September 21, 2017

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Comments on *Notice Seeking Public Input on the Volcker Rule*
issued by the Office of the Comptroller of the Currency

Japanese Bankers Association

We, the Japanese Bankers Association ("JBA"), would like to express our gratitude for this opportunity to comment on the *Notice Seeking Public Input on the Volcker Rule* issued by the Office of the Comptroller of the Currency ("OCC") on August 2, 2017.

And we also express our sincere appreciation for the release of, and the efforts made in policy coordination among the agencies for, the no-action relief on certain foreign excluded funds by "Statement regarding Treatment of Certain Foreign Funds under the Rules Implementing Section 13 of the Bank Holding Company Act" on July 21 this year from the Federal Reserve Board ("FRB"), the Federal Deposit Insurance Corporation ("FDIC") and OCC.

We fully understand and respect the regulatory objectives of the Volcker Rule ("Rule") which are to maintain the soundness of the U.S. financial system by, among other things: (i) protecting U.S. depositors and taxpayers from unsafe and unsound practice by depository institutions; and (ii) reducing excessive risk taking by financial institutions. The JBA has similar views on these issues.

Nonetheless not only financial institutions and industry groups but also U.S. government officials have raised a number of questions on the relevance of regulatory measures undertaken to achieve these aforementioned objectives.

On multiple occasions, the JBA has shared its comments and concerns with the relevant Volcker Rule agencies. Taking this opportunity, we would like to restate these comments and respectfully request that they be considered as part of any revisions designed to improve the Rule.

1. Narrowing the scope of entities subject to the Rule

Of paramount concern, the JBA believes the scope of “banking entities” (“BEs”) subject to the Rule should be limited to those entities organized or domiciled in the U.S. in the cases where the entities are in a form of corporation[1]. In the alternative, at a minimum, we believe the definition of the BE should be amended to include only those non-U.S. entities meeting clearly specified criteria.

10 Japanese banks (eight groups) currently subject to the Rule have approximately 1,200 subsidiaries and affiliates which are deemed BEs in accordance with the Rule within and outside the U.S. As such BEs held by Japanese banks are required to assess whether they are engaged in transactions and/or activities subject to the Rule. If they engage in such transactions and/or activities subject to the Rule, they are required to establish a compliance program regardless of the nature of their business activities. As a result, the Rule imposes unreasonable compliance burdens.[2]

Japanese banks are supervised by Japanese financial authorities and also are under supervision of the host authorities in jurisdictions where their non-U.S. subsidiaries and affiliates are domiciled. Accordingly, regulatory deference should be afforded to those entities that are subject to home country supervision, without the undue burden of having to institute a U.S.-based compliance program.

As previously mentioned, we understand that the Rule is designed to protect U.S. depositors and taxpayers from, among other things, unsafe and unsound practices by depository institutions, and to reduce excessive risk-taking by financial institutions in order to maintain the safety and soundness of the financial system as a whole. However, the current BE definition includes entities that only have minor effects on the U.S. financial system, and such entities need to take the same compliance efforts as a BE. Given the regulatory objectives above, such entities should be excluded from the scope of the BE definition, assuming that the Rule still applies to non-U.S. entities.

In the spirit of international comity, the OCC should defer to Japanese laws, frameworks for managing subsidiaries and affiliates agreed with Japanese supervisory authorities, etc. and the international consensus of established managerial standards.[3]

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[1] Corporations that are not deemed “investment companies” defined in Section 3(a)(1) of the Investment Company Act of 1940.

[2] The Japanese Banking Act limits the lines of business and services that banks are allowed to have their subsidiaries engage in. Of such lines of business and services, those that may become subject to the Rules are further limited as follows:
(i) Primary lines of business: 24 lines of business (of which, only 14 lines of business are subject to the Rule.)
(ii) Ancillary services: 27 services (of which, no service is subject to the Rule.)
(iii) Finance-related services: 51 services (of which, only four services are subject to the Rule.)

[3] For example, there are eight banking groups that have a bank which applies international standards under the Basel regime. Of which 21 banks do not have U.S. entities and do not apply international

2. Potential BE Funds

The JBA requests that the Rule be clarified so as to ensure that the funds owned by non-U.S. BEs, that are organized and offered exclusively outside of the United States and that do not otherwise qualify as "covered funds" ("foreign excluded funds"[4]) are not deemed to be BEs by virtue of the non-U.S. BEs' investment in or governance arrangements with the fund.[5]

In order to respond to the difficult market environment surrounding domestic investments as a result of the enduring extremely low interest rate policy, Japanese banks, as part of their normal treasury function, have accumulated sizable foreign excluded fund portfolios, particularly in contractual-type investment trusts, amounting to JPY 151 trillion[6].

