Japan Securities Dealers Association
JSDA

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December 19, 2016

Mr. Christopher Kirkpatrick,
Secretary of the Commission,
Commodity Futures Trading Commission,
Three Lafayette Centre,
1155 21st Street NW.,
Washington, DC 20581

RE: Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants (RIN 3038-AE54)

Dear Mr. Kirkpatrick,

The Japan Securities Dealers Association (JSDA[1]) appreciates the opportunity to provide the following comments on the captioned proposed rules published for public comments on October 11, 2016 by the Commodity Futures Trading Commission (CFTC) ("Proposed Rules").

We recognize and understand that the CFTC intends to extensively keep track of and regulate swap transactions, which may transfer risks to the United States, in order to secure financial stability. This being said, we have some serious concerns as to whether the Proposed Rules are an optimum approach to achieving this goal, whether the CFTC's assumption on which the rules are based is accurate, how much burden financial institutions will need to bear under the rules and whether the rules will bring about benefits greater than or equal to the burden. We request the CFTC to adequately consider and address these concerns.

1. Paying due respect to regulations adopted in each jurisdiction

Regulatory measures on derivatives which were agreed among G20s should be implemented in each jurisdiction while taking concerted action in each jurisdiction. In Japan also, necessary measures have been introduced through law amendments and other steps. That is to say, through introducing requirements for central clearing, trade reporting and margin requirements for uncleared OTC derivatives, for example, a set of regulations on derivative transactions has been put into force under Japanese regulation. Japanese financial institutions registered as financial instruments business operators are conducting their businesses complying with the laws and regulations that incorporate above-mentioned requirements.

The Proposed Rules drastically increase its coverage in relation to "Other Non U.S. Persons" (as defined in page 71954 of the Proposed Rules), increasing the need for such

[1] The Japan Securities Dealers Association (JSDA) is an association that functions as both a self-regulatory organization and as an interlocutor between market participants and various stakeholders, including government authorities. Its legal status is a Financial Instruments Firms Association authorized by the Prime Minister. Both functions operate independently. JSDA is made up of approximately 470 members that include securities firms and other financial institutions running securities businesses in Japan.

firms to register as swap dealers (SDs) when they conduct swap transactions exceeding the de minimis threshold. This means that the transactions conducted outside the United States are subject to the CFTC's regulations which impose an additional regulatory burden on many Japanese financial institutions in addition to the burden that they have already incurred under the regulations in Japan, even though they do not conduct swap transactions in the United States.

We understand that the current CFTC Cross Border Guidance reflects the shared view on regulatory coordination among authorities in the United States and Japan that "FSA Japan has the primary responsibility in determining and implementing appropriate regulation of OTC derivatives market participants and their transactions in Japan." (joint letter by the Financial Service Agency (FSA) Japan and the Bank of Japan to the CFTC on August 13, 2012[2]). The Proposed Rules, however, seem to bring up again the same issue which was already settled four years ago and do not seem to be coordinated enough with other jurisdictions. We think that the Proposed Rules should not be finalized or implemented before completing discussion and coordination with the authorities in other jurisdictions.

We would also like to point out that financial institutions in each jurisdiction have already set up their business flows and administration systems based on the guidance published in 2012. We are concerned that the Proposed Rules which, if enacted in its proposed form, would drastically change the regulations fixed only a few years ago, would seriously impair the predictability of CFTC regulation.

Based on the above-mentioned considerations, we humbly but firmly request the CFTC to review the Proposed Rules comprehensively. Particularly, it is not acceptable to introduce the additional regulations on "Other Non U.S. Persons." We strongly request the CFTC to reconsider this point.

2. Assumption on which the Proposed Rules are based

The Proposed Rules describe that "the Commission is unable to estimate the number of new SDs that may be required to register as a result of the proposed rule's requirement that an Other Non-U.S. Person include swaps with an FCS for SD registration threshold purposes", and that "the Commission also is not estimating the number of new SDs that may be required to register as a result of the proposed rule's requirement that an Other Non-U.S. Person include swaps with a U.S. Person or U.S. Guaranteed Entity in its SD de minimis registration threshold" with a footnote that few "Non-U.S. persons" would register as an SD even if the Proposed Rules would be implemented[3]. In the current Japanese market, U.S. financial institutions possess a considerable market share as major market liquidity providers through their foreign branches and subsidiaries outside the United States Actually, in one Japanese financial institution, swap transactions with U.S. financial institutions' subsidiaries and branches account for more than 40% of its whole transactions and have exceeded the proposed SD registration threshold. There will be other Japanese financial institutions that are in a similar situation.

