

15 August, 2013

Elizabeth M. Murphy
Secretary of the Commission
Securities and Exchange Commission
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Washington, DC 20549-1090

*Submitted by email: rule-comments@sec.gov
(File Numbers S7-02-13, S7-34-10 and S7-40-11)*

**Comment letter: Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants
RIN 3235-AL25**

Dear Ms Murphy

1. Overall Position

The Japan Financial Markets Council (JFMC)¹ is grateful for the opportunity to comment on the Securities and Exchange Commission's (SEC) regulatory proposals for cross-border security-based swaps.

The JFMC welcomes many aspects of the SEC's proposals and is particularly encouraged by the strong focus on substituted compliance including a commitment to an 'outcomes based approach'. This is a major step toward honoring the spirit of international comity, and the cooperation that was a specific commitment by the G20 countries at the Pittsburgh Summit of 2009. We also applaud the SEC's effort to have a constructive dialogue between regulators and the industry, and to first agree on the overall regime rather than putting in place an arbitrary timeline for the completion of different aspects of the proposal. This approach will allow for a more efficient and rational implementation of the final

¹ The JFMC is an association which includes representatives from five Japan-based institutions and five international firms active in Japanese capital markets. Its aim is to ensure that authorities deciding on regulatory initiatives that have a global impact are aware of and take into account the effect of new regulations on Japanese capital markets. The current JFMC members are: Bank of Tokyo-Mitsubishi UFJ, Daiwa Securities Group, Mizuho Securities, Nomura Holdings, SMBC Nikko Securities Inc, Bank of America Merrill Lynch, BNP Paribas, Citigroup Japan Holdings Corp, Deutsche Bank Group, JPMorgan Securities Japan Co., Ltd. and Morgan Stanley Japan Holdings. The co-chairs of the JFMC are the representatives from Morgan Stanley and Nomura.

rules. But we also have concerns about the proposals and in particular some areas that will result in a lack of harmonization across the regulation of swap and security-based swap markets.

The JFMC notes that the Commodity Futures Trading Commission (CFTC) has recently finalized its own interpretive guidance and exemptive order for cross-border swaps regulation² which has an impact on the overall regulatory environment. In light of this the JFMC calls on the SEC to:

a. Seek greater harmony, where appropriate, between the SEC and the CFTC's cross border swaps regulations

- On a number of issues which are fundamental to the entire market (for example the definition of a U.S. person) there are significant benefits of having one standard in place. We need to recognize that the CFTC has already finalized its guidance and in these cases we believe the approaches should be harmonized.
- For these fundamental issues the duplicative costs would cause the market to be 'too complicated to implement' for participants in Japan, where swaps and security-based swaps are considered one market.
- But the JFMC does support some of the SEC's proposals including how de minimus thresholds are calculated.³

b. Apply substituted compliance to Japan

- The CFTC's public release on July 11, 2013 of 'A Path Forward' is useful in that it sets an approach of how to coordinate U.S. and European Commission swap regulations, and a recognition that substituted compliance will play an important role.
- We encourage that an agreement, which recognizes the role of substituted compliance, is also made between the Japanese regulatory authorities and the joint U.S agencies (both the SEC and the CFTC). This might be done in a bilateral way, for example by employing a Memorandum of Understanding similar to the agreement with the EU

² 17 CFR Chapter 1 RIN 3038-AD85 'Interpretive Guidance and Policy Statement Regarding Compliance with Certain Swap' and RIN 30386AE05 'Exemptive Order Regarding Compliance With Certain Swap Regulations'.

³ For example, a security-based swap dealing with a non-U.S. persons conducted outside the U.S. should not be counted towards the securities-based swap dealer's (SBSD) threshold, even if they are guaranteed by a U.S. person, and also dealings with a foreign branch of a U.S. bank are not part of the SBSD calculation).

authorities. Such an agreement should take into account the differences in the two markets in terms of size, liquidity and stages of regulatory development. Alternatively, a multi-national approach might also be desirable to avoid a profusion of global agreements.

- The U.S regulatory authorities should recognize the Japanese program of reforms which are in line with G20 commitments, including in the areas of mandatory clearing, trade execution and reporting

2. Detailed response

We have divided our detailed response below into two sections: harmonization, and substituted compliance and time relief.

