



INTERNATIONAL BANKERS ASSOCIATION OF JAPAN

October 6, 2022

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

Re: Japan Swap Dealer Capital Comparability Determination, 87 Fed. Reg. 48092 (August 8, 2022)

Dear Mr. Kirkpatrick:

I. Introduction

The International Bankers Association of Japan (“IBAJ”)¹ welcomes the opportunity to provide the Commodity Futures Trading Commission (the “Commission” or “CFTC”) with comments on the Commission’s proposed order regarding the swap dealer capital comparability determination for Japan (“Draft Order”) released in August 2022.² We greatly appreciate the Commission’s efforts in proposing the Draft Order providing for the conditional availability of substituted compliance in connection with the application for a capital comparability determination from the Financial Services Agency of Japan (“FSA”).

II. General Comments on Comparability

We generally support the overall framework reflected in the Draft Order. In response to the Commission’s request for public comment, we agree with the Commission’s comparability analysis with respect to the regulatory objectives of (i) the CFTC Capital Rules and CFTC Financial Reporting Rules and (ii) the Japanese Capital Rules and Japanese Financial Reporting Rules.³ Similarly, we agree with the Commission’s comparability analysis with respect to the qualifying capital under the CFTC Capital Rules and the Japanese Capital Rules, save for a few technical comments addressed later in this letter.⁴

¹ IBAJ is an association for foreign banks, securities companies and associate members based in Japan. It carries out a range of services and activities to promote a strong and efficient financial sector and support members’ business interests. <http://www.ibajapan.org/>

² Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination From the Financial Services Agency of Japan, 87 Fed. Reg. 48092 (August 8, 2022), available at <https://www.cftc.gov/sites/default/files/2022/08/2022-16684a.pdf>

³ See Draft Order, 87 Fed. Reg. at 48099-48100.

⁴ See Draft Order, 87 Fed. Reg. at 48101.

III. Minimum Capital Requirements

In connection with the comparability analysis with respect to the minimum capital requirement, the Commission specifically seeks public comment on the question of whether the requirements under the Japanese Capital Rules are comparable in purpose and effect to the Commission's requirement for a nonbank SD to hold regulatory capital equal to or greater than 8 percent of its uncleared swap margin amount.⁵

Our strong view is that the requirements under the Japanese Capital Rules⁶ are comparable in purpose and effect to the Commission's requirement for a nonbank SD to hold regulatory capital equal to or greater than 8 percent of its uncleared swap margin amount based on the below analysis.

The Commission states that "[t]he intent of the minimum capital requirement based on a percentage of the nonbank SD's uncleared swap margin was to establish a minimum capital requirement that would help ensure that the nonbank SD meets all of its obligations as a SD to market participants, and to cover potential operational risk, legal risk and liquidity risk in addition to the risks associated with its trading portfolio (emphasis added)."⁷

Under the Japanese Capital Rules, (i) liquidity risk is covered through the deduction of the balance sheet carrying value of fixed assets and (ii) operational risk and legal risk are covered by basic risk, which is a simplified but conservative approach to calculate a proxy for operational risks under the Basel 3 capital framework. As basic risk is incrementally added to market risk and credit risk, this will further increase the required capital amount under the Japanese Capital Rules. Furthermore, Japanese nonbank SD must maintain capital equal to 120 percent of the market risk, credit risk and basic risk equivalent amounts, which translates into an effective capital requirement of 9.6 percent of risk weighted assets, which is higher than that required by the Basel 3 capital framework or CFTC Capital Rules⁸.

On this basis, we believe the requirements under the Japanese Capital Rules are comparable in purpose and effect to the Commission's requirement for a nonbank SD to hold regulatory capital equal to or greater than 8 percent of its uncleared swap margin amount.

In connection with the comparability analysis with respect to the minimum capital requirement, the Commission specifically seeks public comment on the question of whether the requirement under the Japanese Capital Rules for a Japanese nonbank SD to hold qualifying capital in an amount equal to 25 percent of its defined annual operating expenses is sufficiently comparable in purpose and effect to the CFTC's requirement for a nonbank

⁵ See Draft Order, 87 Fed. Reg. at 48105.

⁶ See Draft Order, 87 Fed. Reg. at 48095.

⁷ See Draft Order, 87 Fed. Reg. at 48102.

