Ref: CHC/6/H25
February 6, 2013

Comment on Further Proposed Guidance Regarding Compliance With Certain Swap Regulations

Japanese Bankers Association

We, the Japanese Bankers Association, would like to express our gratitude for this opportunity to comment on the further proposed guidance regarding compliance with certain swap regulations released on 7 January 2013 by the Commodity Futures Trading Commission (the "Commission" or "CFTC").
We hope that our comments below will be fully taken into consideration as you work towards finalizing the rules proposed by the Commission.

<Preamble>

It is well understood that swap dealing activities are undertaken across borders. Nonetheless, we respectfully reiterate our opposition to the proposed cross-border application guidance framework imposing a registration requirement and compliance with the U.S. rules based on the only fact that a non-U.S. Swap Dealer (SD) is dealing with U.S. persons. We have previously stated this in our comment of August 27, 2012[1] with regard to the Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act, published by CFTC on July 12, 2012.

With respect to the cross-border application, Further Proposed Guidance Regarding Compliance With Certain Swap Regulations ("Further Proposed Guidance") has been issued while the Final Exemptive Order is temporarily applied until July 12, 2013. Compliance actions which Japanese financial institutions need to take will be fully determined only after the final rules are issued. Even minor changes, needless to say significant changes, under the final rules to the requirements set forth in the Final Exemptive Order will necessitate financial institutions to take certain actions to such changes for compliance purposes. Therefore, we respectfully request the Commission to provide a clear timeline of promulgating and implementing the final rules, and set a sufficient preparatory period in consultation with each national authority including Japan based on *the Joint Press Statement of Leaders on Operating Principles and Areas of Exploration in the Regulation of the Cross-border OTC Derivatives Market*, published on December 5, 2012.

[1] See our comment of August 27, 2012 submitted to CFTC. (P.1-2)
(http://www.zenginkyo.or.jp/abstract/opinion/entryitems/opinion240847.pdf)

The Specific Comment section below addresses issues raised by the CFTC, providing our proposed solutions.

1. Aggregation of Affiliates' Swaps for Purpose of the De Minimis Test (Q1-3)

(Rules on Aggregation of Affiliates' Swaps) (See *Appendix*.)

We do not support the alternative interpretation of the aggregation requirement proposed under the Further Proposed Guidance where "a non-U.S. person would be required, in determining whether its swap dealing transactions exceed the de minimis threshold [("De Minimis Test")], to include the aggregate notional value of swap dealing transactions entered into by all its affiliates under common control (i.e., both non-U.S. affiliates and U.S. affiliates)". In addition, the Final Exemptive Order which allows the De Minimis Test on an affiliate-by-affiliate basis should be retained after July 12, 2013.

As discussed in our comment of August 27, 2012;[2] given the fact that the determination of whether transactions with U.S. persons constitute a core business depends on each affiliate of a non-U.S. person, it is considered excessive to require such non-U.S. person and its non-U.S. affiliates under common control which have only a limited impact on the U.S. economy, to register as an SD simply because some of its affiliates engage in a significant amount of transactions with U.S. persons even when the non-U.S. person engages in only a small amount of transactions with U.S. persons (excluding transactions with U.S. affiliates under common control).

Our position is that the De Minimis Test should be carried out on an affiliate-by-affiliate basis. However, should the aggregation requirement of affiliates' swaps be applied to a non-U.S. person, we firmly request that (similarly to the treatment under the Final Exemptive Order), regardless of whether registered as an SD or not, the swap dealing transactions of any of its U.S. affiliates under common control should be excluded from the De Minimis Test.

U.S. affiliates, whether registered as an SD or not, are subject to various requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act"), as a U.S. person. Further, the intent of the cross-border application of the swap provisions is to focus on transactions executed between non-U.S. persons and U.S. persons. In light of these facts, there seems to be no justification in requiring a non-U.S. person to aggregate the notional value of its swap dealing transactions with U.S. affiliates for purposes of the De Minimis Test.[3] Including swap dealing

[2] See our comment of August 27, 2012 submitted to CFTC. (P.4)
[3] See the comment below stipulated in P. 41220 of the Proposed Guidance.

transactions with U.S. affiliates registered as an SD as a U.S. person in the calculation of the de minimis threshold may give rise to a concern that, even non-U.S. financial institutions (a non-U.S. person) dealing a small amount of derivative transactions with U.S. persons (excluding transactions with U.S. affiliates under common control) may be forced to reduce the volume of their swap transactions, in order to avoid exceeding the de minimis threshold.

