July 12, 2019

By Electronic Mail

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Notice of Proposed Rulemaking, Control and Divestiture Proceedings: (FRB Docket No. R-1662 and RIN 7100-AF49)

The Japanese Bankers Association ("**JBA**")[1] appreciates the opportunity to comment on the proposal issued by the Board of Governors of the Federal Reserve System ("**FRB**") regarding Control and Divestiture Proceedings (the "**Proposal**").[2]

I. Executive Summary

We appreciate the FRB's efforts through the Proposal to simplify and make more transparent the standards that will be applied in determining whether one company has control over another company under the U.S. Bank Holding Company Act of 1956, as amended (the "**BHC Act**"). In general, the JBA supports the FRB's efforts to provide more clarity and predictability with respect to "controlling influence" determinations, as this could reduce the operational burdens and legal costs traditionally associated with interpreting and applying complex, ambiguous, and often times unpublished control rules when making investment decisions.

Notwithstanding our general support for the objectives sought to be addressed by the Proposal, we have several fundamental concerns regarding the manner in which the FRB has proposed to address those objectives, particularly with respect to the impact of the Proposal on the non-U.S. holdings of Japanese and other foreign banks.

[1] The Japanese Bankers Association is an association of 137 Japanese banks and 54 non-Japanese banks with operations in Japan. Several of its member banks are active participants in the U.S. financial markets.

[2] 84 Fed. Reg. 21,634 (May 14, 2019).

The BHC Act, as implemented by the FRB in Regulation Y and Regulation K, has long recognized the jurisdictional limits of U.S. bank regulatory and supervisory interests. Likewise, the FRB historically has sought in its supervision and regulation of internationally active banks to balance the imperatives of competitive equity and safeguarding the U.S. financial system with appropriate comity and deference to home country laws, regulations, and business customs.

However, to the extent that certain aspects of the Proposal are more restrictive than current FRB policy, the Proposal could result in some non-U.S. companies—including companies with no U.S. activities or investments—being deemed subject to the BHC Act for the first time. While the BHC Act itself is clear that non-U.S. activities and investments of foreign banking organizations ("**FBOs**") are generally exempt (e.g., from the nonbanking restrictions of section 4), internationally active banks are required to monitor and enforce compliance by these entities once they are deemed to be controlled subsidiaries and, as a result of the extraterritorial reach of the Volcker Rule, may also be obligated to impose a Volcker Rule compliance program on such companies.[3]

Certain presumptions of control set forth in the Proposal are overly broad and could result in an investor FBO being determined to have acquired control over another company with no intent to have done so and on terms that provide the FBO with no actual control over the target company. Under these circumstances, the FBO will be unable, among other things, to monitor and enforce compliance with the BHC Act by the target company on a go-forward basis. The JBA therefore recommends both that the FRB reconsider certain thresholds at which a presumption of control will be triggered and also ensure that existing investments and other holdings that were entered into on terms reasonably understood at the time to be noncontrolling not be "recharacterized" as controlling without appropriate accommodations. These issues are addressed more specifically below.

[3] If a company is controlled by a BHC or FBO, then the company must comply with the restrictions on nonbanking activities and investments in section 4 of the BHC Act (collectively, the "**Activities Restrictions**") and also will generally be treated as a banking entity ("**Banking Entity**") subject to the Volcker Rule.

II. Specific Comments on the Proposal

A. Scope of Application and Approach

1. The FRB should confirm that lawful home country activities and relationships will not be affected in any way by the Proposal

One of the primary objectives of the Activities Restrictions is to prevent domestic bank holding companies ("**BHCs**") and FBOs from engaging in "commercial" activities that may expose a BHC or FBO to different types of risks, thus helping to ensure the soundness of these banking organizations and ultimately the stability of the financial system. The different Activities Restrictions in different jurisdictions, including Japan, have evolved to appropriately achieve these objectives in consideration of each jurisdiction's own history and business customs. With respect to Japanese banks, the Antimonopoly Act of Japan and the Banking Act of Japan already impose a robust framework of restrictions to separate banking from commercial activities. Specifically, Japanese banks have been subject to the Activities Restrictions stipulated under the Banking Act of Japan since the 1980s, and, to date, there has been no instance of Japanese banks posing risks to U.S. financial stability, whether as a result of commercial exposures incurred under home country law or otherwise.

Moreover, pursuant to the "Comprehensive Guidelines for Supervision of Major Banks" by the Financial Services Agency of Japan ("**JFSA**"), Japanese financial institutions are expected not only to play a role as a supplier of funds to their clients, but also to provide maximum support for the clients' self-help efforts by providing consulting functions, such as support for the formulation of restructuring plan, continuous monitoring after loan modifications, and management consulting services. As part of these efforts, Japanese banks historically have also provided support to their clients in the form of capital contributions, such as acquiring preferred stock and subordinated loans.

