



July 13, 2015

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

Brent Fields  
Secretary  
Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

**Re: Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected With a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent (File Number S7-06-15)**

Dear Mr. Fields:

Managed Funds Association (“MFA”)<sup>1</sup> welcomes the opportunity to provide comments to the Securities and Exchange Commission (“Commission”) on its proposed rules on “Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected With a Non-U.S. Person’s Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent” (the “Proposed Rules”).<sup>2</sup> We appreciate the Commission’s careful consideration of the comments it received on its initial proposed cross-border rule,<sup>3</sup> and we support the Commission’s decision to consider and solicit further comment on its proposed treatment of “transactions conducted within the United States”. We applaud the Commission for employing such a measured and thoughtful approach to addressing the cross-border application of Title VII of the Dodd-Frank Wall Street

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<sup>1</sup> 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.

<sup>2</sup> 80 Fed. Reg. 27444 (May 13, 2015), available at: <http://www.gpo.gov/fdsys/pkg/FR-2015-05-13/pdf/2015-10382.pdf> (“Proposed Rule Release”).

<sup>3</sup> Commission 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”, 78 Fed. Reg. 30968 (May 23, 2013), available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf> (“Commission’s Initial Proposed Rules”).

Reform and Consumer Protection Act (“**Dodd-Frank Act**”)<sup>4</sup> to security-based swap (“**SBS**”) activities.

We generally support the Commission’s approach to cross-border regulation of the SBS market because it balances the need to regulate market participants whose trading activities affect the U.S. derivatives markets and the need to prevent regulatory duplication and conflicts. In particular, we support the final “U.S. person” definition and approach to substituted compliance that the Commission has implemented.<sup>5</sup> With respect to the Proposed Rules, to assist the Commission with further striking the balance between these core goals, MFA:

- (1) Emphasizes the need for the Commission, the Commodity Futures Trading Commission (“**CFTC**”), and the Prudential Regulators<sup>6</sup> to work together to adopt a single, harmonized, U.S. approach to cross-border derivatives regulation. In particular, MFA urges all U.S. regulators to adopt the Commission’s “U.S. person” definition as it applies to investment funds for purposes of their Title VII rules;
- (2) Urges the Commission to apply its SBS clearing and trade execution rules to SBS transactions between two non-U.S. persons, where at least one of the persons is a registered SBS dealer, that are arranged, negotiated, or executed by personnel of such persons (or personnel of an agent) located in a U.S. branch or office (“**U.S. Arranged SBS**”).

## **I. Adopting a Single, Harmonized, U.S. Approach to Cross-Border Regulation**

MFA requests that the Commission work with the CFTC, and the Prudential Regulators<sup>7</sup> to adopt a single, harmonized, U.S. approach to cross-border derivatives regulation.

MFA strongly supports the Commission’s efforts to implement a rational and proportionate approach to the extraterritorial application of its SBS rules that “reflect the global nature of the security-based swap market and its development prior to the enactment of the Dodd-Frank Act”.<sup>8</sup> We also appreciate that, in developing the Proposed Rules, the Commission

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

<sup>5</sup> See Commission final rules; interpretation on “Application of ‘Security-Based Swap Dealer’ and ‘Major Security-Based Swap Participant’ Definitions to Cross-Border Security-Based Swap Activities”, 79 Fed. Reg. 39068 (July 9, 2014), available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-07-09/pdf/2014-15337.pdf> (“**Commission’s Final Cross-Border Rules**”).

<sup>6</sup> The prudential regulators are collectively the following five agencies: the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency.

<sup>7</sup> The prudential regulators are collectively the following five agencies: the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Farm Credit Administration, and the Federal Housing Finance Agency.

<sup>8</sup> Proposing Release at 27446.

consulted and coordinated with the CFTC, the Prudential Regulators, and foreign authorities.<sup>9</sup> However, after reviewing the Proposed Rules, we are concerned about the material substantive differences among the various U.S. derivatives cross-border proposals, including the Proposed Rules, the Commission’s Final Cross-Border Rules, the CFTC final interpretive guidance,<sup>10</sup> the CFTC advanced notice of proposed rulemaking on cross-border application of its uncleared margin rules,<sup>11</sup> and the Prudential Regulators’ proposed rules regarding the cross-border application of its uncleared margin rules.<sup>12</sup>

Each of these proposals addresses the cross-border application of rules that govern the U.S. derivatives market under Title VII of the Dodd-Frank Act. However, each proposal also contains substantive differences from the others. For example, each of the Commission, CFTC, and the Prudential Regulators have proposed or adopted a term that effectively defines what constitutes a “U.S. person” for purposes of their Title VII rules. However, the persons and entities captured under each regulator’s definition differ from each other.<sup>13</sup> In the aggregate, the differences among these various U.S. cross-border proposals are problematic because, despite the Commission, CFTC, and Prudential Regulators seeking to implement the mandates of the Dodd-Frank Act in respect of the same U.S. derivatives market, it remains possible that each U.S. regulator will adopt a final cross-border approach that is different in its scope and practical application.

