



New Regulation of OTC Derivatives in Japan

October 2010



**Financial Services Agency
Government of Japan**

LEADERS' STATEMENT AT THE PITTSBURGH SUMMIT (September 24–25, 2009)

Strengthening the International Financial Regulatory System

“Improving over-the-counter derivatives markets: 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.

OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse. ”

Japan's legislative action: Amendment of the Financial Instrument and Exchange Act (2010)

- In order to improve the stability and transparency in Japanese financial system and ensure protection of investors, the Financial Instruments and Exchange Act (FIEA) was amended on May 2010.
- 2010 Amendment of the FIEA aims:
 - to improve the stability and transparency of the settlement of OTC derivative transactions
 - Mandatory CCP clearing of large-scale derivative transactions
 - Mandatory clearing at domestic CCPs for derivative transactions that are closely related to Japanese bankruptcy procedures
 - Storing and reporting of trade information data
 - to strengthen group-wide regulation and supervision of financial instruments business operators (e.g. securities firms)

Mandatory CCP Clearing

OTC derivatives that need to be cleared at CCPs (domestic or foreign) are to be designated by a cabinet office ordinance no later than November 18th 2012. The designation will be considered in light of the market size and regulatory approach by other regulators.

(at present “plain vanilla” yen-denominated interest rate swaps are considered for inclusion)

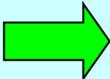
Bankruptcy related OTC derivatives

Those OTC derivative transactions need to be cleared at domestic CCPs

- a) for which clearing criteria relate closely to the bankruptcy procedures under Japanese law
- b) of which transaction volume in Japan is above a certain level.

(at present “iTraxx Japan” CDS index is considered for inclusion)

Rationale for mandatory clearing at domestic CCP

-  ***· A CDS CCP should consider establishing an internal determination committee that may determine the credit event where no decisions are taken by the market participants.***
(CPSS/IOSCO Consultative report on OTC derivatives CCPs in May 2010)

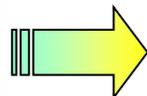
※ Other countries CDS CCPs (e.g. ICE trust (US, UK), Eurex Clearing (Germany)) determine Credit Events under their operational rules in instances where no decisions are taken by the market participants.

Strengthening the Infrastructures for Central Clearing

Strengthening the financial base of domestic CCPs

[Existing regulation]

License is required. No minimum capital requirements, nor authorization to become major share holders.

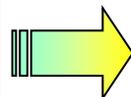


[New regulation]

- Introduction of minimum capital requirement
- Authorization is required in order to hold more than 20% of voting rights

Foreign CCPs will be allowed into Japanese market

Provision of central clearing services by foreign CCPs to domestic financial institutions is not allowed.



Provision of CC services by foreign CCPs will be allowed in the following two forms:

- A) Through Link System (Authorization is required for the linked domestic CCP) ; or,**
- B) Direct Provision (License is required for the foreign CCP)**
 - *Maintain an adequate infrastructure to operate appropriately and reliably during Japanese market hours*
 - *The foreign CCP is subject to proper supervision by its home country regulator*
 - ※ The licensed foreign CCP will be subject to inspection and business improvement order by Japanese FSA as well.

Exemptions: Exemption can be granted if designated by the cabinet order (e.g. CDS transactions which refer to foreign companies and is cleared by foreign CCPs.)

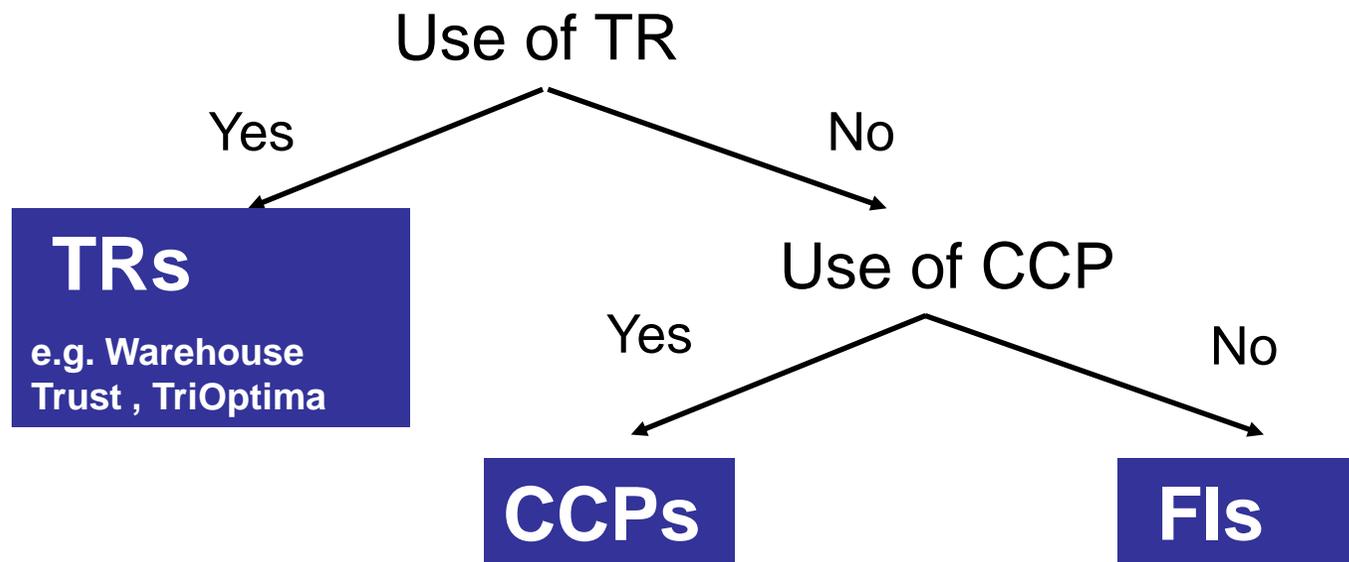
Storing and Reporting of trade information data for OTC Derivatives Transactions

➤ Financial institutions will be responsible for storing and reporting of trade information data for their OTC derivative transactions.

However;

➤ If Financial Institutions use Trade Repositories, the Trade Repositories will become responsible.

➤ If Financial Institutions use CCPs, the CCPs will become responsible.



Schedule for Implementation