Therefore, at a minimum, the Proposal should not result in an excessive extraterritorial application of the BHC Act that may have a significant impact on <u>existing</u> investments and business relationships that already incorporate Japanese business practices. It is essential to consider regulations, supervision and practices established in home jurisdictions of FBOs, including Japan, to avoid excessive compliance burdens.[4]

2. *The final rule implementing the Proposal should not retroactively apply to investments that have been entered into under a reasonable understanding that they were noncontrolling at the time of the investment.*

The Proposal is essentially silent with respect to its impact on existing investments. However, we believe it would be unreasonable to require a FBO to rebut a presumption that the FBO has “control” over another company as a result of (i) newly articulated thresholds and/or (ii) thresholds that have for the first time come to reflect an essentially “conclusive” determination of control in situations where the FBO undertook a review and reached a good faith determination of noncontrol at the time of investment based on the FRB’s published statements. The Proposal should not be applied retrospectively.

3. *When the Proposal is finalized, FBOs will require a sufficient period for preparation (at least three years) before compliance should be required.*

It is essential to set a sufficient transition period of at least three years from the finalization of the Proposal to the application of the revised control rules. Depending on the content of the final rule, this amount of time may need to be longer given the substantial initiatives that Japanese banks would need to undertake in order to develop the necessary infrastructure and provide appropriate prior notice to clients before making adjustments to investments.

[4] “Effective cooperation between host and parent authorities is a central prerequisite for the supervision of banks’ international operations. In relation to the supervision of banks’ foreign establishments there are two basic principles which are fundamental to such cooperation and which call for consultation and contacts between respective host and parent authorities: firstly, that no foreign banking establishment should escape supervision; and secondly, that the supervision should be adequate.” *Principles for the Supervision of Banks' Foreign Establishments* (May 1, 1983). This document is also known as the Basel Concordat.

B. Consistency with the Volcker Rule[5]

The JBA understands that U.S. authorities also are developing proposed revisions to the Volcker Rule. Japanese banks have been focusing on compliance with the Volcker Rule on a daily basis, and the JBA believes that the Proposal should be in line with the rules and practices of the Volcker Rule.

Under the Proposal, the seeding period for a noncontrolled investment fund is set at one year, while guidance developed in the context of Volcker Rule provides that longer seed investments such as three years and over can be made in regulated investment companies ("**RICs**") and foreign public funds ("**FPFs**"). Despite the differences in regulatory content, we believe that different permissible seed investment periods could result in practical disruptions.

Considering the fact that a seeding period of at least three years is allowed under the Volcker Rule, as in the case of the above-mentioned RICs and FPFs, setting the seeding period at one year would be unreasonable from the perspective of the BHC Act. Moreover, given that the ideal seed investment horizon is not of an absolute nature, the seed investment horizon should be determined rationally by each manager and the FRB should clarify that control is not presumed during the seeding period regardless of its duration.[6]

C. Comments on Tiered Presumptions

1. Directors Representation

Although the Proposal in many respects is a reflection of the Board's existing interpretations, the definition of "director representative" appears to represent a

[5] The concern is consistent with our previous comments on the Volcker Rule that the JBA has submitted to U.S. authorities. See (i) "Requests related to the Volcker Rule" dated November 20, 2014 (Addressees: FRB, OCC, SEC, CFTC, and FDIC); (ii) "Requests related to the Volcker Rule" dated May 21, 2015 (the same addressees as above); (iii) "Requests related to the Volcker Rule" dated March 7, 2016 (the same addressees as above); (iv) "Comments on Notice Seeking Public Input on the Volcker Rule issued by the Office of the Comptroller of the Currency" dated September 21, 2017 (Addressee: OCC); and (v) "Comments on Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" dated October 17, 2018 (Addressees: FRB, OCC, SEC, CFTC, and FDIC).

[6] As a practical matter, an asset management company develops a variety of products to meet the needs of investors. When investors evaluate a new product, they place the highest priority on the actual track record, which is often used as a standard for making investment decisions. From the practical experience of seed investment and track record creation, it is generally possible to start full-fledged marketing only after three years of track record accumulation.

departure from the Board's historic practice in a way that would present significant implementation difficulties without meaningfully advancing the Board's objectives. The element of the definition that would pose the most practical difficulties is the expansion of the definition of "director representative" to include "the immediate family member of any employee, director, or agent of the first company." Taken literally, this means that a BHC or FBO would need to confirm whether each director of any company in which the BHC or FBO holds a voting interest of less than 25 percent is an immediate family member of any single one of its employees, directors, or agents. This would even apply to directors serving before the BHC or FBO made its investment. For a FBO, developing procedures to identify immediate family members of such an immense range of people would be an extraordinary undertaking. We expect that in almost all cases, even if an immediate family member of an employee, director, or agent of the first company were identified among the directors of a second company, the family member's presence on the board would be entirely unrelated to any investment by the first company in the second company. Moreover, we believe that such a family member's presence would not in any way represent an attempt by the first company to exert a controlling influence on the second company.

