ISDA® Safe, Efficient Markets

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RE: the Draft of "JFSA's Supervisory Approaches - Replacing Checklists with Engagement -"

The International Swaps and Derivatives Association, Inc. (ISDA)[1] welcomes the opportunity to make comments to the Financial Services Agency (the "JFSA") on the draft of the "JFSA's supervisory approaches - Replacing checklists with engagement -" (the "Policy")[2].

ISDA strongly supports the Policy aimed at the balance between: (i) financial stability and effective intermediation and (ii) market integrity and vigor, as the basic goals of financial regulation. Similarly, in the United States, a series of reports titled "A Financial System That Creates Economic Opportunities" have been issued to the President by the United States Department of the Treasury since last June, which aim at the financial regulatory reform in the balanced views. Under the international direction going toward the development of balanced financial regulatory systems, ISDA recognizes that the Policy goes on the leading edge of such international direction and set the good precedents of an appropriate regulatory system to the other countries. ISDA would be grateful for the chance to work with the JFSA in a more multifaceted manner as an international industrial organization for sound and effective market revitalization in light of factors such as "industry initiatives" and "domestic policy formation and the global regulatory reforms" presented in the Policy.

While ISDA endorses the JFSA's innovative Policy as mentioned above, we have the following comments on a few specific points, for your attention and consideration.

1 Requests and Points We Would Like You to Consider

(1) Strengthening cooperation with foreign authorities

It is extremely important to balance "market integrity and transparency" and "market vigor" in today's financial environment where globalization of the market has progressed to an extreme. The fact that "the balance point differs in each jurisdiction" means those subject to regulations will be forced to needlessly spend more time and incur higher costs to deal with regulations and develop systems, so it is highly likely that "market vigor" will significantly reduce as a result. From the perspective of eliminating that negative effect, we request the JFSA to continue to make efforts so that regulations of the authorities of various countries and the viewpoint pertaining to the enforcement of those regulations are as consistent as possible, and to work on spreading the right balance, which JFSA would find out, to foreign authorities.

[1] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 875 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

[2] http://www.fsa.go.jp/en/wp/wp.html

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With the increasing significant impact on trading parties not only of the regulations of their respective jurisdictions, but also of global regulations and financial regulations of other countries, we strongly welcome cooperation between the JFSA’s domestic and international sections. With cross-border trading being conducted on a daily basis, it is important to note that there is actually a situation where the financial regulations of various countries could have a negative impact on the global competitiveness of regulated financial institutions. Especially where it is necessary to simultaneously comply with multiple regulations that are imposed directly and indirectly, the burden of regulatory compliance by financial institutions is increasing (regulatory compliance that conforms to strict requirements under the approach of stricter-rule-applies). If there is a difference between the regulations and supervisory guidelines in any jurisdictions, that burden will be even higher. We therefore hope that, by establishing closer cooperation with foreign authorities, the JFSA will make efforts to achieve a supervisory system to widely accept substituted compliance based on equivalence determination. Currently, the timing for allowing substituted compliance and equivalence determination is rather slow and there was a case that it is only finalized after the implementation date of the regulations. The financial institutions are required to be compliant with the foreign regulations before the compliance date, so the effect of substituted compliance is limited in such cases. In order to facilitate the process of equivalence determination, for example, procedures could also be standardized, as well as setting the standard timeline for equivalence determination. On the other hand, it is true that approaches taken by supervisory authorities vary by country due to differences in financial markets, market participants, industry issues and available solutions, and therefore, substituted compliance is not applicable. It is appreciated if the JFSA would consider taking actions where activities conducted by Japanese financial institutions are seriously affected by such foreign regulations, with consideration for discussions in the foreign markets, as well as actual circumstances in the Japanese market.

Further, even in the aspects of examination and supervision, we expect flexible operation in light of practical rationality based on the substantive perspective of whether reasonable steps are being taken to achieve regulatory goals. In that operation, it will be important to obtain in a timely manner best practices and failures in other jurisdictions from foreign authorities, and to reflect those from time to time in the supervisory process of the JFSA in light of the actual circumstances in the Japanese market.

