May 3, 2021

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Certain Requirements Applicable to Non-U.S. Security-Based Swap Dealers and Major Security-Based Swap Participants Subject to Regulation in the French Republic; Proposed Order (Release No. 34–91477; File No. S7–22–20)

Dear Ms. Countryman:

Better Markets[1] appreciates the opportunity to comment on the above-captioned proposal ("Proposal" or "Release") released for public comment by the Securities and Exchange Commission ("SEC" or "Commission").[2] The Commission is reopening the comment period regarding a proposed order relating to substituted compliance for SBS entities, including SBS dealers and SBS major swap participants, that are subject to regulation in France. The proposed order specifically addressed the requirements surrounding (1) trade acknowledgment, portfolio reconciliation and risk control requirements, and (2) capital requirements.

The original substituted compliance application was submitted by the French Autorite des Marches Financiers (''AMF'') and the Autorite de Controle Prudentiel et de Resolution (''ACPR''), the French financial authorities. They sought a determination from the SEC that SBS entities subject to regulation in France conditionally may satisfy requirements under the Exchange Act (listed above) by complying with comparable French and European Union (''EU'') requirements. In December of 2020, the Commission published the application along with a proposed order granting it subject to a number of conditions. As a result of comments received from industry organizations, including SIFMA and others in France, the Commission is now

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 86 Fed. Reg. 18,378 (Apr. 8, 2021).

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seeking comment on potential changes to the proposed order, changes which are uniformly aimed at weakening the conditions.

The SEC should not accede to the commenters' requests and it should not weaken the conditions. As a threshold matter, it appears that the French regulatory framework governing the areas listed above—including capital requirements and others—does not satisfy the test for an order of substituted compliance, as they are not comparable to U.S. requirements. This is evidenced by the very need for the imposition of significant conditions necessary to compensate for the acknowledged gaps in the French framework. In any case, the Commission should certainly not weaken those conditions any further. Below, we detail our concerns and we also set forth some general principles that must guide the SEC as it evaluates this request for a substituted compliance order and other requests in the future.

BACKGROUND

The 2007-2009 financial crisis was catastrophic for our financial markets, our economy, and millions of American families. In monetary terms, it destroyed $20 trillion in GDP. And the human toll resulting from millions of home foreclosures, deep and prolonged unemployment and underemployment, and massive loss of wealth is incalculable, and it continues to be felt today.[3] Moreover, on top of the damage caused by the deep recession, as much as $29 trillion was lent, spent, pledged, committed, loaned, guaranteed, and otherwise used or made available to bailout the financial system during the crisis.

One of the key factors that led to and exacerbated the crisis was regulatory arbitrage, both within the United States as between multiple different financial regulatory agencies, and as most relevant here, cross-border. Foreign financial services firms were key actors during the financial crisis, engaging in high-risk activities, suffering existential instability, and ultimately requiring massive bailouts. In fact, fully nine of the top 20 largest users of Federal Reserve emergency lending facilities were foreign entities. Moreover, ten of the top 16 beneficiaries of the AIG bailout, which paid its counterparties 100 cents on the dollar, ten were foreign.[4]

In response to the financial crisis, Congress passed the Dodd-Frank Act, a comprehensive financial reform bill specifically intended to prevent another financial crisis. As relevant here, the Dodd-Frank Act directed the SEC to promulgate rules relating to SBS capital, margin, recordkeeping, and other issues to reduce the possibility and severity of another crisis related to

3 BETTER MARKETS, THE COST OF CRISIS, $20 TRILLION AND COUNTING (July, 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf.

4 *The U.S. Bailed Out Foreign Banks in 2008 & Shouldn't Have to Do That Again*, BETTER MARKETS BLOG (Jan. 23, 2014), https://bettermarkets.com/blog/us-bailed-out-foreign-banks-2008-shouldn%E2%80%99t-have-do-again.

excessive buildup of risk in the swaps markets.[5] The Dodd-Frank Act also included a provision allowing the SEC to establish cross-border rules to prevent evasion of SBS rules.