We recommend eliminating the immediate family member prong from the definition of director representative. The Board's authority to find control based on other facts and circumstances should be sufficient to address the potential risk that a first company could expand its influence through an immediate family member of an employee, director or agent.[7]

In addition, the tiered framework should clearly state that a person is only treated as a director representative for the two-year period following the termination of his or her status as a director, employee, or agent of a first company if he or she was a director, employee, or agent of the first company on the date that he or she joined the board of the second company. Thus, if a former employee of a first company joins a board of a second company one year after leaving the first company, the individual would no longer be treated as a director representative of the first company.[8]

The definition of "agent" in the Proposal is somewhat unclear, and the JBA

[7] Comments on Question 54 of the Proposal.

[8] Comments on Question 54 of the Proposal.

requests that the FRB provide a definition of the term in any final rule.[9]

Additionally, the control presumption related to director representation on board committees should be limited to those committees that make important management decisions on behalf of the company (i.e. the so-called Executive Committee). For director representatives of investor on board committees, the thresholds for investments of between 10 percent and 24.99 percent is at up to 25% or less, which is almost identical to the category of "number of director representative of investor."[10]

However, the composition of board committees is generally much smaller than that of the full board of directors. It would be easily presumed to control the investee company, though the investor does not intend to control the investee company. Thus, the JBA requests that the FRB ease the thresholds of director representation on board committees to at less than 50%.

2. Business Relationships

The business relationship revenue and expense thresholds for investments of between 15 percent and 24.99 percent of voting shares are too low (i.e., two percent).[11] Moreover, we believe that business relationships should not result in a presumption of control at all where an investment remains less than 15 percent of a class of voting securities. Such an approach is reasonable because the key point in determining control in any practical sense are voting securities and equity ownership. If an investment falls below the 25 percent control threshold for voting shares and the 33.3 percent equity ownership limit and an investor also has no director representation at all, concerns about other elements of the relationship should be substantially mitigated.[12]

In order to eliminate temporary special factors, we also recommend that the control rules be revised to assess business relationships over multiple years (e.g., three years) rather than a single year. In addition, a grace period of at least two years should be allowed for companies in the startup stage or fundraising stage. As a practical matter, application of and compliance with the FRB's traditional "revenue tests" for companies at this stage are virtually impossible, given the uncertainty and volatility of earnings.[13]

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[9] Comments on Question 54 of the Proposal.

[10] Comments on Question 3 of the Proposal.

[11] Comments on Question 5 of the Proposal.

[12] Comments on Question 8 of the Proposal.

[13] Comments on Question 5 of the Proposal.

The final control rules also should make clear that a company would not be presumed to control another company if the first company fails to affirmatively measure business relationships with the second company but has a good faith basis for believing that such business relationships will be comfortably below the applicable threshold. While the Proposal provides much transparency in the form of clear presumptions of control, particularly around the business relationships, it creates compliance burdens that far outweigh the benefits from the proposal. In the case of any investment of five percent or more, the company will have to undertake cumbersome and far-reaching analyses to confirm compliance with the business relationships restrictions.[14]

In the case where a first company refers a potential client to a second company and the second company eventually earns revenues through the business with the referred client, we believe that the revenue from the referrals should not be included as revenue "attributable" to the first company. Referrals may be only one of multiple reasons why the client uses the second company, and incorporation of "referral" revenue as opposed to just direct payment from a first company to a second company introduces significant measurement and monitoring problems. A first company cannot affect the business relationship between the client and a second company after the referral is made. A first company also cannot compel the client to do business with a second company or terminate a business relationship once begun. Accordingly, there is little risk that the first company can "leverage" the relationship to exert any influence over a second company. Including referral revenue would substantially undermine the objectives of simplicity and predictability that the Proposal is intended to address.

Finally, the market terms presumption is not necessary. The controlling nature of a relationship is not always reflected in the terms and conditions of business relationships.[15]

3. Senior Management Interlocks

In the case of investments by Japanese banks, it is common for target companies to accept secondments from their investors without either party intending or expecting such an arrangement to provide a controlling influence. Rather, this practice permits financial institutions to provide expertise to the target companies, allowing them to grow and expand their businesses in specific areas.

[14] Comments on Question 8 of the Proposal.

[15] Comments on Question 9 of the Proposal.

Large companies and small and medium-sized companies have different numbers of senior management officers, and it would be inappropriate to set an absolute threshold regardless of company scale. Therefore, officer/employee interlocks thresholds should reflect company size (sales and capital), with larger firms allowed higher thresholds than smaller firms.[16]

4. Contractual Limits on Major Operational or Policy Decisions

All loan covenants should be regarded as "standard covenants" unless the loan agreement prohibits prepayment of the loan. At a minimum, loan covenants should not raise issues under the control rules unless such covenants are directly related to equity investments. The reasons are that (i) it is common, as the FRB notes in the Proposal, to set covenants in lending under the banking business, (ii) such standard loan covenants are usually measures for credit protection and are not intended to exert control, and (iii) the borrower can simply prepay the loan to avoid any impact on the borrower so that the lender cannot use the loan covenants to exercise actual control over a company.

