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EUROPEAN
COMMISSION

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# COMMISSION IMPLEMENTING DECISION (EU) …/…

**of XXX**

**on the recognition of the legal, supervisory and enforcement arrangements of Japan for derivatives transactions supervised by the Japan Financial Services Agency as equivalent to the valuation, dispute resolution and margin requirements of Article 11 of Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories**

(Text with EEA relevance)

*This draft has not been adopted or endorsed by the European Commission. Any views expressed are the preliminary views of the Commission services and may not in any circumstances be regarded as stating an official position of the Commission.*

**COMMISSION IMPLEMENTING DECISION (EU) …/…**

**of XXX**

**on the recognition of the legal, supervisory and enforcement arrangements of Japan for derivatives transactions supervised by the Japan Financial Services Agency as equivalent to the valuation, dispute resolution and margin requirements of Article 11 of Regulation (EU) No 648/2012 of the European Parliament and Council on OTC derivatives, central counterparties and trade repositories**

(Text with EEA relevance)



THE EUROPEAN COMMISSION,

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 13(2) thereof,

After consulting the European Securities Committee,

Whereas:

(1) Article 13 of Regulation (EU) No 648/2012 provides for a mechanism to ensure consistency between the legal, supervisory and enforcement arrangements established by the Union and those of third countries in the areas within the scope of that Regulation. The Commission is empowered to adopt equivalence decisions whereby the legal, supervisory and enforcement arrangements of a third country are declared equivalent to the requirements laid down in Articles 4, 9, 10 and 11 of Regulation (EU) No 648/2012 so that counterparties which enter into a transaction within the scope of that Regulation, where at least one of the counterparties is established in that third country, should be deemed to have fulfilled those requirements by complying with the requirements set out in that third country's legal regime. The declaration of equivalence avoids the application of duplicative or conflicting rules. Furthermore, the declaration of equivalence contributes to the achievement of the overarching aim of Regulation (EU) No 648/2012 namely to reduce systemic risk and increase the transparency of derivatives markets by ensuring an internationally consistent application of the principles agreed with third countries and laid down in that Regulation.

(2) Paragraphs 1, 2 and 3 of Article 11 of Regulation (EU) No 648/2012 which is supplemented by Commission Delegated Regulation (EU) No 149/2013[2] and Commission Delegated Regulation (EU) 2016/2251[3], establish the Union's legal

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1 OJ L 201, 27.7.2012, p. 1.

2 Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP (OJ L 52, 23.2.2013, p. 11).

3 Commission Delegated Regulation (EU) 2016/2251 of 4 October 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties

requirements concerning the timely confirmation of the terms of an OTC derivative contract, the conduct of a portfolio compression exercise and the arrangements under which portfolios are reconciled in relation to OTC derivative contracts not cleared by a central counterparty ('CCP'). In addition, those paragraphs lay down the valuation and dispute resolution obligations applicable to those contracts ('operational risk mitigation techniques') as well as the obligations on the exchange of collateral ('margins') between counterparties.

(3) In order for a third country's legal, supervisory and enforcement regime to be considered equivalent to the regime of the Union in respect of operational risk mitigation techniques and margins requirements, the substantive outcome of the applicable legal, supervisory and enforcement arrangements should be equivalent to Union requirements under Article 11 of Regulation (EU) No 648/2012, ensure protection of professional secrecy that is equivalent to that set out in this Regulation; and the legal, supervisory and enforcement arrangements should be effectively applied and enforced in an equitable and non-distortive manner so as to ensure effective supervision and enforcement in that third country. The purpose of this equivalence assessment is therefore to verify that the legal, supervisory and enforcement arrangements of Japan ensure that OTC derivative contracts not cleared by a CCP and entered into by at least one counterparty established in that third country do not expose financial markets in the Union to a higher level of risk and consequently do not pose unacceptable levels of systemic risk in the Union.