COMMENTS

I. SUBSTITUTED COMPLIANCE DETERMINATIONS MUST BE MADE ONLY UPON A COMPELLING SHOWING THAT BINDING LEGAL REQUIREMENTS IN FOREIGN JURISDICTIONS ARE COMPARABLE TO U.S. REQUIREMENTS AND WILL PROTECT THE U.S. FINANCIAL SYSTEM

Better Markets continues to have reservations about the "substituted compliance" approach to cross-border regulation taken by the SEC, and in particular its adherence to a "regulatory outcomes" test.[6] However, although the SEC has opted for a suboptimal framework to address cross-border issues, it can, and must, still apply that framework in a manner designed to protect the U.S. financial system which is, after all, the whole purpose of the Dodd-Frank Act. The SEC must do this by carefully examining foreign regulatory requirements to ensure that they protect the U.S. financial system in substance, form, over time, and as enforced. Below we articulate some general principles to guide the SEC as it considers the current application for substituted compliance, as well as others in the future.

A. The SEC's duty under the Dodd-Frank Act is to protect the U.S. financial system

Congress passed the Dodd-Frank Act to, among other things, "promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail,' [and] to protect the American taxpayer by ending bailouts."[7] All of the SEC's actions, including analyzing substituted compliance applications and granting substituted compliance requests, must serve, and not undermine those goals. This is a critical point, because far too often regulators ignore or lose sight of the fact that Congress has explicitly told them to protect the financial system, and they instead prioritize other goals.[8] Not only is this flawed from a policy perspective, but emphasizing other goals, such as reducing costs or burden for the industry,

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[5] 15 U.S.C. 78o-10.

[6] *See* Better Markets Comment Letter on Cross-Border SBS at 24-

[7] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, July 21, 2010, 124 Stat 1376.

[8] *See e.g.* Remarks of CFTC Chairman J. Christopher Giancarlo to the ABA Derivatives and Futures Section Conference (Jan. 19, 2018) (expressing support for CFTC comparability determinations for the EU, despite differences in rules, because the determination ensures "certainty to market participants and also ensure that our global markets are not stifled by fragmentation, inefficiencies, and higher costs" without mentioning whether the comparability determination would serve to protect the U.S. financial system or serve other stated goals of the Dodd-Frank Act).

while ignoring or minimizing the actual goals Congress directed the SEC to consider, is plainly unlawful.[9]

Put simply, if there is tension between the statutorily-mandated goal of protecting the American financial system on the one hand, and serving some other goal on the other hand, the former wins, period. The SEC simply cannot, as a matter of law or policy, subordinate Congress's will to other goals, no matter how important the SEC's other goals are. Accordingly, before the SEC grants substituted compliance in order to reduce burdens for the industry, provide certainty, or promote international comity, it must first and foremost make a determination that granting substituted compliance promotes the protection of the American financial system.

B. There must be a compelling reason to grant substituted compliance where there are material differences in binding legal requirements.

While the SEC has eschewed a more substantial and precise "requirement-by-requirement"[10] approach to substituted compliance in favor of a broader, ill-defined, and difficult to apply focus on "regulatory outcomes," the reality is that the best way to have confidence that a foreign jurisdiction's regulatory regime will produce substantially equivalent outcomes is to ensure that the relevant jurisdiction has substantially similar binding legal requirements. Simply put, it is difficult to imagine there are many cases where materially different legal requirements produce substantially similar "regulatory outcomes."

Nevertheless, if the SEC is going to grant substituted compliance with regard to materially different regulatory requirements, the SEC must make a well-supported, evidence-based determination that those different requirements will, in fact, lead to comparable regulatory outcomes. At a minimum, this would seem to require clearly and specifically articulating the desired regulatory outcome, and providing a fulsome, evidence-based explanation as to how the jurisdiction's different legal requirement nonetheless leads to that regulatory outcome. Speculation and conclusory statements are not sufficient.

