JFMC Japan Financial Markets Council

March 14, 2019

Mr. Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St, N.W.
Washington, DC 20581

Re: Swap Execution Facilities and Trade Execution Requirements; Proposed Rule – RIN 3038-AE25

Dear Mr. Kirkpatrick:

1. Introduction

The Japan Financial Markets Council ("JFMC")[1] is grateful for the opportunity to comment on the U.S. Commodity Futures Trading Commission ("CFTC") request for views on the proposed revisions to the regulations governing swap execution facilities ("SEFs") and the trade execution requirement published by the CFTC on November 30, 2018 ("Proposal").[2]

The JFMC welcome and support the CFTC's objective of amending the current SEF regulations to further promote the execution of swaps on SEFs. We further support efforts to foster competition, efficiency, liquidity and transparency of the derivatives markets. In particular, we welcome and support the CFTC's proposal to allow flexible execution methods and reduce regulatory burdens on SEFs.

However, we are concerned with the cross-border impact of the Proposal. More specifically, we are particularly concerned with the potential overlaps of the CFTC's trade execution requirement and SEF registration requirement with similar or equivalent requirements under Japanese regulations and how the overlaps could result in a reduction of market participants and potentially lead to stagnation and stifling of the growth and development of the Japanese derivatives market.

2. Overlap with the Japanese trade execution requirement for OTC derivatives

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[1] The JFMC is an association which includes representatives from five Japan-based institutions and five international firms active in Japanese capital markets. Its aim is to ensure that authorities deciding on regulatory initiatives that have a global impact are aware of and take into account the effect of new regulations on Japanese capital markets. The current JFMC members are MUFG Bank, Ltd., Daiwa Securities Group Inc., Mizuho Securities, Nomura Holdings, SMBC Nikko Securities Inc., BNP Paribas, Citigroup Japan, Morgan Stanley, UBS Securities Japan Co., Ltd. and State Street. The co-chairs of the JFMC are the representatives from BNP Paribas and Nomura Holdings. The Secretariat of the International Bankers Association of Japan ("IBA Japan") serves as the Secretariat for JFMC. IBA Japan is a trade association for foreign banks and securities firms based in Japan and also other associated financial services firms. It carries out a range of services and activities to promote a strong and efficient financial sector and support members' business interests.

[2] *Swap Execution Facilities and Trade Execution Requirement*; *Proposed Rule*, 83 Fed. Reg. 61,946 (Nov. 30, 2018), *available at* https://www.cftc.gov/sites/default/files/2018-11/2018-24642a.pdf.

Under current Japanese regulations, certain interest rate swaps denominated in Japanese Yen referencing 6 month JPY-LIBOR with certain tenors are required to be executed on a Japanese electronic trading platform ("ETP") licensed with the Financial Services Agency of Japan ("JFSA").[3] The entities subject to the trade execution requirement under Japanese regulations are, save for certain exemptions, financial instrument business operators ("FIBOs") and registered financial institutions ("RFIs") licensed with the JFSA with an average outstanding notional amount of OTC derivatives transactions of JPY6 trillion or more.[4]

Conversely, certain classes of interest rate swaps denominated in Japanese Yen referencing JPY-LIBOR with a stated termination date range of 28 days to 30 years are currently designated for mandatory clearing by the CFTC. To the extent such swaps are or will be listed for trading on a SEF or a designated contract market ("DCM"), the Japanese Yen interest rate swaps could, among other products, become subject to the CFTC's trade execution requirement under the Proposal. Under the CFTC's cross-border guidance,[5] the CFTC's trade execution requirement, a category A transaction-level requirement, will apply to, among other cases, (a) a foreign branch of a U.S. swap dealer when trading with any counterparty or (b) a non-US swap dealer when trading with a U.S. person, including its foreign branches, or a guaranteed or conduit affiliate.