We also request that the FRB clarify the treatment of leveraged buyout ("**LBO**") finance using securities, such as preferred stock, which do not exercise voting rights under Japanese law. If a general level of covenants or requirements for approval is incorporated in Japan's LBO finance, there is a concern that such contractual rights limitations will lead to securities being determined to have voting rights. It may be difficult to offer LBO finance in securities, which has been generally used in Japan. We would appreciate a clarification to avoid such a result.[17]

Debt covenants should be permissible even when there is an accompanying equity investment. The Proposal indicates that the standard types of restrictive covenants in credit contractual agreements are generally acceptable but potentially not when such a credit arrangement is accompanied by an equity investment exceeding certain thresholds. The Proposal should make clear that restrictive covenants in a credit arrangement are acceptable so long as they are included in a *bona fide* arm's-length credit transaction where the borrower can repay the extension of credit and thereby be relieved from the restrictive covenants. This is appropriate as the interest paid and received would also factor into the business relationships test. Imposing limits on debt covenants as proposed would tend to restrict credit and thus inhibit economic growth.

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[16] Comments on Question 10 of the Proposal.

[17] Comments on Question 51 of the Proposal.

Moreover, the investment and credit decisions are often made in separate business units of a banking organization, and, as noted in the footnote 31 of the Proposal, these arrangements can be addressed in the context of assessing safety and soundness concerns of a particular relationship.[18]

5. Total Equity

Only total equity held by a company's direct subsidiaries should be attributed to the company. It is practically difficult to ask target companies to submit the list of their investments and sum such investments as a company's entire position. It also is not reasonable to consider the ownership ratio in non-subsidiary companies when calculating the total equity.[19]

The JBA is deeply concerned that the total equity presumption may place unreasonable burdens on foreign financial institutions in the following respects. First, in the case of contract-type investment trusts (which are mainly fund investments by Japanese banks), in many case, investors do not have control influence over the trust. Many funds invest in a small percentage of a large number of stocks with diversified investments, so it is quite burden to look through the fund's shares only for the purpose of the presumptions of control. The JBA recommends that the FRB implement measures to reduce the compliance burden, such as excluding equity holdings by non-U.S. funds which investors do not exercise control or excluding those that have only a small percentage of equity holdings in target companies from conducting a look-through analysis. Complex and sophisticated calculations of total ownership are required under the Proposal for a number of non-U.S. funds that are generally characterized as noncontrolled by investors in the country where the fund is located, which creates a significant compliance burden solely to "confirm" the same result under the BHC Act.[20]

It is highly complicated and difficult to manage the "total equity ratio" of numerous non-U.S. funds, which investors are not permitted to control in many countries. Therefore, Japanese banks may refrain from otherwise-attractive "contract-type investment trusts" solely to avoid U.S. regulatory issues, which would have an adverse effect on economic and capital markets growth.[21]

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[18] Comments on Question 51 of the Proposal.

[19] Comments on Question 46 of the Proposal.

[20] Comments on Question 46 of the Proposal.

[21] Comments on Question 46 of the Proposal.

The total equity percentage can be significantly overstated in circumstances where the target company has negative retained earnings. Therefore, an investor should be required to calculate its total equity percentage upon any investment or transaction that will change the relative total equity percentage.[22]

Moreover, the JFSA is promoting the active use of "equity debt" by small and medium-sized companies. The aim is to improve the balance sheets of companies facing a capital shortage due to the impact of the Great East Japan Earthquake. The treatment of debt instruments under the Proposal is vague and broad and may have an adverse effect on the JFSA's efforts mentioned above.[23]

In particular, the JFSA's supervisory guidelines stipulate the "Utilization of DES/DDS and DIP finance, in addition to modification of loan terms and conditions, in accordance with market position and transaction status of financial institutions" for client companies that need business revitalization, making it important to utilize debt instruments. Taking debt instruments into consideration for total equity, without taking into account the position of Japanese banks in society and the life stage of the target companies, would put pressure on expected operations of Japanese banks.[24]

According to the Proposal, the characteristics of liabilities treated as equity include (i) being treated as equity under accounting principles, (ii) being very long-term, or (iii) being subordinated. In this regard, hybrid loans that meet certain conditions necessary for rating are considered to have all of the characteristics described above. However, in light of financial strategies, hybrid loans are financing methods selected at the borrower's discretion, and they are not intended to be controlled by the lender. In practice, hybrid loans have a subordinated feature, so it is impossible to control hybrid loans against the wishes of senior lenders. It is inappropriate to include such instruments in the concept of total equity to determine control, and debt instruments that have traditionally been used in relation to a company's financial strategy should not be included in Equity.[25]

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22 Comments on Question 50 of the Proposal.

