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July 13, 2015

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: *Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected with a Non-U.S. Person's Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent (File No. S7-06-15)*

Dear Mr. Fields:

ICI Global<sup>1</sup> appreciates the opportunity to comment on the proposed rule amendments and the re-proposed rule by the Securities and Exchange Commission (“Commission” or “SEC”) to address the application of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) to cross-border security-based swap activities.<sup>2</sup> The Proposal generally modifies the Commission’s original proposal to focus on a non-U.S. person’s dealing activity as the trigger for the application of a number of the SEC’s security-based swap rules.<sup>3</sup> We support the Proposal’s modified approach and believe it is appropriate to focus on such dealing

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<sup>1</sup> The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$19.7 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> Application of Certain Title VII Requirements to Security-Based Swap Transactions Connected with a Non-U.S. Person’s Dealing Activity That Are Arranged, Negotiated, or Executed by Personnel Located in a U.S. Branch or Office or in a U.S. Branch or Office of an Agent, 80 FR 27443 (May 13, 2015), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2015-05-13/pdf/2015-10382.pdf> (“Proposal”).

<sup>3</sup> 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, 78 FR 30967 (May 23, 2013), *available at* <http://www.gpo.gov/fdsys/pkg/FR-2013-05-23/pdf/2013-10835.pdf> (“Original Cross-Border Proposal”).

activity, rather than the activities of a non-U.S. person not engaged in dealing activity (*e.g.*, a non-U.S. regulated fund), in determining whether certain of the SEC's security-based swap rules would apply to transactions between such a non-U.S. person and a non-U.S. dealer.

Specifically, we have the following comments.

- We support the Commission's proposal not to require a non-U.S. person engaging in dealing activity to consider the location of its non-U.S. counterparty or that counterparty's agent for purposes of the de minimis exemption from registration as a security-based swap dealer ("SBSD"). The Commission's modified approach would no longer incentivize non-U.S. dealers to avoid engaging in swaps transactions with a non-U.S. regulated fund with a U.S. manager to stay under the de minimis threshold.
- We support the Commission's decision to eliminate the activities of a non-U.S. person that is not engaged in dealing activity as a trigger for the application of the external business conduct requirements. Imposition of these requirements on a non-U.S. regulated fund solely because of its retention of a U.S. asset manager would be inconsistent with the expectations of investors in the non-U.S. regulated fund and is unnecessary to protect U.S. markets or U.S. investors. We also urge the Commission not to apply the external business conduct standards to transactions between a non-U.S. person and a non-U.S. SBSBD, including transactions that are arranged, negotiated, or executed by personnel of the non-U.S. SBSBD located in a U.S. branch or office.
- We support the Commission's proposal not to subject transactions between two non-U.S. persons to the clearing and trade execution requirements on the basis of dealing activity in the United States, including transactions that are arranged, negotiated, or executed by personnel located in a U.S. branch or office. Non-U.S. persons (including non-U.S. regulated funds that are managed by U.S. asset managers and investors in such funds) would not expect to be provided such protections.
- We request that the Commission modify the reporting hierarchy so that a non-U.S. person engaging in dealing activity in the United States (but not registered as an SBSBD) would be the reporting side if it conducts a transaction with a U.S. person that is not engaging in dealing activity (such as a U.S. regulated fund). The entity engaged in dealing activity would have a greater capacity to fulfill that responsibility than a U.S. regulated fund.
- We continue to urge the Commission to re-propose the margin rules for uncleared security-based swaps to be in line with both U.S. and international regulators so that non-U.S. SBSBDs may be able to use substituted compliance to comply with the margin requirements for their transactions with their non-U.S. counterparties.

#### Background

Our members – investment companies that are registered under the Investment Company Act of 1940 and other regulated funds in jurisdictions around the world (collectively, "regulated

funds”)<sup>4</sup> – find security-based swaps, as well as other derivative instruments, particularly useful portfolio management tools that offer considerable flexibility in structuring funds’ investment portfolios. Regulated funds employ security-based swaps and other derivatives in a variety of ways, including to hedge other investment positions, equitize cash that the fund cannot immediately invest in direct equity holdings, manage a fund’s cash positions more generally, adjust the duration of a fund’s portfolio or manage a fund’s portfolio in accordance with the investment objectives stated in the fund’s prospectus. ICI members, as market participants representing millions of investors, generally support the goal of providing greater oversight of the swaps markets.