It is presumed that the aggregation requirement under the Further Proposed Guidance builds on the CFTC's concern that U.S. banks and their affiliates may establish an entity outside the U.S. through which these entities engage in swap transactions with non-U.S. persons with the aim of evading the application of the Dodd-Frank requirements to such swaps (i.e. to avoid oversight by the U.S. authorities). While the CFTC's proposal may prevent such an evasion, it may also have a significant impact on the case, such as Japanese banks, where an entity operating inside the U.S. (i.e. a U.S. affiliate) that primarily engages in swap dealing activities with U.S. persons is only registered as an SD. In such a case, the application of the proposed aggregation rule may result in requiring a non-U.S. person to register as an SD.

Given the approach as in the Japanese-bank case above, such swap transactions with U.S. persons will still be under the supervision of the U.S. regulatory authority, and hence registering only its U.S. affiliates under common control should not be construed as an act to avoid regulation. Rather, such acts by Japanese banks should be recognized as favorable, since it is a positive response to the regulation by enhancing the transparency of transactions through registering its U.S. affiliates under common control as an SD.[4] Given this, it is not considered reasonable that a non-U.S. person results in being subject to the SD registration even though it hardly engages in swap transactions with U.S. persons that are not under common control, simply because it exceeds the de minimis threshold by being required to include its SD-registered U.S. affiliates' swap dealing transactions. In other words, if the U.S. regulatory authority requires a non-U.S. person to register as an SD even when its swap dealing transactions with U.S. persons are below the de minimis threshold, this would mean that the cross-border application of regulation of one jurisdiction is imposed to other jurisdictions beyond the intent of such regulation. This would not only undermine the supervisory/administrative independence of each jurisdiction but also contradicts the agreement reached among national

"However, since the focus is on the level of activity conducted by non-U.S. persons, swap dealing transactions of affiliated U.S. persons should not be included."

[4] Our comment of August 27, 2012 to CFTC proposed the following solution: "a solution for foreign banks to both maintains its current dealing activity and access to discount window is to push out its swap activity to its affiliate and register such an affiliate as a SD/MSP. (paragraph 2, page 9)" This should be considered as a reasonable action in line with Sec. 716 of the Dodd-Frank Act.

authorities to harmonize regulations across jurisdictions.

On the other hand, we support the proposal in the Further Proposed Guidance not to require non-U.S. affiliates under common control that are registered as an SD to be included in the aggregate notional value of swap dealing transactions for De Minimis Test purposes, on the grounds that such SD-registered affiliates are already under the direct oversight by the CFTC.

Given the above, if the requirement to aggregate affiliates' swap transactions would be adopted in the final rules, it should be sufficient to require a non-U.S. person to include the aggregate notional value of swap dealing transactions with U.S person entered into by its non-U.S. affiliate that is not registered as an SD for De Minimis Test purposes, in order to ensure proper regulation over swap dealing activities of a non-U.S. person with U.S. persons.

In addition, the Proposed Guidance of July 12, 2012 does not require a non-U.S. person to count swaps with foreign branches of U.S. SDs for De Minimis Test purposes, and we request such treatment be retained in the final rules. In our understanding, this treatment is adopted on the grounds that a U.S. person registered as an SD is subject to regulations governing Swap Dealers and as such regulatory concerns would be limited. This treatment is considered to be beneficial for market participants of both non-U.S. persons and U.S. persons.

(Proposed solution to address the CFTC's concern)

If, as previously stated, the CFTC's concern stems from the case where U.S. banks and their affiliates may establish an entity outside the U.S. through which these entities engage in swap transactions with non-U.S. persons with the aim of evading the application of the Dodd-Frank requirements to such swaps, then the CFTC should set a rule that only prevents such an evasion.

As aforementioned, we are concerned that including in the non-U.S. person's De Minimis Test swap transactions by a non-U.S. person and its non-U.S. affiliates under common control that only have a limited impact on the U.S. economy and imposing the SD registration to such non-U.S. person may lead to over-regulation, and therefore firmly request that all swap transactions of U.S. affiliates under common control be excluded from the De Minimis Test.

If our comment above would be taken into account in finalizing the rules, it is further requested to consider not to impose excessive regulation on non-U.S. person(s) under common control that is

subject to the prudential regulation by its home supervisor, and to hold a sufficient consultation with each national supervisor.

2. Definition of "U.S. Person"

(General comments)

Our comment of August 27, 2012[5] requested the Commission to clarify the definition of the term "U.S. person", and reduce the burden required for the assessment of the U.S. person status. While the Further Proposed Guidance provided clarification on some areas, unclear and complex areas still exist, allowing several interpretations in applying the requirements. However, no specific approach is provided to confirm which interpretation to follow. As such, a concern that the assessment of the U.S. person status may be inconsistently carried out across entities, as indicated in the CFTC Letter No.12-22 (issued on October 10, 2012), is not yet fully resolved.

