



Brussels, **XXX**
[...] (2014) **XXX** draft

COMMISSION IMPLEMENTING DECISION

of **XXX**

on the equivalence of the regulatory framework of Japan for central counterparties to the requirements of Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the functioning of the European Union,

Having regard to Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ⁽¹⁾, and in particular Article 25(6) thereof,

Whereas:

- (1) The procedure for recognition of central counterparties (“CCPs”) established in third countries set out in Article 25 of Regulation (EU) No 648/2012 aims to allow CCPs established and authorised in third countries whose regulatory standards are equivalent to those laid down in that Regulation to provide clearing services to clearing members or trading venues established in the Union. That recognition procedure and the equivalence decision provided for therein thus contribute to the achievement of the overarching aim of Regulation (EU) No 648/2012 to reduce systemic risk by extending the use of safe and sound CCPs to clear over-the-counter (“OTC”) derivative contracts, including where those CCPs are established and authorised in a third country.
- (2) In order for a third country legal regime to be considered equivalent to the legal regime of the Union in respect of CCPs, the substantial outcome of the applicable legal and supervisory arrangements should be equivalent to Union requirements in respect of the regulatory objectives they achieve. The purpose of this equivalence assessment is therefore to verify that the legal and supervisory arrangements of Japan ensure that CCPs established and authorised therein do not expose clearing members and trading venues established in the Union to a higher level of risk than the latter could be exposed to by CCPs authorised in the Union and, consequently, do not pose unacceptable levels of systemic risk in the Union.
- (3) On 1 September 2013, the Commission received the technical advice of the European Securities and Markets Authority (“ESMA”) on the legal and supervisory arrangements applicable to CCPs established in Japan. A supplement to this advice was received on 27 January 2014. The technical advice identified a number of differences between the legally binding requirements applicable, at a jurisdictional level, to CCPs in Japan and the legally binding requirements applicable to CCPs under Regulation (EU) No 648/2012. This Decision is not only based, however, on a comparative analysis of the legally binding requirements applicable to CCPs in Japan, but also on an assessment of the outcome of those requirements in terms of the level of risk mitigation they achieve.

¹ OJ L 201, 27.7.2012, p. 1.

- (4) In accordance with Article 25(6) of Regulation (EU) No 648/2012, three conditions need to be fulfilled in order to determine that the legal and supervisory arrangements of a third country regarding CCPs authorised therein are equivalent to those laid down in that Regulation.
- (5) According to the first condition, CCPs authorised in a third country must comply with legally binding requirements which are equivalent to the requirements laid down in Title IV of Regulation (EU) No 648/2012.
- (6) The legally binding requirements of Japan for clearing organisations ("COs") authorised therein consist of the Financial Instruments and Exchange Act 2006 ("FIEA"), which establishes the supervisory framework for organisations clearing securities and financial derivatives, and the Commodity Derivatives Act 2009 ("CDA"), which provides the supervisory framework for organisations clearing commodities. The present decision only covers the regime set out in the FIEA.
- (7) The FIEA provides that before granting a licence to carry out the activities of clearing, the Prime Minister of Japan must be satisfied that the CO has business rules —the internal rules and procedures of the clearing organisation— which conform to the applicable laws and regulations; that the financial standing of the CO is sufficient for undertaking the clearing of financial instruments; that the expected income and expenditure pertaining to the business of the CO are favourable; that the CO's staff has sufficient knowledge and experience for conducting the clearing of financial instruments appropriately and with certainty; and that the structure and system of the CO are adequately developed so that settlement can function adequately. Pursuant to Article 194-7(1) of the FIEA, the Prime Minister delegates to the Commissioner of the Financial Services Agency of Japan (JFSA) the powers vested under the FIEA. Therefore, the Commissioner of the JFSA has the responsibility for granting a license for clearing.
- (8) Moreover, in December 2013, the JFSA published the Comprehensive Guidelines for Supervision of Financial Market Infrastructures ("the Guidelines"), which detail the supervisory framework with regard to financial market infrastructures, including COs, and in particular the way in which the FIEA will have to be complied with by the COs. The Guidelines are implemented in the internal rules and procedures of COs.
- (9) The legally binding requirements in Japan therefore comprise a two-tiered structure. The core principles for COs laid down in the FIEA (the 'primary rules') set out the high-level standards with which COs must comply in order to obtain a license to provide clearing services in Japan. Those primary rules comprise the first tier of the legally binding requirements in Japan. In order to prove compliance with the primary rules, a CO must submit its internal rules and procedures to the Commissioner of the JFSA for approval. Those internal rules and procedures comprise the second tier of the legally binding requirements in Japan, which must provide prescriptive detail regarding the way in which the applicant CO will meet those standards in accordance with the Guidelines. Moreover, the internal rules and procedures of COs contain additional provisions which complement the primary rules. Once approved by the Commissioner of the JFSA, those internal rules and procedures become legally binding upon the CO. Those rules therefore form an integral part of the legal and supervisory arrangements that CCPs established in Japan must comply with. In the case of non-compliance with the primary rules or the CO's internal rules and procedures, the Commissioner of the JFSA has the power to take administrative

actions against the CO, including issuing of orders to improve business operations or rescinding all or part of the CO's licence.