Similarly, the SEC should not be in the position of trying to force fit incomparable foreign regulatory requirements to the SEC's "regulatory outcomes" so as to be able to grant substituted compliance. The appropriate question for the SEC to ask is "Would this jurisdiction's regulatory requirements, as they exist, protect the U.S. financial system, and therefore justify granting substituted compliance?" not "What can we do to reconfigure this jurisdiction's regulatory requirements so they meet the threshold for substituted compliance?" Put another way, if the only way to justify granting substituted compliance is to require layer-upon-layer of conditions to ensure that otherwise inadequate regulatory requirements produce comparable regulatory outcomes, then the conditions for substituted compliance have not been met.

9 Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) ("Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider")

10 *See* Release at 18,341.

The SEC has limited resources. It should not be in the position of essentially creating, ad hoc, custom-made rules to supplement inadequate rules of other jurisdictions, all for the benefit of industry participants that want to avail themselves of the benefits of the U.S. financial system without abiding by U.S. regulatory requirements. We note that these are not merely theoretical concerns, as substituted compliance becomes a consideration only once a derivatives dealer has already engaged in threshold dealing activities in the U.S. and already poses the types of proximate risks to the U.S. financial system that the SEC itself has determined warrants application of the Dodd-Frank Act.

C. The SEC must ensure that a grant of substituted compliance remains appropriate on an ongoing basis.

A determination that a foreign jurisdiction's SBS rules would produce comparable regulatory outcomes is the beginning, not the end, of the SEC's obligation to ensure that the activities of foreign SBS entities do not pose risks to the U.S. financial system. As time goes on, regulatory requirements that, in theory, are expected to produce one regulatory outcome may, in practice, produce a different one. And, of course, the regulatory requirements may change outright in a variety of ways.

Finally, the effectiveness of an authority's supervision and enforcement program can weaken for any number of reasons—the SEC cannot assume that an enforcement program that is presently effective will continue to be effective. Accordingly, to fulfill its statutory obligation to protect the U.S. financial system the SEC must ensure, on an ongoing basis, that each grant of substituted compliance remains appropriate over time. At the very least, this would require that each order granting substituted compliance, and each memorandum of understanding with a foreign regulatory authority, impose an obligation that the applicant, as appropriate:

(1) Periodically apprise the SEC of the activities and results of its supervision and enforcement programs, to ensure that they remain sufficiently robust to deter and address violations of the law; and
(2) To immediately apprise the SEC of any material changes to the regulatory regime, whether explicit (i.e. rule changes) or implicit (i.e. changes in how a rule is interpreted).

II. THE SEC HAS FAILED TO JUSTIFY A CHANGE IN APPROACH WITH REGARD TO EMIR-RELATED CONDITIONS

The SEC is reopening the comment period with regard to "EMIR-related General Conditions" in response to industry comments raising concerns about the SEC's proposed approach to trade acknowledgment, verification, and risk control requirements. Specifically, commenters

> "requested that those parts of the final Order not incorporate proposed conditions requiring compliance with certain provisions under MiFID [Markets in Financial Instruments Directive], arguing that those MiFID-related conditions in practice would prevent SBS Entities with branches in other EU countries from relying on substituted compliance for those requirements, and that compliance with proposed

> EMIR conditions would be sufficient to produce the requisite regulatory outcomes."[11]

This is based on concerns raised by industry groups to the effect that, where an SBS entity has branches in other EU countries besides France, and compliance by those non-French branches with MiFID-related provisions is overseen by regulators in those jurisdictions rather than French authorities, the SBS entity would not be able to take advantage of substituted compliance.[12]