Differences among U.S. regulators as to the cross-border scope of their regulations will lead to different regulatory outcomes. This problem is particularly the case with respect to the credit default swap (“CDS”) market. Specifically, given the close economic correlation between the single-name CDS market regulated by the Commission and the CDS index market regulated by the CFTC, and the fact that many market participants maintain portfolios that include both sets of instruments, it is important that there is consistent regulation of the CDS market by U.S. regulators.

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<sup>9</sup> *See id.*

<sup>10</sup> *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> (“**CFTC’s Final Guidance**”).

<sup>11</sup> *See* CFTC proposed rule and advance notice of proposed rulemaking on “Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants”, 79 Fed. Reg. 59898 (Oct. 3, 2014), available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-10-03/pdf/2014-22962.pdf> (“**CFTC’s Uncleared Margin Rules**”).

<sup>12</sup> *See* Prudential Regulators’ proposed rules on “Margin and Capital Requirements for Covered Swap Entities”, 79 Fed. Reg. 57348 (Sept. 24, 2014), available at: <http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf> (“**Prudential Regulators’ Proposed Rules**”).

<sup>13</sup> *See* Commission’s Final Cross-Border Rules at 39161, §240.3a71–3(a)(4), which defines as a “U.S. person”, among other persons, investment funds that are organized in the U.S. or have a U.S. principal place of business. *See* CFTC’s Final Guidance at 45316-7, which defines as a “U.S. person”, among other persons, investment funds organized in the U.S., with a U.S. principal place of business, or with majority U.S. person ownership. *See* Prudential Regulators’ Proposed Rules at 57395, which uses the term “foreign non-cleared swap or foreign non-cleared security-based swap”, rather than “U.S. person”, and defines it to exclude, among other swaps, any covered swap where neither party is organized in the U.S.

Therefore, MFA emphasizes the need for the Commission and its U.S. counterparts collectively to develop a single, harmonized, U.S. approach to cross-border derivatives regulation. In some areas, we think achieving such harmonization would necessitate the CFTC and the Prudential Regulators adopting parts of the Commission's cross-border SBS approach. For example, as an initial matter, MFA urges all U.S. regulators to align the Commission's "U.S. person" definition as it applies to investment funds for purposes of their Title VII rules.<sup>14</sup> We believe that by including investment funds organized in the U.S. or with a U.S. principal place of business, but not investment funds that solely have majority U.S. person ownership, the Commission's "U.S. person" definition reflects appropriate consideration of which investment funds have a substantial U.S. nexus. To that end, we have urged the CFTC and Prudential Regulators to align their respective definitions to harmonize them with the Commission's definition.<sup>15</sup>

However, in other areas, such as with respect to the treatment of U.S. Arranged SBS (as discussed further below), we think harmonization necessitates that the Commission adopt the CFTC's approach and apply the Commission SBS clearing and trade execution rules to U.S. Arranged SBS.

## **II. Transactions Arranged, Negotiated, or Executed in the United States**

In the Proposed Rules, the Commission determines which of its SBS rules will apply to transactions between two non-U.S. persons, where at least one of the persons is a registered SBS dealer, based on whether the transaction is "arranged, negotiated, or executed" by personnel of such persons (or personnel of an agent) located in a U.S. branch or office.<sup>16</sup> However, in the Proposed Rules, the Commission proposes to exclude such U.S. Arranged SBS entirely from the SBS mandatory clearing and trade execution rules.<sup>17</sup> MFA strongly urges the Commission to apply its SBS clearing and trade execution rules to U.S. Arranged SBS to: (1) further the goal of developing a single, harmonized U.S. cross-border derivatives approach; (2) promote trading on security-based swap execution facilities ("SBSEFs"); (3) create a level competitive playing field; and (4) prevent the entrenchment of a two-tier SBSEF market.

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<sup>14</sup> MFA notes that it is supportive of the CFTC guidance as to what constitutes a "principal place of business" with respect to investment funds.