23 Comments on Question 50 of the Proposal.

24 Comments on Question 50 of the Proposal.

25 Comments on Question 50 of the Proposal.

D. Comments on Additional Proposed Presumptions and Exclusions

1. Investment Advice

Contract-type investment trusts in Japan are merely "tools" for owning assets under management, and their status under the Proposal, particularly in relation to the investment adviser provisions, is a cause for concern. In a typical Japanese investment trust structure, a manager (investment manager) sets the investment policies and conducts all investment activities. We understand that the managers are not synonymous with the "investment adviser" defined in the Proposal, as the manager typically controls a contract-type investment trust in a manner analogous to a general partner. Nevertheless, the contract-type investment trust may also have an investment adviser. Investment advisers do not have the authority to control contract-type investment trusts in any respect and are readily terminable by the manager. In our view, the FRB should not presume control by any investment adviser, at least for contract-type investment trusts of the type described above.[26]

The reference in the Proposal to acting "without sole discretionary authority to exercise the voting rights" needs to be clarified. Specifically, the JBA requests the FRB clarify whether a company would be acting "without sole discretionary authority to exercise the voting rights" in the following situations:

- The trustee holds the voting securities including the right to exercise voting rights in a fiduciary capacity and there is a legislative/contractual limit on doing so, such as a requirement to vote in the best interest of the beneficiary.
- The trustee holds the voting securities including the right to exercise voting rights in a fiduciary capacity and the trustee is required to report the results of its exercise of voting to invest managers, investment advisers, or the third parties.[27]

2. Accounting Consolidation

The Proposal should not create a presumption of control because a second company is consolidated on the balance sheet of the first company under GAAP. [28]

As proposed, if GAAP consolidation is a benchmark, it would affect (among

[26] Comments on Question 20 of the Proposal.

[27] Comments on Question 17 of the Proposal.

[28] Comments on Question 21 of the Proposal.

other things) how the FRB views control in the context of asset-backed commercial paper conduits. For FBOs that have engaged in extensive discussions with the FRB staff and received comfort that a particular conduit would not be viewed as being controlled (and therefore would not be subject to Regulation YY), the implications of this change would be significant.[29]

For investments in VIEs that are consolidated and equity method affiliates, one of the objectives for accounting purposes is to add earnings as a result of investments. Consolidation is not intended to be a proxy for control, and, therefore, the control presumptions should not be expanded to include consolidated VIEs and equity method affiliates. We believe that whether one company accounts for another company as an equity method affiliate should not by itself be considered indicative of control; instead, such companies should be evaluated on the same tiered framework as all others. The level of control required for full consolidation (a “controlling interest,” which is typically achieved through direct or indirect ownership of a majority of voting securities) is different from the criteria for equity accounting (a “significant influence,” which is presumed when there is direct or indirect ownership of 20 percent of voting securities). To consider equity method accounting to be determinative of control would be to conflate two very different standards.[30]

Furthermore, because equity accounting is presumed under U.S. GAAP when one party owns 20 percent of the voting securities of another party, if control were presumed whenever equity accounting is used, the practical effect would be the creation of a new presumption of control at ownership of 20 percent of voting securities that could only be rebutted by rebutting the presumption of equity accounting under U.S. GAAP.[31]

Question 22 in the Proposal asks whether the FRB should presume that a company controls a second company when the first company accounts for the second company using the GAAP equity method accounting. We do not believe it should because such presumption negates the general approach the Proposal takes. The Proposal does not presume control when the percentage of a class of voting securities held by a company is between 15 percent and 24.99 percent and certain business

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29 Comments on Question 21 of the Proposal.

30 Comments on Question 22 of the Proposal.

31 Comments on Question 22 of the Proposal.

relationships exist. However, the GAAP equity method of accounting may be applied with 20 percent voting ownership without any other relationships. We do not believe such an investment should be presumed to be a controlling investment because in the Proposal an investor who owns 20 percent of voting rights would be allowed to have certain board representation and/or business relationships with the target company (as long as they are less than 2 percent of revenues or expenditures) without being presumed to control the target company.

3. Divesture

For control divestures, the presumptions of control should be the same as those that are applied at the time of acquisition/addition of a new company.[32] The FRB's historical presumption of some "residual" basis for exerting controlling influence over a company that has been spun out or otherwise divested, which does not manifest itself in any measurable way under any of the indicia of control applied by the FRB, does not appear to be supported in any empirical way. Any such immeasurable form of residual control also must be truly *de minimis* to the extent it does not involve voting rights, equity ownership, board presence, business relationships, interlocks, or other factors. We recommend that the FRB do away completely with a separate set of rules for divestitures.

