IBA JAPAN | INTERNATIONAL BANKERS ASSOCIATION OF JAPAN | JFMC Japan Financial Markets Council

March 5, 2020

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

Re: Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants (RIN 3038-AE84)

Dear Mr. Kirkpatrick:

I. Introduction

The Japan Financial Markets Council ("JFMC")[1] and the International Bankers Association of Japan and ("IBAJ")[2] are grateful for the opportunity to provide our comments to the notice of proposed rulemaking on the Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants ("Proposal") released by the Commodity Futures Trading Commission ("Commission" or "CFTC").[3] We support the

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1 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. http://www.japanfmc.org/

2 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/

3 *Cross-Border Application of the Registration Thresholds and Certain Requirements Applicable to Swap Dealers and Major Swap Participants*; *Proposed Rule*, 85 Fed. Reg. 952 (January 8, 2020), *available at https://www.cftc.gov/sites/default/files/2020/01/2019-28075a.pdf*

codification of the CFTC's 2013 cross-border guidance ("2013 Guidance")[4] that has governed the cross-border application of the CFTC's swaps rules since July 2013. We believe the codification will provide market participants with legal certainty that the 2013 Guidance, a non-legally binding policy statement, was not able to provide.

We commend the Commission's efforts to strike the right balance in protecting the integrity, safety and soundness of the U.S. financial system while promoting global regulatory harmonization and striving to show deference to comparable foreign regulations by recognizing the principles of international comity. While we support the general approach under the Proposal, we would like to express a few concerns with certain elements of the Proposal from the Japan market participants' perspective. We believe the Commission will be able to better achieve the policy goals of the Proposal by considering our recommendations as more fully discussed below.

II. Key Definitions

1. U.S. Person

The definition of "U.S. Person" is a critical aspect of the Commission's cross-border framework. The cross border application of the Commission's swap rules predominantly hinges on the U.S. Person status of the parties to the swap transaction. Given this criticality, it is of vital importance to establish a simple and objective U.S. Person definition so that a given entity's U.S. Person status can be easily determined based on externally visible factors. To this end, a practical and workable definition must provide a clear bright line as to whether a given entity is a U.S. Person or not. In this light, we support the proposed U.S. Person definition consisting of simple and objective four exhaustive prongs, unlike the definition under the 2013 Guidance, and consistent with the SEC's U.S. Person definition.[5]

Of particular note, we commend the Commission for proposing to eliminate the prong capturing collective investment vehicles that are majority-

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[4] Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (July 26, 2013).

[5] Proposed § 23.23(a)(22).

owned by U.S. Persons. This elimination will alleviate the practical burden, in some cases an untenable burden, imposed on market participants in Japan of having to constantly monitor the ownership composition, which changes throughout the life of the vehicle due to redemptions and additional investments, of non-U.S. organized vehicles for the purpose of confirming its non-U.S. Person status.

Further, we request the Commission to make conforming amendments to the U.S. Person definition under the cross-border application of margin requirements for uncleared swaps of SDs and MSPs that do not have a prudential regulator ("2016 Cross-Border Margin Rules").[6] In addition, when adopting the amended U.S .Person definition, we request the Commission to specify that the amended U.S. Person definition will also apply to, and supersede, the definition referenced in the CFTC's Orders of Exemption from Registration ("JSCC DCO Exemptive Order")[7] granted to the Japan Securities Clearing Corporation ("JSCC"). As noted in the Proposal, the proposed U.S. Person definition is designed to capture those persons with sufficient jurisdictional nexus to the U.S. financial system and commerce. The same policy rationale applies for the U.S. Person definition under the 2016 Cross-Border Margin Rules and referenced in the JSCC DCO Exemptive Order. We see no compelling reason or countervailing policy benefits of having different U.S. Person definitions within the CFTC's cross-border swaps regulatory framework. We believe having different U.S. Person definitions will introduce unnecessary compliance complexities in analyzing or providing representations on a given entity's U.S. Person status.

2. Guarantee

We support the Proposal's definition of "guarantee" as it is consistent with the definitions under the 2016 Cross-Border Margin Rules and the

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[6] Margin Requirements for Uncleared Swaps for [SDs] and [MSPs]—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 (May 31, 2016).