(4) On 1 September 2013, the Commission received the technical advice of the European Markets Supervisory Authority ('ESMA') on the legal, supervisory and enforcement arrangements in Japan[4] including *inter alia* the operational risk mitigation techniques applicable to OTC derivative contracts not cleared by a CCP. In its technical advice, ESMA found that there were no legally binding requirements on timely confirmation of the terms of an OTC derivative contract, the arrangements for carrying out portfolio reconciliation, the conduct of a portfolio compression, the valuation of a portfolio and the obligation for dispute resolution or for the exchange of collateral between counterparties to OTC derivative contracts in Japan. ESMA also observed that the equivalence between regimes for bilateral margins could not be assessed at the time, as the technical standards specifying the rules on bilateral margins in the Union had not yet been developed.

(5) The Commission has considered ESMA's technical advice in carrying out its assessment, and has taken into account the regulatory developments that have taken place since then. This Decision is not only based on a comparative analysis of the legal, supervisory and enforcement requirements applicable in Japan, but also on an assessment of the outcome of those requirements and their adequacy in order to mitigate the risks arising from OTC derivative contracts not cleared by a CCP in a manner considered equivalent to the outcome of the requirements laid down in Regulation (EU) No 648/2012.

(6) The legal, supervisory and enforcement arrangements applicable in Japan for OTC derivative contracts are laid out in the Financial Instruments and Exchange Act, No.

and trade repositories with regard to regulatory technical standards for risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty (OJ L 340, 15.12.2016, p. 9).

[4] ESMA/2013/BS/1158, Technical advice on third country regulatory equivalence under EMIR – Japan, Final report, European Securities and Markets Authority, 1 September 2013.

25 of 1948 (‘FIEA’), and apply to Financial Instrument Business Operators (‘FIBOs’) and Registered Financial Institutions (‘RFIs’), which include regulated banks, cooperatives, insurance companies, pension funds and investment funds. The Financial Services Agency of Japan (‘JFSA’) has broad powers to implement the FIEA and has the Cabinet Office Ordinance, Supervisory Guidelines, and Public Notifications (together 'the OTC derivatives rules of Japan'). The JFSA has jurisdiction over OTC derivatives within the meaning of Article 2(7) of Regulation (EU) No 648/2012, with the exception of OTC commodity derivatives, which are under the jurisdiction of the Japanese Ministry of Economy, Trade and Industry (‘METI’) and the Japanese Ministry of Agriculture, Forestry and Fisheries (‘MAFF’).

(7) The operational risk mitigation techniques for OTC derivative contracts not cleared by a CCP, as laid down in the OTC derivatives rules of Japan, continue to be insufficient when compared with the obligations provided for in paragraphs 1 and 2 of Article 11 of Regulation (EU) No 648/2012 and Delegated Regulation (EU) No 149/2013 with regard to timely confirmation of the terms of an OTC derivative contract, the conduct of a portfolio compression exercise and the arrangements under which portfolios are reconciled. This Decision should therefore only cover the legal, supervisory and enforcement arrangements concerning the valuation and dispute resolution obligations as provided for in paragraphs 1 and 2 of Article 11 of Regulation (EU) No 648/2012 and Delegated Regulation (EU) No 149/2013 as well as those concerning margin requirements as provided for in paragraph 3 of Article 11 of Regulation (EU) No 648/2012 and Delegated Regulation (EU) 2016/2251.

(8) With regard to the requirements for the valuation of transactions and for the resolution of disputes applicable to OTC derivatives not cleared by a CCP, the OTC derivatives rules of Japan contain similar obligations to those provided for in paragraphs 1 and 2 of Article 11 of Regulation (EU) No 648/2012. In particular, Section IV-2-4 of the Supervisory Guidelines contains specific requirements regarding dispute resolution applicable to OTC derivative contracts not cleared by a CCP and Article 123 of the Cabinet Office Ordinance lays out the requirements for carrying out daily valuations for the purpose of margin exchanges.

