

Amendments to enforcement orders regarding OTC derivatives and trade execution in Japan



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*These slides were prepared based on the information available as of 16 June 2015.



Mandatory Trade Execution

- The mandatory trade execution was introduced in Japan by the amendment to the Financial Instruments and Exchange Act (“FIEA”) in 2012 and will come into force on 1 September 2015.
- The mandatory trade execution requirement applies to “Registered Dealers” and covers “Specified OTC Derivative Transactions”.

□ Registered Dealers

- The G20-initiated regulatory frameworks (including mandatory trade execution requirement) under the FIEA apply to:
 1. “Registered Financial Instrument Dealers”; and
 2. “Registered Financial Institutions”.



Registered Financial Instrument Dealers

- A person who conducts a Financial Instruments Trading Business (e.g. entering into OTC Derivative Transactions as a business) must be registered as a Registered Financial Instrument Dealer.
- The registration category for OTC Derivative Transactions is a “Category One Financial Instrument Dealer”.



Example of Exemptions from Registration

- OTC Derivative Transactions (excluding Securities Related OTC Derivative Transactions*) with the following investors will not trigger the registration requirement:
 1. a Category One Financial Instrument Dealer;
 2. a Registered Financial Institution; or
 3. a Qualified Institutional Investor or a stock corporation with at least JPY 1 billion paid capital.

*Specified OTC Derivative Transactions will be also excluded from 1 September 2015.



Financial Institutions (Prohibition)

- The FIEA prohibits Financial Institutions (e.g. banks, trust banks, cooperative financial institutions and insurance companies licensed in Japan) from entering into Securities Related OTC Derivative Transactions as a business.
- Certain exceptions from this prohibition (see the next slide).



Financial Institutions (Exceptions)

- A Financial Institution can enter into Securities Related OTC Derivative Transactions for government bonds; and
- A Financial Institution can enter into Securities Related OTC Derivative Transactions to the extent that such transactions;
 1. only allow cash settlement; and
 2. are not entered into with 50 persons or more.



Registered Financial Institutions

- Not prohibited OTC Derivative Transactions would still require the registration as a Registered Financial Institution, unless they are entered into:
 1. for the purpose of investment according to other laws (e.g. Banking Act); or
 2. for the account of the settlor (entrustor) of a trust based on a trust agreement.



Categorisation of Market Participants

	Non-Financial Institutions		Financial Institutions		
Transaction Category	Permitted with Registration	Permitted without Registration	Prohibited	Permitted with Registration	Permitted without Registration
Type of License	Registered Financial Instrument Dealers	Other dealers	N/A (Prohibited)	Registered Financial Institutions	Financial Institutions
Application of Mandatory Trade Execution	Yes*	No	N/A (Prohibited)	Yes*	No**

*Subject to the exemptions shown in the next two slides

**The mandatory trade execution would be still applicable if such transactions are entered into by Registered Financial Institutions.



Lists of Registered Dealers

■ Registered Financial Instrument Dealers

<http://www.fsa.go.jp/menkyo/menkyoj/kinyushohin.pdf>

■ Registered Financial Institutions

<http://www.fsa.go.jp/menkyo/menkyoj/touroku.pdf>



Specified OTC Derivative Transactions

- The mandatory trade execution applies to "Specified OTC Derivative Transactions".
- "Specified OTC Derivative Transactions" are JPY interest rate swap transactions involving the exchange of a floating rate and a fixed rate, the exact scope of which is designated by the J-FSA.
- The relevant J-FSA Public Notice has not yet been published.



Electronic Trading Platform

- Registered Dealers must execute Specified OTC Derivative Transactions using an electronic trading platform operated by Registered Dealers.
- An overseas trading platform operator (which is not a Registered Dealer) must obtain a license in order to operate such a platform in Japan.



Exemptions from Mandatory Trade Execution (1)

- The following transactions are exempt from the mandatory trade execution:
 1. transactions entered into by a trustee on behalf of the trust;
 2. transactions entered into by and between entities within the same corporate group;
and



Exemptions from Mandatory Trade Execution (2)

3. transections entered into by a Registered Dealer that meets any of the following criteria:
 - a Registered Dealer which is not (i) a Category One Financial Instrument Dealer or (ii) a Registered Financial Institution which is a bank or a certain government-affiliated bank; or
 - a Registered Dealer whose average total notional amount of OTC Derivative Transactions is less than 6 trillion yen.



Update on Mandatory Clearing

- The mandatory clearing was introduced in 2010 and came into force in 2012.
- The three month TIBOR and six month TIBOR became subject to the mandatory clearing on 20 June 2014.
- Insurance companies will become subject to the mandatory clearing from 1 December 2015.



Update on Trade Reporting

- The mandatory reporting was introduced in 2010 and came into force in 2012.
- Insurance companies became subject to the mandatory reporting on 1 April 2015.
- Tokyo Stock Exchange (local operation unit) has been allocating JPX-LEI since 1 August 2014.



Update on Margin Requirement

- On 3 July 2014, the J-FSA proposed amendments to OTC derivatives regulations to implement the margin requirement for non-centrally cleared derivatives.
- On 19 March 2015, the J-FSA decided to postpone the implementation date.
- The details of the requirement are not yet finalised.



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