[7] *See*, Amended Order of Exemption from Registration issued for JSCC (May 15, 2017), available here: http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/jsccdcoexemptamdorder5-15-17.pdf

parallel SEC rules.[8] Under the 2013 Guidance, the "guarantee" definition encompassed not only traditional guarantees, but also other arrangements supporting the non-U.S. Person's ability to pay or perform its swap obligations, including keepwells and liquidity puts, certain types of indemnity agreements, master trust agreements, liability or loss transfer or sharing agreements. The 2013 Guidance introduced compliance challenges to market participants globally, including those in Japan, as to the difficulties in confirming or obtaining representations from counterparties regarding whether certain arrangements, particularly purely internal arrangements within a counterparty's corporate group, constitute a "guarantee" under the 2013 Guidance.

We further support the Commission for clarifying that a non-U.S. Person would be considered a "Guaranteed Entity" only with respect to swaps that are guaranteed by a U.S. Person. We agree with the proposed definition of a non-U.S. Person being a Guaranteed Entity with respect to certain swaps with certain counterparties subject to a U.S.-Person guarantee, but not being a Guaranteed Entity with respect to other swaps with other counterparties for which the non-U.S. Person's swaps are not guaranteed by a U.S. Person.

3. Significant Risk Subsidiary

We support eliminating the conduit affiliate definition under the 2013 Guidance. Further, we believe the significant risk subsidiary ("SRS") definition is an improvement over the foreign consolidated subsidiary ("FCS") definition under the 2016 Cross-Border Margin Rules as the SRS definition will exclude, among other things, subsidiaries that are not significant to their U.S. parent[9] or subsidiaries subject to prudential regulation.[10] However, we

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[8] *See* 17 C.F.R. § 240.3a71-3(b)(iii)(B).

[9] A non-U.S. Person would only be considered a "significant subsidiary" if it passes at least one of three tests for significance (i.e., equity capital significance test, revenue significance test and asset significance test) relative to its ultimate U.S. parent entity (the "Significant Subsidiary Test").

[10] A significant subsidiary would only be considered an SRS if it satisfies the following conditions: (a) its ultimate U.S. parent entity has more than $50 billion in global consolidated assets, as determined in accordance with U.S. GAAP at the end of the most recently completed fiscal year and (b) the non-U.S. Person is not subject to either (i) consolidated supervision and regulation by the Federal Reserve Board as a subsidiary of a U.S. bank holding company or (ii) both (1) capital

believe applying swap requirements, including the SD registration requirement, to a foreign subsidiary predominantly based on accounting consolidation with a U.S. parent company will still not be viewed as having sufficient jurisdictional nexus to the U.S. financial system and commerce. Further, significant foreign subsidiaries of large U.S. multinational companies would find themselves falling within scope of the SRS definition. Therefore, while the SRS definition is a significant improvement from the conduit affiliate definition under the 2013 Guidance and the FCS definition under the 2016 Cross-Border Margin Rules, we request the Commission to consider eliminating the SRS definition or, if the Commission decides to adopt the SRS definition, we urge the Commission to retain the Significant Subsidiary Test and the SRS Conditions thereunder.

4. Foreign Branch

We support the codification of the terms "foreign branch" and "swap conducted through a foreign branch." Of particular note, we commend the Commission's proposed elimination of the 2013 Guidance's requirement that the employees negotiating and agreeing to the terms of the swap be located in a foreign branch under the term "swaps conducted through a foreign branch." We believe this elimination will be helpful for global financial institutions operating business in multiple jurisdictions seamlessly across time-zones as, under such global business model, the personnel negotiating and agreeing to the terms of a swap may be in a location different from the location of the non-U.S. Branch in which the swap is ultimately booked. To avoid any unnecessary compliance complexities due to bifurcated treatment, we request the Commission to make this change applicable to all CFTC transaction level requirements and not solely with respect to the transaction level requirements addressed in the Proposal. We also commend the Commission's view that the second prong of the definition (whether the swap is entered into by such

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standards and oversight by the non-U.S. Person's home country regulator that are consistent with the Basel Committee on Banking Supervision's "International Regulatory Framework for Banks" and (2) margin requirements for uncleared swaps in a jurisdiction for which the Commission has issued a comparability determination with respect to uncleared swap margin requirements (the "SRS Conditions").

foreign branch in the normal course of business) would not prevent personnel of the U.S. bank located in the U.S. from participating in the negotiation or execution of the swap so long as the swaps that are booked in the foreign branch are primarily entered into by personnel located in the branch (or another foreign branch of the U.S. bank).