⁸ See Draft Order, 87 Fed. Reg. at 48105. A Japanese nonbank SD is required to maintain a capital adequacy amount that is equal to 120 percent of the SD's risk equivalent amount. This is substantially higher than the 8 percent of total RWAs required under the Basel 3 capital framework or the Bank-Based Approach. In light of this difference, the Japanese Capital Rules contain certain adjustments from the methodology under the Basel 3 capital framework for calculating the risk equivalent amount. A number of these adjustments are comparable to those provided for under the Net Liquid Assets Approach and in practice frequently yield higher requirements than the Bank-Based Approach. For example, like the Net Liquid Assets Approach, the Japanese Capital Rules do not require a Japanese nonbank SD to multiply the market risk equivalent amount by 12.5 to obtain an RWA number and then maintain capital equal to 8 percent of those RWAs; instead, a Japanese nonbank SD must maintain capital equal to 120 percent of the market risk equivalent amount (as well as credit risk and basic risk equivalent amounts), which translates into an effective capital requirement of 9.6 percent of RWAs.

SD to hold qualifying capital in amount equal to at least 8 percent of the nonbank SD's uncleared swap margin amount.⁹

Our strong view is that the requirement under the Japanese Capital Rules for a Japanese nonbank SD to hold qualifying capital in an amount equal to 25 percent of its defined annual operating expenses is sufficiently comparable in purpose and effect to the CFTC's requirement for a nonbank SD to hold qualifying capital in an amount equal to at least 8 percent of the nonbank SD's uncleared swap margin amount based on the below analysis.

As stated in the Draft Order, under the Japanese Capital Rules the basic risk equivalent amount is computed as an amount equal to 25 percent of the Japanese nonbank SD's defined annual operating expenses, and is intended to provide a capital cushion to cover risks that may accrue in the course of executing ordinary business operations, such as error in business transactions.¹⁰ While the amount equal to 25 percent of the defined annual operating expenses is not the only factor in the calculation of the minimum required capital amount under the Japanese Capital Rules, such amount combined with market risk, credit risk and the deduction of the carrying value of fixed assets in the calculation of the minimum capital amount under the Japanese Capital Rules will broadly capture obligations to market participants, potential operational risk, legal risk and liquidity risk as well as market risk and credit risk. Further, the above calculation under the Japanese Capital Rules will capture both the trading portfolio as well as non-trading assets, whereas the latter will generally not be captured under the calculation of the 8 percent of the nonbank SD's uncleared swap margin amount.

On this basis, we believe the requirement under the Japanese Capital Rules for a Japanese nonbank SD to hold qualifying capital in an amount equal to 25 percent of its defined annual operating expenses is sufficiently comparable in purpose and effect to the CFTC's requirement for a nonbank SD to hold qualifying capital in amount equal to at least 8 percent of the nonbank SD's uncleared swap margin amount.

IV. Scope of Financial Information

In connection with the comparability analysis with respect to the financial reporting requirements, the Commission specifically seeks public comment on the scope of the financial information that Japanese nonbank SDs should be required to file with the Commission and NFA, that is, whether the financial information required of Japanese nonbank SDs should be limited to the types of financial information required of nonbank SDs under CFTC Regulation 23.105 of the CFTC Capital Rules. We appreciate the Commission's recognition of the fact that the Monthly Monitoring Reports, Annual Business Reports, and Annual Audited Financial Reports contain financial information of a Japanese nonbank SD that is comparable to the financial information required of nonbank SDs under CFTC Regulation 23.105 (such as statements of financial condition, statements of income, and statements demonstrating compliance with capital requirements).¹¹ Furthermore, as the

⁹ See Draft Order, 87 Fed. Reg. at 48106.

¹⁰ See Draft Order, 87 Fed. Reg. at 48105.

¹⁰ See Draft Order, 87 Fed. Reg. at 48109.

¹¹ See Draft Order, 87 Fed. Reg. at 48109.

Commission notes, the “Monthly Monitoring Reports, Annual Business Reports, and Annual Audited Financial Reports contain financial information that exceeds the requirements of CFTC Regulation 23.105, such as information regarding the holding of customer funds under Japanese laws.”¹²

Our strong view is that the financial information required of Japanese nonbank SDs should be limited to the types of financial information required of Japanese nonbank SDs under CFTC Regulation 23.105 of the CFTC Capital Rules. More specifically, the financial information should be limited to the following.

