MANAGED FUNDS ASSOCIATION

August 19, 2013

Via Electronic Submission: http://www.sec.gov/rules/proposed.shtml

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
1155 21st Street, NW
Washington, DC 20549-1090

Re: Proposed Rules; Proposed Interpretations on "Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants: File Numbers S7–02–13, S7–34–10 and S7–40–11

Dear Sir or Madam:

Managed Funds Association ("**MFA**")[1] and Alternative Investment Management Association[2] ("**AIMA**", and together with MFA, "**we**") welcome the opportunity to provide comments to the Securities and Exchange Commission (the "**Commission**") on its "Proposed Rules; Proposed Interpretations on "Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants" (the "**Proposed Rules**").[3] We support the Commission's decision to address "the application of Title VII [("**Title VII**") of the

[1] Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

[2] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in over 40 countries.

[3] 78 Fed. Reg. 30968 (May 23, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf ("**Proposed Rule Release**").

Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Dodd-Frank**")][4] to cross-border activities holistically in a single proposing release"[5] in order to provide "market participants, foreign regulators, and other interested parties with an opportunity to consider, as an integrated whole, the Commission's proposed approach".[6] We applaud the Commission for its measured and thoughtful approach to addressing the cross-border scope of Title VII to security-based swap ("**SBS**") activities. We believe that the Proposed Rules represent a significant step forward in providing certainty to market participants that, in its application, the Proposed Rules will appropriately subject certain U.S. and non-U.S. market participants and transactions to the Commission's SBS regulations.

We generally support the Proposed Rules, and thus, to assist the Commission with finalizing appropriately robust but flexible cross-border rules, we take this opportunity to raise certain concerns for the Commission's consideration on the practical application of the Proposed Rules to market participants in the SBS market. In particular, we highlight the potential challenges associated with determining whether an SBS transaction meets the standard of being conducted within the United States, as well as the need for an approach to substituted compliance that encompasses all transaction-level requirements that apply to U.S. and non-U.S. persons conducting transactions within the United States.

I. General Views on Proposed Rules and Regulatory Harmonization

Our key interest in the Proposed Rules is the manner in which the Commission proposes to apply the transaction-level requirements[7] to a private fund[8] once it has determined whether it or its counterparty is a "U.S. person".[9] We embrace application of the transaction-level requirements to private fund SBS transactions so long as the Commission's final approach is reasonably straightforward for market participants to understand and implement, and it reflects substantial coordination with international regulators and appropriate recognition of comparable regulatory regimes.

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[4] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010), available at: http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

[5] Proposed Rule Release at 30973.

[6] *Id.*

[7] The Commission's proposed "transaction-level requirements" include external business conduct standards, segregation of assets, regulatory reporting, public reporting, mandatory clearing and mandatory trade execution.

[8] "Private fund" is defined in Section 202(a)(29) of the Investment Advisers Act of 1940, as amended, as "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3), but for section 3(c)(1) or 3(c)(7) of that Act."

[9] *See* Proposed Rule Release at 31207, proposed §240.3a71–3(a)(7)(i), defines a "U.S. person" as: "(A) Any natural person resident in the United States; (B) Any partnership, corporation, trust, or other legal person organized or incorporated under the laws of the United States or having its principal place of business in the United States; and (C) Any account (whether discretionary or non-discretionary) of a U.S. person." We take no position on the substance of the "U.S. person" definition itself.

