December 19, 2016

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

Re: Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants" – RIN 3038-AE54

Dear Mr. Kirkpatrick:

The Japanese Bankers Association ("**JBA**") appreciates the opportunity to submit comments to the Commodity Futures Trading Commission on its recent proposal relating to the cross-border application of the Commission's swap regulatory regime under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("**Title VII**").[1] The JBA has significant concerns with several aspects of the proposal that, in the JBA's view, represent an unnecessary extension of its swap regulatory regime to activities that lack the U.S. nexus to warrant such regulation. In particular, JBA believes that proposed requirements for a non-U.S. entity to count a significantly expanded scope of swap transactions that have minimal U.S. nexus towards its swap dealer *de minimis* threshold,[2] which could require certain JBA members to register as swap dealers, is inconsistent with the jurisdictional limitations under the Commodity Exchange Act, would not further the regulatory purposes of Title VII, and is inconsistent with principals of international comity recently recognized by the Commission.[3]

We strongly urge the Commission to reconsider the proposal, with a view to increased cooperation with non-U.S. regulators to work towards recognition of non-U.S. regulatory regimes through substituted compliance determinations. Doing so will better further the policy goals of enhance cross-border coordination and will help to enhance the stability of cross-border markets. It would also be consistent with the commitment of the U.S. government to "enhance cross-border cooperation to enable regulations to be more effective, particularly in the area[] of . . . over-the-counter (OTC) derivatives

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[1] Commodity Futures Trading Commission, Cross-Border Application of the Registration Thresholds and External Business Conduct Standards Applicable to Swap Dealers and Major Swap Participants 81 Fed. Reg. 71,946 (Oct. 18, 2016), available at http://www.cftc.gov/idc/groups/public/@lrfederalregister/documents/file/2016-24905a.pdf (the "Proposed Rule").

[2] The swap dealer *de minimis* threshold refers to the swap dealing notional threshold above which an entity would be required to register with the Commission as a swap dealer in Commission regulation 1.3(ggg)(4). 17 C.F.R. § 1.3(ggg)(4).

[3] For example, in September 2016 the Commission adopted a substituted compliance determination with respect to its uncleared swap margin regulations for those applicable under Japanese law and regulation. Commodity Futures Trading Commission, Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 63376 (Sept. 15, 2016) ("…[T]he global nature of the swap market, coupled with the interconnectedness of market participants, also necessitate that the Commission recognize the supervisory interests of foreign regulatory authorities and consider the impact of its choices on market efficiency and competition, which the Commission believes are vital to a well-functioning global swap market.")

markets reforms," and for "jurisdictions to defer to each other when it is justified in line with the St. Petersburg Declaration."[4]

The discussion below describes in more detail the key concerns of the JBA and its members with the proposal.

- ***The proposal represents an unjustified expansion of the Commission's cross-border reach, which would unnecessarily require foreign entities with minimal U.S. connections to register for non-U.S. activities.***

Section 2(i) of the Commodity Exchange Act limits the extraterritorial applicability of Title VII to activities outside the United States to only those activities that have a "direct and significant connection with activities in, or effect on, commerce of the United States."[5] The Commission's 2013 cross-border guidance (the "**2013 Guidance**")[6] and related CFTC staff guidance[7] provided the Commission's views on the extraterritorial scope of its Title VII swap regulations, including the swap dealer *de minimis* threshold under Section 2(i) of the Commodity Exchange Act. Under the 2013 Guidance, a non-U.S. entity with no U.S. guarantee (and that is not a conduit affiliate) need not count toward its swap dealer *de minimis* threshold any swap dealing transactions with (1) a foreign branch of a U.S. swap dealer or (2) a non-U.S. affiliate of a registered swap dealer, even where the affiliate has a U.S. guarantee. The basis for this treatment, as recognized by that Commission, is that a "a more circumscribed registration policy applies to non-U.S. persons that are not guaranteed . . ."[8] Indeed, the Commission specifically recognized the concerns raised by the JBA, stating in the 2013 Guidance, that it "believes that under section 2(i) of the CEA, it would generally be appropriate for non-U.S. market participants, such as members of the Japanese Bankers Association, to engage in hedging activities with foreign branches of U.S. swap dealers without being expected to count such transactions for purposes of the swap dealer registration determination."[9]

The proposal would represent a significant change in Commission's interpretation of Section 2(i) of the Commodity Exchange Act—one that would inappropriately expand the reach of the Commission's swap regulations to activities with only a minimal U.S. nexus. We highlight a few key examples of the inconsistencies and lack of support for the proposed changes below, in the context of the treatment of FCS and the request for comment on the treatment of so-called SD conduits.

