March 26, 2019

RE: Commission Draft Implementation Decision - EU recognition of Japan's rules on OTC derivatives

Dear Ladies and Gentlemen,

The International Swaps and Derivatives Association, Inc. (ISDA), the Japanese Bankers Association (JBA), the Japan Securities Dealers Association (JSDA), the Life Insurance Association of Japan (LIAJ), and the General Insurance Association of Japan (GIAJ) appreciate the opportunity to submit these comments on the proposed COMMISSION IMPLEMENTING DECISION (EU) 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 ("Proposal").

The Proposal covers requirements on valuation, dispute resolution and margin requirements, but our comments focus on the recognition of the legal, supervisory and enforcement arrangements of margin requirements.

General Comments

- The Proposal recognizes margin rules of Japan as equivalent with two conditions attached (Article 2 (a) and (b)). Margin requirements of countries, though based on the final report issued by BCBS/IOSCO, are, in practice, different from each other in various respects.

- We understand that the Proposal looks at whether the substantive outcome of the applicable legal, supervisory and enforcement arrangement under the margin rules of Japan would be equivalent to that of EU requirements, rather than sticking to insignificant differences between the two sets of rules, and we strongly support that stance.
- We expect that this equivalence assessment will serve to prevent application of duplicative or inconsistent rules and to lower the compliance cost of market participants without compromising the regulatory goals to lower the systemic risk and enhance the transparency in the derivatives markets.

Our Proposals

As we noted above, we understand that the Proposal recognizes margin rules of Japan as equivalent, including its application to transactions by Japanese firms that have an average total amount of the notional principal of OTC derivatives below JPY 300 billion with the condition that such transactions are subject to requirements that applies to Japanese firms that have an average total amount of the notional principal of OTC derivatives equal to or above JPY 300 billion.

We express our general support to the Proposal, but would like to make two proposals so that the equivalence assessment will realize its full potential.

1. Treatment of foreign exchange forward and swaps.

- The Proposal excludes foreign exchange forward and swaps ("FX Fwd/Sw") from its scope, because such products are in principle covered by Union variation margin rules[1] but not by variation margin rules of Japan. However, it is general practice to trade FX Fwd/Sw under the same master agreement that covers OTC derivatives transactions (this would be particularly so among systemic counterparties who will continue to be required to exchange variation margin for FX Fwd/Sw under reformed EMIR). In addition, margin rules of Japan allows the inclusion of FX Fwd/Sw in regulatory variation margin operation together with OTC

[1] We note that recital 16a) of the EMIR Refit text recognizes that "it is appropriate to restrict the mandatory exchange of variation margins on physically settled foreign exchange forwards and physically settled foreign exchange swaps to transactions between the most systemic counterparties in order to limit the build-up of systemic risk and to avoid international regulatory divergence".

derivatives transactions, and if Japanese firms include FX Fwd/Sw in regulatory variation margin operation, they are required to do so on a continuous basis (Article 123 (viii)(1)(ro) and body of Article 123(vii), of Cabinet Office Ordinance referred to in 4th to 5th lines of paragraph (9) of the Proposal). Given the practical reality described above and also this aspect of margin rules of Japan, it would be fair to say that, when Japanese firms subject to margin rules of Japan trade both OTC derivatives and FX Fwd/Sw with a same counterparty, they are in effect required to comply with margin rules of Japan (in relation to variation margin) in relation not only to OTC derivatives but also to FX Fwd/Sw. If FX Fwd/Sw are excluded from the scope of equivalence assessment, market participants may be required to exchange margin for OTC derivatives in accordance with Japanese rules but do so for FX Fwd/Sw in accordance with EU rules, or may have to separate the netting sets for both types of products, substantially diminishing the benefit of the equivalence assessment.

If market participants exchange VM for FX Fwd/Sw in the same way for OTC derivatives under margin rules of Japan, there should be no concern from the perspective of systemic risk mitigation. We would like FX Fwd/Sw to be covered by this equivalence assessment if such FX Fwd/Sw are traded under a master agreement under which trading of OTC derivatives is also envisaged (therefore, in compliance with the margin rules of Japan).

2. Expansion of the scope to all Japanese firms subject to margin rules of Japan.

   The Proposal covers Japanese firms that are (i) registered as FIBO or RFI and (ii) are subject to the margin rules of Japan (Article 2(a)). But there are Japanese firms that are registered as neither FIBO nor RFI, but are subject to margin rules of Japan. Such firms are not subject to Cabinet Office Ordinance that forms part of margin rules of Japan, but are subject to Supervisory Guidelines of JFSA as in the same way as FIBO or RFI. Based on the above, we believe it appropriate for the equivalence assessment to cover all entities that are subject to margin rules of Japan, including those not registered with the JFSA as FIBO or RFI.

We appreciate the opportunity to convey our views and request. If you have any questions or queries about any of the above we would be pleased to answer them.