flipping a switch. They require a significant systems build, testing, training, and new documentation involving both dealers and customers. In addition, we encourage the regulators to harmonize their rules so that similar products will be subject to similar rules.[2] Conflicting or redundant rules, at best, add unnecessary cost and, at worst, increase risk.

The remainder of this letter will focus on a few specific issues that are under the jurisdiction of the CFTC, which could have a profound impact on the success of Title VII and its effects on the marketplace. In the event of CEA reauthorization, we urge that you consider them.

Cross-Border Impact of Dodd-Frank:

Though Title VII was signed into law two-and-a-half years ago, we still do not know which swaps activities will be subject to U.S. regulation and which will be subject to foreign

[2] SIFMA/ISDA Comments to CFTC on Proposed Schedule for Title VII Rulemaking (June 29, 2012), http://www.sifma.org/issues/item.aspx?id=8589939400; SIFMA Comments to SEC on the Sequencing of Compliance Dates for Security-Based Swap Final Rules (Aug. 13, 2012), http://www.sifma.org/issues/item.aspx?id=8589939893.

regulation. Section 722 of the Dodd-Frank Act limits the CFTC's jurisdiction over swap transactions outside of the United States to those that "have a direct and significant connection with activities in, or effect on, commerce of the United States" or are meant to evade Dodd-Frank. Section 772 limits the Securities and Exchange Commission's ("SEC") jurisdiction over security-based swap transactions outside of the United States to those meant to evade Dodd-Frank. The CFTC and SEC have not yet finalized rules clarifying their interpretation of these statutory provisions. The result has been significant uncertainty in the international marketplace and, due to the aggressive position being taken by the CFTC as described below, a reluctance of foreign market participants to trade with U.S. financial institutions until that uncertainty is resolved.

While the CFTC has proposed guidance on the cross-border impact of their swaps rules, this guidance inappropriately recasts the restriction that Congress placed on CFTC jurisdiction over swap transactions outside the United States into a grant of authority to regulate cross-border trades. The CFTC primarily does so with a very broad definition of "U.S. person," which it applies to persons with even a minimal jurisdictional nexus to the United States. In addition, the CFTC has released several differing interim and proposed definitions of "U.S. person" for varying purposes, resulting in a great deal of ambiguity and confusion for market participants. SIFMA supports a final definition of "U.S. person" that focuses on real, rather than nominal, connections to the United States and that is simple and objective, so a person can determine their status and the status of its counterparties.[3]

Further, the CFTC's proposed guidance has raised significant protests from foreign regulators, as it appears to contradict the history of comity and mutual recognition by seeking to impose a new form of substituted compliance on both a transactional and entity basis, jurisdiction by jurisdiction, in a manner that could result in overlapping or redundant application of rules at the expense of U.S. registered swap dealers.[4] In November, the CFTC held a meeting of its Global Markets Advisory Committee ("GMAC") to discuss cross-border issues related to over-the-counter ("OTC") derivatives reform implementation.[5] At this GMAC, several foreign regulators provided comments about the adverse impacts of the CFTC's proposed guidance.

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[3] SIFMA Comments to CFTC Proposed Interpretive Guidance (August 27, 2013), *available at* http://www.sifma.org/issues/item.aspx?id=8589940053; SIFMA/TCH/FSR Comments to CFTC on Further Proposed Guidance (Feb. 6. 2013), *available at* http://www.sifma.org/issues/item.aspx?id=8589941955.

[4] Letters from: UK FSA (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58432&SearchText=) European Commission (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58430&SearchText=) French Ministry of Finance (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58417&SearchText=)

[5] http://www.cftc.gov/PressRoom/Events/opaevent_gmac110712

More recently a letter was sent to U.S. Treasury Secretary Jacob Lew in which senior representatives of several G20 members expressed concern over the lack of progress in developing workable cross-border rules as a part of global reforms for over-the-counter derivatives markets. The letter stated that a lack of coordination in the rulemaking process would result in a fragmentation of the derivatives markets into localized and less efficient structures, ultimately impairing the ability of businesses across the globe to manage risk. The letter concluded that this would "in turn dampen liquidity, investment and growth".[6]

