October 7, 2022

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

Re: Notice of Proposed Order and Request for Comment on an Application for a Capital Comparability Determination From the Financial Services Agency of Japan

Dear Mr. Kirkpatrick:

The Institute of International Bankers ("**IIB**"), International Swaps and Derivatives Association ("**ISDA**") and Securities and Financial Markets Association ("**SIFMA**", and together with IIB and ISDA, the "**Associations**")[1] appreciate the opportunity to comment on the above-captioned notice by the Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") regarding an application submitted by the Financial Services Agency of Japan ("**JFSA**") requesting that the Commission determine that registered nonbank[2] swap dealers ("**SD**s") organized and domiciled in Japan ("**Japan SDs**") may comply with certain capital and financial reporting requirements under the Commodity Exchange Act ("**CEA**") and Rules 23.101 and 23.105(d)–(e) thereunder (the "**Commission Capital & Reporting Requirements**")[3] via compliance with corresponding capital and financial reporting requirements in Japan (the "**Japan Capital & Reporting Requirements**"), and the proposed order (the "**Japan Order**") providing for the conditional substituted compliance in connection with the application (together, the "**Proposal**").[4]

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[1] Please see the Appendix for more information on the Associations.

[2] As used herein, a "nonbank" SD refers to an SD that does not have a Prudential Regulator as defined in Section 1a(39) of the CEA.

[3] See *Capital Requirements for Swap Dealers and Major Swap Participants*, 85 FR 57462 (Sept. 15, 2020).

[4] See *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 (Aug. 8, 2022).

The Associations support the Proposal and agree with the Commission's overall analysis of and determination of comparability of the Commission's Capital & Reporting Requirements and the Japan Capital & Reporting Requirements. The Proposal reflects a thoughtful, holistic approach to substituted compliance. SIFMA supports the comments provided by the International Bankers Association of Japan ("**IBAJ**").[5] Below we respond to questions included in the Proposal regarding minimum capital requirements.

In the Proposal, the Commission seeks public comment on the question of whether the capital requirements under the Japan Capital & Financial Reporting Requirements 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.[6] The Commission also seeks comment on whether the requirement under the Japan Capital & Reporting Requirements for a nonbank Japan 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.[7]

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."[8] We believe the Japan Capital & Reporting Requirements' minimum capital levels are sound, reflect similar regulatory concerns and lead to comparable regulatory outcomes as the Commission Capital & Reporting Requirements.

Under the Japan Capital & Reporting Requirements, operational risk and legal risk are covered by basic risk, which is a simplified, but conservative approach to calculate proxy for Basel 3 operational risks. Basic risk is incrementally added to market risk and credit risk, further increasing Basel-based capital requirements. Liquidity risk is covered through the deduction of the balance sheet carrying value of fixed assets. As the Commission notes in the Proposal, Japan nonbank SDs are required to maintain regulatory capital equal or greater than 9.6% of the firm's risk weighted assets, which is higher than required by the Basel or CFTC capital rules.[9] Taken together, these

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[5] The IBAJ letter includes comments that are consistent with this letter as well as technical comments to the Japan Order including the comparability conditions.

[6] See Proposal, 87 Fed. Reg. at 48105.

[7] See Proposal, 87 Fed. Reg. at 48106.

[8] See Proposal, 87 Fed. Reg. at 48102.

[9] See Proposal, 87 Fed. Reg. at 48105. A Japan 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 BCBS framework and the Bank-Based Approach. In light of this difference, the Japanese Capital Framework contains certain adjustments from the BCBS

requirements cover potential operational risk, legal risk, and liquidity risk and lead to capital equal or greater than 8% of uncleared swap margin.[10]

In particular, the requirement under the Japan Capital & Reporting Requirements 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 based on the below analysis.

Under the Japan Capital & Reporting Requirements 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.[11] This 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 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 will, in addition to the trading portfolio, cover non-trading assets, which are not captured under the calculation of the 8 percent of uncleared swap margin amount.

For these reasons we believe the requirement for a Japan nonbank SD to hold qualifying capital in an amount equal to 25 percent of its defined annual operating expenses, together with the market risk, credit risk, and other requirements summarized above, are 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.

We would also take the opportunity to note, that we believe a similar analysis leads to the same answer in reference to the currently pending capital substituted applications for Mexico, the European Union ("**EU**") and the United Kingdom ("**UK**"). For example, the minimum capital levels required by the EU capital framework may be compared in some respects to the 8 percent of the uncleared swap margin requirement.

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methodology 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 Framework does not require a Japanese 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.

