January 19, 2016

Comments on the "SWAP DEALER *DE MINIMIS* EXCEPTION PRELIMINARY REPORT" issued by the U.S. Commodity Futures Trading Commission

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the "SWAP DEALER *DE MINIMIS* EXCEPTION PRELIMINARY REPORT," issued on November 18, 2015 by the U.S. Commodity Futures Trading Commission ("CFTC").

We respectfully expect that the following comments on questions in the preliminary report will contribute to your further discussion.

1. III.B.5. Notional Value and Alternative Measures of Dealing Activity

p.20, Question (3):

Are Counterparty and Transaction Counts useful metrics for identifying potential swap dealing activity?

(Our comment)

Using the Counterparty and Transaction Counts for identifying potential swap dealing activity is considered as an appropriate approach.

(Rationale)

The Counterparty and Transaction Counts are appropriate metrics for identifying potential swap dealing activity. The fact that an entity has many counterparties or engages in a number of transactions would indicate that the entity routinely conducts swap dealing activity. On the other hand, under the current methodology which relies solely on the notional value, an entity may be identified as routinely engaging in swap dealing activity even in the case where the notional value of one transaction happens to be a large amount.

Further, reliance on the threshold of a single measure may give rise to regulatory arbitrage in order to avoid the swap dealer ("SD") registration. Therefore, the threshold of multiple measures should be established for identifying swap dealing activity.

2. III.D. Measuring Potential Swap Dealing Activity across Asset Classes

p.33, Question (1):

> Is it reasonable to assume that entities with less than $1 billion of aggregate notional amount in IRS and CDS over a 12-month period are not likely engaged in appreciable swap dealing activity?

p.33, Question (3):

> Is the methodology used to identify affiliated entities and to aggregate notional swap trading activity appropriate?

(Our comment)

It is not reasonable to apply the threshold of $1 billion to IRS and CDS.

(Rationale)

Swap dealing activity cannot be fully identified by only relying on the notional information. Further, a low threshold will only increase the number of registrants and will not be able to appropriately identify those financial institutions which are supposed to be registered as a swap dealer.

Also, global financial institutions may be forced to withdraw from swap dealing activity, so as not to exceed the threshold, so a low threshold would only promote such movement. Consequently, transactions with U.S. persons will be avoided, thereby, causing the liquidity in the U.S. market to decline.

p.34, Question (6):

> Is focusing on the Counterparty and Transaction Count ranges at which the majority of Potential Swap Dealing Entities were registered as swap dealers an appropriate strategy to identify potentially significant swap dealing activity? Should another approach for using Counterparty and/or Transaction Counts be considered?

p.34, Question (7):

> The analysis for this Preliminary Report did not assess the range of products executed by an entity as another alternative indicator of potential dealing activity. Staff invites comments on the value of analyzing this metric, potentially in conjunction with other metrics.

(Our comment)

It is an appropriate strategy to focus on the Counterparty, Transaction Count, and the range of swap products.

(Rationale)

The Counterparty and Transaction Counts are appropriate metrics for identifying routine swap dealing activity. Their use can prevent those financial institutions only engaging in a limited number of transactions from being subjected to the SD registration requirement.

Also, it is reasonable that an entity engaging in a wide range of products is recognized as an SD. On the other hand, those financial institutions only engaging in limited swaps in connection with loans should not be regarded as an SD.

3. IV.A.2. Policies Advanced by a *De Minimis* Exception
p.38, Question (4):

Are entities curtailing their swap dealing activity to avoid swap dealer registration, and if so, what impact does that have on the swap market?

(1) Cost effectiveness

(Our comment)

For financial institutions, it is extremely burdensome to manage thresholds globally and the benefits do not justify the cost, even from the perspective of the overall system.

(Rationale)

Many financial institutions are managing and curtailing their swap dealing activity in order to avoid being subjected to the SD registration requirement, allocating resources to such management activity. There is also a concern about concentrating market shares to a limited number of SDs due to withdrawal of small-sized entities from the market.

(2) Entities qualified for substituted compliance

(Our comment)

With regard to entities incorporated in the six non U.S. jurisdictions (i.e. Australia, Canada, the European Union, Hong Kong, Japan, and Switzerland), which the CFTC granted substituted compliance, the CFTC should at least maintain, or raise, the current *de minimis* notional threshold of $8 billion, but should not consider lowering it.

(Rationale)

At the time when the CFTC set the $8 billion threshold, there were only a limited number of G20 member jurisdictions, other than the U.S., that had implemented comprehensive swap regulations. Since then, the international regulatory environment surrounding the swap market has changed significantly as more jurisdictions have implemented trade reporting requirements and clearing obligations.

Since the nature of the SD registration requirement is similar to regulations in the home jurisdictions of those previously referenced six non U.S jurisdictions, swap dealers which are appropriately supervised by the national authorities of those six jurisdictions eligible for substituted compliance, are subjected to duplicative regulations (because substituted compliance is only available for certain, but not all of the regulatory requirements).

