

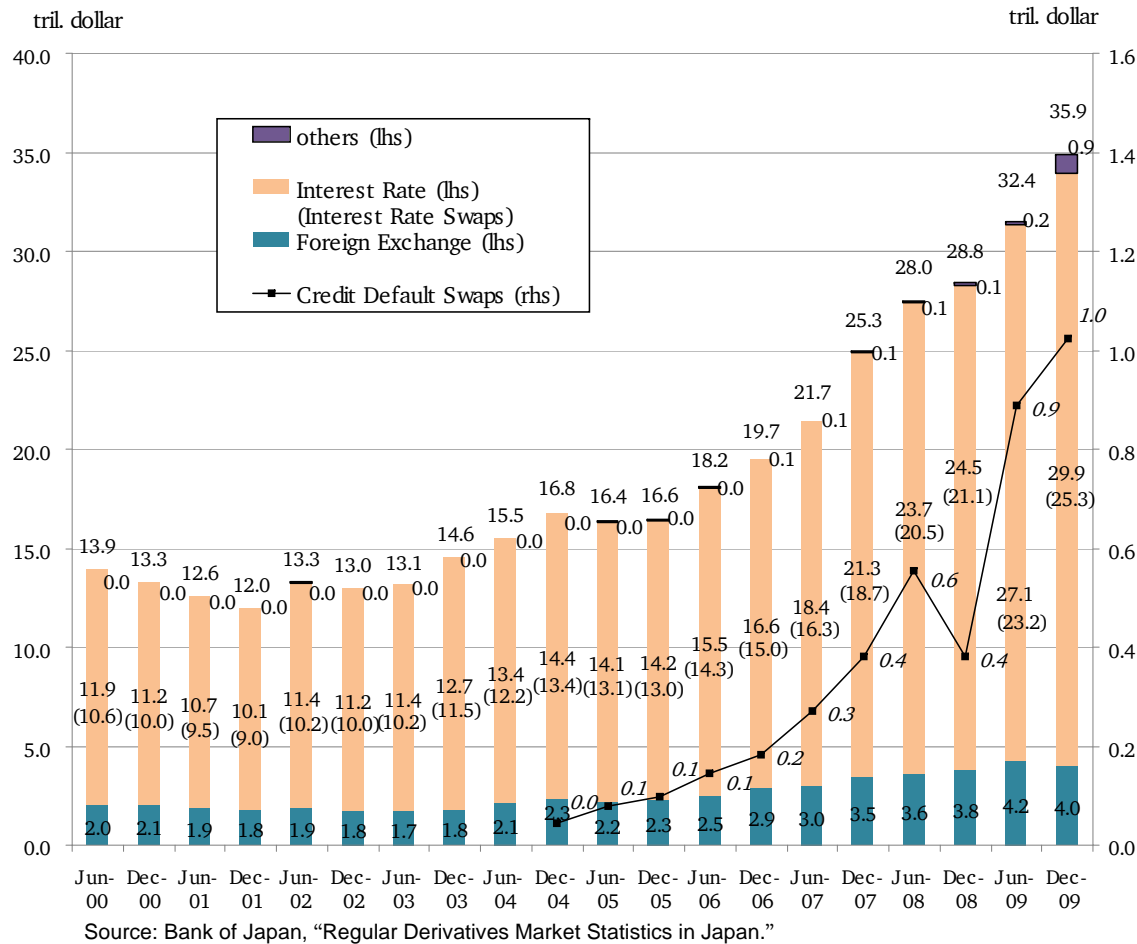


# Regulation of OTC Derivative Trades in Japan

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Financial Law Board  
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# OTC Derivative Trades in Japan



## Market Share of Japanese Financial Institutions as of the end of 2009

(Notional amounts outstanding in billions of US dollars)

	Global market (A)		Japanese Financial Institutions (B)		(B) / (A)
		Composition		Composition	
FX	49,196	8.0%	4,021	11.2%	8.2%
Interest rate	449,793	73.2%	29,915	83.4%	6.7%
Equity-linked	6,591	1.1%	892	2.5%	13.5%
Commodity	2,944	0.5%	39	0.1%	1.3%
CDS	32,693	5.3%	1,023	2.9%	3.1%
Unallocated	73,456	12.0%	—	—	—
Grand total	614,674	100.0%	35,891	100.0%	5.8%

Source: BIS, "OTC derivatives market activity in the second half of 2009"; Bank of Japan, "Regular Derivatives Market Statistics in Japan."