(9) Concerning the margins for OTC derivative contracts not cleared by a CCP, the legally binding requirements of Japan consist of a set of final regulations adopted by the JFSA, published on 31 March 2016 which entered into force on 1 September 2016. Those regulations comprise the Cabinet Office Ordinance on Financial Instrument Businesses No. 52 of 6 August 2007 including the Supplementary Provisions, the Financial Services Agency Public Notices No. 15, 16 and 17 of 31 March 2016 and No. 33 of 25 August 2017, the revised Comprehensive Guidelines for Supervision of Major Banks, etc., the revised Comprehensive Guidelines for Supervision of Small- and Medium-Sized and Regional Financial Institutions, the revised Comprehensive Guidelines for Supervision of Cooperative Banks, the revised Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc., the revised Comprehensive Guidelines for Supervision of Insurance Companies and the revised Comprehensive Guidelines for Supervision with respect to Trust Companies, etc. The rules applicable to OTC Commodity derivatives under the jurisdiction of METI and MAFF replicate the set of final regulations adopted by the JFSA, (together 'the margin rules of Japan').

(10) As laid down in the margin rules of Japan, financial institutions which have an average total amount of notional principal of OTC derivatives for a certain period of time equal to or above JPY 300 billion must exchange variation margin on a daily basis under the

FIEA, while financial institutions below that threshold must exchange variation margin with 'a sufficient frequency'. Because Regulation (EU) No 648/2012 requires all counterparties to an OTC derivative transaction not cleared by a CCP to exchange variation margin on a daily basis, this Decision should therefore be conditional on the daily exchange of variation margin for transactions conducted with FIBOs and RFIs whose average total amount of the notional principal of OTC derivatives for a one-year period, from April two years before the year in which calculation is required (or one year if calculated in December) falls below JPY 300 billion.

(11) Similar to the requirements laid down in Delegated Regulation (EU) 2016/2251, under the margin rules of Japan, all financial institutions which aggregate notional amounts of non-cleared OTC derivatives, non-cleared OTC Commodity derivatives, physically-settled foreign exchange ('FX') forwards and FX swaps of a consolidated group, excluding intragroup transactions, for the months March, April and May one year before the year in which the calculation exceeds JPY 1.1 trillion must exchange details of the initial margin. The margin rules of Japan also provide for a combined minimum transfer amount of initial and variation margins of JPY 70 million, whereas the threshold in Article 25 of Delegated Regulation (EU) 2016/2251 is EUR 500 000. Taking into account the marginal difference in the value of those currencies, those amounts should be considered equivalent.

(12) The margin rules of Japan apply to almost all OTC derivatives contracts as defined in point (7) of Article 2 of Regulation (EU) No 648/2012, with the exception of physically settled FX forwards and FX swaps, for which the margin rules of Japan set no requirements. FX transactions associated with the exchange of principal by means of cross-currency swaps are exempted from initial margin requirements. In addition, the margin rules of Japan do not contain any specific treatment for structured products, including covered bonds and securitisations. Under the terms of Regulation (EU) No 648/2012, only FX swaps and FX forwards are exempted from the initial margins requirements and only derivatives, associated with covered bonds for hedging purposes, are exempted from all margin requirements. This Decision should therefore only apply to OTC derivatives contracts that are subject to margin requirements under Regulation (EU) No 648/2012 and the margin rules of Japan.

(13) The requirements in the margin rules of Japan for the calculation of initial margin are equivalent to the requirements set out in Regulation (EU) No 648/2012. In a similar manner to the standardised method for the calculation of the initial margin set out in Annex IV to Delegated Regulation (EU) 2016/2251, the margin rules of Japan allow for the use of a standardised model equivalent to the one laid out in the aforementioned annex. Alternatively, internal or third party models may be used to calculate the initial margin where those models contain certain specific parameters, including minimum confidence intervals and margin periods of risk and certain historical data, including stressed periods. Counterparties must notify the JFSA, METI or MAFF, as appropriate, of their intention to use those internal or third party models and must disclose any necessary assumptions, hypotheses and changes thereto.

(14) The requirements in the margin rules of Japan on eligible collateral and on how that collateral is held and segregated are equivalent to those set out in Delegated Regulation (EU) 2016/2251. The margin rules of Japan also contain an equivalent list of eligible collateral and require FIBOs and RFIs to reasonably diversify the collateral they collect, including by limiting securities with low liquidity in order to avoid concentration of collateral. The requirements in the margin rules of Japan applicable to

the valuation of collateral are comparable to the requirements laid out in Article 19 of Delegated Regulation (EU) 2016/2251.