4. Closely-Held Companies and Widely-Held Companies

Contrary to the FRB's traditional approach to controlling influence, the Proposal does not recognize the relevance of other large shareholders as a general matter to mitigate the controlling influence of the investing company.[33] However, in situations where there is an ordinary shareholder who is holding more than a majority of the voting rights, or if there are other companies that are more strongly regarded as having control due to other factors such as a true "Management Agreement," it is appropriate to presume noncontrol for other investors, regardless of the ownership percentage or percentage of total equity held by those other investors. For example, the restrictive contractual rights standard should not be a factor when there is another shareholder that owns more than 50 percent of the voting shares of a company. Accordingly, we believe that the controlling influence test should take into account the existence of other large shareholders, even if this adds additional complexity to the framework.

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[32] Comments on Question 23 of the Proposal.

[33] Comments on Questions 28, 32 and 33 of the Proposal.

5. Rebuttable Presumption of Noncontrol

Control should not be presumed if a company has more than one-third of total equity but still controls less than 10 percent of voting securities. The Proposal assumes that, based on the 2008 Policy Statement, there is control if a company controls less than 15 percent of the voting securities but owns more than one-third of the company's total equity. On the other hand, since the FRB will not presume control over shareholdings in securities that have less than 10 percent of the voting rights according to the Proposal, only if voting securities which is between 10 percent and 15 percent and total Equity owned by the company is over a third, the FRB should presume control. For example, the provision of necessary support by banks to enterprises that require financial restructuring with insufficient capital may be implemented using the preferred stock style, etc. without voting rights. If not arranged as described above, however, there is a possibility that the existence of a one-third threshold may lead to the presumption of control, which may preclude the provision of necessary support, thereby unduly constraining expected bank operations.[34]

6. Market Making Activities for ETFs

In order to avoid that ETFs are judged to be under control of a BHC by temporary possession of ETFs resulting from Market Making Activities for the market and clients, an exception under §225.32(h) should be given to such temporary possession. In this exception, the definition of ETFs should include contractual-type ETFs such as Japanese ETFs as well as investment company-type ETFs such as U.S. ETFs.

Japanese Financial Instruments Business Operators ("**FIBOs**") (equivalent to Broker-Dealers in the U.S.) act as market makers for ETFs in Stock Exchanges to provide liquidity to the market, and FIBOs also trade ETFs with clients bilaterally as Block Trades. FIBOs usually possess ETFs in their own accounts/books temporarily for those market making activities. ETFs can hardly comply with the Volker Rules if ETFs are judged to be under control of a BHC, so, currently FIBOs under the control of BHCs are forced to manage position of an ETF below 25 percent (or 33 percent) of outstanding shares of each ETFs. Under the Proposal, in the case of that a FIBO and a trustee or/and an asset manager of a ETF are under the control of the same BHC, the FBO would be forced to manage position of the ETF below 5 percent of outstanding

[34] Comments on Question 30 and 31 of the Proposal.

shares because fees paid to the trustee / the asset manager accounts for a lot of ratio of expenditures of the ETFs. However, such management must bring harmful effects that obstructs Market Making Activities for ETFs significantly and lowers liquidity of the ETF in the market. Especially, it must be harmful for small and mid-sized ETFs.

E. Comments on Proposed Definitions

1. First Company and Second Company

In examining the relationships between entities in a group, it is more appropriate to examine the relationships between the top-tier parent companies than the relationships between companies in the groups, as described in the main text of the Proposal. For example, in most cases, transactions between a bank and the parent company of a company group preface initiation of transactions between their subsidiaries and affiliates, such as stockholdings and financial transactions. However, transactions between top-tier parent companies are predominant in terms of both quality and quantity, and there is little significance for group aggregation, as the aggregation of transactions does not appear to change. Therefore, we believe that first company and second company should not include their respective subsidiaries and affiliates.[35]

In the Proposal, it is unclear whether the control presumptions are to be made by the second company group or by the second company or its subsidiaries alone. In any case, it does not appear to be addressed in the Proposal that the control presumption of one subsidiary of the second company group affects the control presumption of the second company as the parent company. Therefore, control presumptions should be determined on a second company basis alone: provided, however, that this shall not apply under certain conditions.[36]

2. Voting Securities and Nonvoting Securities

With respect to such securities as limited partner shares, units of investment corporations like REITs, silent partnership investments, and trust beneficiary rights, which do not carry any authority to execute business or the right to vote at general meetings of shareholders, it should be clarified that such securities do not have any

[35] Comments on Question 34 of the Proposal.

[36] Comments on Question 34 of the Proposal. Relevant conditions could be where the second company is a holding company, etc. and sales of the relevant subsidiary account for the majority of the consolidated sales (accounting) of the second company group, etc. or where it is the core business of the group.

voting rights. These types of securities do not enable control of a target company and are merely a method of financing. Given the current situation where the scope of voting rights in securities is at times unclear (particularly for non-U.S. structures that will be more substantially affected by the Proposal), a conservative definition of "voting security" would unnecessarily increase the difficulty of investing in such securities. Accordingly, a more affirmative and transparent statement on the status of these instruments by the FRB would facilitate the objectives of the Proposal.[37]

In cases where the exercise of voting rights depends by contract on the ratio of rights held, the determination of voting rights should take into consideration such holding ratios. For example, in cases where a contract provides for the consent of a certain proportion or more of preferred shareholders in relation to the execution of business of the target company, the JBA understands that, based on the Proposal, a preferred shareholder holding a proportion of equity that is too small to trigger the consent provision may still be regarded as holding voting securities, even though the shareholder cannot trigger the consent right. Because securities holders cannot control where they invest unless they can exercise their rights independently, such securities should be treated as non-voting securities.[38]

F. Other Comments to Specific Questions in the Proposal

1. Question 7

Should the presumptions incorporate limits on business relationships in light of the economic significance of such relationships to both the first company and the second company? Would it be appropriate to apply different thresholds in the presumptions to measure the materiality of a business relationship to the first company versus the second company?

