

COMMODITY FUTURES TRADING COMMISSION

17 CFR Chapter 1

Amendment to Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of Amendment to Comparability Determination for Margin Requirements for Uncleared Swaps under the Laws of Japan.

SUMMARY: The following is an amendment (this “Amendment”) to the Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants of the Commodity Futures Trading Commission (“Commission” or “CFTC”) published on September 15, 2016 (the “Japan Determination”). This Amendment amends the Japan Determination by: (1) making a positive determination of comparability with respect to the scope of entities subject to margin requirements, and (2) making a positive determination of comparability with respect to the treatment of inter-affiliate transactions. All other findings and determinations contained in the Japan Determination remain unchanged and in full force and effect.

DATES: This Amendment is effective **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

FOR FURTHER INFORMATION CONTACT: Matthew B. Kulkin, Director, 202-418-5213, mkulkin@cftc.gov, or Frank N. Fisanich, Chief Counsel, 202-418-5949, ffisanich@cftc.gov, Division of Swap Dealer and Intermediary Oversight, Commodity

Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW.,
Washington, DC 20581.

SUPPLEMENTARY INFORMATION:

I. Introduction

On September 15, 2016, the Commission published the Japan Determination,¹ which provided the analysis and determination of the Commission regarding a request by the Japan Financial Services Agency (“JFSA”) that the Commission determine that laws and regulations applicable in Japan provide a sufficient basis for an affirmative finding of comparability with respect to margin requirements for uncleared swaps applicable to certain swap dealers (“SDs”) and major swap participants (“MSPs”) registered with the Commission. Although discussed in the Japan Determination, the Commission did not make a finding regarding whether the scope of entities subject to the JFSA’s margin requirements for non-cleared OTC derivatives was comparable in outcome to the scope of entities subject to the Commission’s margin requirements for uncleared swaps. As discussed below, the Commission now finds that it is. Further, the Japan Determination found the JFSA’s margin requirements for non-cleared OTC derivatives between affiliates not comparable in outcome to the Commission’s margin requirements for uncleared swaps between affiliates. As discussed below, the Commission has reconsidered this finding and now finds that such requirements are comparable in outcome to the Commission’s own.

II. Regulatory Background

¹ See Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 63376 (Sept. 15, 2016).

Pursuant to section 4s(e) of the CEA,² the Commission is required to promulgate margin requirements for uncleared swaps applicable to each SD and MSP for which there is no U.S. Prudential Regulator (collectively, “Covered Swap Entities” or “CSEs”).³ The Commission published final margin requirements for such CSEs in January 2016 (the “CFTC Margin Rule”).⁴

Subsequently, on May 31, 2016, the Commission published in the Federal Register its final rule with respect to the cross-border application of the CFTC Margin Rule (hereinafter, the “Cross-Border Margin Rule”).⁵ The Cross-Border Margin Rule sets out the circumstances under which a CSE is allowed to satisfy the requirements under the CFTC Margin Rule by complying with comparable foreign margin requirements (“substituted compliance”); offers certain CSEs a limited exclusion from the Commission’s margin requirements; and outlined a framework for assessing whether a foreign jurisdiction’s margin requirements are comparable in outcome to the CFTC Margin Rule (“comparability determinations”). The Commission stated that substituted compliance helps preserve the benefits of an integrated, global swap market by reducing the degree to which market participants will be subject to multiple sets of regulations.

² 7 U.S.C. 1 *et. seq.*

³ *See* 7 U.S.C. 6s(e)(1)(B). SDs and MSPs for which there is a U.S. Prudential Regulator must meet the margin requirements for uncleared swaps established by the applicable U.S. Prudential Regulator. 7 U.S.C. 6s(e)(1)(A). *See also* 7 U.S.C. 1a(39) (defining the term “Prudential Regulator” to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The U.S. Prudential Regulators published final margin requirements in November 2015. *See* Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015).

⁴ *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). The CFTC Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission’s regulations. *See* §§ 23.150-159, 161. The Commission’s regulations are found in Chapter 17 of the Code of Federal Regulations, 17 CFR 1 *et. seq.*

⁵ *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016). The Cross-Border Margin Rule, which became effective August 1, 2016, is codified in part 23 of the Commission’s regulations. *See* § 23.160.

Further, substituted compliance builds on international efforts to develop a global margin framework.⁶

On June 17, 2016, the JFSA submitted a request that the Commission determine that laws and regulations applicable in Japan provide a sufficient basis for an affirmative finding of comparability with respect to the CFTC Margin Rule. In due course, the Commission published the Japan Determination on September 15, 2017.

III. Margin Requirements for Swaps Activities in Japan

As represented to the Commission by the JFSA, margin requirements for swap activities in Japan are governed by the Financial Instruments and Exchange Act, No. 25 of 1948 (the “Japan FIEA”), covering Financial Instrument Business Operators (“FIBOs”) and Registered Financial Institutions (“RFIs”), which include regulated banks, cooperatives, insurance companies, pension funds, and investment funds.⁷ The Japanese Prime Minister delegated broad authority to implement these laws to the JFSA. Pursuant to this authority, the JFSA has promulgated the FIB Ordinance,⁸ Supervisory Guidelines,⁹

⁶ In October 2011, the Basel Committee on Banking Supervision (“BCBS”) and the International Organization of Securities Commissions (“IOSCO”), in consultation with the Committee on Payment and Settlement Systems and the Committee on Global Financial Systems, formed a Working Group on Margining Requirements to develop international standards for margin requirements for uncleared swaps. Representatives of 26 regulatory authorities participated, including the Commission. In September 2013, the WGMR published a final report articulating eight key principles for non-cleared derivatives margin rules. These principles represent the minimum standards approved by BCBS and IOSCO and their recommendations to the regulatory authorities in member jurisdictions. See BCBS/IOSCO, Margin requirements for non-centrally cleared derivatives (updated March 2015) (“BCBS/IOSCO Framework”), available at <http://www.bis.org/bcbs/publ/d317.pdf>.

