The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 27482

August 22, 2013

ICI and ICI Global Submit Letter on SEC's Proposed Rules on Cross-Border Security-Based Swap Activities

[27482]

August 22, 2013

TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 71-13
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 63-13
ICI GLOBAL MEMBERS
INVESTMENT ADVISER MEMBERS No. 60-13
INTERNATIONAL MEMBERS No. 37-13
SEC RULES MEMBERS No. 77-13 RE: ICI AND ICI GLOBAL SUBMIT LETTER ON SEC's PROPOSED RULES ON CROSS-BORDER SECURITY-BASED SWAP ACTIVITIES

On August 21, ICI and ICI Global filed a comment letter in response to the proposed rules and interpretive guidance for parties to cross-border security-based ("SB") swap transactions issued by the Securities and Exchange Commission ("SEC"). [1] The Proposal addresses the application of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") to market intermediaries, participants, and infrastructures for SB swaps and certain transaction-related requirements under Title VII in connection with reporting and dissemination, clearing, and trade execution for SB swaps. Concurrently, the SEC re-opened for comment all of its currently pending rule proposals related to Title VII of the Dodd-Frank Act in light of the Proposal. [2] The SEC's proposed approach to the regulation of cross-border activities differs in significant ways from the approach adopted recently by the Commodity Futures Trading Commission ("CFTC") in its interpretive guidance regarding the cross-border application of the swap provisions of the Commodity Exchange Act ("CEA"). [3] The ICI and ICI Global comment letter is attached and summarized below.

The letter states that, with the adoption of CFTC's final guidance, consistency between the CFTC and the SEC in the outcome of whether an entity or transaction would be subject to the Dodd-Frank Act requirements to the extent possible and reasonable should be the primary goal. To ensure certainty and simplicity, the letter urges the adoption of SEC rules that will produce outcomes similar to those under the CFTC's guidance. Global firms will face significant costs and burdens if the two regulatory approaches produce different outcomes regarding whether an entity or transaction would be subject to the Dodd-Frank

Act. The letter suggests several modifications to the SEC's proposal both to address concerns with the SEC's proposed approach and to ensure that the outcome is broadly consistent with the CFTC's approach.

Definition of U.S. Person

The letter argues that the "principal place of business" test in the proposed definition of "U.S. person" is not appropriate for funds and other collective investment vehicles, which are generally externally managed and have no employees or offices of their own. The letter recommends that the SEC not apply the "principal place of business" provision to funds and other collective investment vehicles. In the alternative, the letter suggests that the principal place of business test not apply to a non-U.S. regulated fund, as defined. [4] The suggested modification would exclude from the definition of "U.S. person" non-U.S. regulated funds that are offered publicly to only non-U.S. persons; non-U.S. regulated funds that are publicly offered to only non-U.S. persons but offered privately to U.S. persons under Section 3(c)(1) or Section 3(c)(7) of the ICA; and certain non-U.S. regulated funds authorized to make a public offering but that elect only to offer privately to non-U.S. institutional investors.

Proposed Exceptions for Transactions Conducted in the United States between Non-U.S. Persons

The letter requests that the SEC extend the exceptions proposed for clearing and trade execution requirements to all of the transactional requirements for transactions between non-U.S. counterparties if those transactions technically are conducted within the United States solely because of the engagement of a U.S. asset manager. The letter notes that the risk borne in these transactions would reside with non-U.S. persons outside the United States and would not migrate to the United States merely because of the use of a U.S. asset manager. In addition, the letter states that excluding these transactions from the Title VII requirements would not reduce counterparty protection or reduce protection for the U.S. markets. A non-U.S. regulated fund would not have any expectation of having its derivatives transactions with other non-U.S. counterparties subject to Title VII, nor would shareholders of that fund expect to receive the protections of U.S. regulation solely based on the engagement of a U.S. asset manager. Moreover, non-U.S. counterparties of a non-U.S. regulated fund would not expect to be subject to Title VII requirements merely because their counterparty was managed by a U.S. asset manager.

Finally, the letter states that imposing Title VII obligations on non-U.S. counterparties solely because of the engagement of a U.S. asset manager would disadvantage the U.S. asset management industry without furthering the SEC's policy objectives. If the SEC does not provide an exception, U.S. asset managers to non-U.S. regulated funds would find themselves at a significant disadvantage to their non-U.S. counterparts, resulting in harm to U.S. business and potentially driving such asset management business overseas.

Substituted Compliance Framework

The letter makes several suggestions on the SEC's proposed approach to substituted compliance. The letter requests that foreign regulatory authorities be permitted to submit an application for substituted compliance for entities that would be subject to their regulations. In addition, the letter suggests that the SEC should not deny substituted compliance applications merely if the foreign regulatory regime differs technically from those requirements in the United States. Finally, the letter urges the SEC to consult closely, and to coordinate, with the CFTC in making its substituted compliance determinations. Inconsistent findings by the SEC and the CFTC with respect to the regulatory framework of

a foreign jurisdiction would impose significant costs and burdens on market participants.

Jennifer S. Choi
Senior Associate Counsel – Securities Regulation

Attachment

endnotes

[1] 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, Release No. 34-69490, 78 FR 30967 (May 23, 2013), available at http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf ("Proposal"). For a summary of the Proposal, see ICI Memorandum No. 27238 (May 13, 2013), available at http://www.ici.org/my_ici/memorandum/memo27238.

[2] Reopening of Comment Periods for Certain Rulemaking Releases and Policy Statement Applicable to Security-Based Swaps Proposed Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act, Release No. 34-69491, 78 FR 30800 (May 23, 2013), available at http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10836.pdf. The re-opened comment period for these pending proposals closed on July 22, 2013.

[3] Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap Regulations, 78 FR 45292 (July 26, 2013) available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2013-17958a.pdf ("Final Cross-Border Guidance"); See Further Proposed Guidance regarding Compliance with Certain Swap Regulations, 78 FR 909 (Jan. 7, 2013), available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2012-31734a.pdf; Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, 77 FR 41214 (July 12, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-07-12/pdf/2012-16496.pdf (together "CFTC Proposed Cross-Border Guidance").

[4] For purposes of the letter, the term "non-U.S. regulated fund" refers to any fund that is organized or formed outside the United States, is authorized for public sale in the country in which it is organized or formed, and is regulated as a public investment company under the laws of that country. Generally, non-U.S. regulated funds are regulated to make them eligible for sale to the retail public, even if a particular fund may elect to limit its offering to institutional investors.