The JBA requests the FRB clarify that the revenue and expense tests are measured only by direct payments between the two companies involved. Revenues from third parties that result from referral arrangements or joint marketing efforts should not count toward revenues generated by the relationship for purposes of the revenue tests.

[37] Comments on Question 35 of the Proposal.

[38] Comments on Question 35 of the Proposal.

2. Question 8

Is the proposed measurement of business relationships for purposes of the presumptions sufficiently clear? Would companies have any difficulty measuring the economic significance of a business relationship as described in the presumptions? If so, would a shorter measurement period (e.g., quarterly) or a longer measurement period be appropriate? Is the proposed annual measurement period appropriate for all business relationships or should the proposal provide alternative standards for certain relationships?

The JBA believes that the definition and calculation methods for assessing business relationships in the Proposal are not set forth in sufficient detail to allow companies to efficiently assess business relationships. The JBA requests the FRB explicitly define in any final rule how companies should calculate "total annual revenues" and "total annual expenses." Specifically, the FRB should provide in any final rule the measurement period, net vs. gross, denominator, numerator, and other factors that are necessary to assess a business relationship.

JBA also requests the FRB confirm, if a company can be recognized as a subsidiary of the second company according to the control presumptions, then, the revenue of such subsidiary (third company) of the second company is to be aggregated in calculating the total annual revenues of the second company for the denominator of the business relationship assessment, even though the third company is an equity method affiliates under accounting standards and its revenue is not consolidated in the second company total revenue in statutory financial statements.

The JBA also requests the FRB to confirm in any final rule whether "control" is presumed immediately after the proposed "threshold percentage/amount" is exceeded or if there is a measuring or transitional period for such a determination.

Limited partnership ("**LP**") investors pay management fees to the general partner **("GP**") on a pro rata basis that is based on the amount of the investment commitment. Therefore, if an LP investor owns a large portion of a partnership and the GP acts as GP for a small number of partnerships, the management fees paid from the LP to the GP could exceed the thresholds set forth in the business relationship tests. The FRB should indicate in any final rule that the management fees in this case do not constitute control under the business relationship presumptions. Administrative fees are part of the transactions normally undertaken in passive investments and should not be included in the calculation as they do not represent a controlling influence by the LP on the GP. Until a GP winds down a partnership (e.g., sells off target companies), revenue for the GP generally will consist of management fees paid by the LPs. On the other hand, considering that the ratio of income will decrease significantly when the target company is sold, the FRB could consider the establishment of a grace period as an alternative to the exclusion of management fees from the business relationship assessment.

Finally, it is difficult to monitor an investor's business relationships with all target companies, because the percentage of total annual revenues and total costs of transactions with each target company generally are not monitored as part of the investment process, and the associated percentages of revenue and expenses fluctuate significantly.

3. Question 46

How could the Board further clarify the proposed general standard for calculating total equity percentages? Should any portion of the proposed general standard be revised and, if so, how and why?

The market value of securities should not be a factor that is used in the calculation of total equity. The important decision-making bodies of the company are the shareholders and the board of directors, and therefore, the most important factor in the control analysis is voting rights as well as control of the board, GP or trustee factors. From this perspective, the market value of securities does not directly affect control. Also, the market value of securities fluctuates depending on the financial condition and business performance of the company, and this variability should not be considered in the control presumptions because it is irrelevant to a determination of control. In addition, taking the value of securities into account may deter financial institutions from providing certain types of support to companies that are undergoing restructuring because the institution could be determined to control the company based on fluctuations in the value of securities.

a) Issues in Calculating Total Equity Calculation

As discussed above, section 225.9(c) of the Proposal would impose an obligation to track ownership of shares by immediate family members of senior management officials, directors, and controlling shareholders of a company that makes a five percent investment in a second company, which is not reasonable given the burden involved in tracking such interests. The final rule should instead be limited to such ownership where the company is given a proxy to vote the shares held by the individual, where the company lends the money to the individual to acquire the shares, or where the holder agrees to vote the shares as instructed by the company. Otherwise, the compliance burden to track such interests would be significant and with limited benefit in terms of aggregating control positions.

b) Issues Regarding Funds

GPs regularly use multiple SPVs to accommodate a LP's tax and legal requirements (depending on the LP's jurisdiction). When a GP makes such an investment, each SPV contributes its pro rata share of the total investment at the same time when instructed to do so by the GP. The calculation for total equity, therefore, should be based on the aggregated amount invested across all SPVs in a structure, not each SPV in which an LP has invested, as no individual SPV will have the ability to make independent decisions.