5. U.S. Branch

We generally support the proposed new definitions for the terms "U.S. branch" and "swap conducted through a U.S. branch." We believe the definitions provide clear and objective standards and provide market participants with legal certainty. However, we request the Commission to include a "normal course of business" prong under the term "swap conducted through a U.S. Branch" for consistency with the term "a swap conducted through a foreign branch." In addition, we request the Commission to apply the definition of a "swap conducted through a U.S. branch" conjunctively (a foreign bank's swap must satisfy all prongs of the definition to be treated as a swap conducted through a U.S. branch) in conformance with the definition for a "swap conducted through a foreign branch" under the Proposal. We see no policy rationale or countervailing policy benefit of these inconsistencies.

6. Reliance on Representations

As stated above, while we generally support the key definitions under the Proposal, amendments to existing definitions or introduction of new definitions, *e.g.*, SRS, will impose compliance burdens on market participants of having to obtain representations from swap counterparties and related entities. To alleviate such compliance burdens, we request the Commission to permit reliance on a permanent basis with respect to U.S. Person representations obtained in respect of the 2013 Guidance or the 2016 Cross-Border Margin Rules. Further, we request the Commission to permit permanent reliance on representations made regarding the "guarantee" definitions under the 2013 Guidance and 2016 Cross-Border Margin Rules.

III. Swap Dealer Registration Threshold

The SD registration threshold is a significant concern for market participants

in Japan, especially for those participants that are not registered as a swap dealer with the CFTC. Many Japanese market participants are constantly monitoring their trading volume to ascertain the volume is below the SD registration threshold or refraining to trade swaps with certain U.S. based firms to avoid being caught under the SD registration requirement. We support the codification of the SD *de minimis* counting conventions that generally track the 2013 Guidance, particularly the codification of exceptions available for Other Non-U.S. Persons with respect to dealing swaps with (a) foreign branch of a U.S. SD, (b) Guaranteed Entity when the Guaranteed Entity (i) is registered as an SD or (ii) is subject to a guarantee by a U.S. Person that is a non-financial entity, and (c) an SRS or Other Non-U.S. Person.[11]

However, we strongly request the Commission to revive the exception, which was available under the 2013 Guidance, allowing an Other Non-U.S. Person to not count transactions with a Guaranteed Entity that is not a SD and itself engages in *de minimis* swap dealing activity and is affiliated with an SD ("Non-SD Guaranteed Entity"). We are not aware of any material change in the swaps market that warrants a policy change as to why this exception, which is available under the 2013 Guidance, needs to be eliminated. If Other Non-U.S. Person are required to count dealing swaps with Non-SD Guaranteed Entities toward the SD registration threshold, Other Non-U.S. Persons will potentially cease trading with Non-SD Guaranteed Entities to avoid the compliance burdens associated with analyzing relevant U.S. regulations. Generally, Non-SD Guaranteed Entities operating business in Japan are locally registered or licensed by the Financial Services Agency of Japan ("JFSA") and subject to local regulation and supervision in Japan.

The Non-SD Guaranteed Entities in Japan are critical liquidity providers in the local Japan market. Japanese market participants, most of which are Other Non-U.S. Persons, heavily rely on their liquidity provision, particularly with respect to U.S.-dollar denominated swaps to hedge exposure incurred in connection with U.S. investments. In addition, reluctance by Japanese market participants to trade swaps with Non-SD Guaranteed Entities may diminish the ability of U.S.-headquartered firms to compete or access liquidity in the Japan swaps market. For instance, such

[11] Proposed Rule §23.23(b)(2).

reluctance may impede a U.S.-headquartered firm's ability to hedge or manage exposures denominated in foreign currencies, which in turn could diminish their ability to offer products and liquidity to non-U.S. clients. This could result in fragmented global swaps markets comprised of small and disconnected liquidity pools leading to exacerbation of systemic risk. Based on these considerations, we request the Commission to revive the exception from an Other Non-U.S. Person counting transactions with a Non-SD Guaranteed Entity.

In addition, we generally support the Commission to establish an exception for cleared swaps executed anonymously on a SEF or DCM.[12] However, we request the Commission to (a) not require the clearing organization or trading venue to be registered or exempt from registration with the CFTC and (b) expand the scope of the exception to include cleared swaps executed bilaterally outside a trading venue. With respect to (a), we believe the same policy rationale of exempting cleared swaps executed anonymously on a SEF or DCM applies to swaps executed on non-U.S. trading venues or clearing organizations operating without a CFTC registration or exemption. Trading venues or clearing organization operating outside the United States will not be required to register or be exempt by the Commission to the extent U.S. Person are not accessing the trading venue or clearing organization. With respect to (b), regardless of whether a swap was executed on a trading venue or bilaterally, we believe that to the extent a swap is cleared at a clearinghouse there should be no importation of risk to the U.S. financial system thus no direct and significant jurisdictional nexus for the purpose of Section 2(i) of the Commodity Exchange Act ("Section 2(i)").