Contractual-type investment trusts launched under the applicable Japanese law are major investment products for Japanese banks' fund investments, and pursuant to contract and custom, investors do not have control over these funds from a Japanese law perspective. However, under the current Rule, funds, including contractual-type investment trusts, whose ownership interests exceeding a certain threshold are owned by BEs, are considered as a BE[7], based on the U.S. laws, and the establishment of compliance program with the Rule is required.

Moreover, against the cultural background of a traditionally high savings rate in Japan, both the public and private sectors are taking actions to shift assets "from savings to investments" and to develop the investment trust market by taking advantage of investment trusts as a major investment product. However, according to the survey conducted by the Bank of Japan, the percentage of risk assets[8] in financial assets in the household budget is only 16.8% in Japan, compared to 52.4% in the U.S. This implies

standards.

4 Non-covered funds on the Volcker Rule (involving of those originally designated as covered funds but excluded by the Final Rule) which are owned by a non-U.S. bank and its subsidiary/affiliate and are structured or organized under the laws of a foreign sovereign (including those funds which were deemed as a covered fund but have been excluded/exempted pursuant to the Final Rule). This includes listed investment trusts (e.g. ETF and REIT) irrespective of whether privately placement or publicly offering.

5 See "Requests related to the Volcker Rule" of November 20, 2014 (sent to FRB, OCC, SEC, CFTC and FDIC; "Requests related to the Volcker Rule" of May 21, 2015 (sent to the same agencies); and "Requests related to the Volcker Rule" of March 7, 2016 (sent to the same agencies).

6 The total outstanding amounts of depository financial institutions' trust beneficiary rights, receivables securitization, investment trust beneficiary certificates and investments in foreign securities; Source: "Flow of Funds Accounts (1st Quarter 2017)" released by Bank of Japan (June 2017)

7 The investments by the Japanese Banks subject to the Rule in those funds (with BE's ownership interest ratio more than 25%) is amount to approximately JPY 18 trillion by approximately 1,500 funds.

8 The total of debt securities, investment trusts and equites, etc. (as of March 31, 2017); Source: "Comparison of Flow of Funds among U.S., Europe and Japan" released by Bank of Japan (August 2017)

that Japan's investment trust market still has room for growth in contrast to the U.S. market. We acknowledge that, under such circumstances, there is no choice but to maintain investing a significant amount of seeding money as a national policy to ensure the viability of investment trusts launched.

As foreign excluded funds are organized under, and operated in accordance with laws and regulations of respective jurisdictions, it would be inappropriate to apply the provisions of the Rule which are based on the U.S. laws, regulations and customs, etc.

3. Compliance program and metrics reporting

In order to fulfill smoother and more efficient operation of a compliance program and metrics reporting as required under the Rule, we request that the OCC respects the laws, regulations and customs of each jurisdiction and to incorporate a risk-based approach based on risks within the U.S. into the current Rule. We furthermore request the segregation of roles among the U.S. agencies to be clarified to ensure an efficient operation reflecting "the laws and regulations and custom of each jurisdiction" and "perspectives that are based on risks within the U.S."

Japanese banks already report the status of globally aggregated market risk data to Japanese financial authorities. Furthermore, we are of the view that the scope of application of the Rule should be limited to risks within the U.S. Therefore, limiting the metrics reporting to market risk within the U.S. would be consistent with applicable national laws and regulations.

If it would be difficult to limit the metrics reporting to market risk within the U.S., at the very least, entities with minimal risk should be excluded from the metrics reporting.

In the process of annual attestation, the Rule should be modified to clarify that the attesters should be the appropriate senior management officer in the U.S. in order to meet the determination process for the coverage of the Rule. The internal decision-making process for annual attestation, which is based on the U.S. laws, does not suit Japanese laws, regulations and custom[9]. If the Rule is applied continuously to the non-U.S. entities, the OCC should allow for a decision-making approach that takes into account the applicable laws and regulations of the country of a non-U.S. entity.

[9] Japanese banks have developed policies and procedures that ensure decision-making in accordance with applicable Japanese laws and regulations. However, the Final Rule describes that "senior management (…) report to the board, or an appropriate committee thereof, on the effectiveness of the compliance program and compliance matters (…) annually," assuming the decision-making process in the U.S.

Currently, the scope of the enhanced compliance program is determined based on the size of consolidated assets (on a global basis). However the size of consolidated assets (on a global basis) that include assets outside the U.S. would not be an optimal indicator to determine effects on the U.S. market. In order to better tailor the regulation, "perspectives that are based on risks within the U.S.," such as the balance of trading assets and the actual activities conducted in the U.S. market, should also be taken into account.