- (10) The primary rules applicable to COs complemented by their internal rules and procedures deliver substantial results equivalent to the effects of the rules contained in Title IV of Regulation (EU) No 648/2012. In particular, the legally binding requirements applicable to COs regarding the number of defaults to be covered by total financial resources require COs clearing more than 95% of the volumes cleared in Japan to cover the default of at least the two clearing members to which they have the largest exposures under extreme but plausible market conditions (the 'cover 2 principle'). That requirement ensures an equivalent degree of risk mitigation to that pursued by the requirements set out under Title IV of Regulation (EU) No 648/2012 and therefore should be considered equivalent.
- (11) The legally binding requirements applicable to COs regarding liquidity risk require COs clearing more than 95% of the volumes cleared in Japan to apply the "cover 2 principle". That requirement ensures an equivalent degree of risk mitigation to that pursued by the requirements set out under Title IV of Regulation (EU) No 648/2012 and should therefore be considered equivalent. Finally, the legally binding requirements applicable to all COs regarding business continuity, collateral requirements, investment policy, settlement risk, segregation and portability, calculation of initial margins and governance, including organisational requirements, requirements relating to senior management, risk committee, record keeping, qualifying holdings, information transmitted to the competent authority, conflict of interests, outsourcing and conduct of business deliver substantial results equivalent to those laid down in Regulation (EU) No 648/2012 and therefore should be considered equivalent.
- (12) The Commission therefore concludes that the legal and supervisory arrangements of Japan ensure that COs authorised therein comply with legally binding requirements which are equivalent to the requirements laid down in Title IV of Regulation (EU) No 648/2012.
- (13) According to the second condition under Article 25(6), the legal and supervisory arrangements of Japan in respect of CCPs authorised therein must provide for effective supervision and enforcement of those CCPs on an ongoing basis.
- (14) The JFSA is responsible for the supervision of financial market infrastructures. The JFSA conducts ongoing monitoring of COs' compliance with risk management requirements through surveillance and risk-based examination procedures including testing of prudential requirements. In particular, the JFSA can request COs to provide information, reports and other materials concerning their business and can inspect the business, records and books of COs. It also assesses COs' compliance with their obligations. Those examination exercises result in a report which identifies any deficiencies perceived. Various measures are available to the JFSA to ensure that COs appropriately address any identified issues, including requiring COs to demonstrate, in writing, timely correction of such issues. The JFSA has additional means to enforce compliance, including the ability to issue orders to improve business operations and the enforcement of such orders. The JFSA can also rescind all or part of the CO's licence.
- (15) The Commission therefore concludes that the legal and supervisory arrangements of Japan in respect of CCPs authorised therein provide for effective supervision and enforcement of CCPs on an ongoing basis.

- (16) According to the third condition under Article 25(6) of Regulation (EU) No 648/2012, the legal and supervisory arrangements of Japan must include an effective equivalent system for the recognition of CCPs authorised under third country legal regimes (“third country CCPs”).
- (17) Third country CCPs may apply for a ‘foreign CCP’ licence enabling them to provide the same services in Japan as they are authorised to provide in that third country. The criteria applied to a third country CCP applying for a licence are similar to the criteria applied to the licensing of Japanese clearing organisations. In particular, the applicant third country CCP, on the basis of the legal and supervisory arrangements applicable in the third country, should have sufficient financial basis, sufficient knowledge and experienced personnel as well as a sufficient system and structure for carrying out clearing activities appropriately and with certainty. Moreover, third country CCPs are exempted from certain requirements applicable to domestic CCPs authorised in Japan where they have been granted an equivalent licence from foreign authorities with whom the JFSA has concluded cooperative agreements.
- (18) It should therefore be considered that the legal and supervisory arrangements of Japan provide for an effective equivalent system for the recognition of third country CCPs.
- (19) The conditions laid down in Article 25(6) of Regulation (EU) No 648/2012 can therefore be considered to be met by the legal and supervisory arrangements of Japan regarding COs and those legal and supervisory arrangements should be considered to be equivalent to the requirements laid down in Regulation (EU) No 648/2012. The Commission, informed by ESMA, should continue monitoring the evolution of the Japanese legal and supervisory framework for CCPs and the fulfilment of the conditions on the basis of which this decision has been taken.
- (20) The measures provided for in this Decision are in accordance with the opinion of the European Securities Committee,

HAS ADOPTED THIS DECISION:

Article 1

For the purposes of Article 25(6) of Regulation (EU) No 648/2012, the legal and supervisory arrangements of Japan consisting of the Financial Instruments and Exchange Act 2006 (FIEA) as complemented by the Comprehensive Guidelines for Supervision of Financial Market Infrastructures and applicable to clearing organisations ("COs") authorised therein shall be considered to be equivalent to the requirements laid down in Regulation (EU) No 648/2012.

Article 2

This Decision shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

Done at Brussels,

For the Commission
The President