MEMORANDUM

TO: File
FROM: Richard Grant
RE: Meeting with Representatives of Barclays
DATE: September 28, 2011

On September 28, 2011, representatives from the Securities and Exchange Commission ("SEC") participated in a meeting with representatives from Barclays. The SEC representatives present at the meeting were John Ramsay, Mike Macchiaroli, Brian Bussey, Tom McGowan, Randall Roy, Matt Daigler, Kathleen Kim, Richard Gabbert, Phil Minnick, Leigh Bothe, and Richard Grant. The Barclays representatives present at the meeting were Chris Allen, Keith Bailey, Patrick Durkin, Alex Guest, and Allison Parent, with Alan Kaplan and Kathleen Peacock participating telephonically. At the meeting, the Barclays representatives provided their views and observations on the application of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act to Barclays' global security-based swaps business.

Extraterritorial Application of Title VII

September 2011

Extraterritoriality: Key Parameters

- We believe the following provides for transparent and effective oversight of a non-U.S. bank's global swaps business:

1. **ENTITY-LEVEL REQUIREMENTS**: U.S. regulators should recognise home country regulators' lead on Entity-Level Requirements (e.g. Capital and other matters of prudential regulation) applicable to non-U.S. banks, subject to being satisfied that the relevant home country regulator (e.g. FSA) applies comparable and robust standards. (Note: Fed precedent for deferring to home country regulator or regime in relation to Capital.)

2. **TRANSACTION-LEVEL REQUIREMENTS**: U.S. regulators should apply Transaction-Level Requirements on non-U.S. banks <u>only with respect to business conducted with U.S. Persons</u>. Registration of a non-U.S. bank as a Swap Dealer should not automatically cause all of its off-shore business to fall within the regulatory purview of U.S. regulators.

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Scope of U.S. Regulation of non-U.S. Entities

Key Considerations

- Similar to most large non-U.S. banks, Barclays operates its swaps business on a global basis through a central booking location. Barclays books its swaps in its London branch regardless of counterparty location. There are good reasons to preserve this central booking model:
  - Capital efficient, allows customers to transact with a highly-rated and creditworthy entity, and provides customers with more opportunities for netting and portfolio margining across products.
- Overly broad reach by U.S. regulators could subject such non-U.S. banks to duplicative, inconsistent and contradictory regulatory requirements, and potential tension with home country regulators.
- Non-U.S. bank such as Barclays should be permitted to register its foreign booking office as a swap dealer, with U.S. regulators exercising oversight over entity-level requirements and transaction-level requirements as set out in the prior slide.
- Non-U.S. entities that make swaps markets solely outside of the U.S. and only transact with swap dealers in the U.S. should not be required to register as Swap Dealers.
- Non-U.S. entities that only transact with affiliates should not be required to register as Swap Dealers even if such affiliates are themselves registered Swap Dealers.

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Extraterritoriality Scope Further Defined

Swap Dealer Registration for Foreign Headquartered Banks

Non U.S. banks should be permitted to register as a Swap Dealer their non-U.S. branch where swaps are booked, with certain entity-level rules (e.g. capital, risk management, recordkeeping etc) applying on an entity-wide basis, and with U.S. regulators limiting their oversight to swaps with U.S. persons

Entity Level Rules: Home Regulator Deferral

For entity-level rules such as capital and risk management, U.S. regulators should defer to home regulators' standards so long as the home regulations are comprehensive and based on global standards (e.g. Basel) or otherwise comparable to the U.S. regulatory regime

For monitoring purposes, U.S. regulators could rely on information-sharing arrangements with home regulators

Transaction Specific Rules: US-person Facing Activities

For transaction-level rules, such as clearing, exchange trading, and real-time reporting, U.S. derivatives regulations should apply only to transactions where one or more of the parties is a "US person"

We believe "Reg S" is a suitable starting point for the definition of "US person" for all transaction specific rules