These Japanese financial institutions and their transactions are properly monitored and supervised by FSA Japan. Moreover, their counterparties are U.S financial institutions' subsidiaries or branches which mostly have been already registered as SDs and

[2] http://www.fsa.go.jp/inter/etc/20120820-1/01.pdf

[3] See page 71971 of Federal Register/Vol. 81, No.201/Tuesday, October 18 2016/Proposed Rules

therefore are under the proper supervision by the CFTC. If the Proposed Rules are introduced, these transactions may be unduly restrained and market liquidity may significantly decline.

Therefore, we think that the CFTC should re-examine accurate data, analyze the impact on market liquidity caused by possible suppression or suspension of swap transactions, conduct a cost-benefit analysis of implementing the Proposed Rules, and reconsider the scope of regulation including the de minimis threshold.

3. Burden on Japanese and U.S. financial institutions and concerns about market fragmentation

According to the Proposed Rules, when the amount of swap transactions of a Japanese financial institution with U.S. financial institutions including their branches, U.S. Guaranteed Entities and Foreign Consolidated Subsidiaries (FCSs) exceeds the de minimis threshold, the Japanese financial institution is required to register as an SD within a certain period of time regardless of its domicile and comply with the "Entity Level Requirement" and "Transaction Level Requirement." Although substituted compliance is available for a part of these requirements, its scope is limited. With respect to "Entity Level requirement" for example, preparation and submission of periodical reports on compliance and risk management would be required in addition to the initial registration requirement. To meet the "Transaction Level Requirement", it is unavoidable to develop a large-scale system and establish an operation framework for real-time reporting and recording of transactions. Moreover, parts of the SD regulation have been revised frequently over the years. Therefore, it will be considerably difficult and require a significant amount of work and expense to establish and maintain a framework to accurately trace the frequent revisions to the U.S. regulation from Japan. The work and expense required to address the additional regulations means that financial institutions which have already complied with each jurisdiction's regulation are put under duplicate regulations. As a result, it will lead to considerable social inefficiency and there is no sufficient reason for bearing such costs.

These additional costs will inevitably increase transaction costs in the Japanese market and may reduce market liquidity. As a result of introducing the Proposed Rules, Japanese financial institutions may be inclined to refrain from or avoid swap transactions with U.S. persons and their FCSs as well as "ANE transactions". It should also be kept in mind that it may invite market fragmentation and eventually decrease the market liquidity and U.S. financial institutions' profits as well.

In addition, according to the "Proposed Rules Regarding Capital Requirements of Swap Dealers and Major Swap Participants" which was published for public consultation on December 12, it is proposed that SD registrants will be subject to requirements that include capital and liquidity requirements as required by the U.S. Prudential Regulators or SEC. Also, additional requirement to obtain approval for their internal models from these authorities and periodical reporting requirement on the financial results to the CFTC are also proposed. This means that SD registrants will be directly monitored and supervised by not only the CFTC but also the entire U.S. regulators, which deviates from international comity and also imposes considerable additional burdens on financial institutions in terms of system development costs and human resource expenses.

4. Scope of transactions to be aggregated toward the de minimis threshold

While we are basically requesting the CFTC to withdraw the Proposed Rules as laid out

the afore-mentioned points, we would also like to refer to some concerns about the proposed scope of transactions aggregated toward the de minimis threshold calculation as follows.