In light of this, we believe that the "U.S. person" should be defined in a manner to enable entities to assess the "U.S. person" status solely by reference to information which is reasonably available to bona-fide third parties. Unless the "U.S. person" is defined as such, the assessment would incur an excessive burden for swap participants.

Our recommendation is to classify prongs of the "U.S. person" definition into (i) those which entities are responsible to determine by themselves based on items readily determinable solely by reference to information which is reasonably available to bona-fide third parties, and (ii) those which may likely result in the determination that an entity is a U.S. person, regardless of the result of the assessment under (i), and to require the U.S. person to make a representation of being a U.S. person to its counterparty from the perspective of reducing the practical burden imposed on swap participants (in which case the counterparty can rely on this representation unless there is a reasonable reason to believe that such a representation is not true). Even if the Commission decides to retain the currently proposed framework of the "U.S. person" definition, it is considered necessary to classify and clarify prongs from the perspectives discussed above.

Further, we would like to confirm our understanding that a non-U.S. bank is not required to assess the U.S. person status on a single-entity branch basis. More specifically, a "U.S. branch" of a "foreign bank satisfying the non-U.S. person requirements" is not deemed as a "U.S. person" under

[5] See our comment of August 27, 2012 to CFTC. (First paragraph of section 1. Clarification of the definition of "U.S. Person", General comment, page 2)

the CFTC rules.

Neither the Proposed Guidance, Further Proposed Guidance, nor Final Exemptive Order includes a description about a U.S. branch of a foreign bank in relation to the definition of the term "U.S. person", and accordingly, further clarification is warranted. A U.S. branch of a foreign bank needs clear criteria to determine whether it is deemed as a "U.S. person" because such determination significantly affects actions to the transaction-level requirements. Since the Proposed Guidance stipulates that a foreign branch of a U.S. person "is a part, or an extension, of a U.S. person,"[6] considering a U.S. branch of a foreign bank as a part, or an extension, of a non-U.S. person should be consistent with such an interpretation under the Proposed Guidance.

Our general comment on the definition of the term "U.S. person" is as noted above. Hereunder, we would like to present our comment for each proposed prong based on the proposed rules including the Further Proposed Guidance.

(Specific comments)

(Prong (i))

The definition of the term "resident" should be more explicit, so that assessments are consistently made across entities in practice. For example, whether the term "resident" only includes a person having U.S. citizenship/Green Card, or whether it also includes a foreigner who is temporarily domiciled in the U.S.

(Prongs (ii) and (iv))

A clearer definition of the term "fund" is also requested. In particular, if a "fund" covered in Prong (ii) does not include an "investment fund" covered in Prong (iv), please clarify this point.

If a "fund" under Prong (ii) includes an "investment fund" under Prong (iv), an investment fund needs to be assessed based not only on the Prong (iv) criterion (i.e. majority-ownership) but also on the Prong (ii) criterion (i.e. place of incorporation or principal place of business). Such treatment would be considerably complicated, and also contradict the intent of the Final Exemptive Order which decided not to apply the "principal place of business" assessment to collective investment vehicles (CIVs) etc., in order to avoid complication in applying the rules.

[6] See Federal Register/Vol.77, No.134/Thursday, July 12, 2012/Proposed Rules. (Middle section of page 41218) - "Under this interpretation, the term ''U.S. person'' generally means that a foreign branch or agency of a U.S. person would be covered by virtue of the fact that it is a part, or an extension, of a U.S. person."

(Prong (ii) (A))

The definition in the proposed Prong (ii)(A) should be further clarified and refined to make it clear whether the location of a subsidiary's headquarters can be determined as the principal place of business even when the parent in U.S. has substantial control over its subsidiary's operations. Basically, the principal place of business should be able to be determined based on information which is reasonably available to bona-fide third parties, such as the location of the headquarters.

This is consistent with the judicial precedent in the Hertz v Friend case referred to in the Final Exemptive Order.[7] It should be made clear for the Know Your Counterparty purposes as well that if an entity's headquarters is outside the U.S., such an entity should be deemed as a non-U.S. person.

In addition, please confirm whether funds and CIVs which were excluded from the application of the "principal place of business" assessment under the Final Exemptive Order will be subject to this assessment under the final rules.

(Prong (ii) (B))

While the clarification of the term "unlimited liability" is welcomed, there still remains cases where a majority-ownership criterion cannot be assessed based on reasonably available information. Therefore, it is requested to retain the approach to consider only those satisfying the uniform and readily ascertainable standard presented under the No-Action Letter No. 12-22 issued on October 12, 2012.

(Prong (iv))

The Further Proposed Guidance states that ownership verification is particularly difficult for funds that are publicly traded. Similarly, in cases of those private placement funds which preserve the anonymity of beneficiaries, it is difficult for a third party to verify whether the owner is a U.S. person or not. Therefore, in such cases, the final rules should allow an entity to rely on the counterparty's representation as mentioned in the previous paragraph.