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[4] G-20, Communiqué G20 Finance Ministers and Central Bank Governors Meeting (Feb. 9-10, 2015) at 3 , *available at* http://g20.org.tr/wp-content/uploads/2015/02/Communique-G20-Finance-Ministers-and-Central-Bank-Governors-Istanbul1.pdf. As part of the St. Petersburg Declaration, the G-20 agreed that, in the context of OTC derivatives reforms, "jurisdictions and regulators should be able to defer to each other when it is justified by the quality of their respective regulatory and enforcement regimes, based on similar outcomes, in a non-discriminatory way, paying due respect to home country regulation regimes." G-20, G20 Leaders' Declaration (Sept. 2013) at 17-18, *available at* http://www.g20.utoronto.ca/2013/Saint_Petersburg_Declaration_ENG.pdf.

[5] 7 U.S.C. § 2(i).

[6] Commodity Futures Trading Commission, Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 Fed. Reg. 45292 (Jul. 26, 2013) [*hereinafter* 2013 Guidance].

[7] Commodity Futures Trading Commission, Division of Swap Dealer and Intermediary Oversight, No-Action Letters 13-69, 13-71, 14-01, 14-74, 14-140, and 15-48.

[8] 2013 Guidance, 78 Fed. Reg. 45292, at 45319.

[9] *Id.* at 45320.

- *The proposal would require non-U.S. entities to count towards the swap dealer* de minimis *threshold swap dealing transactions with foreign branches of U.S. swap dealers and foreign consolidated subsidiaries ("**FCS**"). This requirement is inappropriate, particularly given the insufficient justification provided by the proposal.*

The proposal would newly require a non-U.S. entity (that has no U.S. guarantee or U.S. ultimate parent) to count towards its swap dealer *de minimis* threshold any swap dealing transactions with a foreign branch of a U.S. swap dealer and with an FCS, which would include a non-U.S. entity that has no U.S. guarantee but that is consolidated for accounting purposes with an ultimate U.S. parent. The Commission, in proposing these new requirements, fails to sufficiently address why the proposed approach is consistent with the requirements of Section 2(i) of the Commodity Exchange Act, particularly given its existing interpretation of that provision in the 2013 Guidance.

The proposal's treatment of FCS, and transactions with FCS under the *de minimis* threshold, represents a particularly significant and unexplained departure from the Commission's previous interpretations. In the 2013 Guidance and subsequent statements, the Commission focused on whether a guarantee of a non-U.S. entity's swap activities by a U.S. affiliate would result in risk being transferred into the United States by virtue of that guarantee—not whether the non-U.S. entity was consolidated for accounting purposes with a U.S. affiliate, which is the proposed standard for an entity to qualify as an FCS.[10] More recently, the Commission considered the treatment of FCS in its regulations applying the Commission's uncleared swap margin rules to cross-border transactions. In those rules, the Commission determined that an FCS does not pose the same level of risk as a non-U.S. entity that is guaranteed by a U.S. entity and that "in the absence of a direct recourse guarantee from a U.S. person, an FCS should not be treated in the same manner as a U.S. [swap dealer] or U.S. [guaranteed swap dealer]."[11] The Commission's basis for the distinction in that rulemaking was that: "In contrast with a U.S. [guaranteed swap dealer], in the event of the FCS's default, the U.S. ultimate parent entity does not have a legal obligation to fulfill the obligations of the FCS. Rather, that decision would depend on the business judgment of its parent." [12]

The Commission does not explain its new and expansive approach to FCS in this proposal, and JBA believes this new approach is inconsistent with both the 2013 Guidance and its uncleared swap margin cross-border rules and exceeds its statutory authority under Section 2(i) of the Commodity Exchange Act. The proposal in effect treats FCS—and transactions with FCS—as equivalent to transactions with a U.S. person. For its justification for this departure, the Commission looks to a series of potential events—for example that the default of the non-U.S. entity "could have a direct adverse effect" on an FCS counterparty which, in turn, through the FCS's U.S. parent "could have knock-on effect, potentially leading to disruptions of the U.S. financial system."[13] These statements do not accord with the discussion provided by the Commission in its uncleared swap margin rules or the position taken in its 2013 Guidance, and JBA respectfully submits that the most recent assertion, without significant further substantiation, does not rise to the level of having a direct and significant connection with activities in, or effect on, commerce of the United States.