<sup>15</sup> See MFA letter to the CFTC on the CFTC's Uncleared Margin Rules (Dec. 2, 2014), at 22-23, available at: <https://www.managedfunds.org/wp-content/uploads/2014/12/MFA-Letter-to-CFTC-re-Margin-Letter.pdf>. See also MFA letter to the Prudential Regulators on the Prudential Regulators' Proposed Rules (Nov. 24, 2014), at 20-22, available at: <https://www.managedfunds.org/wp-content/uploads/2014/11/MFA-Letter-Prudential-Regulators-Margin-Proposal1.pdf>.

<sup>16</sup> See Proposed Rule Release at 27510, §240.3a71-3, defining the "U.S. business" of a foreign security-based swap dealer to include "any security-based swap transaction arranged, negotiated, or executed by personnel of the foreign security-based swap dealer located in a U.S. branch or office, or by personnel of an agent of the foreign security-based swap dealer located in a U.S. branch or office".

<sup>17</sup> See *id.* at 27511, §240.3a71-5.

### A. Aligns with CFTC Approach

Requiring U.S. Arranged SBS to be subject to the Commission's clearing and trade execution mandates would harmonize the Proposed Rules with CFTC Staff Advisory 13-69,<sup>18</sup> and thus, with the CFTC cross-border approach in its CFTC's Final Guidance.

As the Commission recognizes in the Proposed Rule Release,<sup>19</sup> on November 14, 2013, the CFTC's Division of Swap Dealer and Intermediary Oversight ("**DSIO**") issued the CFTC Staff Advisory clarifying the CFTC's Final Guidance and the applicability of the CFTC's transaction-level requirements<sup>20</sup> to swaps between two non-U.S. persons ("**CFTC's Staff Advisory**"). In the CFTC's Staff Advisory, DSIO stated its belief that, pursuant to the Dodd-Frank Act, the CFTC "has a strong supervisory interest in swap dealing activities that occur within the United States, regardless of the status of the counterparties".<sup>21</sup> DSIO believed that persons regularly arranging, negotiating, or executing swaps for or on behalf of a swap dealer ("**SD**") are performing core activities of that SD's dealing business.<sup>22</sup> Therefore, in DSIO's view, the CFTC's transaction-level requirements would apply to a non-U.S. SD regularly using U.S. personnel or agents to arrange, negotiate, or execute a swap with a non-U.S. person.<sup>23</sup>

The CFTC has since solicited public comments on the CFTC's Staff Advisory,<sup>24</sup> and because some commenters raised concerns with the CFTC's transaction-level requirements applying to the conduct of non-U.S. persons within the United States, in the Proposed Rules, the Commission has determined to diverge from the CFTC's approach.<sup>25</sup> In the Proposed Rule Release, the Commission provides that "a key objective of the clearing requirement is to mitigate systemic and operational risk in the United States, but the counterparty credit risk and operational risk of such transactions reside primarily outside the United States".<sup>26</sup> Therefore, the Commission believes that "subjecting such security-based swaps to the clearing requirement

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<sup>18</sup> CFTC Staff Advisory 13-69, *Division of Swap Dealer and Intermediary Oversight Advisory: Applicability of Transaction-Level Requirements to Activity in the United States* (Nov. 14, 2013), available at: <http://www.cftc.gov/ucm/groups/public/@llettergeneral/documents/letter/13-69.pdf> ("**CFTC's Staff Advisory**").

<sup>19</sup> See Proposed Rule Release at 27447, 27458-9, 27461-3, and 27480-1.

<sup>20</sup> See CFTC's Final Guidance at 45333, where the CFTC provides that the transaction-level requirements include: (1) required clearing and swap processing; (2) margining and segregation for uncleared swaps; (3) mandatory trade execution; (4) swap trading relationship documentation; (5) portfolio reconciliation and compression; (6) real-time public reporting; (7) trade confirmation; (8) daily trading records; and (9) external business conduct standards.

<sup>21</sup> See CFTC's Staff Advisory at 2.

<sup>22</sup> See *id.*

<sup>23</sup> See *id.*

<sup>24</sup> See CFTC Extension of No-Action Relief: Transaction-Level Requirements for Non-U.S. Swap Dealers, CFTC Letter No. 14-140 (Nov. 14, 2014), available at: <http://www.cftc.gov/ucm/groups/public/@llettergeneral/documents/letter/14-140.pdf>.

