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Commodity Futures Trading Commission
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Comments on *Swap Execution Facilities and Trade Execution Requirement* published by the Commodity Futures Trading Commission

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on *Swap Execution Facilities and Trade Execution Requirement* published on November 30, 2018 by the U.S. Commodity Futures Trading Commission (CFTC). We respectfully expect that the following comments will contribute to your further discussion.

We understand that the proposed rules seek to improve swaps trading on SEFs and further enhance flexibility, efficiency and transparency for SEFs and SEF users, having taken into account the issues identified for CFTC's current swap execution facility (SEF) regulations.

However, we would like to point out following three concerns over the proposed rules, which may potentially lead to the extraterritorial application and include excessively strict requirements that could impair liquidity of the global derivatives markets.

First, the proposal to expand the scope of the registration requirement, in particular to foreign swaps broking entities, may result in the extraterritorial application of the requirement to non-U.S. persons because non-U.S. platforms will be deemed as SEFs.

Second, the expansion of the trade execution requirement may cause a substantial increase in the number of products subject to this requirement. This will increase costs to comply with duplicative regulations established in the U.S. and home jurisdiction (for some

products), and may result in non-compliance with the U.S. regulations as entities comply with their home jurisdiction's regulations under the situation where there are inconsistencies (discrepancies) between the two regulations.

Third, the strict proposal that prohibits pre-execution communications off-SEF may have significant impacts on block trades and it is unclear how the proposal will be enforced in extraterritorial application.

All of these proposals can be major factors for non-U.S persons to avoid transactions with U.S. persons. We agree with CFTC's policy to establish SEF rules avoiding market fragmentation between non-U.S. persons and U.S. persons in the global swap markets as indicated in White Paper 2.0[1] released by the CFTC Chairman in October 2018. We are however concerned that these proposed rules may contradict to such a policy, and rather aggravate market fragmentation.

Consequently, we would respectfully request the CFTC to carefully assess the degree of impacts of these revisions and the concerns raised by market participants in finalizing the proposed revisions, since the revisions cover a wide range of areas and include major changes on the current framework. Especially, we consider that the review of the scope of regulations and due consideration on regulations established in other jurisdictions are significant issues.

From perspectives including practical point of view, etc., we have organized the comments according to the following three important issues: Expansion of the SEF registration requirement, Expansion of the trade execution requirement, and Prohibition of pre-execution communications.

1. Expansion of the SEF registration requirement

The proposed rule requires a platform that conducts multiple-to-multiple trading activities to register as a SEF. As a result, swaps broking entities (SBEs) and foreign SBEs will also be subject to the new registration requirement. We are particularly concerned about the latter.

Foreign SBEs generally provide a range of services globally to market participants. If they are registered as SEFs based on the fact that they provide services to U.S. persons, even though the U.S. persons account for only a very small proportion of the total number of their clients, a large number of other non-U.S. persons will also be subject to supervision by U.S. authorities through the self-regulation by the platforms. This will cause an unexpected indirect

[1] See https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118_0.pdf

extraterritorial application to non-U.S. persons. Furthermore, this extraterritorial application would overlap with supervision by home (non-U.S.) authorities, which give rise to duplicated regulatory costs.

Therefore, foreign SBEs that are subject to regulations established by authority of their home jurisdiction might refuse or avoid providing services to U.S. persons in order to avoid being subject to the CFTC's regulations. Even if quantitative threshold (de minimis threshold) were set in the future, given a burden of managing such a threshold from time to time as well as a risk of non-compliance with the regulation[2], offering services to U.S. persons is expected to be extremely limited, or consequentially avoided. Therefore, we are strongly concerned that uniformly requiring foreign SBEs to register as SEFs contravenes the policy recommended in White paper 2.0[3], and is highly likely to trigger the fragmentation of the U.S. and non-U.S. markets. These are fundamental issues inherent in the proposed rules and cannot be resolved by simply allowing a transition period for the registration.

As noted above, considering reduced market liquidity caused by avoiding services to U.S. persons and the risk of market fragmentation triggered by such a situation, we believe that foreign SBEs should not be subject to the SEF registration requirement because platforms in other jurisdictions should not be unduly bounded by the U.S. regulations. It is reasonable to delegate the supervisory function on such entities to their home authorities to minimize negative effects by the expansion of the registration requirement.

