August 21, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE.
Washington, DC 20549–1090

Via agency website

Re: "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" / RIN 3235–AL25

The Coalition for Derivatives End-Users (the "Coalition") is pleased to respond to the request for comments by the Securities and Exchange Commission (the "Commission" or the "SEC") regarding its proposed rules and proposed interpretations under the Dodd-Frank Wall Street Reform and Consumer Protection Act[1] (the "Dodd-Frank Act") entitled *Cross-Border Security Based Swap Activities* (the "Proposal").

I. Introduction

The Coalition represents end-user companies that use derivatives predominantly to manage risks. Hundreds of companies have been active in the Coalition throughout the legislative and regulatory process, and our message is straightforward: Financial regulatory reform measures should promote economic stability and transparency without imposing undue burdens on derivatives end-users. Imposing unnecessary regulation on derivatives end-users, which did not contribute to the financial crisis, would create more economic instability, restrict job growth, decrease productive investment, and hamper U.S. competitiveness in the global economy.

Many end-user companies operate globally with numerous affiliates throughout the world. Accordingly, end-users frequently engage in cross-border derivatives transactions as part of their hedging programs. The Coalition is concerned that the Proposal would impose burdens and costs on end-users and end-user transactions without any corresponding regulatory benefit or prevention of systemic risk. We are also concerned that the term "conduit," as used in the CFTC's guidance and referenced by the SEC in the Proposal, could lead some end-users to move away from using a centralized treasury unit for executing their trades. Because centralized hedging has numerous benefits to end-user companies, including increased efficiency and reduced settlement risk, the Coalition urges the SEC not to consider an approach similar to the CFTC in defining "conduits."

Also, as a general matter, the Coalition represents all end-users and believes there is not a compelling reason to impose disparate cross-border requirements on financial and non-financial end-users. Financial end-users include pension plans, captive finance affiliates, mutual life insurance companies, and commercial companies with non-captive finance arms. Like nonfinancial

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[1] Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

end-users, these entities do not pose systemic risk to the financial system and use derivatives to hedge risks associated with their business.

The Coalition is pleased to offer comments focused on ensuring that the cross-border scope of the Dodd-Frank Act reflects legislative intent, does not impose undue burdens on the business community, and permits end-users to manage risks efficiently and effectively. We also want to note our appreciation that the SEC is proceeding with rulemaking according to the Administrative Procedures Act, rather than through the issuance of guidance. There are significant open questions, and getting the regulation wrong could have costly effects on the swaps market. Creating regulation through guidance, instead of a proposed rule, defeats one of the primary reasons for this effort: to provide greater regulatory certainty to market participants. By issuing a proposal and inviting public comment, the SEC has helped to promote greater regulatory certainty in the cross-border swaps market. That said, given the vagueness of some of the Proposal's provisions and the significant number of broad, information-gathering questions it poses, it seems likely that the rule will need to be re-proposed.

II. Avoid Conflicting Rules

We urge the SEC to take steps to avoid imposing costly conflicting rule regimes on the U.S. market, a decision that could otherwise result in increased regulatory and compliance costs without a corresponding decrease in systemic risk. The SEC

> "request[ed] comments generally on (i) the impact of any differences between the Commission and CFTC approaches to the application of Title VII to cross-border activities, including the application of registration requirements and the substantive requirements of Title VII, (ii) whether the Commission's proposed application of Title VII in the cross-border context should be modified to conform to the proposals made by the CFTC, and (iii) whether any cross-border interpretations proposed by the CFTC, but not proposed by the Commission (whether as interpretations or rules), should be adopted by the Commission."[2]

Conflicting regulatory regimes will lead to an inefficient financial system, increasing compliance costs without securing any further reductions in systemic risks. Accordingly, the SEC's proposed application and rules relating to the cross-border application of Title VII should ensure that such rules will not conflict with the guidance adopted by the CFTC. The SEC should also work closely with the CFTC when determining whether substituted compliance is applicable with respect to a particular jurisdiction. With respect to substituted compliance, the regulatory requirements of end-users operating globally depend on whether the SEC has made a comparability determination for the relevant non-U.S. jurisdiction. Conflicting regimes will lead to increased costs and unnecessary duplicative regulations which may be directly or indirectly imposed on derivatives end-users.

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[2] 78 Fed. Reg. 31102 (May 23, 2013).

III. "Conduit Affiliate" Concept Should Not Be Included

The concept of a "conduit affiliate" should not be included in the regulation of cross-border security-based swaps and, if it is, the concept should not include end-users. The SEC notes that "the CFTC has proposed an interpretation that includes a description of a 'conduit affiliate' … [that] would be subject to transaction-level requirements as if they were U.S. persons." The SEC asks "[s]hould the Commission consider a similar approach?"[3] We note that since the release of the Proposal, the CFTC has finalized its cross-border guidance that includes the concept of a "conduit affiliate."