<sup>25</sup> See Proposed Rule Release at 27481.

<sup>26</sup> *Id.*

would not significantly advance what we view as a key policy objective of the clearing requirement applicable to security-based swaps under the Dodd-Frank Act”<sup>27</sup>.

MFA respectfully disagrees with the Commission. We do not agree that the counterparty credit risk and operational risk of U.S. Arranged SBS resides primarily outside the U.S. As Commissioner Stein recognized with respect to SBS arranged outside of the U.S. (“**Non-U.S. Arranged SBS**”), “the U.S. is such an important market center, and the swaps marketplace is so interconnected. Are there really many situations in which swaps booked abroad would actually pose no risk to the United States?”<sup>28</sup> Therefore, if such Non-U.S. Arranged SBS create credit and operational risk in the U.S. and for the U.S. market, transactions arranged in the U.S. (*i.e.*, U.S. Arranged SBS) have greater risk for the U.S. market. In addition, we believe that the policy objectives related to central clearing go far beyond the goals of mitigating counterparty credit risk and operational risk. In particular, central clearing is important because it: (1) increases transparency of the derivatives market; (2) enhances market integrity and oversight; (3) increases access to the markets by creating lowers barriers to entry; (4) levels the competitive playing field; and (5) facilitates access to trading on SBSEFs and other trading venues.

MFA also emphasizes that, in the Dodd-Frank Act, Congress expressed another key objective, which was to harmonize derivatives regulation<sup>29</sup> and “to promote effective and consistent global regulation of swaps and security-based swaps”.<sup>30</sup> Since the U.S. derivatives market represents a substantial portion of the global derivatives market, U.S. regulatory harmonization (*e.g.*, Commission and CFTC harmonization) is an important and necessary first step towards achieving Congress’ goal of global harmonization. As mentioned previously, such a harmonized approach is especially important in the CDS market. In addition, as discussed further below, proceeding with the Commission’s proposed treatment of U.S. Arranged SBS (rather than the CFTC’s approach) would perpetuate the existence of a two-tier SBSEF market and harm liquidity in the SBS market. Therefore, to facilitate U.S. harmonization and to eliminate any negative impact of the Proposed Rules on the SBSEF market, MFA requests that the Commission adopt the CFTC’s Staff Advisory cross-border approach by applying the SBS clearing and trade execution requirements to U.S. Arranged SBS.

## **B. Prevents Persistence of Two-Tier SBSEF Market**

MFA has substantial concerns about the Commission’s proposed treatment of U.S. Arranged SBS under the Proposed Rules because it would significantly impair liquidity and undermine market structure evolution in the U.S. SBS market. This impairment would be due, in

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<sup>27</sup> *Id.*

<sup>28</sup> Commissioner Kara M. Stein, *Statement on Proposed Rules for U.S. Personnel and Certain Activities of Non-U.S. Person’s Security-Based Swaps Dealing* (Apr. 29, 2015), available at: <http://www.sec.gov/news/statement/stein-statement-on-proposed-security-based-swaps-dealing.html>.

<sup>29</sup> §719(c)(1) of the Dodd-Frank Act, requiring the CFTC and Commission to conduct a jointly study an areas of swap regulation that could be harmonized.

<sup>30</sup> §752(a) of the Dodd-Frank Act.

large part, to how the Proposed Rules would affect the regulation of the inter-dealer market. MFA fears that the Proposed Rules would shift inter-dealer markets outside the U.S., undermine the Dodd-Frank Act's impartial access requirements, and exacerbate the persistence of a two-tiered market for SBS.<sup>31</sup>

By way of background, the OTC derivatives markets have historically operated as a "two-tier" market, where a select group of dealers transact with each other on exclusive "dealer-only" trading platforms, commonly referred to as the "inter-dealer" or "D2D" market. Such inter-dealer trading platforms deny access to all non-dealer market participants, including customers (*e.g.*, investment funds, insurance companies, corporations). Therefore, customers are only able to trade with a select group of dealers either bilaterally or on a limited number of "dealer-to-customer" or "D2C" trading platforms.