In cases of publicly-traded funds, an entity should be allowed to determine that a fund is not offered directly or indirectly to U.S. persons, provided that it is concluded, after taking into account each jurisdiction's circumstances and business practices, that there is no evidence that explicitly indicates the offering to U.S. investors based on such as an agreement, and no relevant representation of being

[7] See Note 42 to CFTC's Final Exemptive Order (page 20).

a U.S. person is made by the counterparty. In such cases, it should be interpreted that the majority of the fund is not owned by a U.S. person, and thus such a fund is not a U.S. person.

Please note that currently the majority of Japanese trust funds are owned by residents in Japan. However, if U.S. persons which are a non-Japan resident own a majority of such funds, it is our concern that such situations may not be properly captured.

(Prong (v))

Prong (v) should exclude the case where an entity entrusts with investment management under a discretionary investment agreement and sub-entrusts such investment management to another entity who is registered as a commodity pool operator under the Commodity Exchange Act (CEA). It should, by factoring in local circumstances and business practices, specify that the term “operator” represents a “person who has all authority in relation to investment” but does not include a “person who simply has the authority to place an order and to instruct a trustee”.

Under the investment trust scheme in Japan, an investment management company serves as an investment manager for an investment trust under the investment discretionary agreement entered into with a trustor. If such investment management service is outsourced to another investment management company, this sub-investment manager only has the authority to place orders and issue instructions to a trustee. Therefore, such sub-investment manager is deemed to have no relationship with the trust fund that may trigger systemic risk. Even if such an entity is determined to be a U.S. person under the guidance, this entity should not affect the determination of how to treat the trust fund since it is not in substance a party to a swap transaction. Therefore such an entity shall be excluded from the definition (v).

(Other issues associated with the definition of a U.S. person)

It is requested to explicitly specify that the assessment of the scope of entities entrusting investment to an overseas (U.S.) entity under an investment trust fund scheme should be on a final beneficiary basis.

Appendix (Summary of Aggregation Rules of Affiliates' Swaps for Purposes of the De Minimis Test)

Our comment is based on our understanding of the aggregation rules as summarized below:

<table>
<tr><td>Proposed Guidance
(July 2012)</td><td><u>a non-U.S. person</u>, […], <u>would include</u> the aggregate notional value of swap dealing transactions entered into by <u>its non-U.S. affiliates</u> under common control but <u>would not include</u> the aggregate notional value of swap dealing transactions entered into by <u>its U.S. affiliates</u>.

<table><tr><td></td><td>U.S. affiliate
(Affiliate in U.S.)</td><td>non-U.S. affiliate
(Affiliate outside U.S.)</td></tr><tr><td>SD</td><td>Excluded</td><td>Included in aggregation</td></tr><tr><td>Non-SD</td><td>Excluded</td><td>Included in aggregation</td></tr></table></td></tr>
<tr><td>Final Exemptive Order
[Alternative 1]
(Temporary rules applicable from Dec. 21, 2012 up to Jul. 12, 2013)</td><td><u>a non-U.S. person</u> <u>is not required to include</u>, […], the swap dealing transactions of <u>any of its U.S. affiliates</u>, [and]
<u>a non-U.S. person that is an affiliate of a person that is registered as an SD</u> <u>is not required to include</u> [...] the swap dealing transactions of <u>any of its non-U.S. affiliates</u> that engage in swap dealing activities, so long as <u>such excluded affiliates</u> are either (1) engaged in swap dealing activities with U.S. persons as of the effective date of the Final Order or (2) <u>registered as an SD</u>.

<table><tr><td></td><td>U.S. affiliate</td><td>non-U.S. affiliate</td></tr><tr><td>SD</td><td>Excluded</td><td>Excluded</td></tr><tr><td>Non-SD</td><td>Excluded</td><td>Included in aggregation</td></tr></table></td></tr>
<tr><td>Further Proposed Guidance
[Alternative 2]
(January 2013)</td><td><u>a non-U.S. person</u> would <u>be required</u>, […], <u>to include</u> the aggregate notional value of swap dealing transactions entered into by <u>all its affiliates</u> under common control <u>(i.e., both non-U.S. affiliates and U.S. affiliates)</u>, but would <u>not be required to include</u> […] the aggregate notional value of swap dealing transactions of <u>any non-U.S. affiliate</u> under common control that is <u>registered as an SD</u>.

<table><tr><td></td><td>U.S. affiliate</td><td>non-U.S. affiliate</td></tr><tr><td>SD</td><td>Included in aggregation</td><td>Excluded</td></tr><tr><td>Non-SD</td><td>Included in aggregation</td><td>Included in aggregation</td></tr></table></td></tr>
</table>