Many other international financial regulatory and governing bodies also have sent letters in response to the CFTC's original proposed cross-border guidance.[7] A number of concerns over the proposal recur in these letters, including the process by which substituted compliance will be determined, the broad and unclear definition of "U.S. person," and legal barriers pertaining to compliance with the CFTC's reporting requirements. These commenters note that the guidance fails to spell out exactly how the CFTC will make substituted compliance determinations, thus creating uncertainty over whether and how duplicative and conflicting requirements under different regulatory regimes can be avoided. European regulators specifically pointed to potential conflicts with the European Market Infrastructure Regulation and the application of the CFTC Interpretative Guidance as currently proposed. Based on these concerns, the respondents recommended that comparability assessments be made on a country-by-country basis rather than a rule-by-rule basis.

Equally significant, the CFTC has issued its proposed cross-border release as "guidance" rather than through a formal rulemaking process subject to the Administrative Procedure Act. By doing so, the CFTC avoids the need to conduct a cost-benefit analysis, which is critical for ensuring that the CFTC appropriately weighs any costs imposed on market participants as a result of implementing an overly broad and complex "U.S. person" definition against its

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[6] http://www.hm-treasury.gov.uk/d/letter_crossborder_otc_derivatives_reform_180413.pdf

[7] See comments from: Australian Securities and Investments Commission, Hong Kong Monetary Authority, Monetary Authority of Singapore Reserve Bank of Australia, Securities and Futures Commission (Hong Kong) (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58444&SearchText) ; Comissao de Valores Mobiliaros (CVM Brazil) (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58454&SearchText); European Securities and Markets Authority (ESMA) (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58451&SearchText); Financial Services Authority Japan, Bank of Japan (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58383&SearchText); Hong Kong Special Administrative Region (Secretary for Financial Services and the Treasury) (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58448&SearchText); Swiss Financial Market Supervisory Authority (FINMA) (http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=58317&SearchText).

perceived benefits.

The SEC proposed its cross-border rules on May 1, 2013. Rather than issuing cross-border interpretive guidance, the SEC is engaging in its full rulemaking process and is emphasizing the importance of providing sufficient opportunity for public comment on its proposed rules, including the associated cost-benefit analysis. While we have not yet had an opportunity to study the SEC cross-border release, we appreciate the SEC's efforts to address the cross-border issue holistically and to do so in a manner that is consistent with the Administrative Procedures Act.

SIFMA appreciates the comments of the Senate Agriculture Committee regarding the timely implementation of swaps regulations since the passage of the Dodd-Frank Act. Chairman Stabenow has applauded CFTC efforts in addressing complex issues and considerations of public comments in response, but expressed concern that "after two years of deliberation, it is time to get the rules written and to fully implement this strong reform bill."[8] We also appreciate the Committee's efforts in noting the importance of harmonizing rules across agencies and jurisdictions, as well as expressing concern about a potential overreach of the CFTC's cross-border guidance.

Last Congress, Congressmen Himes and Garrett introduced bipartisan legislation (H.R. 3283) that would provide clarity on this issue. The Himes-Garrett bill would permit non-U.S. swap dealers to comply with capital rules in their home jurisdiction that are comparable to U.S. capital rules and to adhere to Basel standards. The legislation also prevents the requirement that registered swap dealers post separate margins for each jurisdiction under which they are regulated. During the 112th Congress, the House Financial Services Committee acted to support this legislation by a vote of 41 to 18. SIFMA strongly supported this effort to clarify the jurisdiction of U.S. regulators.

In this Congress, Congressmen Garrett, Carney, Conaway and Scott have introduced bipartisan legislation, the Swaps Jurisdiction Certainty Act (H.R. 1256), that would harmonize the cross-border approaches by requiring the CFTC and SEC to jointly issue a rule related to the cross-border application of the Dodd Frank Act within 180 days, in accordance with the Administrative Procedures Act. This measure also ensures that firms in foreign countries with broadly equivalent swap regulatory regimes will not be subject to U.S. swap regulations. Finally, this legislation requires that the Commissions jointly provide a report to Congress if they determine that a foreign regulatory regime is not broadly equivalent to U.S. swap regulatory requirements. On March 20, 2013, H.R. 1256 was approved by voice vote by the

[8] http://www.ag.senate.gov/newsroom/press/release/chairwoman-stabenow-it-is-time-to-fully-implement-wall-street-reform

House Agriculture Committee to be recommended favorably to the House. SIFMA urges that Senate Agriculture Committee to include H.R. 1256 in the CEA reauthorization legislation.

