JFMC Japan Financial Markets Council

2 November 2012

Mr. David A. Stawick
Secretary
US Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street
NW Washington
DC 20581

Comment letter on proposed Cross-Border Swap Regulations[1]

Dear Mr Stawick,

The Japan Financial Market Council (JFMC) would like to share with you our concerns as the CFTC pursues the final shaping and implementation of regulatory proposals relating to cross-border swap transactions.

The JFMC is a new industry 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.[2]

The JFMC endorses the goals, adopted at the 2009 Group of 20 Pittsburgh summit and reaffirmed in Toronto in 2010, regarding the strengthening of the regulation of derivatives. Our members therefore welcome the CFTC's active participation and leadership in the process of achieving those goals through its implementation of the Dodd Frank Act.

The JFMC has identified two specific concerns regarding the CFTC's proposed changes to the rules governing swaps, first the cross-border application of the rules, and second the confusion resulting from the rules' implementation process.

Cross-border application

With regards cross-border application, the JFMC is sympathetic to the CFTC's concern that risks associated with swaps trading at overseas affiliates of a major US financial group, might flow back to the entire group. We believe all G20 members share both an understanding of this danger and a strong desire to avoid it.

---

[1] This letter is a follow up to your recent consultation on: **Cross-Border Application of Certain Swaps Provisions of the Commodity Exchange Act (RIN 3038–AD57).**

[2] The JFMC membership consists of Bank of Tokyo-Mitsubishi UFJ, Daiwa Securities Group, Mizuho Securities, Nomura Holdings, SMBC Nikko Securities Inc, Bank of America Merrill Lynch, BNP Paribas, 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.

The G20, however, have called for the global harmonization of rules, an appeal that is mirrored in the CFTC's own explicit recognition of the importance of comity between international jurisdictions. The JFMC is concerned the cross-border applications of the CFTC's rules, as they stand now, run counter to this ideal and may indeed undermine the goal of reducing risks in the swaps market.

Japan has made the outcomes of G20 discussions a priority. The Japanese Diet passed reforms including the mandatory clearing, trade reporting of swaps (in May 2010) and trading on electronic platforms (in September 2012). From the beginning of November 2012 mandatory central clearing requirements have been put in place and therefore Japan has met the agreed end-2012 deadline. While Japan's regulatory regime is not identical to that of the US, it shares the same goals as the CFTC and is consistent with the objectives of the G20.

In fulfilling commitments to the G20, Japan's experience is instructive. The amendments to its Financial Instruments and Exchange Law allowed for central clearing of yen interest rate transactions as a successful first step toward broader strengthening of derivatives regulation. The JFMC understands each country has specific needs requiring tailored regulation. But an approach that settles domestic issues first, followed by the coordination of cross-border applications through agreements between regulators or through trans-national institutions, would go a long way toward avoiding uncertainty, and facilitating the introduction of a strengthened regulatory regime.

While the JFMC welcomes some of the CFTC's current cross-border proposals, such as the exemption of overseas branches of US affiliates from de minimis calculation, we would urge the CFTC, before writing the final version of any rules or implementing deadlines, to prioritize consistency with the principles of comity, equivalence and substituted compliance, wherever local jurisdictional rules are supportive of the G20 objectives and thereby substantially similar to those of the US.

A failure to accept this principle will result in unintended consequences. It will potentially subject swap market participants to two different sets of rules, which in their final forms may conflict with one another, and as a result, lead to avoidance of certain counterparties or a reduction in liquidity as participants seek to avoid regulatory risk by a curtailment of trading.

Implementation

The JFMC remains concerned about the implementation process for the CFTC's various proposed rule changes regarding swaps. We already see in Japan a rising danger that the market for non-cleared derivatives is becoming fragmented and unnaturally concentrated as a result of the hurried and uneven implementation of CFTC's rules.

The recent no action letters helped clear up confusion to a limited extent. But many counterparties in Japan still face considerable uncertainty over how these rules will affect their business over the long term. For example, Japanese institutions remain unclear over which counterparties will be deemed U.S. persons or if the US Treasury will formally exempt foreign exchange forwards and swaps. Other concerns include the potential trading stoppages or disruptions caused by fears of transactional requirements such as duplicative clearing or other similarly conflicting regulation.

The implementation schedule for registration, before the final rules are known, is causing many to rethink counterparties and trading patterns based on the potential regulatory considerations rather than market considerations. Some are looking at ways to avoid any transaction that might lead to a requirement to register with the CFTC. Others are simply refraining from trading. Both of these have significant implications for liquidity, pricing and concentration risk.

Conclusion

We are all aware that participants in the 2009 G20 summit agreed the regulation of the derivatives market should be strengthened, and that a significant effort is underway to set new international standards. Derivatives, and swaps in particular, remain crucial instruments for risk management, hedging and the facilitation of growth. For the swaps market to provide this important function, it is crucial the market remain liquid, price competitive and ultimately driven by market considerations within a harmonized set of global regulatory parameters.

The JFMC would caution against rules that, in pursuing the goals of the G20, inadvertently pose risks associated with a reduction in liquidity. Moreover, any regulatory regime that is significantly out of step with those being developed elsewhere, either in substance or in implementation, will inevitably cause distortions and unintended consequences.

That puts the responsibility on regulators and industry to ensure rules are effective not only domestically but internationally as well. May we therefore suggest the CFTC consider implementing its cross-border swaps regulations, as applied to non-U.S. persons, with the achievement of full coordination with each relevant G20 regulator, through formal and comprehensive intergovernmental agreements.

If you require further information we would be very happy to provide it.

Yours sincerely,

Jonathan B. Kindred　　　　Shigesuke Kashiwagi
Co-chairmen of the Japan Financial Markets Council

Contact: International Bankers Association (IBA Japan): Paul Hunter
Telephone +81 (0)3-6225-2212　　E-mail paul.hunter@ibajapan.org or g-info@ibajapan.org

cc. Chairman Gary Gensler
Commissioner Bart Chilton
Commissioner Scott O'Malia
Commissioner Jill Sommers
Commissioner Mark Wetjen