As the Commission well recognizes, the security-based swaps market is a global market and security-based swap transactions are “largely cross-border in practice.”<sup>5</sup> Given the international nature of these transactions and efforts by regulators worldwide to regulate these activities, ICI Global has emphasized repeatedly the importance of global coordination among regulators with respect to cross-border application of derivatives regulations to avoid imposing, at best, duplicative and, at worst, conflicting regulatory requirements on counterparties.<sup>6</sup> We have expressed our concern that there may be reluctance to engage in cross-border derivatives transactions, unless regulators coordinate the requirements that would apply to such activities. International comity

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<sup>4</sup> For purposes of this letter, the term “regulated fund” refers to any fund that is organized or formed under the laws of a nation, 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, such 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. Such funds typically are subject to substantive regulation in areas such as disclosure, form of organization, custody, minimum capital, valuation, investment restrictions (*e.g.*, leverage, types of investments or “eligible assets,” concentration limits and/or diversification standards). Examples of such funds include: U.S. investment companies regulated under the Investment Company Act of 1940 (“Investment Company Act”); EU “Undertakings for Collective Investment in Transferable Securities,” or UCITS; Canadian mutual funds; and Japanese investment trusts.

<sup>5</sup> Proposal, *supra* note 2, at 27446.

<sup>6</sup> See Letter from Dan Waters, Managing Director, ICI Global, to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, Alfred M. Pollard, General Counsel, Federal Housing Financing Agency, Legislative and Regulatory Activities Division, Office of Comptroller of the Currency, and Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, dated November 24, 2014; Letter from David W. Blass, General Counsel, ICI, to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, Barry F. Mardock, Deputy Director, Office of Regulatory Policy, Farm Credit Administration, Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation, Alfred M. Pollard, General Counsel, Federal Housing Financing Agency, Legislative and Regulatory Activities Division, Office of Comptroller of the Currency, and Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, dated November 24, 2014; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Elizabeth Murphy, Secretary, SEC, dated August 21, 2013 (“ICI Letter to Original Cross-Border Proposal”); Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated Mar. 14, 2013; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Melissa Jergens, Secretary, CFTC, dated Feb. 6, 2013; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to Wayne Byres, Secretary General, Basel Committee on Banking Supervision, Bank for International Settlements, and David Wright, Secretary General, International Organization of Securities Commissions, dated Sept. 27, 2012; Letter from Karrie McMillan, General Counsel, ICI, and Dan Waters, Managing Director, ICI Global, to David Stawick, Secretary, CFTC, dated Aug. 23, 2012.

and practical considerations dictate that there be real and meaningful coordination among regulators on how cross-border transactions between counterparties in different jurisdictions should be appropriately regulated.

Under the Original Cross-Border Proposal, security-based swap transactions would be subject to the SEC's security-based swap rules if they are (1) entered into with a U.S. person or (2) otherwise "conducted within the United States." When the Commission adopted certain aspects of the Original Cross-Border Proposal, including the definition of "U.S. person" for the purposes of the application of the security-based swap rules, the Commission deferred adoption of the "transactions conducted within the United States" prong to allow for further consideration.<sup>7</sup>

In this Proposal, rather than using the term "transaction conducted within the United States" (or looking to the activities of counterparties that are not engaged in dealing activities) as the trigger for the application of the SEC's security-based swap rules, the Commission has determined to consider whether certain aspects of the dealing activity are conducted by personnel located in a U.S. branch or office. Specifically, the Commission is proposing amendments to certain rules under the Securities Exchange Act of 1934 ("Exchange Act") to address the application of the de minimis exception to security-based swap transactions connected with a non-U.S. person's security-based swap dealing activities that are arranged, negotiated, or executed by personnel of such person located in a U.S. branch or office or by personnel of such person's agent located in a U.S. branch or office.

In addition, the Commission is re-proposing a rule and proposing rule amendments that, among other things, would not apply most of the external business conduct rules to the "foreign business" (including security-based swap transactions that are not arranged, negotiated, or executed by personnel of the non-U.S. SBSD located in a U.S. branch or office or by personnel of its agent located in a U.S. branch or office) of non-U.S. registered SBSDs. Finally, the Commission is proposing amendments to Regulation SBSR to require any security-based swap transaction connected with a person's security-based swap dealing activity that is arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office or by personnel of its agent located in a U.S. branch or office to be reported to a registered swap data repository ("SDR") and publicly disseminated pursuant to Regulation SBSR.