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Swap Dealer Registration

- Swap Dealer designation for a non-U.S. bank that books swaps in its non-U.S. branch should be limited to its U.S. facing activities. Such limited designation of the booking entity would:
  1. Be expressly limited to the branch of the bank at which swaps are booked; or
  2. If entity wide registration is required, be expressly limited to supervisory oversight of the activities of the relevant branch.
  - In either scenario:
    - Application of transaction-level requirements only apply to transactions with U.S. Persons
    - Defer to home country standards for prudential / entity-level requirements
- If U.S. regulators require that a U.S. affiliate of a non-U.S. bank be registered in respect of the affiliate's activities on behalf of the bank (e.g. soliciting or negotiating swaps):
  1. U.S. affiliate should be registered as broker under relevant CFTC and SEC rules, as it is not a principal to swaps and does not book any swaps in its own account; or
  2. U.S. affiliate may be registered as Swap Dealer but would be required to comply only with regulations applicable to the customer-facing activities it conducts, e.g. business conduct and recordkeeping.
  - In either scenario:
    - Compliance by U.S. affiliate with other swap dealer requirements should be flexible enough to accommodate group-structured systems, policies and procedures.
    - U.S. affiliate should not be required to hold capital against market and credit risk arising from swaps booked to the non-U.S. booking entity

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Transaction-Level Requirements

- The Commissions' Rules must provide clarity on U.S. nexus. SEC Reg S definition is useful starting point
- Extending Transaction-Level Requirements to transactions where there is no U.S. Person is challenging both in principle and in practice:
  - No relevant policy goal – what risk to the U.S. markets or investors is mitigated by having one of the Commissions regulate e.g. documentation disclosure standards in a trade between Barclays London and a client in France?
  - Conflict – internationally, local market regulators where the market activity is taking place e.g., the French regulators, will dictate conduct of business standards applicable when dealing with French investors. Imposing additional overseas (i.e., U.S.) rules could be duplicative but worse, conflicting. Non-U.S. regulators may also be concerned about such an approach.
  - Cost – what is the cost/benefit for the U.S. taxpayer? No systemic risk mitigation achieved (prudential standards), U.S. investor receives no enhanced protection (any trade with a U.S. Person will be covered by U.S. rules) and yet significant cost for U.S. regulators to supervise on a global activities

<u>Potential Consequences</u>

- Firms having to subsidiarize their U.S. facing business – very capital intensive and not compatible with a global booking model creating inefficiencies in capital, tax, netting and portfolio margining.
- Customers would face less creditworthy and lower-rated counterparties. It would require counterparty approval and a massive effort over many years to move swap transactions and documentation to a separate entity.

Title VII Breakdown of Entity & Transaction Level Oversight

Entity Level*	**Transaction Level**
Capital	Clearing
Internal Business Conduct Rules	Exchange trading
•Risk Management Procedures	End of day reporting
•Chief Compliance Officer	Real Time reporting
•Recordkeeping	Business conduct rules (external)
•Conflicts of Interests	Documentation standards
	Daily trading records
	Uncleared margin segregation/amount
	Position limits

*Defer to home country regulator (subject to U.S. regulatory determination of comparable standards)

**** Transaction-Level requirements should not apply to inter-affiliate transactions.**

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Conflicting Standards vs. Duplicative Requirements

International collaboration is essential to further the goals of G20 and the DFA to protect investors, provide level playing field for safe, fair markets while promoting capital formation.

- **Conflicts**: inability to comply with different sets of rules at same time may curtail the continuity of global business models and use of global risk management tools for clients
  - Recommend an international end-user exemption
  - Swap transaction subject to EMIR and DFA clearing requirements may prove difficult to harmonize
  - Japan requires certain OTC derivative transactions to be cleared by licensed <u>domestic</u> CCP; Compliance under DFA and Japanese laws could prove impossible
  - Execution requirement by EMIR and DFA would require platforms to register with both
- **Duplication**: question of cost. At what point would it make it difficult or impractical for a global foreign bank to comply with both requirements under Title VII and local jurisdiction requirements
  - Duplicative reporting requirements could diminish the efficacy of information received by regulators and decrease the goals for transparent markets and price discovery. For example, EMIR requires a swap to be reported to an ESMA registered trade repository and DFA to registered swap data repository—leads to separate reporting for same trade and increasing likelihood of duplication
  - Duplicative calculation of capital for EU financial services firms subject to Mifid or the Banking Consolidation Directives, coupled with the Basel III standards directed under CRDIV would be excessive. Subsidiarization increases to the detriment of client needs for safe and effective risk management
- Foreign jurisdictions are committed to ensuring effective internal risk management standards:
  - (Compromise Proposal by the Council of the European Union dated 29 August 2011) require firms to have in place "*robust, resilient and auditable processes in order to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve them, and to monitor the value of outstanding contracts*".