We would also like the JFSA to steadily proceed with sharing the Policy with key foreign authorities. In Europe and the United States, there is a move towards direct supervision of activities within a region by financial institutions located outside of that region through the establishment of interim holding companies, and we understand that it will become important to share your basic stance with supervisory authorities in Europe and the United States.

(2) Assessing and improving the effect of implemented financial regulations

We would like the JFSA to examine the effect of implemented regulations and be aware of the perspective of the PDCA even in financial regulations. At actual trading sites, companies take a conservative approach to matters that are not determined in detailed rules, so there is a stronger tendency to hold back on conducting transactions, which often impacts market liquidity. We believe examining whether such regulations can really contribute to improving market transparency and implementing other regulatory goals, and making improvements through “inquiry-based dialogue” will contribute to achieving regulatory goals.

(3) Detailed cost-benefit analyses

While it goes without saying that cost-benefit analyses are indispensable when introducing new regulations, we would like the JFSA to focus on that perspective even in new supervision under the Policy. In connection with the shift from a backward-looking, element-by-element check on compliance with formal requirements to a substantive, forward-looking, holistic supervisory approach, each financial institution might be forced to make excessive examination preparations due to factors such as a lack of transparency of the supervisory viewpoint, and it is assumed that would lead to an increase in the burden to deal with regulations. We therefore hope the JFSA will ensure a reasonable and effective operation of regulations after analyzing the effect of changing the supervision approach and the additional burden that will be incurred by each stakeholder.

(4) Human resource policy

As the level of expertise required in examinations and supervision of financial institutions increases, it is increasingly important to focus on training expert personnel at the JFSA, including increased public-private personnel exchanges. It is also necessary to secure personnel with systematic knowledge of complex derivatives regulations and other regulations by extending rotation period and actively using outside personnel. We would like the JFSA to make efforts to train and secure personnel with international knowledge and diplomatic negotiating skills to ensure it does not lag behind the rapidly changing financial market by allowing flexibility in terms of the treatment and employment periods of mid-career employees.

(5) Other points

- With respect to problems and improvements gained through “inquiry-based dialogue” between the JFSA and various financial institutions, we would like the JFSA to publicly announce the information that can be shared under appropriate information management and also be aware of making individual discussions more efficient.

- It is provided in the Policy that “excessive prescriptiveness should be rectified” with respect to supervisory guidelines, but there are also cases where supervisory guidelines are implemented in equivalence determinations with other foreign authorities, so the JFSA should proceed in a manner that does not hinder future equivalence determinations.

- While we endorse “industry initiatives,” we would like the JFSA to give support as a means of “contributing to fair competition” and “ensuring market mechanism functions effectively” to ensure that competition laws will not be an obstacle.

- If market vigor and effective intermediation are added as goals, it will be necessary to not only conduct a review based on an analysis of “examinations and supervision of financial institutions,” but also a review based on the perspectives of “overseas markets”, i.e. when we consider the “market vigor”, we should focus not only on the Japanese market but also on markets outside of Japan, and market infrastructure outside of Japan. For example, we would like the JFSA to examine whether the same direction (supervision that focuses on a substantive, forward-looking, holistic perspective) is being adopted with respect to licenses and supervision regarding overseas infrastructure.

2 <u>Future Cooperation with ISDA</u>

We are very grateful that we were able to work with the JFSA and that you have respected our position and opinions in the process of introducing over-the-counter (OTC) derivatives regulations. We hope to continue to work with the JFSA in the future and we believe it is necessary to specifically work on the following matters.

(a) Assessment and improvements to OTC derivatives regulations (such as the following regulations)

(i) Clearing

(ii) Transaction reporting

(iii) Trading rules on electronic trading platform (ETP)

(iv) Margin regulations for non-cleared OTC derivatives

(b) Development of the ISDA Common Domain Model (CDM)[3] and implementation of that to the market

(c) Transition from financial benchmarks (IBOR+) and consideration of fallbacks

ISDA and its members would like to reiterate our appreciation to the JFSA for the opportunity to provide feedback on the draft of the Policy.

Please contact me, or Tomoko Morita, Head of Tokyo Office (03-5200-3301), if you have any questions or need any additional information that may be helpful.

Sincerely,

Scott O'Malia
Chief Executive Officer

[3] https://www.isda.org/2017/10/16/isda-common-domain-model-version-1-0-design-definition-document/