(15) With regard to the equivalent level of protection of professional secrecy in Japan, information held by the JFSA is subject to the JFSA Information Security Policy and the employees of the JFSA are subject to the National Public Service Act, which prohibits employees from divulging information which has come to their knowledge in the course of their duties. Therefore, the National Public Service Act and the JFSA Information Security Policy both guarantee professional secrecy, including the protection of business secrets exchanged by competent authorities with third parties, equivalent to those set out in Title VIII of Regulation (EU) No 648/2012. Therefore together, the National Public Service Act and the JFSA Information Security Policy should be considered as providing an equivalent level of protection as regards professional secrecy as that provided in Regulation (EU) No 648/2012.

(16) Finally, as regards the effective application and enforcement in an equitable and non-distortive manner so as to ensure effective supervision and enforcement in that third country, the JFSA has broad investigative and surveillance powers to assess compliance with margin requirements applicable to OTC derivative contracts not cleared by a CCP. The JFSA can take a wide range of supervisory measures to prevent any breach of the applicable requirements, such as a business improvement order based on Article 51 of FIEA and other supervisory measures based on Article 52 of FIEA. Those measures should therefore be considered as providing for the effective application of the relevant legal, regulatory and enforcement arrangements under the OTC derivatives rules of Japan in an equitable and non-distortive manner to ensure effective supervision and enforcement.

(17) This Decision is based on the legally binding requirements relating to OTC derivative contracts applicable at the time of adoption of this Decision. The Commission, in cooperation with ESMA, should continue to monitor on a regular basis the evolution of the legal, supervisory and enforcement arrangements for these OTC derivative contracts and their consistent and effective implementation, regarding the timely confirmation, portfolio compression and reconciliation, valuation, dispute resolution and margin requirements applicable to OTC derivative contracts, not cleared by a CCP on the basis of which this Decision has been taken. This should be without prejudice to the possibility of the Commission to undertake a specific review at any time, where relevant developments make it necessary for the Commission to re-assess the declaration of equivalence granted by this Decision. Such re-assessment may lead to the repeal of this Decision, which would make counterparties automatically subject again to all requirements laid down in Regulation (EU) No 648/2012.

(18) 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 13(3) of Regulation (EU) No 648/2012, the legal, supervisory and enforcement arrangements of Japan for valuation and dispute resolution that are applied to transactions regulated as OTC derivatives by the Financial Services Agency of Japan (‘JFSA’) or OTC Commodity derivatives by the Japanese Ministry of Economy, Trade and Industry (‘METI’) and the Japanese Ministry of Agriculture, Forestry and Fisheries (‘MAFF’) and that are not cleared by a CCP shall be considered as equivalent to the corresponding requirements set out in paragraphs 1 and 2 of Article 11 of Regulation (EU) No 648/2012, where at least one of the counterparties to those transactions is established in Japan and registered with the JFSA as a Financial Instrument Business Operator (‘FIBO’) or a Registered Financial Institution (‘RFI’).

*Article 2*

For the purposes of Article 13(3) of Regulation (EU) No 648/2012, the legal, supervisory and enforcement arrangements of Japan for the exchange of collateral that are applied to transactions regulated as OTC derivatives by the JFSA or OTC Commodity derivatives by METI and MAFF and that are not cleared by a CCP shall be considered as equivalent to the requirements of paragraph 3 of Article 11 of Regulation (EU) No 648/2012, where the following conditions are satisfied:

(a) at least one of the counterparties to those transactions is established in Japan and registered with the JFSA as a FIBO or a RFI and that counterparty is subject to the margin rules of Japan;

(b) transactions are marked-to-market and variation margin is exchanged on a daily basis where the counterparties to those transactions, established in Japan, have an average total amount of the notional principal of OTC derivatives for a one-year period from April two years before the year in which calculation is required (or one year if calculated in December) below JPY 300 billion.

*Article 3*

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*
*Jean Claude Juncker*