EXAMPLES OF CONFLICTS THAT COULD RESULT FROM DODD-FRANK AND EUROPEAN FINANCIAL REGULATION[1]

	SCENARIO	APPLICABLE DODD-FRANK REQUIREMENTS	APPLICABLE EUROPEAN OR OTHER LOCAL REQUIREMENTS	CONFLICTS/ISSUES
1.	Foreign bank with a branch in the US operates a global booking model whereby all swaps executed by the bank or its affiliates are booked to the bank's home state branch.	Requirement to register as a swap dealer and thereby become subject to CFTC/SEC conduct of business regulation and prudential regulation including capital and margin requirements in respect of the non-US branch. The applicability of these requirements to non-US directed activities of such an entity is uncertain. It is unclear whether different branches and agencies of a foreign bank should be treated as the same person for purposes of swap dealer designation. Compare s.1(b) of the International Banking Act 1978, which distinguishes between an agency, branch and a foreign bank.	If the foreign bank is established in the EU, it is likely that it will be subject to licensing under the various EU financial services directives such as the Market in Financial Instruments Directive or the Banking Consolidation Directive. These directives, together with the Capital Adequacy Directive, impose conduct of business and prudential rules and regulations on EU investment firms and banks. These rules will apply to the foreign bank's activities in the EU and may in some cases also apply to activities outside the EU (e.g. in the case of prudential rules).	If the foreign bank is required to register in the US and such registration triggers US regulatory supervision over the foreign bank's activities in the EU, that may give rise to a conflict with its EU home state competent authorities who are unlikely to defer to the assumption of jurisdiction by US regulators over those activities to the extent that different regulatory requirements apply. EU entities falling within the scope of Dodd-Frank capital requirements would also be subject to EU capital requirements. Duplicative calculation of capital could be required. Given that the international standards agreed under Basel III are to be implemented in the EU (through the Capital Requirements Directive IV) this would be excessive. To avoid this, a foreign entity might choose to create a separate subsidiary to handle US-based activity. The use of such a subsidiary, as well as requiring repapering of clients and transactions, could increase inefficiencies and systemic risk, as the US customers of foreign banks may have a more thinly capitalised subsidiary as their counterparty. This would be a particular concern if separate subsidiaries were used across multiple jurisdictions. Extraterritorial laws have often given rise to jurisdictional problems and sparked responses from foreign legal systems that are designed to prevent the extraterrorial application of those laws. For example, the extraterritorial application of US sanctions against Cuba so that any entity, wherever organised, that is owned or controlled by a US person is subject to such sanctions led to the EU adopting Regulation 2271/96 prohibiting EU entities from complying with certain

[1] This note discusses current versions of rule proposals under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**") and European Council's compromise text of the Proposal for a Regulation of the European Parliament and of the Council on OTC derivative transactions, central counterparties and trade repositories ("**EMIR**"). The final, definitive versions of the Dodd-Frank rules and EMIR are likely to differ from the versions discussed in this note.

