

OTC Derivatives Market Reforms and Cross Border Issues

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November 2012

** The views expressed in this presentation are those of the presenter, not necessarily those of the Financial Services Agency of Japan (JFSA) or the International Organization of Securities Commissions (IOSCO).*

Background for OTC Derivatives Market Reforms

G20 Pittsburgh Summit

1. All standardized OTC derivative contracts:
 - a) should be traded on exchanges or electronic trading platforms, where appropriate; and
 - b) cleared through central counterparties.
2. OTC derivative contracts should be reported to trade repositories.

 ***Based on the G20 Summit Statement, regulatory reforms for OTC derivatives markets are being implemented in major jurisdictions (G20 Summit Deadline: end-2012)***

OTC Derivatives Market Reforms in Japan

Amendments to the Financial Instruments and Exchange Act (FIEA)

<First stage: Approved by the Diet on 12 May 2010>

- **Mandatory central clearing at CCPs**
- **Reporting requirements to trade repositories**
- ⇒ **Implemented as of November 1st 2012**

<Second stage: Approved by the Diet on 6 September 2012>

- **Mandatory use of electronic trading platforms**
- ⇒ **Implementation will be phased-in (up to three years)**

OTC Derivatives Market Reforms in Japan

The implementation plan for the initial stage - Centralized clearing-

<Use of CCPs>

- Index-based CDSs and JPY-denominated IRSs with reference to Yen LIBOR are subject to mandatory central clearing
- Mandatory central clearing requirements are applicable to transactions between large domestic financial institutions, who are members of licensed clearing organizations

(Note) Currently, the Japan Securities Clearing Corporation (JSCC) is the only licensed CCP under the FIEA in Japan