⁷ The Commission has provided the JFSA with opportunities to review and comment on the Commission’s description of the JFSA’s laws and regulations on which the Japan Determination and this Amendment are based. The Commission relies on the accuracy and completeness of such review and any corrections received in making its comparability determinations. A comparability determination, including any amendments made thereto, based on an inaccurate description of foreign laws and regulations may not be valid.

⁸ Cabinet Office Ordinance on Financial Instruments Business (Cabinet Office Ordinance No. 52 of August 6, 2007), including supplementary provisions (“FIB Ordinance”).

and Public Notifications.¹⁰ These requirements supplement the requirements of the Japan FIEA with more detailed direction with respect to margin requirements.¹¹

In Japan, the JFSA's margin rules apply to "non-cleared OTC derivatives," which are defined to mean:

OTC derivatives except for those cases where Financial Instruments Clearing Organizations (including an Interoperable Clearing Organization in cases where the Financial Instruments Clearing Organization conducts Interoperable Financial Instruments Obligation Assumption Business; hereinafter the same shall apply in paragraph (11), item (i)(c)1.) or a Foreign Financial Instruments Clearing Organization meets the obligation pertaining to OTC derivatives or cases designated by Commissioner of the Financial Services Agency prescribed in Article 1-18-2 of the Order for Enforcement of the [FIEA].¹²

As represented by the applicant, however, Japan has separate definitions of "OTC Derivatives" and "OTC Commodity Derivatives."¹³ Japan also has separate margin rules for OTC Commodity Derivatives that are administered by the Japan Ministry of Economy, Trade, and Industry (METI) and the Japan Ministry of Agriculture, Forestry, and Fisheries (MAFF). METI/MAFF finalized their margin requirements for non-cleared OTC Commodity Derivatives on August 1, 2016.¹⁴ While the margin rules for non-

⁹ Comprehensive Guideline for Supervision of Major Banks, etc., Comprehensive Guidelines for Supervision of Regional Financial Institutions, Comprehensive Guideline for Supervision of Cooperative Financial Institutions, Comprehensive Guideline for Supervision of Financial Instruments Business Operators, etc., Comprehensive Guidelines for Supervision of Insurance Companies, and Comprehensive Guidelines for Supervision of Trust Companies, etc. (together, "Supervisory Guideline").

¹⁰ JFSA Public Notification No.15 of March 31, 2016 ("JFSA Public Notice No. 15"); JFSA Public Notification No.16 of March 31, 2016 ("JFSA Public Notice No. 16"); and JFSA Public Notification No.17 of March 31, 2016 ("JFSA Public Notice No. 17").

¹¹ Collectively, the Japan FIEA, FIB Ordinance, Supervisory Guideline, and JFSA Public Notifications are referred to herein as the "JFSA's margin rules," "JFSA's margin regime," "JFSA's margin requirements" or the "laws of Japan."

¹² See Cabinet Order No. 321 of 1965; Article 123(1)(xxi)-5 of the FIB Ordinance; and Article 2(22) of FIEA.

¹³ Article 2, Paragraph 14 of the Commodity Derivatives Act (Act No. 239 of August 5, 1950) defines OTC commodity derivatives.

¹⁴ See Ministry of Agriculture, Forestry and Fisheries/Ministry of Economy, Trade and Industry Public Notification No. 2 of August 1, 2016; Ordinance for Enforcement of the Commodity Derivatives Act (Ordinance of the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Economy, Trade and Industry No. 3 of February 22, 2005); Supplementary Provisions of Ordinance for Enforcement of the

cleared OTC Derivatives and OTC Commodity Derivatives are separate, the METI/MAFF non-cleared OTC Commodity Derivative rules incorporate by reference the corresponding JFSA margin rules,¹⁵ and thus, for all purposes material to the determinations below, the METI/MAFF rules and JFSA margin rules are identical. Accordingly, for ease of reference, the discussion below refers only to the JFSA and the JFSA margin rules, but such discussion is equally applicable to METI/MAFF and the METI/MAFF non-cleared OTC Commodity Derivative margin rules. Further, CSEs may rely on the determinations set forth below regarding non-cleared OTC Derivatives subject to the JFSA margin rules equally with respect to non-cleared OTC Commodity Derivatives subject to the METI/MAFF margin rules.

IV. Amendments to the Japan Determination

A. Entities Subject to Margin Requirements.

The following amends and restates the entirety of the discussion with respect to entities subject to margin requirements as it appeared in the Japan Determination.¹⁶

The scope of entities subject to the JFSA's margin requirements and how it compares to the scope of entities subject to the CFTC Margin Rule was discussed in the Japan Determination, but the Commission made no determination of comparability or non-comparability.¹⁷ Instead, the Commission noted certain differences with respect to the scope of application of the two regimes, noted the possibility that the CFTC Margin Rule and the JFSA's margin rules may not apply to every uncleared swap that a CSE may

Commodity Derivatives Act No. 3 of February 22, 2005; and Basic Supervision Guidelines of Commodity Derivatives Business Operators, etc.

¹⁵ See *id.*

¹⁶ See Japan Determination 81 FR at 63380-81.