IV. ANE Transactions

We generally support the Commission's proposal to not apply swaps-related requirements, other than anti-fraud and anti-manipulation rules, to swap transactions between non-U.S. Persons that are arranged, negotiated or executed by personnel or agents located in the U.S. ("ANE Transactions") to the extent neither party to the

[12] Proposed Rule §23.23(d).

swap transaction is a SRS or Guaranteed Entity.[13] We believe that mere involvement of U.S. located personnel to arrange, negotiate or execute a swap does not amount to direct and significant connections to U.S. activities or U.S. commerce thus does not satisfy the jurisdictional nexus test for the purpose of Section 2(i). In addition, not applying swaps-related requirements to ANE Transactions will help avoid conflicts and overlaps with Japanese OTC derivatives regulations.

Currently, ANE Transactions are subject to the CFTC staff advisory No. 13-69 ("ANE Staff Advisory")[14] and related no-action relief. Given that the Proposal does not capture certain requirements such as mandatory clearing, mandatory trade execution and real-time public reporting, even if adopted as proposed, it will only supersede the ANE Staff Advisory with respect to those requirements captured by the Proposal. To avoid any unnecessary compliance complexities due to bifurcated treatment, we request the Commission to fully withdraw the ANE Staff Advisory.

V. Categorization of Swap Dealer Requirements

We generally support the Proposal's approach in categorizing the CFTC swap rules to Group A, B and C requirements. In particular, we believe the elimination of the bifurcated treatment of the recordkeeping rules under the 2013 Guidance is helpful to alleviate compliance challenges. In furtherance of the goal to provide legal certainty and streamline the recordkeeping requirements, we request the Commission to explicitly categorize CFTC Rule § 1.31 as a Group A requirement pursuant to CFTC Rule § 23.603.

VI. Exceptions from Swap Dealer Requirements

We generally support the exceptions to the application of Group B and C requirements under the Proposal. We believe the exceptions generally strike the right balance in protecting the integrity, safety and soundness of the U.S. financial system while recognizing the principles of international comity.

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[13] Proposal, 85 Fed. Reg. at 966.

[14] CFTC Staff Advisory No. 13-69, Applicability of Transaction-Level Requirements to Activity in the United States (Nov. 14, 2013).

1. Swaps with Guaranteed Swap Entities and SRS Swap Entities

However, we request the Commission to exclude transactions between a Swap Entity that is a Guaranteed Entity ("Guaranteed Swap Entity") or a Swap Entity that is an SRS ("SRS Swap Entity") and an Other Non-U.S. Person from the application of Group B requirements. Under the 2013 Guidance, the Category A Transaction-Level Requirements do not apply to a non-U.S. Swap Entity with respect to swaps traded with a non-U.S. Person that is not a guaranteed or conduit affiliate. The expanded extraterritorial application of the CFTC requirements will particularly be problematic for Group B requirements.[15]

We see no change in the swap market to justify a policy change from the 2013 Guidance to now expand the cross border reach of the Group B requirements to capture swap transactions between a non-U.S. Swap Entity and an Other Non-U.S. Person when the non-U.S. Swap Entity's swap obligations are guaranteed by a U.S. Person.

The expanded extraterritorial application will indirectly impose regulatory compliance burdens on Japanese market participants, most of which are Other Non-U.S. Persons, when trading swaps with Guaranteed Swap Entities. This compliance burden will be significantly acute when a Guaranteed Swap Entity cannot rely on substituted compliance with local Japanese regulations to satisfy Group B requirements. In such case, Japanese market participants will likely refrain from trading swaps with a Guaranteed Swap Entity to avoid the indirect imposition of the CFTC swaps regulation.

Currently, Japanese rules have not been determined comparable by the CFTC with respect to portfolio reconciliation and compression (CFTC Rule § 23.502 and § 23.503) and trade confirmation (CFTC Rule § 23.501). As such, Japanese market participants will likely refrain from trading swaps with Guaranteed Swap Entity to avoid the need to retain U.S. counsel to understand

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[15] Proposed § 23.23(a)(6) defines Group B requirements consisting of daily trading records (CFTC Rule § 23.202); swap confirmation (CFTC Rule § 23.501); portfolio reconciliation (CFTC Rule § 23.502); portfolio compression (CFTC Rule § 23.503); and swap trading relationship documentation (CFTC Rule § 23.504).

the March 2013 ISDA Dodd-Frank Protocol and set up the operational infrastructure to engage in portfolio reconciliation and compression exercises.

