## OTC Derivative Trades in Japan

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

<table>
<thead>
<tr>
<th></th>
<th>Global market (A)</th>
<th>Japanese Financial Institutions (B)</th>
<th>(B) / (A)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Composition</strong></td>
<td><strong>Composition</strong></td>
<td></td>
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<tr>
<td>FX</td>
<td>49,196</td>
<td>4,021</td>
<td>11.2%</td>
</tr>
<tr>
<td>Interest rate</td>
<td>449,793</td>
<td>29,915</td>
<td>83.4%</td>
</tr>
<tr>
<td>Equity-linked</td>
<td>6,591</td>
<td>892</td>
<td>11.2%</td>
</tr>
<tr>
<td>Commodity</td>
<td>2,944</td>
<td>39</td>
<td>0.1%</td>
</tr>
<tr>
<td>CDS</td>
<td>32,693</td>
<td>1,023</td>
<td>3.1%</td>
</tr>
<tr>
<td>Unallocated</td>
<td>73,456</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Grand total</strong></td>
<td>614,674</td>
<td>35,891</td>
<td>5.8%</td>
</tr>
</tbody>
</table>


*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~)

- 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

<table>
<thead>
<tr>
<th>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)*</th>
<th>Cleared by either of ; (i) Domestic CCPs (ii) Link method*** (iii) Licensed foreign CCP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Among such OTC derivatives stated above, those required to be cleared in Japan** (e.g. iTraxx Japan CDS index transaction)*</td>
<td>Cleared by ; Domestic CCPs</td>
</tr>
</tbody>
</table>

* 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 ①a domestic CCP and another domestic CCP, ②a 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”.

Major Japanese FIs have OTC derivatives trades with major FIs in the EU and the US.

Existence of global clearing services providers
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.
Remaining issues…

- The details of the amendment are left to subordinate regulations which should be published by the FSA and the Cabinet Office.
  - Scope of exempted transactions (e.g. in case of conflict of dual regulations, treatment of cross-border transactions…)?
  - Scope of the dealers subject to the mandatory use of CCPs?
  - Involvement of domestic CCPs in the determination of a credit event?

- Incentives to use CCPs
  - Capital Requirements for exposures to CCPs?

- Domestic CCP or foreign CCP or link method
  - Conveniences for globally active dealers?
  - Accessibility by wider range of financial institutions in Japan?
  - Risk control (e.g. time zone difference, operational risk control…)?
  - Enforcement of regulation?