[10] Further, we note that in the Security and Exchange Commission's substituted compliance determinations that Basel-based approaches were comparable to the SEC's capital rules applicable to non-prudentially regulated SBSDs and that such an 8% of uncleared swap margin was not necessary.

[11] See Proposal, 87 Fed. Reg. at 48105.

As noted in our submitted application, in calculating its risk weighted assets for purposes of the EU capital framework's risk-based ratios, an EU SD must incorporate risk exposure amounts composed of market, credit, settlement, credit valuation adjustment, and operational risk. Because they cover the full range of a firm's exposures, not just those related to swaps, these exposure amounts will generally yield capital requirements that substantially exceed 8 percent of the SD's uncleared swap margin amount. In addition, the EU framework mandates a leverage ratio floor that, similar to the uncleared swap margin requirement, is based principally on volume and counterparties without regard to risk-weighting. Lastly, EU SDs are subject to comprehensive liquidity requirements that are designed to ensure that an SD has sufficient liquid assets to meet its ongoing obligations. As a result, although the EU capital framework does not have a direct analogue to the 8 percent uncleared swap margin requirement, it has various other measures that achieve the same regulatory objective.[12]

The above analysis and conclusions also apply to Mexico's capital framework, which requires that an SD calculate risk weighted assets incorporating risk exposure amounts composed of market, credit and equity exposures, and operational risk. Mexican SDs are also subject to liquidity requirements that are designed to ensure that an SD has sufficient liquid assets to meet its ongoing obligations. Furthermore, Mexican SDs are subject to leverage limitations that, similar to the uncleared swap margin requirement, are based principally on volume and counterparties without regard to risk-weighting. Lastly, Mexican SDs must conduct regular stress tests to ensure that they have sufficient resources to withstand adverse economic scenarios. As a result, although Mexico's capital framework does not have a direct analogue to the 8 percent uncleared swap margin requirement, it has various other measures that achieve the same regulatory objective of ensuring that an SD maintains an amount of capital that is sufficient to cover the full range of risks a Mexican SD may face.[13]

In the Proposal, the Commission also seeks public comment on the compliance dates for the reporting conditions that the Japan Order, as defined in the Proposal, would impose on Japan nonbank SDs. We respectfully request the Commission to set the compliance date at least six months following the issuance of the final comparability determination order. We believe a six-month period is necessary to adequately prepare for compliance with the reporting conditions.

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[12] A similar analysis applies to the UK minimum capital requirements. Please see *Substituted Compliance Application for EU Swap Dealers from CEA Sections 4s(e)–(f)and Rules 23.101 and 23.105(d)–(e), (p)(2)* and *Substituted Compliance Application for UK Swap Dealers from CEA Sections 4s(e)–(f) and Rules 23.101 and 23.105(d)–(e), (p)(2)*.

[13] Please see *Application for a Capital Comparability Determination Order Submitted on behalf of Nonbank Swap Dealers subject to Regulation by the Mexican Comision Nacional Bancaria y de Valores*.

The Associations appreciate the opportunity to comment on the Proposal and the Commission's consideration of our views. We look forward to continuing dialogue with the Commission regarding substituted compliance. If you have questions or would like additional information, please contact the undersigned.

Very truly yours,

Stephanie Webster
General Counsel
IIB

Steven Kennedy
Global Head of Public Policy
ISDA

Kyle L Brandon
Managing Director, Head of Derivatives Policy
SIFMA

cc: The Honorable Rostin Behnam, Chair, Commodity Futures Trading Commission
The Honorable Kristin N. Johnson, Commissioner
The Honorable Christy Goldsmith Romero, Commissioner
The Honorable Summer K. Mersinger, Commissioner
The Honorable Caroline D. Pham, Commissioner
Ms. Amanda Olear, Director, Market Participants Division
Mr. Thomas Smith, Deputy Director
Mr. Joshua Beale, Associate Director
Mr. Rafael Martinez, Associate Director

Appendix

The **IIB** represents internationally headquartered financial institutions from over thirty-five countries around the world doing business in the United States. Its members consist principally of international banks that conduct U.S. operations through branches and agencies, bank subsidiaries, and broker-dealer subsidiaries. The IIB's mission is to help resolve the many special legislative, regulatory, and tax issues confronting internationally headquartered financial institutions that engage in banking, securities, and/or insurance activities in the United States. For more information, visit http://www.iib.org.

Since 1985, **ISDA** has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 950 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter, LinkedIn, Facebook and YouTube

SIFMA is the leading trade association for broker-dealers, investment banks, and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation, and business policy, affecting retail and institutional investors, equity and fixed income markets, and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.