¹⁷ See *id.*

enter into with a Japanese counterparty, and reminded CSEs that substituted compliance is only available to a CSE where it and its transaction are subject to both the CFTC Margin Rule and the JFSA's margin requirements.¹⁸

Subsequent to publication of the Japan Determination, Commission staff was made aware that the lack of a comparability determination with respect to the scope of entities subject to the CFTC Margin Rule and the JFSA's margin requirements was causing some confusion as to the scope of substituted compliance available under the Japan Determination. Specifically, the Japan Determination spoke only to the comparability of certain requirements under the Japan FIEA and the FIB Ordinance but did not determine whether margin requirements under the JFSA Supervisory Guidelines could be considered in making a substituted compliance determination with respect to Japanese entities that fall under certain thresholds. To avoid any such confusion going forward, the Commission is addressing the comparability of the scope of entities subject to the jurisdictions' respective margin requirements, including the JFSA Supervisory Guidelines.

The CFTC Margin Rule and Cross-Border Margin Rule apply only to CSEs, i.e., SDs and MSPs registered with the Commission for which there is not a U.S. Prudential Regulator. Thus, only such CSEs may rely on the determinations herein for substituted compliance, while CSEs for which there is a U.S. Prudential Regulator must look to the determinations of the U.S. Prudential Regulators. The Commission has consulted with the U.S. Prudential Regulators in making these determinations.

¹⁸ Or the METI/MAFF margin rules, as discussed above.

CSEs are not required to collect and/or post margin with every uncleared swap counterparty. The initial margin obligations of CSEs under the CFTC Margin Rule apply only to uncleared swaps with counterparties that meet the definition of “covered counterparty” in § 23.151.¹⁹ Such definition provides that a “covered counterparty” is a counterparty to a swap with a CSE that is either a financial end user²⁰ that exceeds a certain threshold of swap activity (“material swaps exposure”)²¹ or another SD or MSP.²² On the other hand, the variation margin obligations of CSEs under the CFTC Margin Rule apply more broadly. Such obligations apply to counterparties that are SDs or MSPs and all financial end users, not just those with “material swaps exposure.”²³ Thus, importantly for comparison with the non-cleared OTC derivative margin requirements of Japan, under the CFTC Margin Rule, CSEs must exchange variation margin with any counterparty that falls within the definition of “financial end user” without regard to the size of such counterparty’s involvement in the swap market or the risk it may present to the CSE.

¹⁹ See § 23.152.

²⁰ See definition of “Financial end user” in § 23.151. In general, the definition covers entities involved in regulated financial activity, including banks, brokers, intermediaries, advisers, asset managers, collective investment vehicles, and insurers.

²¹ See § 23.150, which defines the initial margin threshold for financial end users as “material swaps exposure.” Material swaps exposure for a financial end user means that the entity and its margin affiliates have an average daily aggregate notional amount of uncleared swaps, uncleared security-based swaps, foreign exchange forwards, and foreign exchange swaps with all counterparties for June, July and August of the previous calendar year that exceeds \$8 billion, where such amount is calculated only for business days. An entity counts the average daily aggregate notional amount of an uncleared swap, an uncleared security-based swap, a foreign exchange forward, or a foreign exchange swap between the entity and a margin affiliate only one time. For purposes of the calculation, an entity does not count a swap that is exempt pursuant to § 23.150(b) or a security-based swap that qualifies for an exemption under section 3C(g)(10) of the Securities Exchange Act of 1934 (15 U.S.C. 78c-3(g)(4)) and implementing regulations or that satisfies the criteria in section 3C(g)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78-c3(g)(4)) and implementing regulations.

²² See definition of “swap entity” in § 23.150.

²³ See § 23.153.

Pursuant to Article 29 of the Japan FIEA, any person that engages in trade activities that constitute “Financial Instruments Business” – which, among other things, includes over-the-counter transactions in derivatives (“OTC derivatives”)²⁴ – must register as a FIBO. Banks that conduct specified activities in the course of trade, including OTC derivatives, must register under the FIEA as RFIs pursuant to Article 33-2 of the FIEA. Banks registered as RFIs are required to comply with relevant laws and regulations for FIBOs regarding specified activities, including transacting in OTC derivatives. Failure to comply with any relevant laws and regulations, Supervisory Guidelines, or Public Notifications would subject the applicant to potential sanctions or corrective measures.

The JFSA margin requirements generally apply to Type I FIBOs and RFIs (“JFSA Covered Entities”), and JFSA Covered Entities must comply with such requirements when transacting with each other as well as with foreign financial entities that enter into non-centrally cleared OTC derivatives “as a business” in a foreign jurisdiction where the legal validity of close-out netting is appropriately confirmed.²⁵ These entities are collectively referred to hereinafter as “JFSA Covered Counterparties.” All current CSEs established under the laws of Japan are registered in Japan as Type I FIBOs under the supervision of the JFSA, and are thus JFSA Covered Entities.

Similar to the CFTC Margin Rule’s “material swaps exposure” threshold for application of the initial margin requirements, the FIB Ordinance requires initial margin with JFSA Covered Counterparties only when both counterparties meet or exceed a

²⁴ See Article 2(8)(iv) of the FIEA.

²⁵ See FIB Ordinance, Article 123(10)(i)(a) and Article 123(11)(i)(a). However, foreign governments, foreign central banks, multilateral development banks, and the Bank for International Settlements are excluded. See *id.*

certain threshold of non-cleared OTC derivatives activity (the “JFSA Initial Margin Threshold”).²⁶ But, dissimilar to the CFTC Margin Rule’s requirement that CSEs exchange variation margin with all swap entity and “financial end user” counterparties regardless of the level of activity in uncleared swaps, the JFSA margin requirements only require JFSA Covered Entities to exchange variation margin with JFSA Covered Counterparties when both counterparties exceed a minimum trading volume threshold (the “JFSA Variation Margin Threshold”).²⁷ The JFSA represents such minimum threshold is expected to exclude only those market participants that present so little risk, at an individual firm level, that the considerable costs associated with compliance are not warranted.

