Japan Securities Dealers Association
JSDA

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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: 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 (File numbers: S7-02-13, S7-34-10 and S7-40-11)

Dear Ms. Murphy,

The Japan Securities Dealers Association (JSDA)[1] appreciates the opportunity to comment on Cross-Border Security-Based Swap (SBS) 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. We would like to take this opportunity to express our gratitude to the Securities and Exchange Commission (SEC) representatives for conducting a session at JSDA to brief our representatives on these proposed rules.

We have distilled our comments regarding the proposed cross-border regulations on SBS transactions to the following two points:

- **Substituted compliance, under which market participants may comply with foreign regulatory requirements in substitution for the Dodd-Frank Act (DFA) Title VII requirements, should be broadly and flexibly permitted, and**
- **Consistency between the SEC and CFTC regulations should be ensured.**

We commend the SEC's practical approach as shown in broad-ranging allocation and outcomes-based judgment of substituted compliance. This said, there still exist differences in extraterritoriality between the rules proposed by the SEC and CFTC, which incur operational difficulties in achieving compliance with these rules. It is our strong hope that both the authorities will make efforts toward the convergence of the rules and consistent rules will be extraterritorially applied to derivative transactions. Regulatory coordination should be carried out permitting substituted compliance to a maximum extent in order to avoid conflicts with foreign regulations. The following are our views on specific points of interest.

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[1] Japan Securities Dealers Association (JSDA) is an association functioning as a self-regulatory organization (SRO). Its legal status is a Financial Instruments Firms Association authorized by the Prime Minister. As a fully empowered SRO, JSDA extensively regulates market intermediaries. Its self-regulatory functions encompass rule-making, enforcement, inspection, disciplinary actions, accreditation of sales representatives, and dispute mediation.
JSDA also acts as an interlocutor for the securities industry between the market participants and other stakeholders, separately from its self-regulatory functions. This letter is submitted in the context of this latter function incorporating views expressed by some of its members. The views expressed here therefore should not be interpreted as those of the Self-Regulation Board or the Board of Governors of JSDA.
Today JSDA comprises around 500 members consisting of securities firms and other financial institutions operating securities businesses in Japan.

I. Substituted Compliance

1. Coordination among regulators

The European Commission and CFTC announced on July 11 a "Path Forward" regarding their joint understandings on a package of measures for how to approach cross-border derivatives. We expect that the SEC and CFTC will jointly adopt the same approach regarding application of substituted compliance to Japan. In order to avoid duplicate imposition of the US's and home jurisdictions' regulations on market participants, the SEC, CFTC and regulatory authorities in other jurisdictions should coordinate among themselves to harmonize the contents of regulations and synchronize the extraterritorial application of final rules using permissible substituted compliance.

It is preferable for substituted compliance to be broadly permitted. This said, under the SEC's proposed approach whereby a market participant or group of market participants of each jurisdiction could request a substituted compliance determination with respect to a particular category or categories of foreign regulatory requirements, we are concerned about the possibility that foreign market participants (those participating in Japan's markets for instance) may be placed under the US regulatory authorities' supervision. Therefore, it is recommendable to adopt an intergovernmental approach whereby substituted compliance would be permitted by an agreement between regulatory authorities and, after concluding such an interauthority agreement, be automatically applied to market participants in the jurisdiction concerned.

In order to implement the agreement at the Pittsburgh Summit in 2009, G20 jurisdictions have committed to improve OTC derivatives markets establishing necessary regulatory frameworks which are internationally consistent. We therefore believe that the comparability of regulatory requirements should be assessed consistently between the SEC and CFTC as well as among G20 jurisdictions and that the results of assessment should be announced by regulatory authorities in a concerted manner. In this regard, we welcome the SEC's policy to make the comparability determination based on regulatory outcomes, not by rule-by-rule comparisons and urge the commission to flexibly permit substituted compliance in its actual assessments.

2. Compliance regarding data reporting and dissemination

Single name securities-based derivatives markets under the SEC's supervision may considerably differ from those overseas in terms of scale, liquidity and participants. Considering these differences, substituted compliance with regard to systems for transactions reporting and data dissemination should be assessed and flexibly permitted. Each overseas regulator establishes a regulatory framework for such reporting and dissemination (including frequency of reporting and dissemination and data aggregation method) in a way that fits the scale and features of the market that it regulates. For instance, therefore, it seems not to be appropriate to rate an overseas data dissemination system as "not be sufficient" simply because it disseminates data on an aggregate basis, not on the trade-by-trade basis required by the SEC.

