OTC Derivatives Regulation in Japan
- Improving the stability and transparency of OTC derivative transactions -

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To improve the stability and transparency of OTC derivative transactions:

- Mandatory CCP clearing for high trade volume products
- Mandatory clearing by domestic CCPs for derivative trades that are closely linked with Japan’s bankruptcy regime
- Storing and reporting of trade information
Mandatory CCP Clearing

For actively traded OTC derivatives, where the reduction of clearing and settlement risk through use of CCP would be deemed beneficial for the stability of Japanese market
("plain vanilla" type interest rate swaps are thought to be applicable at present)

For OTC derivatives where the clearing criteria relates closely to the corporate bankruptcy criteria under the domestic law
("iTraxx Japan" CDS index is thought to be applicable at present)

Due to extensive cross-border trade relationships, mandatory CCP clearing may be undertaken by the following:
- Domestic CCP
- Domestic CCP and foreign CCP under an interoperability arrangement
- Foreign CCP

Mandatory clearing by a domestic CCP

CDS

Whilst an internationally adopted protocol among contractual parties concerning the determination of a credit event should be respected, domestic CCPs should also be appropriately involved in determining whether a credit event has occurred. Furthermore, the domestic CCPs, as contractual parties, need to maintain the right to assert their views concerning the determination.

Centrally cleared by domestic CCPs
Strengthening the Infrastructure of CCPs

Strengthening the financial base of domestic CCP

[Existing regulation]
No restrictions on major shareholders and no minimum capital requirements for CCPs

Considering the importance of CCP as an infrastructure to protect against risk spreading within the financial system

[Revised regulation]
- Introduction of authorization requirement for shareholders intending to hold more than 20% by voting rights of the CCP
- Introduction of minimum capital requirement

Enabling foreign CCPs to enter the Japanese market

[Existing regulation]
Central clearing of financial instruments trades are permitted only by domestic CCPs

* Provision of central clearing services by foreign CCPs to domestic financial institutions are prohibited

In consideration of the fact that, among financial institutions in Japan, trade relationships exist across nations

[Revised regulation] Introduction of new regimes

- LINK SYSTEM
  Subject to Authorization Regime
  * The following requirements need to be fulfilled:
    - Maintain an adequate infrastructure to operate appropriately and reliably during Japanese market hours
    - Linked foreign CCP is subject to full supervision by its primary regulator

- DIRECT ENTRY
  Subject to Licensing Regime
  * Need to satisfy the above requirements; same regime as for domestic CCPs will be applied to foreign CCPs
I. For trades that are subject to mandatory CCP clearing, CCP stores the trade information and reports them to the regulator

II. Designation of trade repositories (TR) by public notice
   - Designated Domestic TR: Designated upon an application by the TR
   - Designated Foreign TR: Designated if an international cooperative supervisory framework is established and is compliant with the domestic reporting regime

III. Financial institutions can report trade information through TRs or directly to the regulator

IV. Domestic TRs are required to store and to submit trade information to the regulator
Strengthening the CCP infrastructure
Enabling foreign CCPs to operate in Japan
Mandatory clearing
Data storage and reporting requirement

Schedule for Implementation

Promulgation of Law

1 year

2 years and 6 months

Comes into force 1 year after the promulgation

Comes into force 2 years and 6 months after the promulgation
Issues to be addressed (1)

- OTC derivative products that are frequently traded internationally
- Avoiding regulatory arbitrage between jurisdictions and maintaining the stability of the financial system

Need for international coordination

A. Participating in multilateral policy discussions
   - G20 • FSB
   - IOSCO Task Force on OTC Derivatives Regulation: international standards setting
   - CPSS • IOSCO: Principles for financial market infrastructures
   - Others (on matters regarding CCP access, CCP links and non-CCP cleared contracts)

B. Promoting cooperation between authorities
   - Seeking consistencies with Dodd Frank Act (established on 21 July, 2010), EMIR (proposal published on 15 September, 2010) and MiFID (proposal was published on 8 December, 2010), etc.
   - International supervisory cooperation on foreign TRs
Issues to be resolved in considering OTC derivative regulation in Japan

1. Taking account of the characteristics of Japanese market (considerable proportion of trades are cross-border with limited number of major participants, etc)
2. Highly developed market infrastructure
3. Future development of the Japanese market

A Multi-stage application of regulations

- Scope of central clearing
- Storing and reporting of trade data
- Electronic trading platform

B Practical matters

- Commencement of CCP clearing for OTC derivative trades (CDS and interest rate swap) by JSCC
- Encouraging financial institutions in Japan to report to TRs