Finally, non-centrally cleared OTC derivatives with JFSA Covered Counterparties below the JFSA Variation Margin Threshold and with counterparties that are not JFSA Covered Counterparties (together, “Supervised Counterparties”) are only subject to the JFSA Supervisory Guidelines, which require the establishment of an appropriate risk management system in accordance with relevant margin requirements under the JFSA FIEA, but with considerable latitude to tailor such requirements based on the risk profiles and individual circumstances of the Supervised Counterparties.²⁸

²⁶ See FIB Ordinance, Article 123(11)(iv). In general, the threshold for initial margin is whether the average month-end aggregate notional amount of non-cleared OTC derivatives, non-cleared OTC commodity derivatives, and physically-settled FX forwards and FX swaps of a consolidated group (excluding inter-affiliate transactions) for March, April, and May one year before the year in which calculation is required exceeds JPY 1.1 trillion. As of the date of this determination, JPY 1.1 trillion is equivalent to approximately USD 10 billion.

²⁷ In general, a JFSA Covered Entity has exceeded the JFSA Variation Margin Threshold if the average total amount of the notional principal of its OTC derivatives for a one-year period from April two years before the year in which calculation is required (or one year if calculated in December) exceeds JPY 300 billion (approximately \$2.7 billion).

²⁸ See JFSA Supervisory Guidelines at IV-2-4(4)(i).

Despite the definitional differences and differences in activity thresholds with respect to the scope of application of the CFTC Margin Rule and the JFSA's margin requirements, the Commission notes that in transactions between counterparties with the highest levels activity in uncleared swaps (and thus presumably present the most risk), both the CFTC Margin Rule and the JFSA margin requirements require both initial and variation margin. CSEs that exceed the JFSA Initial Margin Threshold transacting with JFSA Covered Counterparties that also exceed the JFSA Initial Margin Threshold would be required to collect and post initial and variation margin in amounts and with frequencies found comparable to the same requirements under the CFTC Margin Rule pursuant to the Japan Determination.²⁹ Although the “material swaps exposure” threshold under the CFTC Margin Rule (denominated in USD) is currently lower than the JFSA Initial Margin Threshold (denominated in JPY), the Commission recognizes that both are of relatively similar magnitudes and differences between the two are largely due to fluctuating JPY/USD exchange rates. Given that the initial margin thresholds serve the same purpose and are of relatively similar magnitudes, the Commission has concluded that the JFSA Initial Margin Threshold is comparable in purpose and effect to the CFTC “material swaps exposure” threshold. The Commission also notes that if a CSE/JFSA Covered Entity enters into an uncleared swap with a CSE that is a U.S. person, then it will be required to exchange variation margin and post initial margin in accordance with the CFTC Margin Rule because substituted compliance for variation margin and the collection of initial margin is not available.³⁰ This requirement significantly limits the extent to which differences between the JFSA Initial Margin Threshold and the CFTC

²⁹ See Japan Determination, 81 FR at 63385-87.

³⁰ See Cross-Border Margin Rule, 81 FR at 34829.

“material swaps exposure” threshold could negatively impact systemic risk in the United States.

With respect to uncleared swaps between CSEs and Supervised Counterparties that would be subject to the CFTC Margin Rule but not subject to the JFSA margin requirements other than the more flexible JFSA Supervisory Guidelines, the Commission recognizes that the JFSA has determined that Supervised Counterparties have so little activity in the relevant uncleared derivatives that they do not present risk that warrants the considerable costs associated with compliance to the full extent of the JFSA margin requirements.

The Commission also notes that application of the CFTC Margin Rule to these Supervised Counterparties would place CSEs otherwise eligible for substituted compliance that are seeking to transact business in Japan with Supervised Counterparties at a competitive disadvantage relative to other firms subject only to the JFSA Supervisory Guidelines.

With these factors in mind, the Commission has concluded that with respect to the margin requirements for uncleared swaps between CSEs and Supervised Counterparties, the JFSA Supervisory Guidelines are comparable in purpose and outcome to the CFTC Margin Rule.

Accordingly, the Commission finds that the scope of entities subject to non-cleared OTC derivatives margin requirements under the laws of Japan is comparable in outcome to the scope of entities subject to the CFTC Margin Rule for purposes of § 23.160. A CSE that is a JFSA Covered Entity and eligible for substituted compliance under § 23.160 may therefore classify counterparties in accordance with the margin

requirements of the JFSA FIEA, FIB Ordinance, and JFSA Supervisory Guidelines with respect to determining whether initial or variation margin must be exchanged, or whether only the risk management requirements of the JFSA Supervisory Guidelines will apply. Where only the JFSA Supervisory Guidelines will apply to non-cleared OTC derivatives with a counterparty, a CSE that is a JFSA Covered Entity and eligible for substituted compliance under § 23.160 may comply with any relevant aspect of the CFTC Margin Rule by complying with the JFSA Supervisory Guidelines.