If the SEC were to not accept overseas trade-reporting and data dissemination systems regardless of differences in market scale and features, application of substituted compliance to foreign security-based swap dealers would be considerably limited and regulatory harmonization among jurisdictions would be hampered. Accordingly, we would reiterate the importance for the SEC to conduct assessment for substituted compliance giving much thought to differences with overseas markets.

3. Issues related to "Mixed Swap"

We are still concerned that discrepancies may remain between the SEC and CFTC with respect to the extraterritorial application of rules concerning "Mixed Swap", which is to be jointly supervised by the two authorities. In such cases, foreign market participants should be allowed to comply with the home jurisdiction's regulation under a substituted compliance framework at least until the discrepancy is resolved between the two US authorities.

II. Consistency between the SEC and CFTC Regulations

1. General views

It is our strong hope that the SEC and CFTC will work toward establishing mutually-consistent rules governing cross-border swap transactions. If inconsistencies were to remain between the two authorities' regulations, different rules would apply to transactions with the same asset class depending on whether it was a single name or index transaction. This would invite an undue cost burden for financial institutions to establish an internal administration system to address such incompatible regulations. Such conditions, if they persisted, would discourage market participants fearing rule violations from engaging in the US-related OTC derivative transactions and result in the decline of the OTC derivatives market as a whole.

2. Definitions of "US persons"

The SEC and CFTC should not adopt different definitions of "US persons" and are strongly urged to align the definitions to make them consistent. To avoid complication and operational burdens, we would recommend that the unified definition should drop "having principal place of business in the US" from the criteria to determine "US persons." However, if this criterion is to be maintained, market participants should be allowed to rely on what their counterparties represent themselves as in judgment of "US persons".
In this regard, we support the SEC's approach that certain international organizations would not be treated as "US persons" and hope that the CFTC will also adopt a similar approach. In addition, it would be advisable that foreign public sector financial institutions should be also excluded from "US persons".

3. Definitions of "transactions conducted within the US"

Transactions covered by the regulation should be adequately aligned between the SEC and CFTC to ensure consistency. The CFTC rules have not adopted a criterion for "transactions conducted within the US". Accordingly, in same asset class transactions such as CDS over which the SEC and CFTC share regulatory responsibilities, the solicitation process for each transaction may need to be changed depending on which regulator's rules apply. We are seriously concerned about the operational confusion and additional burdens caused by this definitional inconsistency of rules enforced in the same jurisdiction.

The scope of defined "transactions conducted within the US" should be limited to those booked by non-US persons with US entities. Actually, it seems inappropriate to apply the US regulations to transactions between non-US persons under the current circumstance where there is no international agreement to extraterritorially apply one jurisdiction's rules to another jurisdictions' persons.

If the criterion for "transactions conducted within the US" were to be adopted with no clear definitions for the four listed activities, that is, "solicitation", "negotiation", "execution" and "account booking", further operational confusion may occur. While clearing, SDR (swap data

repository) reporting and usage of custody for collateral transfer are excluded from transactions covered by the SEC proposed rules, we would also like to see, at the very least, operational activities based market practice, such as usage of MarketWire, portfolio collation through TriResolve, research service and data transfer excluded. With transactions being increasingly globalized, it would be fairly burdensome work to confirm whether each of the four listed activities is conducted outside the US. If a criterion for "transactions conducted within the US" were to be introduced, its confirmation procedure should be simplified at least allowing market participants to rely on what their counterparties represent themselves as.

4. De minimis calculation for SBSD registration

With regard to de minimis calculation for Security-Based Swap Dealers (SBSD) registration, we would provide the following comments and suggestions.

1) Transactions to be included in de minimis calculation

i) Under the proposed rules that require transactions concluded and cleared through Security-Based Swap Execution Facilities (SBSEF) or Security-Based Clearing Agencies (SBCA) to be included in de minimis calculation, non-US parties to transactions who are not registered as SBSD are likely to refrain from transactions with US persons to avoid the burdens associated with SBSD registration.

   Therefore, we would recommend that transactions concluded through SBSEF or SBCA should not be included in calculating the de minimis threshold for SBSD. Transparency of trading prices in transactions ordered and concluded through an SBSEF registered with the SEC can be secured by the SBSEF. Moreover, all the transaction data are reported to and deposited with Security-Based Swap Data Repositories (SBSDR) which are also registered with the SEC. Accordingly, the SEC can access such transaction data and fully assess fairness of transactions as well as risk exposures to the US market.