The concept of a conduit affiliate is not based on statutory or regulatory authority, and does not decrease the potential for systemic risk. Moreover, including end-users within the "conduit affiliate" definition or applying the concept to end-user transactions does not advance the CFTC's stated goals for the concept, and would not advance the SEC's efforts to reduce systemic risk. Because end-users do not increase systemic risk, a non-U.S. end-user entity cannot increase the systemic risk exposure of its U.S. affiliates. Also, because end-users are already exempt from many Dodd-Frank Act requirements for their U.S. security-based swap transactions, there is little incentive for end-users to execute security-based swaps abroad for the purpose of avoiding Dodd-Frank Act requirements.

The Coalition raised this issue in 2012 in response to the CFTC's proposed interpretive guidance and policy statement regarding cross-border security-based swaps.[4] The concept of a "conduit affiliate" is not found in the Dodd-Frank Act or any implementing regulation, but, as noted in the Coalition's August 2012 comment letter, the CFTC "nonetheless create[d] a new type of regulated entity—the 'conduit' entity—in the Proposal." Because the CFTC recently finalized this concept in its final cross-border guidance,[5] the Coalition believes it is necessary to again raise this issue in response to the SEC's request for comment about replicating the CFTC's decision.

The Coalition is still of the position that the conduit concept should be rejected or, at a minimum, should exclude end-users and should not be applied to security-based swaps in which neither party is a security-based swap dealer or major security-based swap participant. Including any end-users in the "conduit affiliate" definition would not help achieve the U.S. regulators' stated goal of addressing the possible flow of risk to the United States. While the CFTC modified the

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[3] 78 Fed. Reg. 31024 (May 23, 2013).

[4] 77 Fed. Reg. 41213 (July 12, 2012). Comment 58510, Coalition for Derivatives End-Users, p.3-6 (Aug. 27, 2012).

[5] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, CFTC (July 2013) (hereinafter "CFTC Interpretive Guidance") http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister071213b.pdf

proposal's factors to clarify the meaning of "regularly entered into swaps," and added a control concept,[6] the "conduit affiliate" definition, as adopted in the final guidance, is still overly-broad and unnecessarily classifies many non-U.S. end-user affiliates as "conduit affiliates."

For example, a U.S. end-user may have majority ownership in a non-U.S. end-user entity where the non-U.S end-user entity executes swaps and security-based swaps with non-U.S. entities for commercial business reasons. The non-U.S. end-user entity then enters into internal swaps and security-based swap transactions with an affiliated U.S. end-user. For end-users, inter-affiliate trades serve to internally allocate risk—not to speculate, therefore creating risk. In effect, inter-affiliate trades are largely equivalent to inter-company loans, which merely shift capital and risk among entities in the same corporate group. Yet, under the CFTC's "conduit affiliate" definition, swap transactions entered into by the non-U.S. end-user referenced in the example above could be subject to increased regulatory requirements as compared to other non-U.S. entities operating in the same swaps market. These increased regulatory burdens could be placed on the non-U.S. end-user's swap and security-based swap transactions even though, because it is an end-user that is hedging or mitigating commercial risk, the non-U.S. end-user would not be increasing the systemic risk exposure of its U.S. affiliate. The non-U.S. end-user could thus face higher transaction costs when executing trades with non-U.S. persons, and some security-based swap dealers might well refuse to enter into security-based swaps with a non-U.S. end-user that is classified as a "conduit affiliate." As a result, the U.S. end-user and the non-U.S. end-user affiliates could face higher hedging costs and reduced hedging choice without any corresponding prevention of systemic risk to the U.S. financial system.

Many end-users execute a significant portion of their swap and security-based swap transactions through wholly-owned centralized treasury units.[7] In this common organizational model, the centralized treasury unit typically structures transactions to offset commercial risk for the parent company and its affiliates or follows specific hedging instructions from affiliated entities within a corporate group. From a risk perspective, the central hedging combines trade expertise and execution in a single entity. Although variation in the structure of trades exists, a hedging center typically serves as the primary market-facing entity for an end-user's entire corporate group, entering into hedge positions with unaffiliated security-based swap dealers to lay off commercial risk and entering into inter-affiliate trades internally with affiliated entities. Central hedging allows for the central hedging affiliate to manage risk across the entire corporate group, leading to

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[6] CFTC Interpretive Guidance at 250 (July 2013).

[7] Some end-users have central hedging units execute market-facing swaps and security-based swaps as an agent on behalf of the end-user (i.e., the swap or security-based swap is executed in the end-user's name). Other end-users have central hedging units execute market-facing swaps and security-based swaps as the principal (i.e., the swap or security-based swap is executed in the name of the central hedging unit). In both structures, the central hedging unit enters into internal, inter-affiliate trades in connection with the market-facing swap or security-based swap.

increased efficiency and more comprehensive risk management and has the added benefit of being able to net positions across an entire corporate group, which lowers the overall credit risk a corporate group poses to the market generally. The Coalition is concerned that non-U.S. centralized treasury units could be categorized as "conduit affiliates" and therefore could be disadvantaged when transacting with non-U.S. counterparties, as described above.