1) ANE transactions

We are supportive of requiring only certain “External Business Conduct Rules” such as preventing fraud and market manipulation of transactions to apply on ANE transactions where transactions are being arranged, negotiated or executed by personnel located in the United States to maintain sound market. We also agree with the CFTC’s view to exclude ANE transactions where both counterparties are non U.S. persons from the de minimis threshold calculation. The reason to involve a U.S. person in ANE transactions is not to intend circumvention of the law or regulation but to optimize swap transactions with consideration for geographical factors such as time differences, expertise on transactions and market liquidity. Acts conducted by optimum persons in optimum markets do not increase risk. Furthermore, with ANE transactions involving U.S. persons, actual risks belong to the booking entities located outside the United States and do not extend to the United States. Rather, if ANE transactions are included in the de minimis calculation, non U.S. financial institutions will likely avoid ANE transactions and transfer those operations from the United States to Europe or other regions. This will result in a decline in job opportunities in the United States

2) Question about SD conduit

Swap activities, with non U.S. persons or Japanese branches of U.S. persons conducted in Japan by Japanese financial institutions which do not have parent companies in the United States, and their risk management are properly supervised by FSA Japan. Those activities have no direct and significant connections with activities conducted in the United States nor they make direct and significant impacts on commerce in the United States. Therefore, adding those transactions to the de minimis calculation is not consistent with the principle of international comity and seems to be beyond the CFTC‘s authority. In addition, the case of SD Conduit, when a Japanese financial institution conducts transaction with its U.S. affiliate that is registered as SD, there will be no occurrence of any event where risks in the U.S. market are not fully regulated, as the CFTC already has regulatory authority over the SD registered U.S. affiliate. In fact, the CFTC listed in the Cross-border Guidance published in July, 2013, as a reason for excluding a U.S. person’s swap activities guaranteed by another U.S. person with an SD registration from the de minimis calculation, that “one counterparty to the swap is a swap dealer subject to comprehensive swap regulation and operating under the oversight of the Commission.” (P45324 of the Guidance)

3) Guaranteed transactions

As the CFTC currently allows, when a guaranteed entity is subject to the Capital Accord of the Basel Committee on Banking Supervision (“the Accord”) or appropriate capital requirement equivalent to the Accord, such an entity’s swap transactions guaranteed by a non U.S. person should be excluded from the MSP registration threshold calculation. As the CFTC states in the Proposed Rules that “the parent entity may, for reputational or other reasons, choose or be compelled to assume the risk incurred by its affiliates, branches, or offices located overseas”, we suppose that swap transactions guaranteed by a non U.S. person do not have any direct and significant impacts on the United States.

4) Transactions cleared through clearing organizations

The Proposed Rules provide that “any transaction that is executed anonymously on a swap execution facility (SEF), designated contract market (DCM), or Foreign Board of Trade (FBOT) and cleared through a registered or exempt derivatives clearing organization (DCO) is exempted from other non U.S. persons’ SD de minimis threshold calculation.” We would like to make a request to the CFTC that all transactions cleared through these facilities are excluded from the SD de minimis threshold calculation regardless of the anonymity of transaction. As regulators also understand, risks of transactions cleared through these facilities are mitigated because their counterparties are those facilities. Therefore, those transactions do not pose risks to the U.S. market and should be exempted from the SD de minimis threshold calculation. Even in the case that an original counterparty is a U.S. person, its Guaranteed Entity or FCS, such a transaction does not pose a risk to the U.S. market as long as the transaction is cleared through a clearing organization.

5) Transactions subject to margin requirement

The Cross-Border Margin Rules which became effective in Canada, Japan and the United States on September 1, 2016 in accordance with international regulatory harmonization strictly require the exchange of initial and variation margins on non-centrally-cleared OTC derivative transactions conducted by financial institutions in these jurisdictions. Particularly, if there is a difference in how the initial amount should be calculated between jurisdictions, firms are required to exchange the larger amount, resulting in a fairly conservative treatment. Accordingly, transactions subject to margin requirement should be excluded from the SD de minimis threshold calculation since transactions subject to margin requirement can be regarded to meet the same level of credit enhancement as centrally-cleared transactions.

In conclusion, we appreciate this consultation process involving foreign market stakeholders, which we believe indispensable for developing regulatory standards that efficiently and effectively work on a cross-border basis. We hope that the comments described above will be of help in your future deliberations. Please feel free to contact us should you encounter anything unclear in the comments.

Sincerely,

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Cc: Chairman Mr. Timothy G. Massad
Commissioner Ms. Sharon Y. Bowen
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