B. Treatment of Inter-Affiliate Derivative Transactions.

The Japan Determination was the first comparability determination regarding uncleared swap margin requirements issued by the Commission following the establishment of its substituted compliance framework in May, 2016.³¹ In the two years since issuing the Japan Determination, the Commission has issued one other determination for the European Union (“EU”),³² and is issuing a third for the requirements of the Australia Prudential Regulatory Authority concurrently with this Amendment (the “Australia Determination”). The Commission has found the margin requirements for uncleared swaps between affiliates applicable in both the EU and Australia comparable in outcome to the Commission’s requirements, despite marked differences between the approach of the Commission and the approach of those jurisdictions.³³ In addition, Commission staff is currently analyzing the comparability of the uncleared swap margin requirements of a number of additional jurisdictions. Based

³¹ See Cross-Border Margin Rule.

³² See Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 82 FR 48394 (Oct. 18, 2017) (hereinafter, the “EU Determination”).

³³ See e.g., the EU Determination, 82 FR at 48399-01.

on our additional experience, the Commission is now weighing certain relevant factors in its determination differently than when it first made the Japan Determination, but still using an outcomes-based approach.³⁴ In the Japan Determination, the Commission concluded that the lack of a margin requirement for inter-affiliate transactions meant that the outcomes of the two jurisdictions' rules were not comparable. In doing so, the Commission acknowledged the JFSA's general oversight of the risk management practices of JFSA Covered Entities but did not believe that this factor was sufficient to address the differences between the two jurisdictions' margin regimes.³⁵ The Commission has reconsidered the effect of this factor in light of a more complete understanding of the JFSA's oversight practices, and other relevant facts and circumstances, in conducting its assessment of whether the Japanese margin regime achieves an outcome that is comparable to that of the CFTC Margin Rule.

The Commission notes that the BCBS/IOSCO Framework recognizes that the treatment of inter-affiliate derivative transactions will vary between jurisdictions. Thus, the BCBS/IOSCO Framework does not set standards with respect to the treatment of inter-affiliate transactions. Rather, it recommends that regulators in each jurisdiction review their own legal frameworks and market conditions and put in place margin requirements applicable to inter-affiliate transactions as appropriate.³⁶ In determining comparability, considerations of comity are particularly relevant under this type of international framework.³⁷

³⁴ See § 23.160(c)(3).

³⁵ See Japan Determination, 81 FR at 63382.

³⁶ See BCBS/IOSCO Framework, Element 6: Treatment of transactions with affiliates.

³⁷ As discussed above, the CFTC and the JFSA participated in the BCBS/IOSCO WGMR.

The following amends and restates the entirety of the discussion and determination of the Commission with respect to Commission requirements for treatment of inter-affiliate transactions as it appeared in the Japan Determination.

1. Commission Requirements for Inter-Affiliate Transactions.

The Commission determined through its CFTC Margin Rule to provide rules for swaps between “margin affiliates.” The definition of “margin affiliates” provides that a company is a margin affiliate of another company if: (1) either company consolidates the other on a financial statement prepared in accordance with U.S. Generally Accepted Accounting Principles, the International Financial Reporting Standards, or other similar standards; (2) both companies are consolidated with a third company on a financial statement prepared in accordance with such principles or standards; or (3) for a company that is not subject to such principles or standards, if consolidation as described in paragraph (1) or (2) would have occurred if such principles or standards had applied.³⁸

With respect to swaps between margin affiliates, the CFTC Margin Rule, with one exception explained below, provides that a CSE is not required to collect initial margin³⁹ from a margin affiliate provided that the CSE meets the following conditions: (i) the swaps are subject to a centralized risk management program that is reasonably designed to monitor and to manage the risks associated with the inter-affiliate swaps; and (ii) the CSE exchanges variation margin with the margin affiliate.⁴⁰

³⁸ See § 23.151.

³⁹ “Initial margin” is margin exchanged to protect against a potential future exposure and is defined in § 23.151 to mean “the collateral, as calculated in accordance with § 23.154 that is collected or posted in connection with one or more uncleared swaps.”

⁴⁰ See § 23.159(a).

In an exception to the foregoing general rule, the CFTC Margin Rule does require CSEs to collect initial margin from non-U.S. affiliates that are financial end users that are not subject to comparable initial margin collection requirements on their own outward-facing swaps with financial end users.⁴¹ This provision is an anti-evasion measure that is designed to prevent the potential use of affiliates to avoid collecting initial margin from third parties. For example, suppose an unregistered non-U.S. affiliate of a CSE enters into a swap with a financial end user and does not collect initial margin equivalent to that which would have been required if such affiliate were subject to the CFTC Margin Rule. Suppose further that the affiliate then enters into a swap with the CSE. Effectively, the risk of the swap with the third party would have been passed to the CSE without any initial margin. The rule would require this affiliate to post initial margin with the CSE. The rule would further require that the CSE collect initial margin even if the affiliate routed the trade through one or more other affiliates.⁴²

The Commission stated in the CFTC Margin Rule that its inter-affiliate initial margin requirement is consistent with its goal of harmonizing its margin rules as much as possible with the BCBS/IOSCO Framework.⁴³ Such Framework, for example, states that the exchange of initial and variation margin by affiliated parties “is not customary” and that initial margin in particular “would likely create additional liquidity demands.”⁴⁴ With an understanding that many authorities, such as those in Europe and Japan, were not expected to require initial margin for inter-affiliate swaps, the Commission recognized that requiring the posting and collection of initial margin for inter-affiliate swaps

⁴¹ See § 23.159(c).

⁴² See *id.*

⁴³ See CFTC Margin Rule, 81 FR at 674.