The Coalition believes that the regulation of inter-affiliate trades should square with a simple economic reality: these internal trades do not increase systemic risk. Thus, imposing requirements that are designed to address systemic risk on inter-affiliate trades would create costs without any corresponding benefit. We urge the SEC not to consider an approach similar to that of the CFTC regarding conduit affiliates.

IV. The Requirements Must Be Clear

The Proposal, in several places, includes vague or unclear provisions. Such provisions create regulatory uncertainty and deny the public the opportunity to comment on the proposed rule in an effective manner. For example, with regard to substituted compliance, the Proposal only sets forth vague criteria about how determinations will be made. Proposed section 240.3a71-5(a)(2) states that comparable determinations will be made "after taking into account such factors as the Commission determines are appropriate."[8] The SEC asks "How should the Commission evaluate whether a foreign system is 'comparable' for purposes of regulatory reporting and public dissemination?"[9] The SEC should conduct such evaluations based on a clear, defined set of criteria. While the SEC does suggest some factors that may be considered (e.g., scope and objectives of the foreign regulatory requirements), the failure to provide a complete list of factors that will be considered denies the public the opportunity to evaluate and comment on the regulation as it might apply to covered companies.

In both of these cases, as well as elsewhere in the Proposal, the lack of specific, defined factors denies the public the ability to comment directly on provisions that would be applied to regulated entities. This results in a less informed and responsive rulemaking process and also potentially creates a rule regime that is inefficient, more costly to comply with, and increases business planning difficulties.

V. SEC Should Conduct a Full Cost-Benefit Analysis

The Proposal addresses a long list of items in its cost-benefit analysis, yet appears to avoid discussing the additional costs it would impose on the market by drafting rules that conflict with existing cross-border swaps and security-based swaps rule regimes. Moreover, the SEC seems to be aware that by imposing conflicting rules it will create additional negative economic effects, but

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[8] 78 Fed. Reg. 31207 (May 23, 2013).

[9] 78 Fed. Reg. 31096 (May 23, 2013).

nevertheless chooses not to conduct a cost-benefit analysis of the decision. In the economic analysis section of the proposal, the SEC:

> "seeks comment on the expected economic effects of the interplay between our rules and those [adopted/proposed] by the CFTC. In particular, to the extent that the Commission's proposed rules and interpretations take a different approach from the CFTC's approach to the application of Title VII requirements in the cross-border context, what would be the economic impact, including the costs and benefits, of these differences on market participants and the U.S. security-based swap market as a whole? What effect would such differences have on efficiency, competition and capital formation in the U.S. security-based swap market? Commenters should provide analysis and empirical data to support their views on the costs, benefits and other economic effects associated with the differences between the Commission's proposed approach and the CFTC's approach. The Commission also seeks comment on the relevant economic considerations for the Commission if we modify our proposed approach to conform to the CFTC's [proposed/final] guidance. Similarly, what would the economic considerations be for the Commission to adopt any cross-border interpretations proposed by the CFTC, but not proposed by the Commission?"[10]

To better understand the negative effects of imposing conflicting rules on the market, the SEC should conduct a direct cost-benefit analysis of the conflicting rule regimes (e.g., with the European Market Infrastructure Regulation and the CFTC's cross-border guidance). Instead, the SEC asks the public to conduct such an analysis for the SEC: "what would be the economic impact, including the costs and benefits, of these differences on market participants…?" Robert Cook, former Director of the SEC's Division of Trading and Markets testified at a July 17, 2012 hearing before the Senate Committee on Agriculture, Nutrition and Forestry, that the SEC will conduct the "full economic analysis and the cost-benefit analysis" that is required before it issues its regulation about the cross-border reach of Title VII.[11]

Absent an analysis of the effects of these conflicting rule regimes, the SEC has failed to fulfill this pledge to Congress. The resulting effects of the Proposal will impact virtually all market participants either directly or indirectly, including end-users. Given the significant new costs, both direct and indirect, that the Proposal is creating on the security-based swap market and the Proposal's function as a substantive rule, the Coalition urges the Commission to conduct the full cost-benefit analysis that it is required to perform prior to finalizing the Proposal.

[10] 78 Fed. Reg. 31204 (May 23, 2013).

[11] Senate Committee on Agriculture, Nutrition and Forestry. "Holds Hearing on the Impact of the 2010 Financial Regulatory Overhaul Law, Panel 1." (Date: 7/17/12). Text from: CQ Congressional Transcripts. Available from CQ Transcriptswire.

VI. Conclusion

We thank the Commission for the opportunity to comment on these important issues. The Coalition looks forward to working with regulators to create a robust regulatory regime without unduly burdening end-users and the economy at large. We are available to meet with the Commission to discuss these issues in more detail.

Sincerely,

Agricultural Retailers Association
Business Roundtable
Financial Executives International
National Association of Corporate Treasurers
National Association of Manufacturers
U.S. Chamber of Commerce