BETTER MARKETS

– FACT SHEET –

Elements of the CFTC's Proposed Cross-Border Regulations Facilitate Regulatory Arbitrage, If Not Evasion, of U.S. Law

On March 9, 2020, Better Markets filed a comment letter on the Commodity Futures Trading Commission's ("CFTC") proposed framework for applying the Dodd-Frank Act's swaps requirements to certain non-U.S. activities and non-U.S. persons having a direct and significant (1) connection with activities in U.S. commerce; or (2) effect on U.S. commerce.

Better Markets agrees with certain elements of the CFTC's complex and critically important proposal. However, numerous elements violate the Commodity Exchange Act's statutory commands to protect the safety and soundness of swap dealers, prevent disruptions to the integrity of derivatives markets, and preserve the stability of the U.S. financial system. **The most problematic elements of the proposal open avenues to avoiding, if not evading, U.S. derivatives markets reforms and therefore must be substantially revised, or withdrawn, in the public interest.**

Better Markets commented on the following select elements of the CFTC's present cross-border proposal:

- **Enforceability and Legal Reach of Title VII**: The CFTC's commendable decision to propose clearly enforceable cross-border regulations, as opposed to guidance, in conjunction with a proper legal interpretation of the CFTC's "broad" extraterritorial reach under CEA section 2(i).

- **Guaranteed Entities**: The CFTC's narrow proposed definition of "guarantee," which would exclude a host of financial arrangements between U.S. banks (and other U.S. legal entities) and non-U.S. legal entities. This definitional loophole could remove tens of thousands of swaps executed with U.S. financial support from the reach of U.S. law and perhaps result in de-registration of non-U.S. SDs posing risks to affiliated U.S. banks (and others) and the U.S. financial system.

- **Significant Risk Subsidiaries:** The CFTC's new proposed category of non-U.S. persons financially consolidated with a U.S. parent—the significant risk subsidiary ("SRS"). The proposed SRS tests for determining whether *sufficient* risk is presented to a U.S. parent, however, would exclude far too many (almost all) consolidated non-U.S. entities from the CFTC's oversight and would not address avoidance or evasion risks addressed by the "conduit affiliate" category it is proposed to replace.

- **Foreign Branch Activities Restrictions**: The CFTC's proposed deviation from its previous guidance relating to "swaps conducted through a foreign branch." The proposal fails to establish restrictions that reasonably separate functions and activities of foreign branches and associated U.S. banks, permitting booking practices that do not properly mitigate risks associated with swaps booked into foreign branches (which are themselves U.S. persons and present direct and significant risks to their associated U.S. banks and the U.S. financial system).

- **Swaps Arranged, Negotiated, or Executed through U.S.-Located Personnel**: The CFTC's proposed disregard of swaps arranged, negotiated, or executed on behalf of non-U.S. persons by U.S.-located persons, which would unlawfully exclude U.S. territorial activities from the reach of U.S. law and thereby facilitate avoidance, if not evasion, of the Dodd-Frank Act.

- **Global Dealing Aggregation:** The CFTC's proposed swap dealing aggregation requirement for global SD corporate groups, which would properly prevent avoidance or evasion of the de minimis threshold through intra-group structuring but suffers from proposed deficiencies in other aspects of the release that exclude dealing activities from the threshold.

- **Exchange-Trading Exception**: The CFTC's proposed exclusion of certain exchange-traded and cleared swaps from swap dealing de minimis calculations. The CFTC's proposal is conceptually reasonable but must be amended to limit the exclusion to swaps cleared and anonymously executed through regulated, transparent—and not exempted—trading and clearing intermediaries. In addition, the exclusion must require truly "anonymous" execution in which neither counterparty is disclosed pursuant to the unlawful practice of Post-Trade Name Give-Up (see our previous comment letter on that practice here).

- **Substituted Compliance:** The CFTC's proposed standard of review for comparability determinations, which provides the CFTC unreasonably broad, if not unlimited, discretion to consider, or not to consider, several factors in connection with assessments of foreign swaps regulatory frameworks.

The above issues are complex, but collectively present serious systemic risk issues that have the potential to jeopardize U.S. financial stability. With the U.S. well into its longest continuous economic expansion in modern history, the inevitable financial markets downturns, and eventual crises, ahead will undoubtedly expose any deficiencies in the adopted framework.

For this reason alone, the CFTC's proposal is not amenable to hurried rulemaking, designed to satisfy *political* objectives; it demands deliberate rulemaking, designed to satisfy systemic risk reduction and other *statutory* objectives. We hope the CFTC gives all comments due consideration and provides its staff and commissioners time for that deliberation, in particular as the proposal's policy judgments largely reverse and/or substantially amend the CFTC's 2013 cross-border policy statements and guidance and the previously proposed (but now withdrawn) 2016 cross-border regulations.

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