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Extraterritorial Application of Title VII

September 2011

Extraterritoriality: Key Parameters

- We believe the following provides for transparent and effective oversight of a non-U.S. bank’s global swaps business:

1. **ENTITY-LEVEL REQUIREMENTS**: U.S. regulators should recognise home country regulators’ lead on Entity-Level Requirements (e.g. Capital and other matters of prudential regulation) applicable to non-U.S. banks, subject to being satisfied that the relevant home country regulator (e.g. FSA) applies comparable and robust standards. (Note: Fed precedent for deferring to home country regulator or regime in relation to Capital.)

2. **TRANSACTION-LEVEL REQUIREMENTS**: U.S. regulators should apply Transaction-Level Requirements on non-U.S. banks only with respect to business conducted with U.S. Persons. Registration of a non-U.S. bank as a Swap Dealer should not automatically cause all of its off-shore business to fall within the regulatory purview of U.S. regulators.

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Scope of U.S. Regulation of non-U.S. Entities

Key Considerations

- Similar to most large non-U.S. banks, Barclays operates its swaps business on a global basis through a central booking location. Barclays books its swaps in its London branch regardless of counterparty location. There are good reasons to preserve this central booking model:
  - Capital efficient, allows customers to transact with a highly-rated and creditworthy entity, and provides customers with more opportunities for netting and portfolio margining across products.
- Overly broad reach by U.S. regulators could subject such non-U.S. banks to duplicative, inconsistent and contradictory regulatory requirements, and potential tension with home country regulators.
- Non-U.S. bank such as Barclays should be permitted to register its foreign booking office as a swap dealer, with U.S. regulators exercising oversight over entity-level requirements and transaction-level requirements as set out in the prior slide.
- Non-U.S. entities that make swaps markets solely outside of the U.S. and only transact with swap dealers in the U.S. should not be required to register as Swap Dealers.
- Non-U.S. entities that only transact with affiliates should not be required to register as Swap Dealers even if such affiliates are themselves registered Swap Dealers.

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Extraterritoriality Scope Further Defined

Swap Dealer Registration for Foreign Headquartered Banks

Non U.S. banks should be permitted to register as a Swap Dealer their non-U.S. branch where swaps are booked, with certain entity-level rules (e.g. capital, risk management, recordkeeping etc) applying on an entity-wide basis, and with U.S. regulators limiting their oversight to swaps with U.S. persons

Entity Level Rules: Home Regulator Deferral

For entity-level rules such as capital and risk management, U.S. regulators should defer to home regulators' standards so long as the home regulations are comprehensive and based on global standards (e.g. Basel) or otherwise comparable to the U.S. regulatory regime

For monitoring purposes, U.S. regulators could rely on information-sharing arrangements with home regulators

Transaction Specific Rules: US-person Facing Activities

For transaction-level rules, such as clearing, exchange trading, and real-time reporting, U.S. derivatives regulations should apply only to transactions where one or more of the parties is a "US person"

We believe "Reg S" is a suitable starting point for the definition of "US person" for all transaction specific rules

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Swap Dealer Registration

- Swap Dealer designation for a non-U.S. bank that books swaps in its non-U.S. branch should be limited to its U.S. facing activities. Such limited designation of the booking entity would:
  1. Be expressly limited to the branch of the bank at which swaps are booked; or
  2. If entity wide registration is required, be expressly limited to supervisory oversight of the activities of the relevant branch.
  - In either scenario:
    - Application of transaction-level requirements only apply to transactions with U.S. Persons
    - Defer to home country standards for prudential / entity-level requirements
- If U.S. regulators require that a U.S. affiliate of a non-U.S. bank be registered in respect of the affiliate's activities on behalf of the bank (e.g. soliciting or negotiating swaps):
  1. U.S. affiliate should be registered as broker under relevant CFTC and SEC rules, as it is not a principal to swaps and does not book any swaps in its own account; or
  2. U.S. affiliate may be registered as Swap Dealer but would be required to comply only with regulations applicable to the customer-facing activities it conducts, e.g. business conduct and recordkeeping.
  - In either scenario:
    - Compliance by U.S. affiliate with other swap dealer requirements should be flexible enough to accommodate group-structured systems, policies and procedures.
    - U.S. affiliate should not be required to hold capital against market and credit risk arising from swaps booked to the non-U.S. booking entity