As noted, the Proposed Rules incorporate the concept of SBS transactions "arranged, negotiated, or executed" in the U.S., and exclude U.S. Arranged SBS from the Commission's SBS clearing and trade execution rules.<sup>32</sup> However, the Proposed Rules become problematic when applied to the inter-dealer market. A significant amount of the SBS market activity occurs between two dealers on the inter-dealer market, where inter-dealer brokers facilitate SBS trading. Of this inter-dealer activity, a significant amount is arranged, negotiated, or executed by dealer counterparties through legal entities that are outside of the U.S. As Chair White noted "some of the most significant non-U.S. dealers are in fact part of U.S.-based financial groups."<sup>33</sup> Thus, even though the legal entity that is the "counterparty" to the SBS in many cases is a registered non-U.S. SBS dealer, many of the trading decisions are made, and much of the trading activity occurs, with respect to the SBS within the U.S.<sup>34</sup>

Because the Commission proposes to consider only the jurisdiction of organization of the two non-U.S. counterparties and not where the counterparties arrange, negotiate, and/or execute the SBS, the Proposed Rules would exclude the aforementioned activity from the Commission's SBS clearing and trade execution rules. Since this activity represents a substantial percentage of

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<sup>31</sup> MFA notes that we have similarly raised our concerns with the CFTC and EU regulators about regulatory and structural issues that perpetuate the existence of a two-tier trade execution market. *See e.g.*, MFA response to Her Majesty's Treasury on its consultation on "Transposition of the Markets in Financial Instruments Directive II" (June 18, 2015, available at: [https://www.managedfunds.org/wp-content/uploads/2015/06/MFA-Responses-to-HMT-Consultation-on-MiFID-II-Implementation.final\\_6.18.151.pdf](https://www.managedfunds.org/wp-content/uploads/2015/06/MFA-Responses-to-HMT-Consultation-on-MiFID-II-Implementation.final_6.18.151.pdf)); MFA Position Paper: Why Eliminating Post-Trade Name Disclosure Will Improve The Swaps Market (Mar. 31, 2015), available at: <https://www.managedfunds.org/wp-content/uploads/2015/04/MFA-Position-Paper-on-Post-Trade-Name-Disclosure-Final.pdf>;

<sup>32</sup> *See supra* note 16 and 17.

<sup>33</sup> Chair Mary Jo White, *Statement at Open Meeting on Cross-Border Security-Based Swap Rules Regarding Activity in the United States and Pay Versus Performance* (Apr. 29, 2015), available at: <http://www.sec.gov/news/statement/statement-at-open-meeting-april-29-2015.html>.

<sup>34</sup> MFA notes that it is also common for two traders, each who are part of a U.S.-based financial group and each of who are physically located in the U.S., to conduct a trade with each other but arrange, negotiate, and/or execute that trade through their non-U.S. SBS dealer entity.

U.S. SBS activity, the permanent exclusion of this activity from the clearing and trade execution requirements effectively eviscerates these requirements and harms the U.S. SBS market and other SBS market participants, including buy-side firms.

Of particular concern is that, by excluding this inter-dealer activity from the Commission's SBS trade execution requirement, this activity will never be brought onto SBSEFs. Therefore, when the Commission determines to proceed with its clearing and trading requirements, all buy-side customers that are "U.S. persons" and obligated to trade on SBSEFs, would have access only to a narrow liquidity pool. Because this exclusion severely disadvantages the U.S. buy-side community, harms their investors, and limits their access to best execution, this exclusion perpetuates the legacy two-tier SBSEF structure of the SBS market and circumvents the Dodd-Frank Act provisions that ensure that buy-side market participants have impartial access to trading venues for SBS.

As the Commission correctly highlights in the Proposed Rule Release:

"To the extent that the large inter-dealer market shifts in significant part to non-U.S. dealers as a result of current rules, security-based swap activity in the United States could consist of one very large pool of transactions unregulated under Title VII (inter-dealer trades, and transactions between dealers and non-U.S. person non-dealers) and one much smaller pool limited to transactions between dealers and U.S.-person counterparties. This fragmentation could adversely affect the efficiency of risk sharing among security-based swap market participants, as discussed further in Sections VI.B.4(a) and VI.B.4(b), below."<sup>35</sup>

In addition, Commissioners highlighted the potential negative implications that could arise from the proposed approach.

- Commissioner Piwowar noted, "I hope that we will receive comments from all relevant market participants, as these rules will impact not just the non-U.S. dealers operating under this model, but also their counterparties and U.S. competitors."<sup>36</sup>
- Commissioner Stein stated, "if the transactions governed by today's proposed rules are swept out of the U.S. SEF execution requirement, that could result in an unfortunate loss of liquidity for U.S. SEFs. It seems to me that we risk losing some, or even all, interdealer liquidity from the U.S. SEF marketplace."<sup>37</sup>
- Commissioner Stein also noted that:

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<sup>35</sup> Proposed Rule Release at 22.