It is understandable that industry groups would urge the SEC to make it easier for more members of the industry to avail themselves of the privilege of substituted compliance. It is their job to represent the interests of their members, and the interests of their members are served by easing the regulatory requirements applicable to them. However, easing regulatory burdens for the industry is not the SEC's job. The SEC's job is to protect the American financial system from the devastation of another financial crisis. It is not the SEC's job to accommodate the preferences of market participants regarding how to structure their businesses and where to operate. That some industry participants may not be able to take advantage of substituted compliance under the SEC's proposed framework is not, in and of itself, a reason to change the framework. At a minimum, the SEC must provide its own robust, evidence-based analysis that changing the framework as proposed will still (1) result in comparable regulatory outcomes and (2) protect the American financial system.[13] Yet the Release contains absolutely no analysis about whether changing the approach to accommodate the industry's concerns would be consistent with either goal.

As an initial matter, denying substituted compliance under the applicable circumstances seems perfectly reasonable. If some significant part of a French SBS entity's compliance with relevant legal requirements is overseen by a jurisdiction for which the SEC has not granted a substituted compliance order, and if as a result, the entity has not entered into a memorandum of understanding with regard to supervision and enforcement, then the French SBS entity should **not** be able to take advantage of substituted compliance with regard to the relevant entity-level requirements. The Exchange Act and the SEC's rules require the SEC to make a determination, before granting substituted compliance, that there are comparable legal requirements in the relevant jurisdiction **and** that the relevant jurisdiction have an effective supervisory and enforcement program.[14]

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11 Release at 18,342.

12 SIFMA Comment Letter on French Substituted Compliance 3-6 (Jan. 25, 2021). The Release explains that "[t]he same problem does not arise in connection with requirements under EMIR, which would not allocate oversight of a French entity's compliance to authorities in other EU Member States. Release at 18,343 n.14.

13 *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43, 103 S. Ct. 2856, 2866, 77 L. Ed. 2d 443 (1983) ("Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'")

14 17 C.F.R. §240.3a71-6(a)(2)(i).

If the SEC cannot make a determination as to the latter requirement for a French SBS entity, then the inability of that entity to take advantage of substituted compliance is not a flaw with the SEC's proposal that needs to be corrected, but rather a result of the SEC's straightforward application of its own rules working as intended to protect the U.S. financial system from importing excessive risk from jurisdictions with inadequate regulatory regimes.

III. IN LIGHT OF THE CONDITIONS THE SEC MUST IMPOSE TO ENSURE DIFFERENCES IN CAPITAL REGIMES DO NOT IMPERIL THE U.S. FINANCIAL SYSTEM

The SEC also proposes revisiting its proposal to grant substituted compliance with regard to France's capital requirements for SBS entities.[15] As the Release notes, capital requirements for SBS entities in France are markedly different than those ultimately adopted by the SEC for U.S. SBS entities. The SEC opted for a "net liquid assets test" which is intended to ensure that "each dollar of subordinated liabilities is matched by more than a dollar of highly liquid assets."[16] France, by contrast, has a capital regime for SBS entities that is based on international standards for banks. As the Release explains, this leads to material differences with the SEC's rules—for example, France's standards "allow [French SBS entities] to count illiquid assets such as real estate and fixtures as capital" and also "allow[] them to treat unsecured receivables related to activities beyond dealing in security-based swaps as capital notwithstanding the illiquidity of some of these assets."[17]

There are other differences. In France, the initial margin an SBS entity posts to a counterparty counts toward the capital requirements for that entity; in the U.S. initial margin only counts as capital if the SBS entity has a special loan agreement with an affiliate.[18] This latter requirement is intended to mitigate the SBS entity's counterparty credit risk with respect to return of the initial margin. The result is that, not only are France's capital requirements different from the SEC's in both form and substance, but the regulatory outcome is not comparable. As the SEC explains in the Release, France's different capital requirements mean that French SBS entities "may have less balance sheet liquidity than SBS Entities subject to" the SEC's rules.[19]