The CFTC oversees "(activities with) direct and significant connection with activities in, or effect on, commerce of the United States," most of which can be identified by supervising the entities within the U.S. On the other hand, regulating foreign entities requires significant cost for both the regulators and the foreign entities due to geographical constraints and language differences. In this view, rather than lowering the current threshold, it would be more appropriate and efficient to permit national authorities to oversee the soundness and legitimacy of all swap dealers in their jurisdiction; thereby, making it unnecessary to increase the number of non-U.S. entities subject to the SD registration requirement.

4．IV.B.2.Small to Mid-Sized Banking Enterprises
p.47, Question (3):

Would an expansion of the IDI Exclusion address small to mid-sized banking enterprises' concerns? If so, what sort of expansion would be appropriate given the relevant statutory constraints and competing policy goals?

(Our comment)

We request for a broader interpretation of the IDI Exclusion to include foreign banks that are under the oversight of the deposit insurance corporation in their home country.

(Rationale)

Given that the IDI Exclusion is built on the idea that insured depository institutions carry out sufficient risk management under the FDIC's oversight, Japanese banks, which are under the oversight of the Deposit Insurance Corporation of Japan, should be treated in a similar manner.

Moreover, given that the FRB has expanded the interpretation of insured depository institutions in its discussions on the push-out rule, the same expansion should be consistently applied to the exception for the *de minimis threshold*.

5．V. *De Minimis* Exception Alternatives, p.47

(Our comment)

The CFTC should not only discuss alternative approaches, but should also clarify the exclusion of termination/novation of transactions from the *de minimis* calculation.

(Rationale)

The termination/novation of transactions is intended to reduce counterparty risk and systemic risk; therefore, it does not need to be counted toward the *de minimis* calculation.

In the case of those entities that have already ceased a new swap trading activity and are only engaged in termination/novation of existing transactions, the volume, the number and frequency of transactions executed for such termination and novation is limited. Given this, there is limited significance in regulating such entities in the same manner as SDs.

6. V. A. Higher or Lower Gross Notional *De Minimis* Threshold
p.50, Question (1):

What would be the impact of lowering the de minimis threshold to $3 billion or raising it above $8 billion on each of the Commission's policy objectives?

(Our comment)

Lowering the *de minimis* notional threshold to $3 billion will not produce an effect, but rather may only increase burdens. Therefore, the CFTC should at least maintain or raise, the current threshold of $8 billion, but should not consider lowering it.

(Rationale)

The balance between costs incurred by supervisory authorities from further enhancing SD-related regulation on financial institutions and benefits (i.e. the number and amount of swap dealing activities that will be newly identified from lowering the threshold) is considered extremely inappropriate. We believe that this regulatory enhancement will not produce any benefits appropriate to costs.

Specifically, if the threshold is reduced to $3 billion, the market that can be additionally captured will only amount to 1-2% on a notional activity basis while many entities will be subject to SD registration. This will not meet the objective of the regulation to reduce systemic risk and also may undermine efficient oversight by regulators. In addition, a further decrease in the number of market participants (as a result of withdrawing from swap dealing activity to avoid the SD registration requirement) will lead to an oligopoly and, therefore, may increase systemic risk.

7. V. B.1 Different *De Minimis* Notional Thresholds by Asset Class Alternative pp.51-53,

(Our comment)

We do not support this approach from a cost-benefit viewpoint, since effects that can be produced by establishing different *de minimis* notional thresholds by asset class will be very limited.

(Rationale)

Establishing multiple *de minimis* thresholds will complicate management of those relevant numbers and impair the transparency and simplicity of the regulation. Furthermore, it will require a considerable amount of time and cost for, among other things, investigation to identify transactions subject to the calculation, database development, establishment of relevant processes and procedures and management, therefore creating difficulties for market participants to undertake compliance efforts. At the same time, an increase in authorities' monitoring costs could lead to difficulty in maintaining the soundness and robustness in operating the regulation.

8. V. B.2 Multi-Factor *De Minimis* Threshold Alternative

p.56, Question (4):

If a multi-factor approach is used, what approach should be used and what should the thresholds be for the various metrics, taking into account the Commission's policy objectives?

(Our comment)

We support the approach to require SD registration for those entities which meet all of the following conditions: (i) more than a certain number of counterparties in a one-year period, (ii) more than a certain number of transactions in a one-year period and (iii) exceeding a gross notional amount of $8 billion.