As a general matter, we strongly support an internationally coordinated approach to regulation that ensures consistent regulation, reflects the global nature of the derivatives markets and promotes competition and innovation. Therefore, we greatly appreciate and support that the Commission has "gathered information about foreign regulatory reform efforts and [has] discussed the possibility of conflicts and gaps, as well as inconsistencies and duplications, between U.S. and foreign regulatory regimes".[10] We also appreciate that, in developing the Proposed Rules, the Commission took into consideration the public comments submitted in response to the Commodity Futures Trading Commission's ("**CFTC**") proposed interpretive guidance on cross-border issues as well as the views of other international regulators.[11]

We recognize that there are differences between the Commission's proposed approach and the CFTC's final guidance,[12] and we expect that other international regulators will similarly issue proposals related to the cross-border application of their regulations.[13] Thus, in light of the global nature of the derivatives market, we urge continued harmonization with the CFTC and other regulatory authorities with respect to the extraterritorial scope of all these regimes. In particular, we encourage international coordination of substituted compliance[14] regimes to ensure appropriate recognition of comparable regulations, create practical and administrable frameworks, and alleviate duplicative regulation. In this context, we believe that it is essential for the Commission to provide substituted compliance in respect of all transaction-level requirements for U.S. and non-U.S. persons transacting within the United States.

II. Transaction Conducted within the United States

The Proposed Rules incorporate the concept of a "transaction conducted with the United States",[15] which the Commission uses to determine whether SBS activities create a sufficient

[10] Proposed Rule Release at 30975.

[11] *See id.* at 30974-5. *See also* CFTC "Proposed Interpretive Guidance and Policy Statement on Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act", 77 Fed. Reg. 41214 (July 12, 2012), available at: http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16496.pdf; and CFTC "Further Proposed Guidance Regarding Compliance with Certain Swap Regulations", 78 Fed. Reg. 909 (January 7, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-01-07/pdf/2012-31734.pdf.

[12] *See* CFTC final "Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations", 78 Fed. Reg. 45292 (July 26, 2013), available at: http://www.gpo.gov/fdsys/pkg/FR-2013-07-26/pdf/2013-17958.pdf.

[13] For example, on July 17, 2013, the European Securities and Markets Authority issued a consultation paper on "Draft Regulatory Technical Standards on contracts having a direct, substantial and foreseeable effect within the Union and non-evasion of provisions of EMIR" related to the European Market Infrastructure Regulation, available at: http://www.esma.europa.eu/system/files/2013-892_draft_rts_of_emir.pdf.

[14] *See* Proposed Rule Release at 31085, where the Commission describes how under a Commission substituted compliance determination, a person would be able to satisfy relevant requirements in the Securities Exchange Act of 1934, as amended ("**Exchange Act**"), by substituting compliance with corresponding requirements under a foreign regulatory system.

[15] *See id.* at 31207, proposed §240.3a71–3(a)(5)(i) defining "transaction conducted with the United States" to mean any "security-based swap transaction that is solicited, negotiated, executed, or booked within the United States, by

U.S. nexus such that the various Commission SBS rules should apply.[16] We appreciate the difficulty that the Commission has in ensuring that it prevents market participants from structuring themselves or their trading activities to evade the Title VII requirements,[17] and thus, we agree with the necessity of using this notion as part of determining the obligation to register as a security-based swap dealer ("**SBSD**"). However, we are concerned in certain instances about the practicability of this concept, as it relates to determining the applicability of the transaction-level requirements to SBS transactions.

In particular, private funds that are not U.S. persons would need to determine whether their SBS transactions are subject to the Proposed Rules and related Commission requirements. To make such a determination, a private fund would need to know whether its counterparty "solicited, negotiated, executed or booked" the transaction within the United States. Further, as this standard does not incorporate any materiality threshold, activity in the United States that is purely incidental or immaterial to the transaction may result in the non-U.S. person counterparties having to comply with the relevant Commission rules.[18] We believe that such purely incidental or immaterial United States contact alone should not subject a transaction to the full panoply of Commission SBS rules.

We appreciate that, to address these practical issues, the Commission permits a market participant to rely on "a representation from its counterparty that the transaction is not solicited, negotiated, executed, or booked within the United States by or on behalf of such counterparty, unless such person knows that the representation is not accurate."[19] We agree that, in the event a private fund is able to obtain such a representation from its SBSD counterparty, the Commission's willingness to permit such reliance largely mitigates our concerns. However, we are concerned that it may be difficult for a market participant to know with certainty whether any such United States activity has occurred, and we are uncertain whether SBSDs will be willing to provide such representations to their private fund counterparties. As a result, market participants could be at risk of being in violation of Dodd-Frank and/or the Commission rules, even if the market participant was in good faith seeking to comply with the Commission regulations applicable to its SBS trading activities.