- Monthly Monitoring Report: Forms 1-1 Capital Ratio Summary; 1-2 Capital Ratio: Deductible Assets; 1-3 Market Risk; 1-4 Counterparty Risk; 2-1 Monthly Financial Statement (1); and 2-2 Monthly Financial Statement (2). Limiting the scope of information to these 6 items would be consistent with CFTC no-action letter 22-10. The other information in the Monthly Monitoring Report is either (a) similar to the information contained in the quarterly risk exposure report and monthly risk data report currently being submitted to the Commission and the NFA separately or (b) not required to be submitted under CFTC Regulation 23.105¹³(e.g., client assets segregation status, transaction volumes) thus should not be required to be submitted.
- Annual Business Report: Section 1(11) Status of Regulatory Capital Ratio and Section 2 Financial Statements (for Type 1 Financial Instruments Business Operator), which includes the statements of balance sheets, income (or loss), changes in net assets, appropriation of profit (or loss), annexed detail statements, and footnotes. The other information included in the Annual Business Report is not required to be submitted under CFTC Regulation 23.105 (e.g., client assets segregation status, mutual fund and deemed securities transaction volumes, the status of the deemed securities, and other various asset management business status reports, etc.) thus should not be required to be submitted.

V. Compliance Date

In the Draft Order, the Commission seeks public comment on the compliance dates for the reporting conditions that the Capital Comparability Determination Order, as defined in the Draft Order, would impose on Japanese nonbank SDs. We respectfully request the Commission to set the compliance date at least 6 months following the issue date of the Capital Comparability Determination Order. We believe the 6-month period is necessary to adequately prepare for compliance with the reporting conditions.

¹² Monthly reporting requirements are also specified in regulation 23.105 (l) Additional position and counterparty reporting requirements, and (m) Margin reporting. The position report (Schedule 1) as a part of (l) and the margin reporting are also included in the proposed comparability conditions for the Japanese nonbank SDs.

VI. Technical Comments to the Draft Order

In the following table, we address a few technical comments to the Draft Order with reference to the relevant Federal Register (“FR”) page.

FR Page	Comments
48100	<p>We request the Commission to revise the below text by adding the bold language to clarify that the carrying value of fixed assets will be deducted.</p> <p>“The Japanese Capital Rules require each Japanese nonbank SD to maintain a “capital adequacy amount” (i.e., Basic Items and Supplemental Items, after deducting carrying value of fixed assets) that equals...”</p>
48100	<p>We request the Commission to revise the below text by adding the bold language to clarify that the deduction will be made from the sum of Basic Items and Supplemental Items.</p> <p>“The Japanese Capital Rules further require a Japanese nonbank SD, in computing its capital adequacy amount, to deduct the balance sheet carrying value of fixed assets from its Basic Items and Supplemental Items.”</p>
48103	<p>We request the Commission to revise the below text by adding the bold language to clarify that the carrying value of fixed assets will be deducted.</p> <p>“The “capital adequacy amount” is calculated as the Japanese nonbank SD’s qualifying balance sheet equity capital in the form of Basic Items and Supplemental Items, after deducting carrying value of fixed asset.”</p>
48097	<p>We request the Commission to revise the below text by deleting the bold language, as the expected exposure method is the only internal model allowed for credit risk under the Japanese Capital Rules and internal rating method is not allowed.</p> <p>“Modeled credit risk and market risk capital charges require the estimation of potential losses, with a certain degree of likelihood, within a specified time period, of a portfolio of assets. Internal models allow for consideration of potential co-movement of prices across assets in the portfolio, leading to offsets of gains and losses. Internal credit risk models can also further include estimation of the likelihood of default of counterparties.”</p>
48104	<p>We request the Commission to revise the below text by deleting the bold language, as the expected exposure method is the only internal model allowed for credit risk under the Japanese Capital Rules and internal rating method is not allowed.</p> <p>“The Japanese Capital Rules’ internal credit risk model-based methodology is also based on the Basel 2.5 standard. The Japanese Capital Rules allow for the</p>

FR Page	Comments
	estimation of expected exposure, as a measure of potential future exposure, based on VaR techniques as well, with adjustments to the period of risk, as appropriate to the asset and counterparty. Credit risk models may include internal ratings based on the estimation of default probabilities, consistent with the Basel framework and subject to the same model risk management guidelines.

VII. Technical Comments to the Comparability Conditions

In the following table, we address a few technical comments to the comparability conditions with reference to the relevant FR page.

