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

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

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”.

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.
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

<table>
<thead>
<tr>
<th>Transaction Category</th>
<th>Non-Financial Institutions</th>
<th>Financial Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Permitted with Registration</td>
<td>Prohibited</td>
</tr>
<tr>
<td></td>
<td>Permitted without Registration</td>
<td>Permitted with Registration</td>
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<tr>
<td></td>
<td>Prohibited</td>
<td>Permitted without Registration</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Type of License</th>
<th>Non-Financial Institutions</th>
<th>Financial Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registered Financial Instrument Dealers</td>
<td>Other dealers</td>
<td>N/A (Prohibited)</td>
</tr>
<tr>
<td>Registered Financial Institutions</td>
<td>Registered Financial Institutions</td>
<td>Financial Institutions</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Application of Mandatory Trade Execution</th>
<th>Non-Financial Institutions</th>
<th>Financial Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes*</td>
<td>No</td>
<td>Yes*</td>
</tr>
<tr>
<td>N/A (Prohibited)</td>
<td>Yes*</td>
<td>No**</td>
</tr>
</tbody>
</table>

*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

- Registered Financial Institutions
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.
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.
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. Transactions 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.
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.
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.
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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