Based on the above, interest rate swaps denominated in Japanese Yen referencing 6 month JPY-LIBOR with certain tenors could potentially be subject to the trade execution requirement under both the Japanese regulations and CFTC regulations when traded, for example, between (a) a Tokyo branch of a U.S. Swap Dealer, dually registered with the JFSA as an FIBO or RFI subject to the Japanese trade execution requirement, and a Japanese financial institution subject to the Japanese trade execution requirement or (b) a non-US swap dealer, dually registered with the JFSA as an FIBO or RFI subject to the Japanese trade execution requirement, and either (i) a Tokyo branch of a U.S. person, dually registered with the JFSA as an FIBO or RFI subject to the Japanese trade execution requirement, or (ii) a guaranteed or conduit affiliate, dually registered with the JFSA as an FIBO or RFI subject to the Japanese trade execution requirement.

To the extent certain Japanese Yen interest rate swaps are subject to the trade execution requirement under both Japanese regulations and CFTC regulations, such swaps will be required to be executed at a trading venue dually registered as a SEF with the CFTC and licensed as an ETP with the JFSA. However, we are currently not aware of any trading venue dually registered or licensed as such thus practically the parties may not be able to execute the swaps due to lack of available trading venue.

[3] *See*, Specified OTC Derivatives Transactions defined in Article 40-7 of the Financial Instruments and Exchange Act (Act No. 25 of 1948, as amended) and Article 125-7 of the Cabinet Office Ordinance Concerning Financial Instruments Business, Etc. (Cabinet Office Ordinance No. 52 of 2007, as amended).
[4] Approximately, US$54 billion based on an exchange rate of JPY111.00 per US$1.00.
[5] Interpretive Guidance and Policy Statement regarding Compliance with Certain Swap Regulations, 78 Fed. Reg. 45,292 (July 26, 2013)

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The entities impacted by this overlap of regulations are major market participants in the Japanese Yen swaps market and hence impairing the ability of these market participants to trade certain JPY interest rate swaps due to overlap in regulations could result in a reduction of market participants and potentially lead to stagnation and stifling of the growth and development of the Japanese derivatives market.

3. Overlap with the Japanese ETP license requirement

Under current Japanese regulations, Japanese ETPs are required to satisfy stringent requirements and obtain license from the JFSA in order to engage in the business of operating an electronic trading facility for OTC derivatives. The requirements imposed on Japanese ETPs include minimum capital requirements, internal rules, books and records and publication of transaction information.

Conversely, under the Proposal, the SEF registration requirement will apply to, among other entities, swaps broking entities including interdealer brokers that facilitate swaps trading between multiple market participants and foreign multilateral swaps trading facilities including foreign swaps broking entities. The CFTC estimates approximately 60 swaps broking entities, including 10 to 20 foreign swaps broking entities, would be required to register as a SEF under the Proposal.

In addition, as stated above, Japanese ETPs would need to dually register as a SEF in order to function as an eligible trading venue for certain market participants subject to the trade execution requirement under both the Japanese regulations and CFTC regulations.

We believe imposing both the Japanese ETP regime and CFTC SEF regime on Japanese ETPs is contrary to the general principles of comity and unnecessary as both regimes are equally and comparably stringent. Further, it may result in Japanese ETPs incurring additional compliance cost that may be significant and untenable to sustain for certain Japanese ETPs. In this light, it may be impractical for certain Japanese ETPs to dually register as a SEF.

4. Conclusion

We are grateful for the opportunity to provide our comments to the CFTC's Proposal. While we welcome and support the CFTC's objective of amending the current SEF regulations to further enhance the execution of swaps on SEFs, we urge the CFTC to be cognizant of the cross-border impact of the Proposal in relation to the Japanese regulation to avoid stagnating and stifling the growth and development of the Japanese derivatives market due to overlap of regulations. To this end, among other possible solutions, we encourage the CFTC to consider granting a SEF exemption[6] to Japanese trading venues, which would be considered foreign swaps broking entities or otherwise would be subject to the expanded SEF registration requirement. We are committed to working collaboratively with the CFTC in the furtherance of coordinated and harmonized cross-border swaps regulations that will achieve positive outcomes for market

[6] U.S. Commodity Exchange Act section 5h(g).

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participants. We are pleased to answer any questions you may have.

Sincerely,

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