The Swaps Push-Out Rule:

The Swaps Push-Out Rule, contained in Section 716 of the Dodd-Frank Act, was added to the Act at a late stage in the Senate and was not debated or considered in the House of Representatives. It would force banks to "push out" certain swap activities into separately capitalized affiliates or subsidiaries by providing that a bank that engages in such swap activity would forfeit its right to the Federal Reserve discount window or Federal Deposit Insurance Corporation ("FDIC") insurance.

The Swaps Push-Out Rule has been opposed by senior prudential regulators from the time it was first considered. Ben Bernanke, Chairman of the Federal Reserve, stated in a letter to Congress that "forcing these activities out of insured depository institutions would weaken both financial stability and strong prudential regulation of derivative activities."[9] Sheila Bair, former FDIC Chairwoman, said that "by concentrating the activity in an affiliate of the insured bank, we could end up with less and lower quality capital, less information and oversight for the FDIC, and potentially less support for the insured bank in a time of crisis" further adding that "one unintended outcome of this provision would be weakened, not strengthened, protection of the insured bank and the Deposit Insurance Fund."[10]

In addition to the increase in risk that would be caused by the Swaps Push-Out Rule, it would likely significantly increase the cost to banks of providing customers with swap products as banks would need to fragment related activities across different legal entities. As a result, U.S. corporate end-users and farmers will face higher prices for the instruments they use to hedge the risks of the items they produce. This increased fragmentation also would add unnecessary complexity to the organizational structure of banking organizations. Mark Zandi, Chief Economist at Moody's Analytics, stated in a letter to Congressman Scott Garrett that "Section 716 would create significant complications and counter the efforts to resolve [large financial] firms in an orderly manner."[11]

Bipartisan legislation, the Swaps Regulatory Improvement Act (S. 474), was introduced this Congress by Senators Hagan, Johanns, Toomey, and Warner to modify Section 716 of the Dodd-Frank Act by requiring only structured finance swaps based on asset-back securities to be

[9] Letter from Ben Bernanke, Federal Reserve Chairman, to Senator Christopher Dodd (May 13, 2010), *available at* http://blogs.wsj.com/economics/2010/05/13/bernanke-letter-to-lawmakers-on-swaps-spin-off/.

[10] Letter from Sheila Bair, FDIC Chairman, to Senators Christopher Dodd and Blanche Lincoln (Apr. 30, 2010), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2010-05-04/pdf/CREC-2010-05-04-pt1-PgS3065-2.pdf#page=5.

[11] Letter from Mark Zandi, Chief Economist, Moody's Corporation, to Congressman Scott Garrett (Nov. 14, 2011).

pushed out of banks and would not apply 716 to equity or commodity swaps. The net effect of these changes would be to expand permissible swap activities within a bank, and to only exclude swaps based on asset-backed securities that do not meet qualifications to be established by regulation.[12]

In the House, Congressmen Hultgren introduced bipartisan legislation (H.R. 992) identical to S. 474, and on March 20, 2013, the House Agriculture Committee favorably approved this bill by a vote of 31 to 14. SIFMA urges the Senate Agriculture Committee to include S. 474/H.R. 992 in CEA reauthorization legislation.

Swap Execution Facilities:

As I noted above, the Dodd-Frank Act requires a subset of the most standardized swaps to be traded on an exchange or a new platform known as a "swap execution facility," commonly called a "SEF." Congress generally defined what constitutes a SEF but left further definition to the CFTC and SEC. To date, both the CFTC and SEC have proposed differing SEF definitions for the products under their respective jurisdictions, but neither Commission has adopted a final definition.