   In transactions cleared through an SBCA registered with the SEC, counterparties of transactions are replaced by the SBCA and initial and variation margins are recalculated and redeposited every day. Therefore, risk exposures to the US market of such transactions can be kept to the minimum.

ii) If cancellation, alteration and transfer of contract were to be included in the de minimis calculation, it might invite a rush of cancellation before the enforcement of the proposed rules and make it difficult to cancel or transfer contracts for reducing risks (Non-US persons might refuse US persons' requests for novation of contract.) These consequences would end up increasing risks. The SEC's due consideration to this point would be appreciated.

2) Affiliates to be covered by de minimis calculation

i) The SEC takes an approach similar to the CFTC by allowing non-US persons to exclude security-based swap transactions of an affiliate which is registered with the SEC as a security-based swap dealer. While we welcome the basic concept of this approach, the proposed rules set up the criterion of "operationally independent" as a condition for an SBSD to exclude its affiliate's activities from its de minimis calculation. We are concerned that this criterion may discourage swap dealers' efficient global management of business and impose on them unnecessary system investment costs to manage an SBSD's derivative transactions and those of its affiliates separately. Therefore, we would request the deletion of the "operationally independent" criterion.

ii) On the other hand, some rules as well as conditions of their application should be laid down to exclude transactions between affiliated companies from de minimis calculation.

iii) We request the SEC's consideration regarding common ownership interests in a non-US joint venture entity conducting swap dealing activities (JV). Under certain circumstances, two or more shareholders (all of which are assumed to be conducting swap dealing activities) could be deemed to satisfy the definition of "control" for the purpose of the SEC's regulations with respect to the same JV, notwithstanding that only one of those shareholders (the "Majority Shareholder") controls and operates the JV in practical terms, consolidates the JV in its financial statements under generally accepted accounting principles ("GAAP") and has voting control over the JV.

In such a situation, the proposed aggregation requirements would have the following results:
(i) the JV would be required to aggregate the swap dealing activities conducted by both (a) the Majority Shareholder, and (b) other shareholder(s); and
(ii) the swap dealing activities of the JV would be attributed to both (a) the Majority Shareholder, and (b) other shareholder(s).
Although (i)(a) and (ii)(a) are consistent with the reality that the JV is a consolidated subsidiary of the Majority Shareholder and operating as part of the Majority Shareholder's company group, we submit that (i)(b) and (ii)(b) are not, and will produce results that we consider would not further the anti-evasion purpose of the aggregation requirements, are beyond the confines of the SEC's extraterritorial jurisdiction, and impose significant costs and burdens on non-U.S. market participants.

To avoid these results, we request that, to the extent aggregation is required for non-U.S. persons, the aggregation requirements be limited where a JV is "controlled" by two or more shareholders but only one of them qualifies as a Majority Shareholder so that no aggregation is required between the shareholder(s) that is (are) not a Majority Shareholder and the JV.

5. Margin requirements

Under the SEC proposed rules, entity-level requirements including capital, margin and risk management requirements apply to an SBSD as a whole. This leads to a concern that the SEC regulation may excessively affect transactions between non-US persons conducted outside the US, which should not be put under the SEC regulation.

It is an established practice to collectively manage security-based swaps under the SEC regulation and other swaps under the CFTC regulation based on the same ISDA Master Agreement. This practice is quite rational to ensure appropriate credit risk management. However, if the SEC and CFTC were to apply different rules to margin requirements, complicated operations would hamper efficient management of derivative transactions. We would here again urge the SEC and CFTC to align their rules for consistency.

6. Reporting requirements

The SEC should take an approach consistent with the CFTC in determining whether SDR reporting and real-time reporting should be entity-level requirements or transaction-level requirements. Without consistency, some transactions would be required to be reported and others would not even though both of these are same asset class transactions. In such a case, market participants would bear considerable burdens including system modification.

Reporting duty should be borne by persons directly engaged in transactions and should not be perceived as joint responsibility shared with persons indirectly engaged in transactions (e.g. guarantors of direct transaction-parties). For instance, in cases where the principal office in Tokyo provides its affiliate in the US with a guarantee, it does not make sense that the US regulation is extraterritorially applied to the principal office in Tokyo which is outside the SEC's jurisdiction.

In conclusion, we appreciate this consultation process involving foreign market stakeholders, which we believe indispensable for developing regulatory standards that efficiently and effectively work on a cross-border basis. We hope that the comments described above will be of help in your future deliberations. Please feel free to contact us should you encounter anything unclear in the comments.

Sincerely,

Koichi Ishikura
Executive Chief of Operations for
International Headquarters