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or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty to the transaction."

[16] *See id*., §240.3a71–3; at 31208-9, proposed §240.3Ca–3 and §240.3Ch–1; and at 31215, proposed §242.908. The Proposed Rules count each "transaction conducted within the United States" towards: (1) the *de minimis* threshold in the security-based swap dealer definition, and (2) determining the application of the mandatory clearing, mandatory trade execution and the reporting and dissemination obligations.

[17] *See id*. at 30987, where the Commission discusses that Section 30(c) of the Exchange Act permits it "to impose prophylactic rules intended to prevent possible evasion, even if they affect both evasive and non-evasive conduct".

[18] Such incidental contact may occur, for example, if an SBSD employee based in London is negotiating a transaction with a private fund, and during the course of the employee's travels to the United States, continues such negotiation.

[19] *See id*. at 31207, proposed §240.3a71–3(a)(5)(ii).

We also understand that, even if the "transaction conducted within the United States" standard initially results in the Commission rules applying to an SBS transaction, the Commission has proposed a broad substituted compliance regime. We agree that the Commission's flexibility and willingness to recognize "a foreign regulatory system [that] achieves comparable regulatory outcomes"[20] is a critical component of the Proposed Rules. Moreover, we want to be clear that, in raising our practical concerns, we are not expressing a view as to whether the Commission should retain or eliminate the concept of a "transaction conducted within the United States". Rather, as the Commission finalizes its cross-border rules, we ask it to be mindful of these legitimate, practical issues for market participants, and seek to reduce these burdens, to the extent possible, if the Commission preserves this approach.

III. Substituted Compliance

We generally support the breadth and flexibility of the Commission's proposed substituted compliance regime, although we believe that the Commission should extend it to all transaction-level requirements that apply to U.S. and non-U.S. persons. We understand the need to ensure that, where a market participant's SBS activities have a U.S. nexus, the Commission is following Congress's mandate under Dodd-Frank[21] to subject that market participant and/or its SBS transactions to adequate Commission regulation. However, it is increasingly evident that the scope of various U.S. and international derivatives reforms will, to a certain extent, be duplicative. Therefore, we appreciate the Commission's recognition of this issue and its effort to construct a thoughtful solution to resolve any potential regulatory conflicts thereby preventing the derivatives markets from being impaired.[22]

We agree with the Commission's proposed approach of determining substituted compliance by analyzing the regulatory outcomes of the foreign jurisdiction's framework across four distinct categories of requirements.[23] A line-by-line or rule-by-rule analysis of each country's regulations would place a significant burden on the Commission, and potentially result in disjointed regulation. Similarly, reviewing another country's derivatives regime as a whole and determining whether the regime is comparable in its entirety could result in the Commission determining that a jurisdiction's regime is not comparable to the Commission's regulation, even though the deficiency may exist only in one regulatory area. As a result, we think the four-category approach in the Proposed Rules strikes an appropriate balance between recognizing "that foreign regulatory systems differ in their approaches to achieving particular regulatory outcomes"[24] and ensuring appropriate regulation of cross-border activities where a "foreign

[20] *Id*. at 30975.

[21] *See id*. at 30982, where the Commission summarizes the scope of Title VII's application to cross-border SBS activity.

[22] *See id*. at 30975.

[23] *See id*. at 31085, where the Commission lists the four categories as: (1) requirements applicable to registered SBSDs; (2) requirements relating to regulatory reporting and public dissemination of SBS information; (3) requirements relating to clearing for SBS; and (4) requirements relating to trade execution for SBS.