⁴⁴ See BCBS/IOSCO Framework, Element 6: Treatment of transactions with affiliates.

generally would be likely to put CSEs at a competitive disadvantage to firms in other jurisdictions.⁴⁵

Unlike the general rule for initial margin, however, the CFTC Margin Rule does require CSEs to exchange variation margin with margin affiliates that are SDs, MSPs, or financial end users (as is also required under the U.S. Prudential Regulators' rules).⁴⁶

The Commission believes that marking open positions to market each day and requiring the posting or collection of variation margin reduces the risks of inter-affiliate swaps.

2. Requirements for Inter-Affiliate OTC Derivatives under the Laws of Japan.

Under Article 123(10) and (11) of Japan's FIB Ordinance, the JFSA's margin requirements do not apply to OTC derivative transactions between counterparties that are "Parent Companies of the FIBOs conducting the transactions, Subsidiary Companies or Subsidiary Companies of the Parent Companies (excluding the FIBOs), or an entity equivalent to these under the laws and regulations of a foreign state." These terms are defined in the Ministry of Finance of Japan's Ordinance on Terminology, Forms, and Preparation Methods of Consolidated Financial Statements,⁴⁷ and the Commission recognizes that such are generally defined in keeping with the Commission's definition of "margin affiliate" for purposes of the CFTC Margin Rule, discussed above.

However, in mitigation of not requiring margin between Consolidated Companies, the JFSA has explained that its capital requirements for FIBOs/RFIs apply not only on a consolidated basis but also on an individual, non-consolidated basis. Thus,

⁴⁵ See CFTC Margin Rule, 81 FR at 674.

⁴⁶ See § 23.159(b), Prudential Regulators' Margin Rule, 80 FR at 74909.

⁴⁷ See Ordinance of the Ministry of Finance No. 28 of October 30, 1976.

a CSE that is a FIBO/RFI is required to hold enough capital to cover exposures under non-cleared OTC derivatives to individual entities in the same consolidated group. This capital requirement covers uncollateralized inter-affiliate exposure. Such capital requirement can be reduced if the CSE collects initial and/or variation margin for such inter-affiliate transactions.

In addition to this, the JFSA has explained that its supervision of FIBOs/RFIs is a principles-based approach, and, in accordance with this approach, the JFSA's "Guideline for Financial Conglomerates Supervision" requires financial holding companies and parent companies to measure, monitor, and manage the risks caused by inter-affiliate transactions. Further, the JFSA's "Inspection manual for financial holding companies" requires financial holding companies to establish a robust governance framework and risk management system at a centralized group level, that would, in operation, require management of the risks caused by inter-affiliate transactions. Based on the foregoing, the JFSA has emphasized that it is not necessary for it to require the risk management procedures of FIBOs/RFIs applicable to inter-affiliate transactions to rely on margin requirements alone. Rather, taking into account capital requirements and the JFSA's supervision and inspection programs, the JFSA represents that it ensures the safety and soundness of FIBOs/RFIs as a whole.

3. Commission Determination.

Having compared the outcomes of the JFSA's margin requirements applicable to inter-affiliate non-cleared OTC derivatives to the outcomes of the Commission's corresponding margin requirements applicable to inter-affiliate uncleared swaps and reconsidered those outcomes in the broader context of the JFSA's prudential oversight of

risk management and capital requirements, the Commission finds that the treatment of inter-affiliate transactions under the CFTC Margin Rule and the treatment of those transactions under the JFSA's margin requirements are comparable in outcome for purposes of § 23.160.

The CFTC Margin Rule generally excludes transactions between CSEs and their margin affiliates from its initial margin requirements⁴⁸ and subjects such inter-affiliate transactions to its variation margin requirements. The JFSA margin requirements, on the other hand, exclude inter-affiliate transactions of JFSA Covered Entities from both initial and variation margin requirements.

An uncleared swap with an affiliate presents credit risk to a CSE. The Commission has determined that this credit risk must be managed by marking open positions to market each day and requiring the posting or collection of variation margin. If the affiliate were to default, the margin provided by the affiliate would allow a CSE to continue to meet its obligations. The JFSA on the other hand has determined that this credit risk can be adequately managed by specific capital requirements and more general risk management standards that require financial holding companies and parent companies to measure, monitor, and manage the risks caused by inter-affiliate transactions to holistically ensure the safety and soundness of the consolidated companies of which JFSA Covered Entities are a part. In 2013, the Commission found the JFSA's risk management requirements for JFSA Covered Entities comparable to the Commission's risk management requirements for SDs and MSPs under Subpart J of Part

⁴⁸ See *infra* note 51.

23 of the Commission's regulations.⁴⁹ In addition, uncollateralized credit risk from inter-affiliate swaps would be subject to capital requirements under the Commission's proposed capital rules for CSEs.⁵⁰

The Commission notes that if a CSE/JFSA Covered Entity enters into an uncleared swap with a margin affiliate that is itself a CSE and a U.S. person, then it will be required to exchange variation margin in accordance with the CFTC Margin Rule because the U.S. CSE is required to do so and substituted compliance for the inter-affiliate variation margin requirement is not available to U.S. CSEs.⁵¹ In addition, the Commission is aware of the historic volume and aggregate size of inter-affiliate uncleared swaps of CSEs that may currently be eligible for substituted compliance pursuant to this determination. Given the inability to affirmatively transfer risk to U.S. margin affiliates that are CSEs without variation margin, the historic level of relevant inter-affiliate activity, and the capital and risk management requirements of both the JFSA and the Commission, and considerations of comity,⁵² the Commission has concluded that the requirements under the laws of Japan with respect to inter-affiliate margin for uncleared swaps are comparable to the requirements of the CFTC Margin

⁴⁹ See Comparability Determination for Japan: Certain Entity-Level Requirements, 78 FR 78910 (Dec. 27, 2013).