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[10] 2013 Guidance (discussing the treatment of non-U.S. persons guaranteed by a U.S. person throughout).

[11] Commodity Futures Trading Commission, Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 Fed. Reg. 34818 at 34827 (May 31, 2016).

[12] *Id.*

[13] Proposed Rule at 71956.

- *The suggestion that so-called "SD conduits" be required to count additional types of swaps towards the swap dealer* de minimis *threshold is inappropriate and is not supported by the risks posed by these types of entities.*

The Commission requests comment on whether non-U.S. affiliates of U.S. swap dealers that act as swap dealers in their home jurisdiction and transfer some or all of their swap-related risk to the U.S. affiliate—termed an SD conduit—should be required to count that activity towards its swap dealer *de minimis* threshold.[14] This proposal appears designed to address circumstances where a non-U.S. entity enters into back-to-back transactions with a U.S. swap dealer affiliate.[15] In discussing this concept, the Commission does not describe what specific regulatory risks it is seeking to address. This is a particularly notable omission, given that the transfer of risk by an SD conduit as described by the Commission would be to a registered swap dealer already subject to comprehensive regulation by the Commission. Indeed, in its 2013 Guidance, the Commission implemented the related concept of a "conduit affiliate," which specifically excluded an affiliate of a registered swap dealer.[16] The proposal does not discuss or explain its this significant change of view regarding the potential risks posed under these circumstances and provides no support for imposing additional obligations on swap dealer affiliates in these circumstances.

JBA strongly opposes the proposal's approach to these requirements. The proposed changes would, in effect, lower the *de minimis* threshold by requiring additional transaction to be counted towards that threshold, requiring more entities to register, without appropriate justification and outside of the separate effort the Commission is currently undertaking to determine the appropriate *de minimis* level for swap dealers.[17] We urge the Commission, in considering the *de minimis* threshold, to adopt the position articulated by Commissioner Giancarlo—that cleared swaps be excluded from the registration threshold. As Commissioner Giancarlo stated, "if the true goal of Dodd-Frank is to reduce systemic risk, counting cleared swaps towards the registration threshold is of questionable value."[18] JBA agrees with Commissioner Giancarlo and believes the Commission should employ this approach to the swap dealer *de minimis* threshold, as it reconsiders the threshold going forward.

JBA believes that the proposal also would inappropriately subject activities with only a minimal U.S. nexus to the Commissions Title VII swap regulations. JBA respectfully submits that the significant expansion of the extraterritorial application of the swap dealer registration requirement reflected in the proposal is inconsistent with Section 2(i) of the Commodity Exchange Act and would not result in any significant risk mitigation effect for the swap markets. Moreover, these changes are inconsistent with the principles of international comity as described in the 2013 Guidance[19] and more recently recognized by the Commission.[20]

Similarly, we are opposed to the application of the Commission's swap regulatory requirements to a swap transaction solely by virtue of the transaction being arranged, negotiated or executed by personnel located in the United States. As these activities do not themselves cause risk to be transferred

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[14] Proposed Rule at 71958.

[15] *Id.*

[16] 2013 Guidance at 45359 ("The Commission does not intend that the term ''conduit affiliate'' would include affiliates of swap dealers.)

[17] Staff of Commodity Futures Trading Commission, Swap Dealer *De Minimis* Exception Final Staff Report (Aug. 15, 2016) *available at* http://www.cftc.gov/idc/groups/public/@swaps/documents/file/dfreport_sddeminis081516.pdf.

[18] Commissioner Giancarlo, Statement of Commissioner J. Christopher Giancarlo Swap Dealer De Minimis Exception Preliminary Report (Nov. 18, 2015), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement111815.

[19] 2013 Guidance.

[20] E.g., Commodity Futures Trading Commission, Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 63376 (Sept. 15, 2016).

into the United States, we urge the Commission to provide that its swap regulations do not apply to swap transactions solely on the basis that they are arranged, negotiated, or executed by personnel located in the United States.