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Transaction-Level Requirements

- The Commissions' Rules must provide clarity on U.S. nexus. SEC Reg S definition is useful starting point
- Extending Transaction-Level Requirements to transactions where there is no U.S. Person is challenging both in principle and in practice:
  - No relevant policy goal – what risk to the U.S. markets or investors is mitigated by having one of the Commissions regulate e.g. documentation disclosure standards in a trade between Barclays London and a client in France?
  - Conflict – internationally, local market regulators where the market activity is taking place e.g., the French regulators, will dictate conduct of business standards applicable when dealing with French investors. Imposing additional overseas (i.e., U.S.) rules could be duplicative but worse, conflicting. Non-U.S. regulators may also be concerned about such an approach.
  - Cost – what is the cost/benefit for the U.S. taxpayer? No systemic risk mitigation achieved (prudential standards), U.S. investor receives no enhanced protection (any trade with a U.S. Person will be covered by U.S. rules) and yet significant cost for U.S. regulators to supervise on a global activities

Potential Consequences

- Firms having to subsidiarize their U.S. facing business – very capital intensive and not compatible with a global booking model creating inefficiencies in capital, tax, netting and portfolio margining.
- Customers would face less creditworthy and lower-rated counterparties. It would require counterparty approval and a massive effort over many years to move swap transactions and documentation to a separate entity.

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Title VII Breakdown of Entity & Transaction Level Oversight

Entity Level*	Transaction Level
Capital	Clearing
Internal Business Conduct Rules	Exchange trading
•Risk Management Procedures	End of day reporting
•Chief Compliance Officer	Real Time reporting
•Recordkeeping	Business conduct rules (external)
•Conflicts of Interests	Documentation standards
	Daily trading records
	Uncleared margin segregation/amount
	Position limits

*Defer to home country regulator (subject to U.S. regulatory determination of comparable standards)

**** Transaction-Level requirements should not apply to inter-affiliate transactions.**

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Conflicting Standards vs. Duplicative Requirements

International collaboration is essential to further the goals of G20 and the DFA to protect investors, provide level playing field for safe, fair markets while promoting capital formation.

- **Conflicts**: inability to comply with different sets of rules at same time may curtail the continuity of global business models and use of global risk management tools for clients
  - Recommend an international end-user exemption
  - Swap transaction subject to EMIR and DFA clearing requirements may prove difficult to harmonize
  - Japan requires certain OTC derivative transactions to be cleared by licensed <u>domestic</u> CCP; Compliance under DFA and Japanese laws could prove impossible
  - Execution requirement by EMIR and DFA would require platforms to register with both
- **Duplication**: question of cost. At what point would it make it difficult or impractical for a global foreign bank to comply with both requirements under Title VII and local jurisdiction requirements
  - Duplicative reporting requirements could diminish the efficacy of information received by regulators and decrease the goals for transparent markets and price discovery. For example, EMIR requires a swap to be reported to an ESMA registered trade repository and DFA to registered swap data repository—leads to separate reporting for same trade and increasing likelihood of duplication
  - Duplicative calculation of capital for EU financial services firms subject to Mifid or the Banking Consolidation Directives, coupled with the Basel III standards directed under CRDIV would be excessive. Subsidiarization increases to the detriment of client needs for safe and effective risk management
- Foreign jurisdictions are committed to ensuring effective internal risk management standards:
  - (Compromise Proposal by the Council of the European Union dated 29 August 2011) require firms to have in place "*robust, resilient and auditable processes in order to reconcile portfolios, to manage the associated risk and to identify disputes between parties early and resolve them, and to monitor the value of outstanding contracts*".

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