A specific example for such conditions could be, in reference to the CFTC's estimation, Counterparty Count of 75 or more and Transactions Count of 10,000 or more with a gross notional amount of $8 billion or more in a one-year period

(Rationale)

Compared to the existing single gross notional *de minimis* threshold, the above-mentioned approach better reflects actual conditions of dealing activity, which meets supervisory expectations. The CFTC's policy objective to reduce significant systemic risk can be satisfied even in the case where those entities that exceed a gross notional threshold, but have low Transaction Count or those entities that have high Counterparty Count, but fall below the gross notional threshold, are excluded from the scope of the regulation. On the other hand, requiring those entities exceeding either the Counterparty Count, Transaction Count or the gross notional threshold to register may unexpectedly impose excessive regulatory burden on small-sized entities. In this view, the multi-factor approach is considered as an approach that better reflects actual conditions and is more effective relative to the existing single gross notional *de minimis* threshold.

Furthermore, the Preliminary Report states that *de minimis* exception has the potential to advance other interests (i.e. Regulatory Certainty, Allowing Limited Ancillary Dealing, Encouraging New Participants, and Regulatory Efficiency). To this end, thresholds should not be overly conservative and simplicity should be ensured in any approach taken. Given this, requiring SD registration for only those entities exceeding all the Counterparty Count, Transaction Count and gross notional amount thresholds is considered to be a well-balanced approach.

The specific Counterparty and Transaction Count thresholds referenced above represent the lowest level presented in the Preliminary Report in relation to financial institutions engaged in potential dealing activity. Furthermore, where multiple thresholds are applied, a gross notional threshold of $8 billion or more should be appropriate. (It is requested that swaps provided in connection with loans will be excluded in the case of a U.S. branch of a foreign bank.)

9．V. B.3. Multi-Tiered Swap Dealer Regulation Alternative, pp.57-61

(Our comment)

First of all, we would like to highlight that there are two completely separate issues in considering this multi-tiered approach.

(i) In general, we have a positive view on an approach to reduce some regulatory burdens of certain financial institutions registered as an SD and agree with the CFTC’s suggestion to call them Tier 2 Dealers.

(ii) On the other hand, we strongly disagree with lowering the *de minimis* threshold (i.e. enhancing the requirement) and thereby increasing the number of financial institutions subject to the SD registration requirement.

Our overall view, in light of the two issues mentioned above, is that “we agree with (i) to the extent that (ii) is accepted (i.e. the scope of SD registration will not be expanded).” In other words, the CFTC should not prioritize (i) at the expense of (ii).

The third issue ((iii), hereafter) is that improvements should be made to make substituted compliance (in regards to the six jurisdictions) available for a broader set of regulations.

(Rationale)

With regard to the issues (i) and (ii), we would like to first reiterate our disagreement on expansion of covered entities subject to the SD registration requirement by lowering the *de minimis* threshold (the issue (ii)), because such an approach may result in overregulation of financial institutions engaging in a small amount of derivative transactions. The issue (i) should be discussed only when this point is satisfied. As commented in section 3.(2), it is assumed that common policy objectives across jurisdictions (e.g. reduction of systemic risk and ensuring transparency and customer protections) are being met given that non-U.S. SDs are already regulated by respective national authorities in many cases. Therefore, at least those SDs in the six jurisdictions eligible for substituted compliance should be permitted to be subject to a lesser set of regulations (i.e. to be treated as a Tier 2 Dealer).

With regard to the issue (iii), as substituted compliance is not made available broadly, it is our concern that an approach (e.g.to introduce Tier 2 Dealers by lowering threshold without explicitly implementing substituted compliance) may result in undue regulatory tightening as opposed to supervisors' interest. Regardless of what decisions will be made regarding the implementation of a multi-tiered approach, to expand the scope of the application of substituted compliance and to operate it expressly would contribute to an improved balance between regulations and benefits in reviewing the *de minimis* exception.

<u>10. V. B.4. Swaps Executed on a SEF or DCM and/or Cleared</u>

<u>p.62, Question (1)</u>

How would the exclusion of SEF or DCM-traded and/or cleared swaps from an entity's de minimis calculation impact the policy considerations underlying swap dealer regulation and the de minimis exception?

(Our comment)

Those swaps cleared through CCPs should be excluded from the *de minimis* calculation, not only those swaps traded on a swap execution facility ("SEF") or designated contract market ("DCM").

(Rationale)

Even those swaps, which are not traded on a SEF/DCM, have already reduced their counterparty risk if they have been cleared through a CCP. Given this, swaps cleared through CCPs are deemed as having achieved reduction in significant systemic risk and thus do not need to be included in the Transaction Count.

p.62, Question (4)

Would an exclusion for exchange-traded and/or cleared swaps increase the volume of swaps executed on SEFs or DCMs?

(Our comment)

Exclusion for exchange-traded and/or cleared swaps from the *de minimis* calculation would increase the volume of swaps executed on SEFs or DCMs and would lead to mitigation of counterparty risk and systemic risk as well as enhancement of transparency of the market.

(Rationale)

The exclusion will incentivize market participants to use SEFs and CCPs and as a result will further promote transactions executed through SEF/CCP-related entities.