#### Commission's Determination to Focus on Dealing Activity as the Trigger for Application of SEC's Swap Rules is Appropriate

The Original Cross-Border Proposal defined a "transaction conducted within the United States" to mean any security-based swap transaction that is "solicited, negotiated, executed, or booked within the United States, by or on behalf of either counterparty to the transaction, regardless of the location, domicile, or residence status of either counterparty to the transaction." Under the Original Cross-Border Proposal, if a transaction were conducted within the United

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<sup>7</sup> Application of "Security-Based Swap Dealer" and "Major Security-Based Swap Participant" Definitions to Cross-Border Security-Based Swap Activities, 79 FR 39068 (July 9, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-07-09/pdf/2014-15337.pdf>.

States, SBSBs would be required to include these transactions for purposes of the de minimis exemption calculation for SBSB registration and to comply with certain requirements with respect to their non-U.S. counterparties. In addition, certain transaction level requirements in connection with reporting and dissemination, clearing, and trade execution would apply to transactions conducted within the United States. In response to the Original Cross-Border Proposal, we had expressed concern that the formulation of the definition “transaction conducted within the United States” was so broad that the test as proposed could have captured transactions of non-U.S. clients (including non-U.S. regulated funds) that retain U.S. asset managers to manage their investment portfolios.<sup>8</sup>

We appreciate that, in response in part to comments regarding the breadth of the proposed definition, the SEC has determined not to adopt a definition of this term and generally to focus on certain dealing activity for the imposition of the SEC’s security-based swap rules. Specifically, the Proposal would no longer require a non-U.S. person engaging in dealing activity to consider the location of its non-U.S. counterparty or that counterparty’s agent in determining whether the transaction needs to be included in its own de minimis calculation. Under the modified approach, whether a transaction should be included in the de minimis calculation turns on the activity of the non-U.S. dealers rather than the activities of their counterparties. We believe the Commission’s modified approach would no longer incentivize non-U.S. dealers to avoid engaging in swaps transactions with a non-U.S. regulated fund with a U.S. manager to stay under the de minimis threshold. The modification would prevent non-U.S. regulated funds with a U.S. asset manager from being disadvantaged compared to non-U.S. regulated funds with a non-U.S. asset manager and avoid driving such asset management business overseas.

In addition, the Proposal would apply the external business conduct requirements to the “U.S. business” of foreign SBSBs (*i.e.*, any security-based swap transaction arranged, negotiated, or executed by personnel of the foreign SBSB located in a U.S. branch or office or by personnel of its agent located in a U.S. branch or office or any transaction entered into, or offered to be entered into, by the foreign SBSB with a U.S. person). We support the Commission’s decision to eliminate the activities of a non-U.S. person that is not engaged in dealing activity as a trigger for the application of the external business conduct requirements. As we stated in response to the Original Cross-Border Proposal, Dodd-Frank Act requirements should not be imposed solely because of the retention of a U.S. asset manager. Such a result would be inconsistent with the expectations of investors in non-U.S. regulated funds and is unnecessary to protect U.S. markets or U.S. investors.

We are concerned, however, with the proposal to apply the external business conduct requirements to the “U.S. business” of foreign SBSBs. Where both parties to a transaction are non-U.S. persons, the mere fact that one of the parties uses personnel located in the United States to arrange, negotiate or execute transactions should not cause the external business conduct standards to apply to the parties’ transactions. External business conduct standards are intended to protect the counterparty of an SBSB, but the non-U.S. person counterparties would not expect such protections from their non-U.S. SBSBs. A foreign SBSB will likely be subject to comparable

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<sup>8</sup> ICI Letter to Original Cross-Border Proposal, *supra* note 6.

regulation in its home jurisdiction, and it is not clear that applying the external business conduct standards in this case would protect the U.S. markets.

Moreover, as a practical matter, it is difficult, if not impossible, for non-U.S. regulated funds to know whether a foreign SBSB uses personnel in the United States to arrange, negotiate or execute transactions, and, accordingly, whether transactions with the foreign SBSB will be subject to the external business conduct standards. Although the external business conduct standards apply directly to SBSBs (and not directly to regulated funds), we expect that regulated fund counterparties will need to have appropriate documentation and representations in place (such as ISDA Dodd-Frank Protocols) prior to trading with any SBSB that is subject to the external business conduct standards. These regulated funds therefore could face interruptions in their investment activities because they would not have the documentation in place required by a foreign SBSB to satisfy its own regulatory obligations. The location of a foreign SBSB's activities also could change over time, which could lead to further uncertainty for foreign regulated funds that seek to trade with foreign SBSBs.