When a joint investment, established by a non-U.S. bank and a U.S. bank, is not owned primarily by the U.S. bank, it cannot engage in activities that are permitted for a subsidiary of the non-U.S. bank since the entity will be subject to not only the regulations applicable to the non-U.S. bank but also to the regulations applicable to the U.S. bank in spite of no operation in the U.S. As a result, such joint investment is forced to manage a considerable amount of burdens as a U.S. bank.

In this situation, it would be highly effective to apply the Rule in a way that treats this type of entity solely as a subsidiary of a non-US bank in consideration of actual condition of its business activities because its risks within the U.S. are limited.

Although the JBA and Japanese banks have made inquiries for uncertain areas and proposing improvements regarding the Rule to date, we could not obtain any specific responses in many cases since coordination between the five agencies is necessary for such contact.

Furthermore, pursuing effective regulation with consideration of risk-based factors and business activities within the U.S. as previously mentioned, would be supported by the establishment of an appropriate communication channel among agencies, covered financial institutions and relevant industry groups.

Otherwise, it is necessary to make the segregation of the roles more clearly (e.g. formulation of regulatory policy, enforcement of the regulation and the point of contact for inquiries) among the agencies.

4. Simplifying the process for determining the involvement of a personnel located in the U.S. for proprietary trading

The Rule should clarify provisions on the involvement of a personnel located in the U.S. in relation to the TOTUS exemption under the proprietary trading restriction/prohibition.

While the prohibition of the involvement of a personnel located in the U.S. is set out as a condition to qualify for the TOTUS exemption from the proprietary trading restriction, the definition of such involvement is unclear and therefore Japanese banks have to manage the involvement of a personnel located in the U.S. in a conservative manner. As a result, Japanese banks have no choice but to avoid the involvement of their U.S. entities in their regular business activities and such a situation is becoming a factor for limiting their U.S. operations.

In addition, when transacting with a non-U.S. entity of a U.S. financial institution, Japanese banks must confirm whether any personnel located in the U.S. is involved. This becomes a constraint on transactions with U.S. financial institutions, and a limitation on available liquidity.

Furthermore, regulatory and compliance burdens are unreasonably increasing. Examples include the negotiations required with U.S. financial institutions for receiving a representation letter regarding the involvement of a personnel located in the U.S. and the management of the process to ensure the representation letters have been obtained.

5. Others (Proprietary trading activities and covered fund investments)

There are various issues and areas to be improved for the provisions pertaining to proprietary trading activities and covered fund investments. We have summarized such practical issues Japanese banks are facing and recommended improvements in the Appendix, and would appreciate it if the OCC uses this as a reference for developing guidance going forward.

<Appendix[10]>

1. Proprietary trading activities

(1) Effects on transactions with U.S. counterparties

① In order to minimize compliance burdens relating to metrics reporting, etc., many trading desks of Japanese banks rely on trading outside the U.S. by foreign companies (see §__.6(e); hereinafter referred to as "TOTUS") as a permitted proprietary trading activity.

② As a result, a purchase or sale with or through an U.S. entity (see §__.6(e)(4)) is restricted (see §__.6(e)(3)(v)). From this viewpoint, the proprietary trading regulation is preventing Japanese banks' entry into the U.S. financial markets.

(2) Definition of proprietary trading

① The market capital rule test (see §__.3(b)(1)(ii)) and the status test which assesses whether a purchase or sale is deemed as a dealer's business (see§__.3(b)(1)(iii)) should be sufficient to determine whether an account is deemed as a trading account. Therefore, the purpose test, which assesses whether a purchase or sale is conducted for short-term profit purposes, (see§__.3(b)(1)(i)) should be eliminated.

② Some are of the view that the market risk capital rule test (see §__.3(b)(1)(ii)) should suffice to regulate proprietary trading activities that take excessive risk, as it covers the trading accounts defined under the Basel framework.

(3) Scope of covered transactions

Even if our proposals in the previous paragraph (2) should not be adopted, those transactions, such as the following, which are evidently not conducted for short-term profit purposes should be excluded from the scope of covered transactions.

① Transactions for funding purposes (e.g. forex futures, forex swaps and cross currency swaps)

② Transactions in the banking book conducted for portfolio management purposes.

(4) "Rebuttable Presumption"

Even if our proposals in the previous paragraph (2) or (3) should not be adopted, the following actions should be considered and taken.

[10] Appendix covers all issues and areas for improvement with respect to each item and may overlap with descriptions in the text of this comment letter.

① Transactions in which financial instruments are held for fewer than sixty days or the risk of the financial instruments is transferred within sixty days of the purchase (or sale): Provide specific guidance that could allow simplified rebuttal procedures.

② Transactions in which financial instruments are held for more than sixty days or the risk of the financial instrument are transferred after sixty days of the purchase (or sale): Introduce presumption that in principle a purchase or sale is not deemed as a trading account (“Reverse presumption”).