The difference between the capital regimes for SBS entities in the France and U.S. would seem to be a basis for denying the availability of substituted compliance for French SBS entities. However, instead of simply denying substituted compliance, the SEC proposes to establish a set of conditions that purport to be "designed to ensure the comparability of outcomes in light of the differences between the net liquid assets test and the Basel capital standard."[20] These conditions

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15 Release at 18,343.
16 Release at 18,344.
17 Release at 18,344.
18 Release at 18,344-45.
19 Release at 18,345.
20 Release at 18,388-89.

are the **bare minimum** that the SEC must establish in order to grant substituted compliance for French SBS entities. The SEC **absolutely must not weaken or eliminate these essential conditions** in response to comments by the industry, which is primarily concerned with reducing its own operational costs, without any regard to the systemic risk that doing so would pose. Any determination to find France's capital requirements comparable to and as comprehensive as the SEC's SBS capital framework **without conditions at least as strong as proposed** would not only contravene the agency's own conception of substituted compliance but expose the U.S. financial system to very risks Dodd-Frank instructed the SEC to contain.[21]

Moreover, while Better Markets appreciates the SEC scrutinizing and revisiting its prior proposal to grant substituted compliance for France's capital requirements, the mere fact that the SEC, quite rightly, deems such conditions necessary raises the question of why substituted compliance is being granted if no less than five discrete conditions are required to accomplish this goal. Granting substituted compliance with multiple conditions intended to mimic the SEC's capital requirements would seem to undermine the entire point of substituted compliance in the first place, protecting the stability of the U.S. financial system by allowing substituted compliance **only when** foreign regimes are comparable.

This approach raises yet further concerns. Essentially the SEC is layering another set of capital requirements that French SBS entities will have to abide by, exacerbating complexity and adding to market fragmentation.[22] In addition, the SEC, by essentially crafting a new capital rule ostensibly for the benefit of French SBS entities, is committing to the assumption of additional regulatory burdens; as the Release acknowledges, the SEC will have to "monitor their impact on

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21 For similar reasons, the SEC must also not, as suggested in the Release, eliminate or weaken capital conditions if "a Covered Entity's business with U.S. persons falls below a certain notional threshold, such as \$8 billion, \$20 billion, \$50 billion, or some other threshold." Release at 18,347. Creating such a de minimis exemption for foreign SBS entities would be unacceptable. The Release offers absolutely no analysis or justification for why such a threshold for imposition of capital conditions would be appropriate, much less a threshold as high as \$8 billion or more. Such an approach would significantly increase risks to the U.S. financial system. It would furthermore set a precedent that other foreign regulators would seek to exploit as they petition for substituted compliance determinations. In any event, it would be inappropriate for the SEC to finalize any sort of *de minimis* threshold solely on the basis of a single question in the Release that contains no supporting analysis. The SEC must, at the very least, propose any such threshold with its own independent, robust analysis for why it might be appropriate, which will allow meaningful informed comment from all stakeholders, rather than just the industry (which will almost certainly enthusiastically support establishment of a *de minimis* threshold with self-serving "analysis.").

22 Needless to say, if the SEC grants substituted compliance for France's capital requirements, it must not weaken these conditions.

firms and to make adjustments as appropriate."[23] This in turn further raises the concern that, having granted substituted compliance for these capital requirements, if the SEC's monitoring finds that the conditions increase burdens and costs for impacted firms (as seems inevitable), the SEC will drop the conditions rather than rescinding the grant of substituted compliance. In order to avoid this, the SEC should strongly consider simply denying substituted compliance for capital requirements on the basis that France's capital requirements do not produce comparable regulatory outcomes. The burden would then fall on France, as it should, to raise its standards governing SBS activities, so that the requirements and outcomes under its regime are truly comparable to those produced under U.S. law.

CONCLUSION

We hope you find these comments helpful.

Sincerely,

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[23] Release at 18,345.