2. Expansion of the trade execution requirement

The proposed rules remove the current "made available to trade" (MAT) process, and apply the trade execution requirement to all swaps that meet the criteria. While we do not have any opposing view on this policy, we request the CFTC to fully analyze the impact of a significant expansion in the scope of the requirement on the markets, and consider the following important issues in particular.

(1) Concern about regulatory inconsistencies

Under the proposal, some products may be subject to the duplicative regulations. For example, if a JPY interest rate swap is included in the scope, Japanese entities subject to the requirement need to comply with the regulations established by both CFTC and Japanese authorities (i.e., the Financial Services Agency) if they trade such products.

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[2] In fact, under the SD registration requirement that sets the threshold of $8 billion in notional value, some of our member banks have been avoiding transactions with U.S. persons, and similar disincentive may occur for SEFs.

[3] See https://www.cftc.gov/sites/default/files/2018-10/Whitepaper_CBSR100118_0.pdf., which states "[t]his White Paper recommends that, using this authority, the CFTC should generally exempt from SEF registration non-U.S. trading venues that are regulated in Comparable Jurisdictions with respect to all types of swaps."

Therefore, the CFTC should establish a flexible framework that, for example, exempts entities from the trade execution requirement if products subject to the requirement are properly supervised either by U.S. authority or their home authority.

(2) Practical burdens

If the scope of products subject to the requirement expands, relevant parties bear costs for constructing new flows and systems. For example, under the operation which is added every time the products subject to trade execution requirement are listed on SEF, entities need to check the related website every time they enter into a transaction. Furthermore, if even one of the SEFs is capable of handling products subject to the requirement, entities are required to use that specific SEF in order to execute the transaction involving such products, which requires additional procedures. These procedures impose high practical burdens, and thereby increase costs. Such a situation may motivate non-U.S. persons to avoid using SEFs defined by this requirement, leading to further serious fragmentation between U.S. and non-U.S. markets.

Therefore, we request the CFTC to consider solutions to reduce practical burdens. Such solutions may include specifying a timing for changing product subject to the requirement and setting a notification period, or select products listed on multiple SEFs.

On the other hand, we support the exemptions proposed by CFTC based on the viewpoint of practical efficiency and market efficiency, for the following reasons.

- ✧ We agree to exempt all “Inter-affiliate transactions,” from the trade execution requirement regardless of whether they are cleared or uncleared, since such transactions do not necessarily seek competitive pricing, but are generally based on intra-group risk management and trading strategies.

- ✧ We agree to exempt “swaps that are only listed by exempt SEFs” because it is virtually impossible from the viewpoint of supervisory authority to identify such swaps and announce them as products subject to the trade execution requirement and therefore such operation do not function properly.

- ✧ We agree to exempt “swap transactions excepted or exempted from the clearing requirement” because if they are included in the scope, it would incur regulatory costs and benefits gained from the current exception or exemption from the clearing requirement would be impaired.

3. Prohibition of pre-execution communications

The proposed rules prohibit pre-execution communications off-SEF and eliminate existing exceptions.

We believe that these proposed rules, as described in the following three reasons, contain many uncertainties and are unduly strict, which could result in a decline in liquidity of transactions executed on SEFs and potentially have negative impacts on the markets.

Therefore, the CFTC should clarify and reconsider the scope of transactions and the contents of the requirement after careful analysis of its effects.

First, the relationship between the proposed prohibition on pre-execution communications and the CFTC's extraterritorial application rule is unclear. Proposed Rules related to the trade execution do not seem to extend to transactions between non-U.S. persons in accordance with the extraterritorial application. Therefore, we would like to confirm that this prohibition can be treated in the same way.

Second, the definition of "pre-execution communications" is ambiguous. We request the CFTC to clarify what information can be or cannot be communicated off-SEF, such as whether the exchange of market information or a hearing of potential transaction needs at the initial stage of a transaction would be deemed as "pre-execution communications." Excessive regulations would increase costs and impair efficient operation and market liquidity.

Third, the provision regarding prohibited off-SEF pre-execution communications also applies to block trades which are required to be traded on SEFs. However, we are concerned that it would be difficult to obtain accurate information such as market conditions, and that pre-execution communications aggregated on SEFs might be leaked to outside parties, leading to an increase in costs and deterioration in efficiency, and thereby disincentivize entities from executing block trades.