(5) Requirements for permitted activities

The requirements for permitted activities are unclear and complicated and impose significant compliance burdens. Such requirements should be eased and clarified to facilitate the use of permitted activities.

① Specific requests for each permitted activity are described below.

i) Market making-related activities

a) The compliance program requirement applied to those market making desks below a certain size should be eased (e.g. exemption from metrics reporting).

b) Banks should be allowed to select management indicators (e.g. the near term demands of clients, etc., market maker inventory, exposures and holding period) depending on respective activities, instead of being required to apply all of such indicators uniformly to all activities.

ii) Trading in government obligations

a) Highly liquid sovereign debt issued in the U.S. and countries other than the country where a trading desk is located should also be permitted.

b) Derivative transactions (e.g. futures and options) associated with sovereign debt should also be permitted.

iii) TOTUS

a) As TOTUS desks are subject to limitations on transactions with a U.S. entity, the definition of a U.S. entity and the method to identify a U.S. entity should be clarified.

b) Transactions with U.S. affiliates/branches within the group should be permitted. Regulation on intragroup transactions between a non-U.S. entity and a U.S. entity is preventing efficient asset allocation and risk adjustments within the group. In addition, since these intragroup transactions are within the scope of metrics reporting by the U.S. entity and the U.S. agencies are thereby able to capture risk amounts and other relevant information, it would be unnecessary to regulate these transactions under the TOTUS exemption.

2. Covered funds[11]

(1) Effects of the Rule on fund investments

Investment standards, etc. which have been applied to fund investments have not been changed even after the enforcement of the Rule, and thus the enforcement of the Rule has no impact on judgment regarding exposures.

(2) Definition of a covered fund

① Foreign (privately placed) funds

i) The requirement to identify investors who are a U.S. person should be eliminated.

ii) If it cannot be identified whether an investor is a U.S. person, then that fund should be treated as a non-covered fund.

iii) Foreign privately-placed funds which are held/sponsored by a foreign subsidiary of a U.S. bank should be treated as a non-covered fund.

② Foreign public funds

ETF and REIT should be treated as a non-covered fund, irrespective of the percentage of offerings within the U.S.

③ General definition

i) Whether a fund is a covered fund should be determined also based on the "existence of carried interest" and the "existence of the right to receive other type of performance fees."

ii) The exemption under Rule3a-7, etc. should be simplified.

iii) If a fund investment is aligned with the objectives of the Rule (i.e., it is not a high risk trading strategy), for example, it is "held for held-to-maturity purposes under the accounting standard" and is "not leveraged by derivative contracts, etc.", that fund should be treated as a non-covered fund.

iv) Contractual-type and company-type collective investment vehicles should be excluded.

v) Entities whose purpose is to hold/acquire investment securities that exceed 40% of total assets could be deemed as a covered fund whereas entities whose primary purpose is not to hold/acquire investment securities should be excluded from the scope of covered funds.

[11] All funds that are commented as "should be treated as a non-covered fund" in this paragraph are a fund that should be excluded from the scope of BE in accordance with our comment described in paragraph 2 "Potential BE Funds" of the text.

(3) Definition of ownership interest

The following approaches should be taken to clarify the definition of ownership interest.

① Exclude interests in the senior tranche of the senior/subordinated structure for securitizations whose underlying assets are not replaced during the contract term.

② Exclude holdings of the right to participate in the selection or removal of a general partner, investment manager" for securitizations whose underlying assets are not replaced during the contract term (see §_10(d)(6)(i)(A)).

③ Exclude "has the right to receive the underlying assets of a covered fund after all other interests have been redeemed and/or paid in full" and an interest that "has the right to receive all or a portion of excess spread" and replace with the sponsorship category (see§_10(d)(6)(i)(C) and (D)).

(4) Excluded/exempted activities and permitted activities

① Foreign public funds

ETF and REIT should be treated as a non-covered fund, irrespective of the percentage of offerings within the U.S.

② Asset management activities

i) Seed capital investments should be treated as an exempted/excluded activity.

ii) If seed capital investments will not be exempted/excluded, the investment period exceeding three yours should be allowed.

iii) If seed capital investments will not be exempted/excluded, the investment period exceeding three yours should be allowed for fund investments carried out to measure track records for purposes of sales to institutional investors.

③ SOTUS exemption

SOTUS exemption should not be treated as a permitted activity but as a non-covered fund.

(5) Super 23A

In the case of an entity in which a foreign bank and a U.S. bank has a joint investment, if the foreign bank acting as a major investor is a Japanese bank, the entity should not be treated as a covered fund which is subject to Super 23A even if the investment ratio of the U.S. BE exceeds 25%.