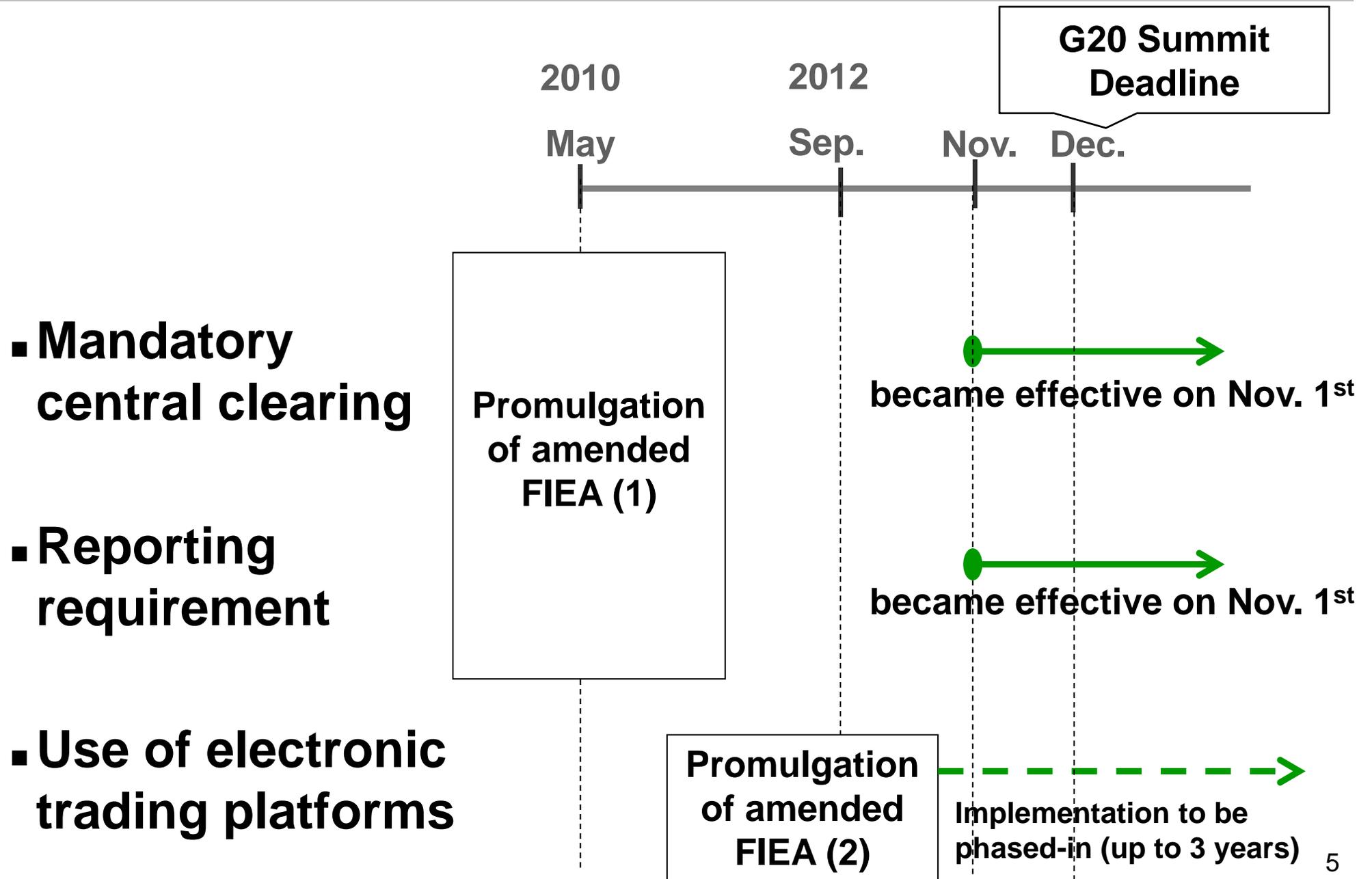
OTC Derivatives Market Reforms in Japan

The implementation plan for the initial stage - Trade reporting -

<Reporting Requirements to Trade Repositories (TRs)>

- **Financial institutions are required to report to TRs their OTC derivatives transactions for which TR services are available**
- **Examples of such transactions are credit derivatives transactions, and forward, option and swap transactions with reference to interest rates, foreign exchanges, and equities**

Current Schedule for Implementation in Japan



Cross Border Issues arising from overlapping or conflicting reforms

Issues arising from CFTC's proposed reforms

- **Swap Dealer registration for non-US persons required before cross-border guidance is finalized**
- **“Substituted compliance” not guaranteed for countries with equivalent regulation and supervision**
- **Cross-border transactions subject to duplicative requirements for central clearing and data reporting**
- **Foreign CCPs not recognized under US regulation**
- **Not coordinated with SEC rules for securities-based swaps**

Cross-border issues arising from reforms

Comments on CFTC's proposed rules (July 2012)

➡ ***Relevant authorities in Japan (JFSA and BOJ) sent a comment letter in August 2012***

A joint ministerial-level letter (※) has been sent in October 2012, with a focus on cross-border issues

(※) The signatories of the letter

- **Chancellor of the Exchequer, the United Kingdom**
- **Commissioner of the European Commission**
- **Minister of Finance, France**
- **Minister of State for Financial Services, Japan**

Cross-border issues arising from the reforms

Overarching concerns expressed in JFSA-BOJ letter

- **Avoidance of overlapping or conflicting regulation**
- **Need for international coordination in cross-border regulation**

Cross-border issues arising from the reforms

Specific requests made in JFSA-BOJ comment letter

- **Further extension of the application of “substituted compliance”, with clarification as soon as possible of its details on procedure and timing**
- **Deferral of application of CFTC regulations with respect to non-US persons**
- **Exclusion of certain transactions from the calculation of swap transactions in regard to the *de-minimis* threshold for non-US persons**

Cross-border issues arising from the reforms

**Proper sequencing of reforms
and sufficient transitional measures are crucial**

- ➔ **Important elements of US regulations are not finalized and remain unclear
(Examples)**
 - **Details of “substituted compliance”**
 - **Exact scope of products subject to mandatory central clearing**
 - **Method for calculating transaction volumes in relation to *de-minimis* thresholds for non-US swap dealer registration, etc.**
- ➔ **Implementing US regulations under such circumstances has created considerable uncertainty in markets**

Cross-border issues arising from the reforms

Proper sequencing of reforms and adequate transitional measures are crucial

- ➔ In particular, a sufficient transition period and special measures for non-US persons are requested to avoid regulatory conflicts and inconsistencies arising from differences in the content and the timing of implementation of national regulations
- ➔ If appropriate steps are not taken, major reductions in market liquidity and/or shifts in transaction venues could occur (already starting to occur)

Cross-border issues arising from the reforms

Transaction-Level Regulations

Mandatory central clearing requirement

-  Under the current circumstances, no single CCP is licensed or registered both in Japan and the US for JPY-denominated IRSs, for example
- As a result, market participants cannot enter into transactions without breaching the regulations of either Japan or the US (especially when Japan extends its regulations to cross-border transactions)
- JSCC is currently seeking CFTC registration as a DCO in the US. However, some of the requirements and the timeline for registration are not entirely clear

Cross-border issues arising from the reforms

Transaction-Level Regulations (continued)

Mandatory central clearing requirement (continued)

- ➔ There should be coordination in inspection and supervision of the CCPs, licensed or registered, both in Japan and the US (e.g. through concluding an MoU)
- ➔ JFSA should be recognized as the primary regulator of CCPs established under Japanese law, tasked with conducting proper inspection and supervision of those CCPs

Cross-border issues arising from the reforms

Transaction-Level Regulations (continued)

Trade execution requirement

- ➔ **Going forward, the same problems as described above would arise, if there exists no electronic trading platforms which are permitted or registered both in Japan and the US**

Cross-border issues arising from the reforms

Entity-Level Regulations

Swap data recordkeeping and reporting, etc.

➡ **Some financial institutions (※) will be subject to overlapping regulations (= not only Japanese regulations but also US regulations will apply to them)**

(※) Examples

- **Head offices of Japanese financial institutions registered as swap dealers in the US**
- **Subsidiaries and branches in Japan of US financial institutions**

Cross-border issues arising from the reforms

Entity-Level Regulations (continued)

Swap data recordkeeping and reporting, etc. (continued)

- ➔ **There should be proper coordination in inspection and supervision of financial institutions subject to overlapping regulation (e.g. substituted compliance under an MoU)**
- ➔ **JFSA should be recognized as the primary regulator to conduct inspection and supervision of financial institutions which are established under Japanese law**

**Thank you very much
for your kind attention**



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