\* The figures of Japanese financial institutions are not adjusted for inter-dealer double-counting.



## Regulatory Framework over OTC Trades

- G20 Pittsburgh Summit (Sep, 2009)
  - “All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest”.
- Deliberations at FSA and Public Comment (Nov, 2009~)
- “Development of Institutional Frameworks Pertaining to Financial and Capital Markets” (Jan. 2010)
  
- Amendment to the Financial Instruments and Exchange Act (May 12, 2010)
  - Enhancement of the Institutional Framework for CCPs
    - Strengthening regulations of domestic CCPs and development of a regulatory framework for foreign CCPs.
  - Mandatory Use of CCPs for clearing of certain types of OTC Derivative Trades
  - Data Storage and Reporting of Trade Information
  
- Effective Date
  - To be Designated by the Cabinet Office Ordinance.



## Enhancement of the Institutional Framework for CCPs : Establishment of a Regulatory Framework for Foreign CCPs

- A Foreign CCP is able to carry out a service in Japan by following methods;

### A) Obtaining a license as “Foreign Financial Instruments Clearing Organization”.

--- Required to have a representative in Japan and to have operated in the foreign jurisdiction for not less than certain period.

--- Other requirements for a license (e.g. “establishment of a system and an organizational structure to ensure appropriate and secure clearing of unsettled obligations” ), regulations (e.g. establishment of business rules, confidentiality obligations) and supervisions (e.g. reporting obligations, on-site inspections, orders to improve business operations and suspensions of business or rescissions of license) are similar to those for Domestic CCPs .

### B) Entering into an alliance with domestic CCP (“link method”) upon an authorization

--- The requirements for authorizations, regulations and supervisions for an aligned financial instruments clearing service are similar to those for “Foreign Financial Instruments Clearing Organization”.

## Mandatory Use of CCPs

<div style="border: 1px dashed black; padding: 5px;"> <ul style="list-style-type: none"> <li>✓ Major Japanese FIs have OTC derivatives trades with major FIs in the EU and the US.</li> <li>✓ Existence of global clearing services providers</li> </ul> </div>	
<p>OTC derivative transactions of large trading volume in Japan, which are likely to have a material impact on Japan's market in case of defaults on those obligations (e.g. Plain vanilla type interest rate swap)*</p>	<p>Cleared by either of ;</p> <ul style="list-style-type: none"> <li>(i) Domestic CCPs</li> <li>(ii) Link method***</li> <li>(iii) Licensed foreign CCP</li> </ul>
<p>Among such OTC derivatives stated above, those required to be cleared in Japan** (e.g. iTraxx Japan CDS index transaction)*</p>	<p>Cleared by ;</p> <p style="text-align: center;">Domestic CCPs</p>

\* The scope of OTC derivative transactions that are subject to the mandatory use of CCPs will be determined by a cabinet office ordinance.

\*\* Specifically, CDS transactions in which credit event of reference entity should be determined in light of Japanese laws.

\*\*\* The methods of linking CCPs; alliances between ① a domestic CCP and another domestic CCP, ② a domestic CCP and a "Foreign Financial Instruments Clearing Organization", and ③ a domestic CCP and an entity which is established under a foreign law and provides "aligned financial instruments clearing service".



## Data Storage and Reporting of Trade Information

- Establishment of a regulatory framework for trade repositories
  - Domestic trade repositories are designated by the Prime Minister upon application.
  - Foreign trade repositories are designated in a public notice on the condition that reports to the FSA are assured under an international agreement, such as a framework for cooperative oversight by relevant authorities of individual countries.
  - The amended act stipulates certain supervisory provisions, such as orders for production of reports, on-site inspections, orders to improve business operations, and rescissions of designation, for trade repositories.
- Data storage and reporting of trading information
  - Financial institutions and clearing organizations are required to store and report trading information on OTC derivative transactions to the authority.
  - A financial institution is given an option to have “trade repositories” collect and report trading information.