[24] *Id*.

jurisdiction has not enacted comprehensive regulation . . . or is still in the process of implementing regulatory reforms".[25]

We commend the Commission's attempt to strike a balance between regulating SBS activities that have a U.S. nexus and ensuring that market participants are not subject to duplicative and/or conflicting regulatory requirements under U.S. and international derivatives reforms, and note that overseas regulators are similarly working to address these issues.[26] We are concerned, however, that the Commission's approach unduly limits the situations in which substituted compliance is possible. For example, under the Proposed Rules, substituted compliance would not be available in respect of trade execution requirements when a U.S. SBSD conducts an SBS transaction within the U.S. with a non-U.S. person.[27]

We believe that the Commission should ensure that its final rules allow market participants to seek substituted compliance in respect of all applicable transaction-level requirements. This flexibility will ensure that, as other jurisdictions implement comparable transaction-level requirements, including in respect of trade execution as well as regulatory and public reporting, the Commission is able to grant substituted compliance, thereby preventing unnecessary duplication where the scope of its regulations overlaps with that of another regulator with comparable requirements.[28]

For the avoidance of doubt, we confirm that we are not seeking to preempt the Commission's substituted compliance determination. We recognize that, ultimately, the Commission alone issues determinations of comparability, and that any Commission determination is subject to modification or withdrawal by the Commission (after "appropriate" notice and opportunity for comment).[29] Hence, although a market participant is able to apply for substituted compliance, we appreciate that the Commission is under no obligation to issue a positive determination, if it is not satisfied that the relevant jurisdiction's regulations have met the necessary requirements.

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[25] *Id*. at 31086.

[26] *See* the letter from the European Commission to the European Securities and Markets Authority, "Revised request for ESMA technical advice on the equivalence between third country legal and supervisory frameworks and the Regulation No.648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)", dated 13 June 2014, available at: http://www.esma.europa.eu/system/files/2013_14_june_2013_letter_esma.pdf.

[27] *See id*. at § 240.3Ca-3(b) and § 240.3Ch-1(b).

[28] For example, the European Union will put in place trade execution requirements under the legislative proposals to amend the Markets in Financial Instruments Directive (2004/39/EC) ("**MiFID**"). These consist of a Directive on markets in financial instruments repealing Directive 2004/39/EC ("**MiFID II**") and a Regulation on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories ("**MiFIR**"). On 18 June 2013, the Presidency of the Council of the European Union (the "**Council**") agreed a *general approach* to MiFID II, available at: http://register.consilium.europa.eu/pdf/en/13/st11/st11007.en13.pdf, and a general approach to MiFIR, available at: http://register.consilium.europa.eu/pdf/en/13/st11/st11007.en13.pdf. Trialogues between the European Parliament, European Commission and the Council have now commenced. The European Commission is likely to agree to the final texts of both MiFID II and MiFIR in early 2014.

[29] *See id*. at § 240.3a71-5(a)(4) and § 240.3Ch-2(a)(4)

In short, by extending the scope of substituted compliance to all market participants, irrespective of their "U.S. person" status, and to all regulatory categories, including trade execution requirements, the Commission would mitigate the risk of duplicative and/or conflicting regulatory requirements, without curtailing the reasonable application of Title VII of Dodd-Frank to relevant market participants.

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We thank the Commission for the opportunity to provide comments on the Proposed Rules. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact Stuart J. Kaswell or Carlotta King of MFA at (202) 730-2600 and Jiří Król, Adam Jacobs or Wesley Lund of AIMA at +44 (0) 20 7822 8380 with any questions the Commission or its staff might have regarding this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel
Managed Funds Association

/s/ Adam Jacobs

Adam Jacobs
Director, Head of Markets Regulation
Alternative Investment Management Association

cc: The Hon. Mary Jo White, Chair
The Hon. Luis A. Aguilar, Commissioner
The Hon. Daniel M. Gallagher, Commissioner
The Hon. Kara M. Stein, Commissioner
The Hon. Michael S. Piwowar, Commissioner