- ***The Commission's cost-benefit analysis is insufficient to justify the proposal: it does not address all relevant entities that may need to register as swap dealers, does not reflect all compliance costs on entities needing to determine whether they are swap dealers, does not take into account market fragmentation and decreased liquidity, and would not meaningfully reduce risk.***

JBA believes that the Commission has not sufficiently considered the additional costs that would be imposed on these non-U.S. entities—not only with respect to registration as swap dealers, which could run into the millions of dollars per entity—but also with respect to complying with the new swap dealer *de minimis* counting requirements, whether or not an entity must register. While the proposal estimates that 14 non-U.S. entities would be FCS and would need to register with the Commission, this does not appear include the non-U.S., non-FCS entities (including JBA members) that might need to register based on their transactions with FCS. As a result, the number provided is under inclusive and the cost-benefit analysis underestimates the costs involved.[21] In addition, we believe that, because JBA members are currently subject to comprehensive regulation under Japanese law, the Commission overestimates the regulatory benefits of the proposal.

In addition, even for entities that would not be required to register, the proposal would impose significant new burdens. Even where activities are entirely outside the United States, such entities would have to reclassify their counterparties and retool systems that were developed under the existing regime at significant cost. For example, non-U.S. entities not currently registered as swap dealers would newly need to identify whether their swaps with foreign branches of U.S. swap dealers or with FCS must be counted toward the swap dealer *de minimis* threshold.

In addition, the Commission does not consider in its cost-benefit analysis the negative impact the proposal will have by fragmenting the derivatives market and decreasing market liquidity. As a result of the proposal, non-U.S. firms may further limit their swap trading activity, so that in addition to not transacting with U.S. persons and non-U.S. persons guaranteed by U.S. persons, they will also seek to avoid transacting with foreign branches of U.S. persons and FCS. This will reduce liquidity, including for FCS that are corporate entities engaging in swap transactions to hedge risks associated with non-U.S. business activities. This further limiting of counterparties for non-U.S. entities is likely not only to negatively affect liquidity in the swaps markets, but also could reduce the ability of non-U.S. banks to provide dollar funding to customers, as those lending activities are tied to the banks' ability to engage in interest rate and other swap transactions.

Moreover, JBA's members are subject to significant regulation under Japanese law, including with respect to their swap activities. These requirements include, among others, clearing, margin. The proposal's expansion to require additional types of non-U.S. swap transactions to be counted toward a non-U.S. entity's swap dealer *de minimis* threshold would result in duplicative and unnecessary registration requirements and regulation for many JBA members. Due to the non-U.S. nature of these activities, this registration would not provide commensurate risk reduction benefits or supervisory benefits, given the minimal U.S. nexus of these swap transactions.

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[21] Proposed Rule at 71963.

JBA believes that these additional costs do not justify the extension of the Commission's regulatory reach, given the minimal U.S. nexus of the activities involved. The Commission should not adopt this, or any other, material expansion to the cross-border reach of its swap regulations without a thorough impact analysis of all affected market participants.

- ***Any revisions should apply prospectively and should be clear and easy to understand.***

To the extent the Commission determines it is appropriate to change the existing requirements related to the swap dealer *de minimis* threshold—including the lowering its level—or otherwise revise the applicably of its swap regulations to cross-border transactions, the Commission should ensure that these changes apply on a prospective basis only. Firms should be given time to make needed changes to their systems and compliance programs to address any new requirements, and those requirements should not apply to transactions entered into before the new requirements become effective. Finally, any rules adopted by the Commissions describing the cross-border application of its swap regulations should be clear and easy to understand,[22] which is particularly important given the potential application to non-U.S. firms that have little U.S. nexus.

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JBA urges the Commission to reconsider these aspects of its proposal and to limit the extraterritorial application of its swap regulatory regime to swap activities that involve a sufficient U.S. nexus to be considered to have a "direct and significant" effect in the United States. JBA believes that the proposal is inconsistent with this goal.

We appreciate the Commission's consideration of these comments. Please contact us if you would like to discuss these points in more detail.

cc: Chairman Timothy G. Massad
Commissioner Sharon Y. Bowen
Commissioner J. Christopher Giancarlo

[22] For example, the existing standard for aggregation for the swap dealer de minimis threshold in CFTC Regulation 1.3(ggg)(4) is based upon a control analysis that references U.S. law concepts. 17 C.F. R. 1.3(ggg)(4); Commodity Futures Trading Commission, Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 77 Fed. Reg. 30596, 30631 fn. 437. The concepts are difficult to apply for non-U.S. firms who otherwise may not have to evaluate their status under these concepts. Instead, the aggregation standard should be based on accounting consolidation under the accounting rules applicable to the organization.