⁵⁰ See Capital Requirements for Swap Dealers and Major Swap Participants, 81 FR 91252, 91258 (Dec. 16, 2016).

⁵¹ See Cross-Border Margin Rule, 81 FR at 34829. The Commission notes that, subject to certain conditions, a CSE is generally not required to collect initial margin from a margin affiliate. See § 23.159(a)(1). However, a CSE would be required to collect initial margin from a margin affiliate that is a financial end user where the margin affiliate is located in a jurisdiction that the Commission has not found to be eligible for substituted compliance with regard to the CFTC Margin Rule, and the margin affiliate does not collect initial margin on its swaps with unaffiliated third parties for which initial margin would be required if the swap were subject to the CFTC Margin Rule. See § 23.159(c)(2)(ii). With this Amendment, the Commission has found Japan to be eligible for substituted compliance with regard to all aspects of the CFTC Margin Rule, and thus, a CSE would generally not be required to collect initial margin from a margin affiliate in Japan that is a financial end user. See § 23.159(c)(2)(iii).

⁵² It is noted that the JFSA has provided reciprocal recognition of the CFTC Margin Rule.

Rule for purposes of § 23.160. The Commission intends to monitor the volume and aggregate size of inter-affiliate swaps of CSEs that may be eligible for substituted compliance pursuant to this determination and, to the extent it deems prudent, may consult with the JFSA regarding the capital and risk management treatment of the attendant risk of such swaps.

Issued in Washington, DC on March 26, 2019, by the Commission.

Robert Sidman,

Deputy Secretary of the Commission.

Note: The following appendices will not appear in the Code of Federal Regulations.

**Appendices to Amendment to Comparability Determination for Japan:
Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap
Participants**

Appendix 1—Commission Voting Summary

On this matter, Chairman Giancarlo and Commissioners Quintenz, Behnam, Stump, and Berkovitz voted in the affirmative. No Commissioner voted in the negative.

Appendix 2—Statement of Chairman J. Christopher Giancarlo

Today the Commission is amending its previous comparability determination for Japan with respect to margin requirements for uncleared swaps published on September

15, 2016.¹ The amendment makes a positive determination of comparability with respect to the scope of entities subject to margin requirements and the treatment of inter-affiliate transactions. All other findings and determinations contained in the original comparability determination remain unchanged and in full force and effect.

When the Commission issued its rule addressing the cross-border application of margin requirements for uncleared swaps in 2016,² I expressed my disagreement with the approach the Commission established as overly complex and unduly narrow.³ I also expressed my concern that the Commission’s “element-by-element” methodology for determining when substituted compliance with a foreign regulator’s margin regime would be permitted is contrary to the principles-based, holistic analysis the Commission has used in the past.

This overly complex and unduly narrow approach was reflected in the original comparability determination for Japan, which left firms subject to an impractical patchwork of U.S. and foreign regulations for cross-border transactions. I am pleased that the Commission has reconsidered its original finding and now finds that the remaining Japanese margin transaction requirements are comparable in outcome to the Commission’s own requirements.

Substituted compliance helps preserve the benefits of an integrated, global swap market by reducing the degree to which market participants will be subject to multiple

¹ See *Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, 81 Fed. Reg. 63376 (Sep. 15, 2016), available at: <https://www.govinfo.gov/content/pkg/FR-2016-09-15/pdf/2016-22045.pdf>.

² See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements*, 81 FR 34818 (May 31, 2016), available at: <https://www.govinfo.gov/content/pkg/FR-2016-05-31/pdf/2016-12612.pdf>.

³ See *Statement of Commissioner J. Christopher Giancarlo on the Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants* (Sep. 8, 2016), available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement090816b>.

sets of regulations. Further, substituted compliance builds on international efforts to develop a global margin framework. Today's comparability determination is further evidence that the Commission is committed to showing deference to foreign jurisdictions that have comparable regulatory and supervisory regimes.

Appendix 3—Supporting Statement of Commissioner Brian Quintenz

I support the expansion of the Commission's 2016 Margin Comparability Determination for Japan (Determination).¹ I am pleased that the amendments to the Determination adopted by the Commission today apply an outcomes-based approach to substituted compliance and recognize the discretion of Japanese financial regulators to implement reforms consistent with the G-20 framework in a manner suited to their local markets. Moreover, the expanded Determination is appropriately deferential to our counterparts in Japan, who have already found CFTC margin regulations to be comparable to their own.

In the past, overly narrow comparability determinations have sometimes required Commission staff to provide additional no-action relief to address relatively minor differences between regimes. For example, after the 2016 Japan Determination was issued, swap dealers requested relief from the requirement to post and collect variation margin on a T+1 timeframe with certain counterparties.² Instead of the T+1 standard, these firms requested a T+3 standard, in order to accommodate the use of Japanese Government Bonds (a very common form of collateral in Japan), which settle in two or

¹ Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 63376 (Sept. 15, 2016).

² CFTC Staff Letter No. 17-13, Commission Regulation 23.153: Time-Limited No-Action Position for the Timing of the Posting and Collection of Variation Margin from Certain Counterparties Operating in Japan (Feb. 23, 2017), <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/17-13.pdf>.

three days. The relief was needed in order to allow swap dealers to continue transacting with smaller Japanese counterparties. I am pleased that under the comprehensive Determination issued today, further no-action relief will not be necessary because the Determination appropriately accounts for swap dealers' various types of counterparties and the timing of collateral exchanges.