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				extraterritorial US laws. No such measures exist in the financial regulatory sector, though this is possible in the future. Given the global nature of financial sector businesses, any extraterritoriality of US regulations is likely to provoke the EU to take measures to counteract this, which could prove counterproductive. For example, the European Parliament proposed to include a requirement for third country entities requesting information from trade repository to provide an indemnity to the trade repository and EU authorities in respect of any legal costs arising from the provision of the information, apparently in response to the inclusion of a similar requirement in the Dodd-Frank legislation.
2.	Foreign branch of a US entity engages in a swap with a foreign (e.g. EU-established) person.	US entities could be required to register as swap dealers or security based swap dealers for all swaps activities, regardless of where they are carried out. New Section 2(i) of the CEA, which was added by Section 722(d) of the Dodd-Frank Act, states that provisions of the CEA that were enacted by Title VII of the Dodd-Frank Act (which includes the definition of swap dealer, and the registration requirement) shall not apply to activities outside the United States unless those activities ''*have a direct and significant connection with activities in, or effect on, commerce of the United States,*'' or contravene rules or regulations the Commission may promulgate to prevent evasion. This could bring activities of foreign branches of such US entities with foreign (non-US) persons within the scope of the Dodd-Frank requirements (such as the clearing requirement and the margin requirements), for example if they are subsidiaries or affiliates of US entities or have US clients. US regulators are also likely to view the entity as a whole,	Derivatives transactions between an EU person and a foreign branch of a US entity may be subject to EMIR. The clearing obligation in EMIR applies to a derivative between a financial counterparty (or a non financial counterparty meeting the clearing threshold) and a third country entity that would be subject to the clearing obligation if it was established in the EU. The risk mitigation provisions set out in the current draft of EMIR (Compromise Proposal by the Council of the European Union dated 29 August 2011) require firms to have in place "*robust, resilient and auditable processes in order to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve them, and to monitor the value of outstanding contracts*". No further detail is provided of what form such processes might take, but it	Foreign branches of US entities will be subject to local regulation in the EU as well as US regulation of the overall entity. Local competent authorities are unlikely to defer to US regulators' jurisdiction over the affairs of branches in the EU, especially as regards conduct of business matters. Further, if a swap transaction is subject to both EMIR mandatory clearing requirements and the Dodd-Frank clearing requirements, it may be difficult for the parties to comply with both sets of requirements. If a swap is required to be executed under Dodd-Frank at a swap execution facility and on an EU-regulated trading platform under EU legislation, then the platform in question would have to have been approved under both pieces of legislation. Whilst it is usually possible to comply with differing requirements in relation to levels and acceptable forms of margin, it may in certain respects be difficult or impracticable for non-US entities to comply with certain aspects of the Dodd-Frank margin requirements, particularly in relation to segregation and appropriate custodians. The US segregation requirement may conflict with the EU practice of title transfer collateral arrangements. The potential for the ESMA technical standards to impose conflicting

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		including foreign branches, as subject to US jurisdiction. The margin requirement exclusion (as set out in Prudential Regulators' proposed rules published on 12 April 2011) (PR rules) applies for transactions between a foreign Dealer or Major Swap Participant (MSP) and a foreign counterparty, but (a) a foreign branch, office, or subsidiary of a U.S. person would not be considered a foreign Dealer or MSP for these purposes and (b) a foreign branch or office of a U.S. person or a counterparty receiving a guarantee from a U.S. affiliate would not be considered to be a foreign counterparty for these purposes. The CFTC's margin rules (published on 12 April 2011) (CFTC rules) for entities within its regulatory oversight and without a prudential regulator are silent on extraterritorial scope but do not distinguish between entities located inside or outside the US. The range of transactions covered could therefore include transactions between a foreign swap entity subject to the CFTC rules and a foreign counterparty. The PR rules impose margin requirements on transactions between US bank swap dealers/MSPs and their counterparties regardless of location. Under the proposed margin rules, initial margin posted by a swap participant would need to be segregated (under the CFTC rules this would be at the option of the counterparty) with an independent third-party custodian located in a jurisdiction that applies the same insolvency regime to the custodian as the posting (PR rules) or receiving (CFTC rules) swap participant. The proposed margin rules classify non-US	is possible that the European Securities and Markets Authority (ESMA)'s technical standards to be adopted pursuant to Article 6(3) could include a margin requirement, and/or other risk mitigation measures, resulting in the possibility of duplication. In the current EMIR draft, it is proposed that the exemption from the scope of the Regulation for "*public bodies charged with or intervening in the management of the public debt*" should apply only to EU entities, whereas in previous drafts this was universal.	requirements could make matters more problematic. Non-US entities are likely to avoid entering into transactions with branches of US entities in order to avoid becoming subject to Dodd Frank margin requirements. Non-US sovereigns may be reluctant to enter into derivatives transactions with US banks if this obliges them to post collateral. The EU appears however to have responded to this in its most recent EMIR text by imposing a reciprocal requirement on third country sovereigns and public bodies.