We appreciate the Commission's acknowledgement of and efforts to address our concerns expressed in response to the Original Cross-Border Proposal. In the Proposal, the Commission notes that the re-proposed approach should mitigate the problems regarding the potential effect of the initially proposed rule on U.S. fund managers that manage offshore funds because only the location of the personnel of the registered foreign SBSB or the location of personnel of its agent (and not that of persons acting on behalf of a non-U.S. regulated fund in the transaction) would be relevant to whether the transaction is U.S. business or foreign business of the registered foreign SBSB.<sup>9</sup> Although we agree with the Commission's proposal not to consider the location of a non-U.S. regulated fund in applying the external business conduct rules, as noted above, we urge the Commission to reconsider its proposal to apply the rules based on the location of personnel of the SBSB. We do not believe that applying the external business conduct rules to transactions between a non-U.S. SBSB and a non-U.S. regulated fund counterparty would be consistent with international comity or necessary for the protection of U.S. markets and U.S. investors.

Commission Should Adopt Its Proposal Not to Subject Transactions between Non-U.S. Persons to Clearing and Trade Execution Requirements

The Proposal would not subject transactions between two non-U.S. persons to the clearing and trade execution requirements on the basis of dealing activity in the United States, including transactions that are arranged, negotiated, or executed by personnel located in a U.S. branch or office. The SEC believes that the risks that would be posed by these transactions would be better addressed through capital and margin requirements and that requiring such transactions to be cleared and executed on a platform would impose a significant burden on certain market participants.

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<sup>9</sup> Proposal, *supra* note 2, at 27476. To the extent that a non-U.S. regulated fund is a U.S. person (including because it has its principal place of business in the United States), a foreign SBSB would be required to comply with external business conduct requirements in any transaction with that fund because the counterparty is a U.S. person. Whether a non-U.S. regulated fund with a U.S. subadviser has its principal place of business in the United States is based on the facts and circumstances of the particular fund.

We agree with the Commission's analysis of the transactions between two non-U.S. persons and support the Commission's proposal to not subject such transactions to the clearing and trade execution requirements. As noted by the Commission, these types of transaction-level requirements focus on counterparty and operational risks, but the risks for "such transactions reside primarily outside the United States."<sup>10</sup> We concur, and we do not believe non-U.S. persons (including non-U.S. regulated funds that are managed by U.S. asset managers and investors in such funds) would expect such protections to be provided. Moreover, it is likely that these non-U.S. persons would be subject to the regulatory requirements in their own jurisdictions, which will likely cover clearing and trade execution requirements as agreed by the G-20 countries.

#### Commission Should Require Non-U.S. Entities That Engage in Dealing Activity to Report Security-Based Swaps

The Proposal sets forth which side would have the duty to report a security-based swap where neither side is a registered SBSB or a registered major security-based swap participant and neither side is a U.S. person or only one side is a U.S. person. In a situation in which one side includes a non-U.S. person that engages in dealing activity in the United States (*i.e.*, the non-U.S. person arranged, negotiated, or executed the relevant transaction through personnel located in a U.S. branch or office or by personnel of its agent located in a U.S. branch or office) and the other side includes a U.S. person, the Proposal would require the sides to select the reporting side.

We recommend that the Commission place the obligation to report on the non-U.S. counterparty that is engaged in dealing activity rather than the U.S. person that is not engaged in dealing activity, such as a U.S. regulated fund.<sup>11</sup> The entity engaged in dealing activity would have a greater capacity to fulfill that responsibility than a U.S. person that is not engaged in dealing activity. U.S. regulated funds are unlikely to have the infrastructure in place to serve as the reporting party, and we are concerned that U.S. regulated funds may not have the economic leverage to require their non-U.S. dealers to report. Therefore, U.S. regulated funds would have to incur considerable expense either to develop a reporting system or to contract with an outside vendor to satisfy this obligation. Either option could impose significant costs on these funds and their investors. Shifting the reporting obligation to the dealing entity likely would impose minimal incremental costs on such dealing entity, given that many dealing entities already have arrangements in place to satisfy derivative transaction reporting obligations.

#### Commission Should Re-Propose Margin Rules for Uncleared Security-Based Swaps

The Proposal would continue to apply "entity-level" requirements, such as margin, to all registered SBSBs. Under the Commission's framework, non-U.S. SBSBs would be permitted to seek substituted compliance for their entity-level requirements. We are concerned, however, that,

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<sup>10</sup> Proposal, *supra* note 2, at 27481.