Generally, Guaranteed Swap Entities in Japan are locally registered or licensed by the JFSA and subject to local regulation and supervision in Japan. They are critical liquidity providers in the local Japan market and Japanese market participants broadly rely on their liquidity provision, particularly with respect to U.S.-dollar denominated swaps. In addition, reluctance by Japanese market participants to trade with Guaranteed Swap Entities may diminish the ability of U.S.-headquartered firms to compete or access liquidity in the Japan swaps market. This could result in fragmented global swaps markets comprised of small and disconnected liquidity pools leading to exacerbation of systemic risk.

Fundamentally, we believe that a guarantee by a U.S. person is not a sufficient nexus for CFTC jurisdiction under Section 2(i). Performance of a swap obligation may be guaranteed by a U.S. Person for a variety of different reasons that should not necessarily implicate CFTC jurisdiction. For example, guarantees may be used to manage capital treatment across entities or avoid negative credit rating consequences. In such circumstances, although a U.S. Person may guarantee a non-U.S. Person's performance of swap obligations, we believe there is no material importation of risk to the U.S. financial system through the guarantee and hence a lack of sufficient jurisdictional nexus for purposes of Section 2(i). If the Commission is concerned about the importation of risk into the United States, we believe such concern can be appropriately addressed where the guarantor is subject to U.S. prudential oversight, such as where the guarantor is a U.S. prudentially regulated entity or a registered swap dealer, without the need to assert jurisdiction under Section 2(i).

Based on these considerations, we request the Commission to exclude transactions between a Guaranteed Swap Entity or SRS Swap Entity and Other Non-U.S. Person from the application of Group B requirements.

2. Swaps Conducted Through a U.S. Branch

Furthermore, we request the Commission to align the regulatory treatment of U.S. Branches of Non-U.S. Swap Entities to that of its Foreign Branches with respect to swaps between a U.S. Branch and an Other Non-U.S. Person or, at the minimum, make substituted compliance available. Specifically, the Commission should expand the definition of "foreign-based swap" and "foreign counterparty" under the Group B and C exceptions to cover swaps conducted through the U.S. branch of a non-U.S. Swap Entity. Essentially, these are swap trades between two non-U.S. Persons thus these trades should be governed by the home country regulation of the non-U.S. Persons in line with the principles of international comity. We believe there is no material importation of risk to the U.S. financial system and hence a lack of sufficient jurisdictional nexus for purposes of Section 2(i).

VII. Substituted Compliance and Comparability Determination

We generally support the Proposal's approach to comparability determinations and availability of substituted compliance and we request the Commission to grant substituted compliance for CFTC Rule 23.607 with respect to jurisdictions which have in place comparable anti-trust laws. We, however, want to emphasize that "whether a foreign regulatory authority has issued a reciprocal comparability determination with respect to the Commission's corresponding regulatory requirements" [16] should not be a factor incorporated in the Commission's comparability determination because some foreign jurisdictions may not necessarily have a comprehensive substituted compliance framework or a deference framework analogous to the Commission's substituted compliance framework encompassing all the listed requirements included in Groups A to C under the Proposal.

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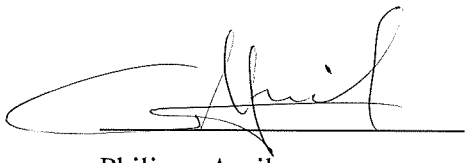
[16] Proposal, 85 Fed. Reg. at 987.

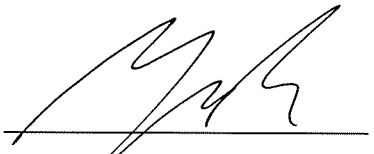
VIII. Conclusion

We appreciate the opportunity to comment on the Proposal and look forward to working with the CFTC as it continues to consider the appropriate cross border framework for swap regulations. We are available to discuss these comments in further detail with you if required.

Yours faithfully,



Philippe Avril
Chairman of the IBA Japan
Co-Chairman of JFMC
Date: 5 MAR 2020



Yuji Nakata
Co-Chairman of JFMC
Date: May 3. 2020