Part A: Harmonization

Coordination and achieving regulatory consistency and comparability, to the extent it is possible, between the U.S. regulatory agencies is a specific requirement of the Dodd Frank statute. In addition, the participating governments in the G20 Pittsburgh Summit agreed to international coordination.

The JFMC is concerned that on a number of significant cross-cutting areas (such as the definition of a U.S. person), there is a discrepancy between the SEC's proposal and CFTC's final guidance. Such differences would impose a significant burden on market participants. It would require firms to use limited resources to distinguish between swaps and security-based swaps and also a long complex list of other criteria regarding counterparty status, as well as the location of trade solicitation, negotiation, booking and execution. Additional client representations would also be required, which would be particularly challenging to obtain from non-U.S. clients.

In addition to the complexities stemming from the lack of co-ordination in the United States, market participants are also likely to have to accommodate rules from non-U.S. regulatory authorities. The likely outcome is that market participants will avoid trading products with U.S. counterparties or indeed avoid any trading at all lest they fail to navigate correctly the uneven regulatory environment and unintentionally breach rules and bear the risks of regulatory sanction. The outcome may result in a number of unintended consequences

including reduced liquidity.

From the perspective of participants in Japan, the SEC proposals need to be examined in the context of the final guidance adopted by the CFTC on July 12, 2013. In Japan, as in many other jurisdictions, swaps and security-based swaps are treated as similarly managed products within one large and active market.

A1.U.S. Persons

Given the CFTC has issued its final guidance the JFMC believes for such a fundamental issue as the definition of a 'U.S. person', the SEC should adopt the same definition as set out by the CFTC.

The JFMC is not necessarily supportive of every aspect of the CFTC's definition, including the impractical and burdensome standard of a 'principal place of business' as a factor in assessing a U.S. person. But even with these imperfections, the JFMC believes that a single definition of U.S. person is preferable to multiple tests. The JFMC is especially supportive of a single approach if the SEC, like the CFTC, allows for participants to rely on representations in determining whether or not a counterparty is a U.S. person.

The JFMC also believes a uniform approach between the SEC and CFTC should also apply to the definitions for 'natural persons', 'corporate entities' and 'discretionary /non-discretionary accounts', and a number of other parts of the consultation such as the treatment of commodity pools.

Security-based swap activities are part of a global market. They include transactions in Japanese Yen that may be with or between Japan market participants for the purpose of hedging the risk associated with capital raising and debt issuing in the international market place. The JFMC therefore supports the exclusion of international organizations from the U.S. person definition and requests that all Foreign Public Sector Financial Institutions and their affiliates be excluded.

A2.Transactions Conducted Within the United States

The JFMC believes the SEC should, in the interest of harmonization, remove from its proposed regulations the concept of rules being applied based on

whether the transactions are conducted within the United States. The CFTC did not include a territorial approach in its final guidance.

The use of such an approach might, for example, capture transactions between non-U.S. persons simply because they may be executed through a U.S. 24-hour electronic facility to which two participants in Japan might have access. The JFMC therefore requests that the SEC, like the CFTC, exempt security-based swaps executed anonymously on a security-based SEF or exchange from counting towards the de minimus threshold⁴. Such transactions do not pose risks to the U.S. financial system that the Dodd Frank statute is designed to regulate. They could also create competitive disadvantages.

The JFMC believes the SEC's approach of capturing on a trade-by-trade basis any transaction that is 'solicited, negotiated, executed or booked' within the United States is highly impractical. It would subject participants to duplicative and conflicting rules, and that it would result in unintended consequences likely to discourage market participation, and ultimately impair liquidity. We believe the risks to the United States appear to arise only from the resulting positions and not the dealing activity. We therefore suggest the SEC would better achieve its goals by focusing instead on the status of counterparties under the U.S. person definition.

A3. Classification of Entity and Transaction Level Requirements

For the classification of requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants, the SEC, unlike the CFTC, proposes to treat margin for non-cleared swaps as an entity level requirement so as to protect the registered entity against the default of counterparties. But margin is calculated based on the circumstances of any given transaction, including the status of the counterparty. Documentation, confirmation, netting and valuation requirements will also vary for different types of counterparties.

The JFMC understands however that capital and margin rules are still not final and this may have an impact on the overall approach. Depending on the outcome of these deliberations, it may be that the SEC should treat both margin for non-cleared swaps and requirements relating to documentation,

⁴ CFTC Final Guidance, page 27

netting and valuation, as transaction-level requirements rather than entity level requirements. We suggest therefore this rule should not be finalized until further information is available.