An appropriately flexible definition of "SEF" is critical for ensuring that the SEF trading requirement does not negatively impact liquidity in the swap markets. In truth, it remains unclear how the SEF trading requirement would impact the liquidity of instruments that have been traditionally transacted bilaterally. Understanding this reality, the SEC has proposed a rule that would permit SEFs to naturally evolve their execution mechanisms for swaps that are widely traded. These SEFs could be structured in many different ways, similar to how electronic trading platforms have evolved in the securities markets.

The CFTC has proposed a different rule that would require customers to either trade swaps on SEFs, as if they were traded on exchanges, or to solicit prices by issuing requests for quotes, generally known as "RFQs," from a minimum of five market participants for each swap subject to the SEF trading requirement. This differs from current market practice and could have a significant negative impact on the liquidity in the swap market. By signaling to the market the desire to purchase a swap, customers may be telegraphing important information that may impede best execution of their orders. While we appreciate the CFTC's goals of encouraging competition among dealers to decrease the price of swaps, the reality is that this practice will do just the opposite and drive up the cost of transactions, ultimately harming the

[12] In addition, the bill would fix a drafting error acknowledged by the Swaps Push-Out Rule's authors, under which the limited exceptions to the rule that apply to insured depositing institutions appear not to include U.S. uninsured branches or agencies of foreign banks.

corporations and other swaps users this rule aims to protect.

Congressmen Garrett, Hurt, Meeks, and Moore recently sent a letter to CFTC Chairman Gensler expressing concern about the minimum requirement of obtaining fives RFQs and noted that an arbitrary requirement for a minimum may undermine the goal of enhancing transparency in the marketplace and would "result in deleterious effects on the marketplace, while not adding any measurable transparency benefit."[13]

Last Congress, the House Financial Services Committee supported, by voice vote, legislation that would require the CFTC and the SEC to adopt SEF rules that allow the swaps markets to naturally evolve to the best form of execution (H.R. 2586). H.R. 2586 would not require a minimum number of participants to receive or respond to quote requests and would prevent regulators from requiring SEFs to display quotes for any period of time. Finally, this bill would prevent regulators from limiting the means by which these contracts should be executed and ensuring that the final regulation does not require trading systems to interact with each other. SIFMA urges the Senate Agriculture Committee to support similar legislation in CEA reauthorization.

Inter-Affiliate Swaps:

The Dodd-Frank Act is effectively silent on the application of swap rules to swaps entered into between affiliates. Such inter-affiliate swaps provide important benefits to corporate groups by enabling centralized management of market, liquidity, capital and other risks inherent in their businesses and allowing these groups to realize hedging efficiencies. Since the swaps are between affiliates, rather than with external counterparties, they pose no systemic risk and, therefore, there are no significant gains to be achieved by requiring them to be cleared or subjecting them to margin posting requirements. In addition, these swaps are not market transactions and, as a result, requiring market participants to report them or trade them on an exchange or swap execution facility provides no transparency benefits to the market—if anything, it would introduce unnecessary information that would make Dodd-Frank's transparency rules less helpful.

Recognizing the distinct characteristics of these transactions, on April 1, 2013 the CFTC published its final rule providing an exemption from clearing obligations for certain inter-affiliate swaps, including inter-affiliate swaps involving insured depository institutions.[14] However, the rule is quite complex and onerous, imposing significant conditions and

[13] Letter to CFTC Chairman Gary Gensler from Reps. Garrett, Hurt, Meeks, and Moore dated April 5, 2013

[14] http://www.gpo.gov/fdsys/pkg/FR-2013-04-11/pdf/2013-07970.pdf.

qualifications on affiliates that limit the usefulness of the exemption. Problematically, in order to utilize this exemption, market participants may be required to clear swaps between "non-U.S. persons" that otherwise would not be subject to U.S. jurisdiction – effectively allowing the CFTC to expand its jurisdictional reach far beyond that contemplated by the Dodd-Frank Act.