It is also important to note that while the Determination is deferential to the approach taken in Japan, it limits the flow of risk back to the United States. This is because under the Commission's Cross-Border Margin Rule, when a U.S. swap dealer enters into an uncleared swap with a Japanese swap dealer or end-user, it is required to collect initial margin and variation margin must be exchanged. In the case of uncleared swaps between affiliated U.S. and non-U.S. swap dealers, variation margin is always required. Moreover, the Commission will continue to work closely with the Financial Services Agency of Japan to coordinate our supervision and oversight of regulated entities that operate on a cross-border basis in both the United States and Japan.³

I would like to thank the staff of the Division of Swap Dealer and Intermediary Oversight for their hard work in issuing today's amended Determination. I would also like to compliment Chairman Giancarlo for his leadership on the cross-border regulation of the global swaps market. The Chairman has presented a vision for cross-border regulation grounded in deference and recognition that many of our global counterparts have implemented post-crisis reforms comparable to our own. I strongly support this

³ Memorandum of Cooperation Related to the Supervision of Cross-Border Covered Entities (March 10, 2014), <https://www.cftc.gov/idc/groups/public/%40internationalaffairs/documents/file/cftc-jfsamoc031014.pdf>.

vision and believe it is essential to maintaining a liquid, competitive global swaps market and avoiding regulatory-driven market fragmentation.

Appendix 4—Statement of Commissioner Dan M. Berkovitz

I support today’s Amendment to Comparability Determination for Japan: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (“Amended Japan Determination”).

The Commission’s regulations governing margin requirements for uncleared swaps (“CFTC Margin Rules”) help mitigate risks posed by uncleared swaps to swap dealers, major swap participants, and the overall U.S. financial system.¹ In this regard, the CFTC Margin Rules—and other rules around the world requiring margin for uncleared swaps—are a fundamental component of the regulatory reforms adopted in the wake of the 2008 financial crisis.

In 2016, the CFTC adopted its cross-border margin rule to permit swap dealers and major swap participants located in non-U.S. jurisdictions to comply with the CFTC’s Margin Rules by meeting the similar rules of their home jurisdiction *if* the Commission has deemed those rules comparable.² This framework for “substituted compliance” supports the global nature of the swaps market and conforms to the directive in the Dodd-Frank Act for the Commission to consult and coordinate with international regulators to establish consistent international standards for the regulation of swaps entities and

¹ See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016).

² See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants—Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016).

activities.³ The substituted compliance framework helps reduce duplicative and overlapping regulatory requirements where effective comparable regulation exists, facilitates the ability of U.S. market participants to compete in foreign jurisdictions, and is consistent with the principle of international comity.

The CFTC's cross-border margin rule establishes an outcomes-based approach that considers a number of factors and does not require strict conformity with the CFTC Margin Rules. As I have said before, a comparability determination should not be based solely on the home country's written laws and regulations, but also consider the country's broader system of regulation, including oversight and enforcement. In addition, the nature of the other country's relevant markets may be taken into account. Finally, in considering these issues, the Commission should keep in mind the principle of comity: the reciprocal recognition of the legislative, executive, and judicial acts of another jurisdiction.⁴ Given all of these factors, the analysis for each determination often is unique and can change over time as circumstances change.

The Amended Japan Determination finds comparability regarding the scope of entities subject to the margin requirements and the treatment of margining for inter-affiliate transactions. The Commission's original determination for Japan's margin rules, issued on September 15, 2016, did not find comparability in these areas. Subsequently, it appeared that the absence of a finding of comparability regarding the scope of entities and inter-affiliate swaps issues was causing some confusion in applying the original determination. The CFTC staff therefore further reviewed applicable Japanese laws and

³ See Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376, at section 752 (2010).

⁴ See Restatement (Third) of The Foreign Relations Law in the United States, section 101 (1987) (Am. Law Inst. 2019); <https://www.law.cornell.edu/wex/comity>.

regulations and engaged heavily with the Japan Financial Services Agency (“JFSA”) to develop a more complete understanding of how the JFSA regulates and supervises margining for the scope of entities that enter into swaps and inter-affiliate swap transactions. The in-depth analysis outlined in today’s Amended Japan Determination reflects a more holistic understanding by the Commission of the JFSA’s approach to managing the risks of swap trading for the scope of relevant entities and inter-affiliate swaps. The analysis also notes the potential for risks from these swap activities returning to the United States is expected to be significantly mitigated.

For example, although the JFSA does not require variation margin for the same scope of entities covered by the CFTC Margin Rules, the JFSA indicated that the entities excluded tend to be smaller and have less regular involvement in the swap markets, thereby presenting less risk to the financial system. Furthermore, as noted in the determination, if a Japanese entity that would otherwise be subject to the CFTC Margin Rules, but for substituted compliance, enters into swaps with any U.S. entity covered by the CFTC Margin Rules, then both entities are required to exchange margin per our rules. This requirement limits the possibility of unmargined risk coming to the U.S. Similarly, for inter-affiliate swap treatment, a more complete understanding of the JFSA’s approach to requiring Japanese affiliates to hold more capital when margin is not exchanged with other affiliates, among other things, helps offset exposures not covered when margin is not collected.

As with other jurisdictions where the legal and regulatory structure does not mirror our own, and the substituted compliance determinations are based on the overall outcome of the regulatory system, subsequent monitoring may be appropriate to confirm

that our initial understanding of the regulatory structure and the expected outcomes is accurate. Accordingly, I encourage the CFTC staff to periodically assess the implementation of this determination to confirm our expectations are accurate.

I thank the CFTC staff for their thorough work on this determination and appreciate their responsiveness to our comments and suggestions. I would also like to thank my fellow Commissioners for their collaboration in helping us reach this positive outcome.