A4.Dealer Requirements and Substituted Compliance

The JFMC notes that the CFTC has signaled its willingness to rely on 'substituted compliance' when deciding whether to apply entity and transaction level requirements to non-U.S. swap dealers; non-U.S. affiliates guaranteed by a U.S. person; and foreign branches of U.S. persons. The SEC has helpfully proposed that substituted compliance would be permissible in many scenarios where a non-U.S. swap dealer trades with a U.S. person or a U.S. swap dealer trades with a non-U.S. person. Japan has put in place a robust set of rules and infrastructure for all types of swaps to comply with the commitments made at the G20 Summit in Pittsburgh. Given this environment the JFMC is highly supportive of the SEC taking a similar approach, which would ideally rely on an outcomes based comparability determination.

A5.Aggregation and Operational Independence

Under the CFTC final guidance a U.S. and non-U.S. persons in an affiliated group may engage in swap dealing until the aggregate level of swaps conducted by all group affiliates, with certain counterparties, clears the de-minimis threshold. Once that threshold is surpassed, then one or more of the group's most active affiliates would be required to register as a swap dealer, whether or not they are organized within the United States. Less active affiliates would not have to aggregate their activity with registered affiliates thus allowing them to avoid a requirement to register simply because of their corporate affiliations.

The JFMC notes, however, that under the SEC's proposal a relatively inactive affiliate would only be eligible for the above exclusion if it is deemed to be operationally independent (defined as having separate sales and trading, operations, and risk management). We believe this proposal is vague and overly broad and severely limits the efficient leveraging of key functions and also impedes the growth of different business models.

This is an important issue to the Tokyo market which is a significant regional

financial center and home to many affiliates of international banking groups. The JFMC believe that the CFTC's final guidance provides a more appropriate framework and therefore requests that the SEC withdraws the operational independence requirement to exclude activities of affiliated registered security-based swap dealer.

Part B: Substituted Compliance and Time Relief

B1.Comparability Standard

The JFMC supports the SEC's proposed 'outcomes-based' approach to substituted compliance. The JFMC also believes that to the extent the SEC's proposal had an impact on the CFTC's final guidance this is an extremely positive development.

When the SEC and the CFTC consider the level of comparability for substituted compliance, the U.S. agencies should take an overview of the timing of international regulatory developments, the local market conditions and the wider environment. Different conditions do not mean they are unequal. For example, because a derivatives market is less liquid or active than the U.S. and thus repository reporting requirements are less detailed or have different time frames, this does not mean that the market is less carefully regulated than in the United States.

Japan, as a G20 member nation, is working towards complying with commitments made at the 2009 Pittsburgh Summit, to implement mandatory clearing, trade execution, and trade reporting requirements for cross-border swap transactions. Because of the inter-connected global nature of OTC derivatives markets, Japan has not yet established or introduced its own set of cross-border rules because it believes that applying such rules without international collaboration will lead to inconsistent approaches and cause market disruption and deterioration. The SEC should take into account when considering the Japanese regime that potentially comparable requirements are proposed and under consideration, but are not yet final.

B2.Substituted Compliance Determination Procedure

The CFTC has provided that applications for substituted compliance can be made by individual firms, trade associations or foreign regulators. The JFMC

urges the SEC to adopt a similar approach and that the SEC and the CFTC work together (either as part of a multilateral or bilateral approach) with their Japanese counterparts to determine comparability. Memorandums of Understanding or equivalent approaches, could be employed as appropriate. This joint U.S. agency approach would avoid unnecessary delays or duplication.

B3.Substituted Compliance, Clearing, Trade Execution and Reporting

Japan has taken the lead in implementing mandatory clearing (introduced in November 2012), mandatory reporting (introduced in April 2013) and has also passed legislation that would meet G20 requirements for trade execution, which will be implemented by 2015. Given these conditions the JFMC specifically requests the SEC (as well as the CFTC) to determine that Japan has comparable standards in the areas of clearing, trade execution and reporting.

3. Conclusion

The JFMC acknowledges the detailed SEC consultation paper and welcomes its commitment to substituted compliance. We strongly urge a co-ordinated approach between the U.S. agencies in the area of cross-border swaps regulation. We would be happy to provide the SEC with any further information on any of the points raised in this letter.

Yours faithfully,



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