4. Question 47

How could the Board further clarify or refine the proposed standards for considering debt or other interests to be functionally equivalent to total equity for purposes of determining an investor's total equity percentage? Should debt that is functionally equivalent to equity only be considered to the extent that it increases a company's total equity percentage?

We strongly believe that debt instruments should not be included in total equity as discussed in the section II.C.5. Even if some of the debt instruments were to be included inevitably for some rationale in the final framework, such debt instruments covered should be limited to such cases as considered functionally equivalent to equity and are treated by credit rating agencies as comprising both equity interests and debt obligations. In such cases, only the part of the instrument that the rating agencies regard as equity should be entered into total equity.

5. Question 48

> Should a first company be required to calculate its total equity percentage in a second company on a continuous basis or more frequently than under the proposal, or instead should a first company only be required to calculate its total equity at the time of its investment in a second company? For example, should a first company be required to calculate its total equity percentage in a second company upon any transaction by the second company that increases or decreases the shareholders equity of the second company by at least 5 percent, 10 percent, 25 percent, etc.? What are the benefits and consequences of more or less frequent recalculation of total equity percentages?

The frequency of calculations of total equity should be at the time an investor acquires additional securities or disposes of securities. However, in the case of investments through a fund, investors and GPs often do not know in advance the detailed terms of the investments (e.g., how much and which legal entity will be investing or ceasing to invest). Accordingly, the FRB should include language in any final rule that recognizes that the timing for analyzing the fund's or the company's financial statements to calculate total equity should be flexible and accommodate commercially reasonable practices.

6. Question 51

> Should the scope of "limiting contractual right" be expanded or reduced? If so, what types of contractual provisions should be covered or not covered? Are there additional examples of contractual rights that should be included in either list of examples?

Companies undergoing turnaround processes should be exempted from all control presumptions. The revitalization support business is a core part of the mission of a Japanese financial institution and includes such measures as the acceptance of Debt Equity Swap and Debtor-in Possession financing and the provision of human resources support. In doing so, it often is possible for the financial institution to contractually impose certain contractual covenants on the company that are needed to protect the financial institution's support. However, it is not appropriate to impose the restrictions associated with the BHC Act (e.g., Activities Restrictions, Volcker Rule) on the companies during the period of rehabilitation, and, therefore, the application of the control rules should be exempted during the period a company is undergoing turnaround processes.

G. Other Comments Without Corresponding Questions

1. Joint Venture Provision

The Proposal provides in Section 225.32(a)(2) that "[f]or purposes of the presumptions in this section, any company that is a subsidiary of the first company and also a subsidiary of the second company is considered to be a subsidiary of the first company and not a subsidiary of the second company." The preamble to the Proposal indicates that this provision is meant to address relationships between companies that are subsidiaries of both the first and second companies referred to as joint venture subsidiaries and the second company, on the other hand, from being considered relationships between the second company and the first company when determining whether the first company controls the second company. We understand that the intent is to allow companies to have joint ventures that, for purposes of the BHC Act, are controlled by both the first company and the second company without their respective control over the joint venture necessarily causing the first company to control the second company. The proposed rule text, however, addresses only the relationships between the first company and the joint venture subsidiary and not the relationships between the second company and the joint venture subsidiary when determining whether the first company controls the second company. As a result, as the proposed rule is drafted, the relationships between the second company and the joint venture would appear to be treated as relationships between the first company and the second company, because the joint venture is treated as a subsidiary of the first company and not of the second company. We believe a simpler approach to achieve the objective would be to permit the first company to exclude the relationships that both companies have with a joint venture subsidiary when determining whether the first company controls the second company.

2. Differentiation for Qualifying FBOs

Currently, the Proposal treats all investments by banking organizations, U.S. or non-U.S., with respect to any investment, U.S. or non-U.S., under the same standards. As mentioned above, the control rules should set specifically tailored presumptions for an investment that a Qualifying FBO ("**QFBO**") under Regulation K makes in a non-U.S. company that has minimal business in the United States (i.e., does not have (i) an office (in the case of a FBO, a branch or agency office) in the United States or (ii) any subsidiaries in the United States that (A) constitute in the aggregate more than five percent of the foreign company's total consolidated assets or (B) engage in activities permissible only for an FHC). The JBA proposes that elements of the tiered framework related to business relationships, officer interlocks (other than CEO or other C-Suite managers), and the presence of restrictive covenants should not apply to such investments. The reason is that ownership of such companies should have virtually no impact on the U.S. markets/financial system but would greatly expand the extraterritorial scope of U.S. regulation and impose substantial U.S. compliance obligations on such non-U.S. companies.