FR Page	Comments
48108	We support the Commission's proposal to accept the Annual Audited Financial Report denominated in yen, provided that the report is translated into the English language, as translating accounts denominated in yen to U.S. dollars on the audited financial statements may impact the opinion provided by the public accountant.
48108	With regard to the filing of Schedule 1 of Appendix B to Subpart E of Part 23, we request the Commission to clarify that the timing of the submission is the same as the Monthly Monitoring Report to maintain consistency with the text under Condition (11) on FR 48115.
48109	We support the Commission's proposal to not require a Japanese nonbank SD, which has been approved by FSA to use capital models, to file the monthly model metric information contained in Regulation 23.105(k) with the Commission or NFA.
48109	With regard to the Commission's proposal to require the submission of the Margin Report specified in Regulation 23.105(m), we request the Commission to specify that the timing of the submission is the same as the Monthly Monitoring Report to maintain consistency with the text under Condition (12) on FR 48115.
48110	With regard to the Commission's request for comment on the proposed filing dates for the reports and information, we believe the filing with the Commission and NFA within 15 business days of the date when the filing is made with the JFSA is sufficient.
48111	We request the Commission to revise the below text by deleting and adding the bold language as shown below to clarify that the relevant Japanese Capital Rules are based on a ratio. "As noted above, pursuant to the Japanese Early Warning Notices, a Japanese nonbank SD is required to provide the FSA with notices if its regulatory capital ratio falls below: (i) 140 percent; or (ii) 120 percent of its minimum

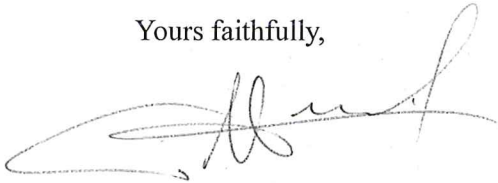
FR Page	Comments
	<p>capital requirement” and “The Commission has preliminarily determined that these Japanese Early Warning Notices achieve comparable outcomes to CFTC notice provisions contained in Regulation 23.105(c)(1) and (2) that require a nonbank SD to provide notice to the Commission and to NFA if a nonbank SD fails to meet its minimum capital requirement or if the firm’s regulatory capital ratio falls below 120 percent of its minimum capital requirement”</p>
48114	<p>We request the Commission to revise the below text by adding the bold language to clarify the liability and penalties provisions under the Japanese Capital Rules.</p> <p>“(4) The Japanese nonbank SD is subject to and complies with: Articles 28(1), 29, 46-3, 46-6(2), 47, 52(1), 53(1) through (3), 56-2, and 198-6 of the Financial Instruments and Exchange Act (Act No. 25 of 1948);”</p>
48115	<p>We request the Commission to revise the below text by adding the bold language as it is practically challenging to notify the Commission prior to discovery of the relevant failure.</p> <p>“(15) The Japanese nonbank SD files a notice with the Commission and NFA within 24 hours following the discovery of its failure to maintain regulatory capital in the form of Basic Items, as defined in Article 176 of the Cabinet Office Order No. 52 of 2007, equal to or in excess of the U.S. dollar equivalent of \$20 million using a commercially reasonable and observed yen/U.S. dollar exchange rate. The notice must be prepared in the English language;”</p> <p>“(18) The Japanese nonbank SD files a notice with the Commission and NFA within 24 hours following the discovery of its failure to make or keep current the financial books and records required by the Financial Services Agency. The notice must be prepared in the English language;”</p>
48115	<p>We request the Commission to revise the below text by adding the bold language for consistency with prong (ii) of condition (19).</p> <p>“(19) The Japanese nonbank SD files a notice with the Commission and NFA within 24 hours of the occurrence of any of the following: (i) a single counterparty, or group of counterparties under common ownership or control, fails to post required initial margin or pay required variation margin to the Japanese nonbank SD on uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 25 percent of the Japanese nonbank SD’s minimum capital requirement; (ii) counterparties fail to post required initial margin or pay required variation margin to the Japanese nonbank SD for uncleared swap and non-cleared security-based swap positions that, in the aggregate, exceeds 50 percent of the Japanese nonbank SD’s minimum capital requirement;”</p>

FR Page	Comments
48115	With respect to condition (19), we would like to seek clarification on the meaning of “exceeds 25 percent of the Japanese nonbank SD’s minimum capital requirement” and “exceeds 50 percent of the Japanese nonbank SD’s minimum capital requirement.” Specifically, does “minimum capital amount” in this context mean the amount calculated by multiplying the risk equivalent amount and 120% under the Japanese Capital Rules?

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We appreciate the Commission's consideration of our comments on the Draft Order. We would be pleased to provide further information at the request of the Commission or its staff. Please do not hesitate to contact us, if you have any questions with regard to the foregoing.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Philippe Avril', with a large, sweeping flourish underneath.

Philippe Avril,
Chair
International Bankers Association of Japan