During the 112th Congress, the House of Representatives voted 357 to 36 in support of legislation (H.R. 2779) that would exempt inter-affiliate trades from certain Title VII requirements due to the important role such transactions play in firms' risk management procedures and the negative impact the full scope of Title VII regulation would have if applied to them. In this Congress, Congressmen Stivers and Moore introduced H.R. 677, the Inter-Affiliate Swap Clarification Act, which would exempt certain inter-affiliate transactions from the margin, clearing, and reporting requirements under Title VII. On March 20, 2013, H.R. 677 was approved by voice vote by the House Agriculture Committee to be recommended favorably to the House. SIFMA urges the Senate Agriculture Committee to include H.R. 677 in CEA reauthorization legislation.

Basel III:

Implementation of the Basel III capital standards accord is an area of great interest and concern for our members and the financial services industry as a whole. The industry is in strong support of efforts to promote consistent international standards.

The European Union is currently finalizing its implementation of Basel III, known as Capital Requirements Directive IV (CRD IV). As drafted, CRD IV would exempt EU supervised swap dealers from certain Basel III capital mandates, specifically the credit valuation adjustment (CVA), when doing business with non-financial end-users, pension funds and sovereign entities. Market participants globally have raised legitimate concerns about the CVA calibration, and we believe the Basel Committee should revise the calibration. The Basel Committee should also take account of the effects on corporate end-users of parallel regulation requiring central clearing or margin for uncleared OTC derivatives. Recently, Canada announced a delay of the CVA (despite finalizing the rest of Basel III) given uncertainty around the provision's global implementation and effects on non-financial entities. Notwithstanding these real problems with CVA, different application by different jurisdictions will result in unlevel treatment and fragmentation in conflict with the G20 principles.

Accordingly, Congressman Fincher introduced the Financial Competitive Act, (H.R. 1341), that would direct the Financial Stability Oversight Council (FSOC) to examine differences in the implementation of derivatives capital requirements and the CVA. Further, the bill would require FSOC to assess the effects on the US financial system and to make recommendations to minimize any negative impact on US financial firms and end-users. This

legislation has been referred to the House Financial Services and Agriculture Committees. SIFMA urges the Senate Agriculture Committee to include H.R. 1341 in CEA reauthorization legislation.

Margin Requirements:

The CFTC is currently considering rulemaking detailing margin requirements for uncleared swap transactions. The Commission originally proposed rules during the summer of 2011, and later reopened its comment period in light of consultative guidance from the Basel Committee on Banking Supervision ("BCBS") and International Organization of Securities Commissions ("IOSCO") released during the summer of 2012 (a second consultation was released in February 2013). Market participants have expressed great concern over the various regulatory proposals regarding initial margin requirements, especially those which would require the mandatory exchange of two-way initial margin subject to restrictions on re-hypothecation and re-use. SIFMA has urged regulators to utilize daily variation margin requirements to meet G20 efforts aimed at reducing systemic risk and increasing market stability, while avoiding the imposition of onerous mandatory initial margin requirements, which would drain liquidity and have negative pro-cyclical impacts on markets during times of stress.[15] SIFMA urges the Senate Agriculture Committee to consider SIFMA's comments regarding proposed margin requirements for uncleared swaps in the CEA reauthorization legislation.

Thank you for giving me this opportunity to explain our views related to several important measures to be considered by the Senate Committee on Agriculture.

Kenneth E. Bentsen, Jr.
Acting President and CEO
Securities Industry and Financial Markets Association

[15] SIFMA has responded to various regulatory proposals on initial margin requirements. These include responses to the CFTC's re-opened comment period on proposed rules on margin for uncleared swaps, submitted Sept. 14, 2012; http://www.sifma.org/issues/item.aspx?id=8589940303), and to the first and second BCBS/IOSCO consultative documents on margin requirements for non-centrally cleared derivatives, submitted Sept. 28, 2012 (http://www.sifma.org/issues/item.aspx?id=8589940507) and March 15, 2013 (https://www.sifma.org/issues/item.aspx?id=8589942551), respectively. SIFMA has also provided comments in response to SEC (http://www.sifma.org/issues/item.aspx?id=8589942116) and U.S. Prudential Regulator proposals (http://www.sifma.org/issues/item.aspx?id=8589941054) on margin requirements for uncleared swaps.