<sup>11</sup> Where a non-U.S. regulated fund that was considered a U.S. person was transacting with a non-U.S. dealer, the Proposal also would require the sides to select the reporting side. Similarly, the non-U.S. counterparty that is engaged in dealing activity would be better situated to fulfill the reporting obligation than the non-U.S. regulated fund.

in the context of margin rules for uncleared security-based swaps, substituted compliance would not be available as a practical matter.

As we have previously expressed to the Commission, the SEC's proposed margin rules for uncleared security-based swaps are substantially different and inconsistent with the proposals advanced by other U.S. regulators<sup>12</sup> and EU regulators<sup>13</sup> and from the international standards adopted by the Basel Committee on Banking Supervision ("BCBS") and the International Organization of Securities Commissions ("IOSCO").<sup>14</sup> If the Commission determines to adopt the margin rules as currently proposed, it would be highly unlikely that the Commission could make a substituted compliance determination for another regulatory regime (including the margin rules adopted by the CFTC). If the Commission is not able to make a substituted compliance determination for margin rules of other major jurisdictions, non-U.S. SBSDs and their counterparties would be subject to duplicative and conflicting margin requirements. We believe this result would be extremely unfortunate given the enormous efforts that other U.S. and international regulators have expended to harmonize the margin rules for uncleared derivatives. We urge the Commission to work with its fellow regulators – both in the United States and abroad – to avoid imposing unnecessarily duplicative and conflicting margin requirements on entities that engage in cross-border transactions.

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<sup>12</sup>Last fall, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Farm Credit Administration, and the Federal Housing Finance Agency (together, the "prudential regulators") and the Commodity Futures Trading Commission ("CFTC") re-proposed their margin requirements for uncleared swaps and security-based swaps. See Margin and Capital Requirements for Covered Swap Entities; Proposed Rule, 79 FR 57348 (Sept. 24, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-09-24/pdf/2014-22001.pdf> ("Prudential Regulators Proposal"); Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 79 FR 59898 (Oct. 2, 2014), available at <http://www.gpo.gov/fdsys/pkg/FR-2014-10-03/pdf/2014-22962.pdf> ("CFTC Proposal").

<sup>13</sup>In June 2015, the European Securities and Market Authority, the European Banking Authority, and the European Insurance and Occupational Pensions Authority (collectively "European Supervisory Authorities" or "ESAs") issued a second consultation paper on draft regulatory technical standards ("RTS") for margin requirements for non-centrally cleared OTC derivatives. Second Consultation Paper on Draft Regulatory Technical Standards on risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under Article 11(15) of Regulation (EU) No 648/2012, June 10, 2015, available at <https://www.esa.europa.eu/documents/10180/1106136/JC-CP-2015-002+JC+CP+on+Risk+Management+Techniques+for+OTC+derivatives+.pdf>.

<sup>14</sup>Letter from Paul Schott Stevens, President and CEO, ICI, to The Honorable Mary Jo White, Chair, SEC, dated May 11, 2015, available at <https://www.ici.org/pdf/28969.pdf>. In the letter, we urged the SEC to re-propose its capital, margin, and segregation proposal for SBSDs and major security-based swap participants ("MSBSPs") in a form that is consistent with both international standards and recent proposals of other U.S. regulators. Were the Commission to act on the proposal now before it, it will be impossible to achieve international harmonization of margin rules for uncleared derivatives. Lack of harmonization would undermine one of the important goals of the G-20 countries in reforming the derivatives markets and could result in regulatory arbitrage. See Margin Requirements for Non-Centrally-Cleared Derivatives, Basel Committee on Banking Supervision and Board of the International Organization of Securities Commissions, September 2013, available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD423.pdf> ("International Margin Framework").



Mr. Brent J. Fields

July 13, 2015

Page 9 of 9

We appreciate the Commission modifying the Original Cross-Border Proposal to address some of our critical concerns. We believe limiting the scope of transactions that would be subject to the SEC's security-based swaps rules properly balances the legitimate interests of the Commission in subjecting transactions that pose risks to the United States against the burdens imposed on non-U.S. entities that have tangential connection to the United States. If you have any questions on our comment letter, please feel free to contact the undersigned, Susan Olson at (202) 326-5813, or Jennifer Choi at (202) 326-5876.

Sincerely,

/s/

Dan Waters  
Managing Director  
ICI Global  
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cc: The Honorable Mary Jo White  
The Honorable Luis A. Aguilar  
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