<sup>36</sup> Commissioner Michael S. Piwowar, *Statement at Open Meeting on Cross-Border Security-Based Swap Rules Regarding Activity in the United States* (Apr. 29, 2015), available at: <http://www.sec.gov/news/statement/statement-cross-border-security-based-swap-rules.html>.

<sup>37</sup> See *supra* note 28.

“Conceptual challenges also exist with regards to the requirement that standardized security-based swaps trade generally through a swap execution facility (SEF). The goal of that requirement is to pool liquidity and facilitate efficient trading, including through pre-trade price transparency. Clearly, where a security-based swap is being arranged, negotiated, or executed by U.S. personnel, price discovery is occurring in the United States. Today’s proposal recognizes our regulatory interests in that by requiring public dissemination. But if the transactions governed by today’s proposed rules are swept out of the U.S. SEF execution requirement, that could result in an unfortunate loss of liquidity for U.S. SEFs. It seems to me that we risk losing some, or even all, interdealer liquidity from the U.S. SEF marketplace.”<sup>38</sup>

MFA agrees with the Commission that purely incidental or immaterial U.S. contact alone should not subject an SBS transaction to the full panoply of Commission SBS rules.<sup>39</sup> However, as discussed above, in many cases the U.S. contact is not incidental or immaterial, such that a blanket exclusion of such SBS from U.S. clearing and trade execution rules is contrary to the goals of the Dodd-Frank Act cited by the Commission.<sup>40</sup> Congress designed the SBS market reforms under Title VII of the Dodd-Frank Act to produce a more competitive and transparent SBS market structure.<sup>41</sup> Because adoption of the Proposed Rules would stifle the Dodd-Frank requirements for impartial access to SBSEFs, it would exacerbate the entrenchment of a two-tier trading market structure, and thus, frustrate this Dodd-Frank Act goal.

Therefore, MFA urges the Commission to modify the Proposed Rules so that U.S. Arranged SBS are subject to the Commission’s SBS clearing and trade execution rules. This modification is critical to: (1) the elimination of the two-tier market; (2) the promotion of open, competitive, and fair market access to SBSEFs; and (3) the facilitation of all market participants’ access to the most beneficial pricing and liquidity possible in the derivatives markets.

### **C. Substituted Compliance Resolves Regulatory Conflicts**

MFA understands that regulatory conflicts could result from subjecting U.S. Arranged SBS to the Commission’s SBS clearing and trade execution rules. However, MFA does not believe that it is necessary to exclude these transactions from U.S. clearing and trade execution rules to resolve these conflicts. Rather, we are of the view that the Commission should resolve these conflicts through substituted compliance, and MFA supports the Commission’s proposed substituted compliance approach.

MFA recognizes that the Commission determined not to finalize a single, general substituted compliance rule, and instead will address the availability of substituted compliance as

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<sup>38</sup> *Id.*

<sup>39</sup> See Proposed Rule Release at 27467 and 27469.

<sup>40</sup> See *supra* note 26.

<sup>41</sup> See Dodd-Frank Act, §763(c).

part of its consideration of the cross-border application of the each final substantive SBS rule.<sup>42</sup> However, if in its final SBS clearing and trade execution rules, the Commission proceeds with the substituted compliance approach from the Commission's Initial Proposed Rules, substituted compliance might be available to many U.S. Arranged SBS. Under the Commission's Initial Proposed Rules, in almost all trades involving two non-U.S. persons, substituted compliance would be available from the clearing and trade execution rules if the SBS is subject to rules of another jurisdiction that the Commission has determined to be equivalent.<sup>43</sup>

MFA generally supports the breadth and flexibility of the Commission's proposed substituted compliance regime. 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.<sup>44</sup> 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 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. Therefore, we would support the Commission's application of this substituted compliance regime where equivalent clearing and trade execution requirements already apply to an SBS in another jurisdiction to resolve any regulatory conflicts that would arise from our recommended treatment of U.S. Arranged SBS.

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<sup>42</sup> See Commission's Final Cross-Border Rules at 39148.

<sup>43</sup> See Commission's Initial Proposed Rules at 31208, § 240.3Ca-3; *id.* at 31209, §240.3Ch-2; and *id.* at 31219-22.

<sup>44</sup> See *id.* at 31085, where the Commission lists the four categories as: (1) requirements applicable to registered SBSs; (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.

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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 Carlotta King or the undersigned at [REDACTED] 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

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