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		sovereigns as financial end-users, and therefore subject to the margin requirement.		
3.	Foreign branch of a US entity engages in a swap with non-US person established outside the EU, e.g., in Asia.	See row 2 above.	Local requirements will apply. In Japan, for example, certain OTC derivative transactions must be cleared by a licensed domestic CCP.	Compliance with both sets of regulations may be impossible.
4.	Foreign entity deals in swaps with a US-person.	The foreign entity (depending on its own US-related activities) could be subject to the Dodd-Frank requirement to register as a swap dealer, security based swap dealer or become subject to the Dodd Frank requirements as an MSP (e.g. through the Substantial Counterparty Exposure Test).	The foreign entity is likely to be subject to regulation in its home state as a bank or investment firm.	Requiring foreign entities to be subject to US registration requirements, in circumstances where US persons would not be subject to equivalent requirements in the jurisdictions of those foreign entities, is likely to impose onerous burdens on such foreign entities and may deter them from entering into any deals with US swap dealers or MSPs. It may also cause the jurisdictions of those foreign entities to adopt retaliatory measures.
5.	Foreign entity deals in swaps with US persons in circumstances where the swap is subject to the EMIR clearing obligation.	The swap may be subject to the mandatory clearing obligation as well as reporting requirements.	Mandatory clearing and reporting obligations under EMIR.	If the swap is required to be cleared both by a clearing house registered under EMIR and by a US clearing house then the clearing house would need to be both registered with EMIR and a US DCO. Furthermore, if a swap is required to be executed under Dodd-Frank at a swap execution facility and on an EU-regulated trading platform under EMIR, then dual regulation for the execution venue would also be required. There are mechanisms in EMIR for recognising third country clearing houses (such as those from the US) and for grandfathering existing UK recognised overseas clearing houses for 2 years. Clearing houses and platforms are presently facing considerable difficulties in seeking to comply with their conflicting regulatory requirements and supervisory processes. Under EMIR, a swap must be reported to an ESMA-registered trade repository, and under Dodd-Frank to a registered swap data repository. Compliance with both

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				regulations will require separate reporting by the parties, potentially leading to duplication if EU and US regulators share data. Some repositories are however providing a "one-stop shop" for reporting and holding data through different legal entities in both jurisdictions. Indemnification may also be required under both Dodd-Frank and EMIR in relation to information requested from repositories.
6.	US registered swap dealer transacts with an EU entity where that EU entity is a financial counterparty or a non-financial counterparty and the swap triggers clearing threshold.	The transaction will be subject to mandatory clearing/execution/reporting under Dodd-Frank.	Mandatory clearing and reporting requirements will also apply under EMIR.	See row 5 above.
7.	Foreign dealer deals in swaps with a non-US person, but with the involvement of US persons in the deal (e.g. back-office support by US persons to foreign dealer)	The registration, mandatory clearing/execution, and trade reporting requirements could apply if the involvement of US persons in back-office or similar functions (as opposed to being parties to the swaps) is seen as having a "*direct and significant connection with activities in, or effect on,*" commerce of the United States, bringing the swaps within the scope of Dodd-Frank.	If the swap is otherwise transacted between EU entities, it is likely to be subject to EMIR requirements.	Apart from the conflicts noted above, applying the requirements of Dodd-Frank to US persons who merely provide administrative support is likely to result in entities moving back-office operations away from the US or no longer locating administrative or support personnel in the US, even though such US persons do not create any risk for the US financial markets.
8.	Reference to a US underlier or reference entity in a swap conducted outside the US by counterparties located outside the US.	See row 7 above. In this case there appears to be a lower likelihood that such a transaction would become subject to Dodd Frank unless a more direct US connection exists, but it is nevertheless a possibility.	See row 7 above.	See row 7 above.
9.	A non-US person contacts a US-domiciled professional fiduciary that acts for a counterparty located outside the US.	See row 7 above.	See row 7 above.	See row 7 above.