

# Outline of the bill for amendment of the Financial Instruments and Exchange Act, etc.

## Background

International discussions based on the current global financial crisis and problems found in Japan's financial and capital market



Need to improve the stability and transparency of Japan's financial system and ensure the protection of investors, etc.

Strengthening the settlement system of Japan  
— Preventing the spread of financial crises in Japan —

Ensuring appropriate regulation and supervision of financial instruments business operators, etc.



Improving the stability and transparency of the settlement of over-the-counter (OTC) derivatives transactions, etc.

### ○Mandatory use of central counterparties (CCPs) for clearing OTC derivatives transactions, etc.

- After strengthening the infrastructure for CCPs, requiring certain OTC derivatives transactions to be cleared at CCPs
- ※ Centralizing the clearing of large-scale derivatives transactions (currently, “plain vanilla” interest rate swaps) at CCPs
- ※ Centralizing the clearing of derivatives transactions of a certain turnover which are closely related to the execution under Japan's legal system (currently, iTraxx Japan CDS index transactions) at domestic CCPs

### ○Establishment of system for data storage and reporting of trading information

- Establishment of a system to require the financial instruments business operators and clearing organizations to store and submit the trading information to the FSA, Japan
- Establishment of system to give financial instruments business operators, etc. the option to have another organization that collects and stores trading information (trade repositories) store and submit the trading information to the FSA, Japan

Strengthening group-wide regulation and supervision

### ○Introduction of consolidated regulation and supervision of securities companies

- Introduction of consolidated regulation and supervision of securities companies
  - ① Large securities companies of above a certain value of total assets
    - Capital adequacy requirements on a consolidated basis for the securities companies
    - Order for the production of reports and inspection on the subsidiary company of the securities companies, etc
  - ② Among the securities companies prescribed in ①, the securities companies providing the securities business with their parent companies in an integrated manner
    - Capital adequacy requirements on a consolidated basis for the parent companies
    - Parent companies subject to administrative disposition
    - Order for the production of report and inspection on the parent companies, subsidiary companies, and sister companies of the securities companies
- Strengthening regulation on major shareholders
  - Among the major shareholders (holding 20% or more of the voting rights) of the financial instruments business operator (type I financial instruments business operator and investment management business operator), major shareholders who hold the majority of voting rights, will be subject to order to improve business operations

### ○Introduction of consolidated prudential regulations of insurance companies

- Introduction of prudential standards (a solvency margin standard) on a consolidated basis for groups led by an insurance company or insurance holding company.

## Other measures for the protection of investors

In cases where there are facts constituting the grounds for commencement of bankruptcy proceedings, the FSA, Japan may file a petition for commencement of bankruptcy proceedings in regard to all the relevant financial instruments business operators  
Establishment of the right for the FSA, Japan to file a petition for the appointment of a new trustee in the event of rescission of the license for trust business  
Establishment of dual liability in cases of violation of the injunction issued by a court

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Need to improve the stability and transparency of Japan's financial system and ensure the protection of investors,

### I Improving the stability and transparency of the settlement of over-the-counter (OTC) derivatives transactions, etc

#### 1. Mandatory use of central counterparties (CCPs) for clearing OTC derivatives transactions, etc.

- Requiring certain OTC derivatives transactions to be cleared at CCPs
  - Certain OTC derivatives transactions of which the transaction volume in Japan is large and of which the default is likely to have a material impact on Japan's markets shall be subject to the mandatory clearing at any of the following CCPs:
    - Domestic CCPs
    - Links between domestic CCPs and foreign CCPs
    - Foreign CCPs
  - Among the OTC derivatives transactions of which the transaction volume in Japan is large and of which the default is likely to have a material impact on Japan's market, those required to be cleared in Japan shall be subject to mandatory clearing at domestic CCPs.

#### 2. Systems for the development of the infrastructure for clearings

- Strengthening the infrastructure for domestic CCPs
  - Introduction of regulations on major shareholders (authorization system for shareholders holding 20 percent or more of the voting rights)
  - Introduction of regulations on the minimum capital requirements
- Development of a system for links between domestic CCPs and foreign CCPs
  - Allowing domestic CCPs to carry out clearing business in alliance with foreign CCPs by obtaining an authorization, in cases where certain requirements, including the following contents, are satisfied:
    - A structure and system for the ensuring of appropriate and certain clearing is established
    - The relevant foreign CCP has obtained a license, etc from a foreign authority
  - Establishment of supervisory provisions, such as orders of suspension of the aligned financial instruments obligations assumption business, or rescissions of the authorization therefor.
- Establishment of a system for foreign CCPs
  - Allowing foreign CCPs to carry out clearing business by obtaining an authorization, in cases where certain requirements, including the following contents, are satisfied:

- A structure and system for the ensuring of appropriate and certain clearing is established.
- The relevant foreign clearing organization has obtained a license from a foreign authority.
- Establishment of supervisory provisions, such as orders for production of reports, on-site inspections, orders to improve business operations, and rescissions of authorization, for foreign CCPs
- Embodiment of the concept of assumption of obligation in clearing
  - Add "novation and other methods" to the current definition of "obligation assumption business," which is "assumption of obligation."
  - Provide exemptions for certain types of transactions which may have only a minor impact on Japan's market.

### 3. Establishment of a system for data storage and reporting of trading information

- Data storage and reporting of trading information
  - Requiring financial instruments business operators, etc. and clearing organizations to store and report trading information.
  - Giving a financial instruments business operator, etc. the option to have another organization (trade repositories) collect and store trading information therefor.
- Establishment of a system for trade repositories
  - Establishment of a system to designate trade repositories
    - Domestic trade repositories: Designation upon application
    - Foreign designated trade repositories: Designation in a public notice on the condition that reports to the FSA, Japan are assured under an international agreement, such as a framework for cooperative supervision by supervisory authorities of individual countries
  - Establishment of supervisory provisions, such as orders for production of reports, on-site inspections, orders to improve business operations, and rescissions of designation, for trade repositories.

## **II Strengthening group-wide regulation and supervision**

### 1. Introduction of consolidated regulation and supervision of securities companies

- Strengthening regulation on major shareholders of financial instruments business operators
  - Introduction of the right to order the major shareholders of the financial instruments business operator (Type I financial instruments business operators and investment management business operators), who hold the majority of voting rights, to take necessary measures to ensure the appropriate business operations of the financial instruments business operator, when especially necessary
- Introduction of consolidated regulation on and supervision of securities companies above a certain scale

### 【Downstream consolidated regulation and supervision】

- Regarding special financial instruments business operators (Type 1 financial instruments business operators above a certain value of total assets):
  - Requiring the notification and reports on the financial conditions of the corporate group to which the special financial instruments business operator belongs and so forth to the Prime Minister
  - Introduction of obligations to submit business reports on a consolidated basis and capital adequacy requirements on a consolidated basis
  - Establishment of supervisory provisions, such as orders for production of reports and inspections, for the special financial instruments business operator's subsidiary companies

### 【Upstream consolidated regulation and supervision】

- When the parent companies, etc. of special financial instruments business operators that are subject to the above-mentioned downstream consolidated regulation and supervision fall under any of the following conditions, and it is found especially necessary to ensure the appropriate business operations of the special financial instruments business operators, the Prime Minister shall designate the parent companies as subject to the following regulation and supervision (in cases where such parent companies are found to be under appropriate supervision based on other laws (including laws of foreign states), such designation may be omitted)
  - That the parent companies are engaged in the business administration of the special financial instruments business operators as the parent companies' business.
  - That the parent companies, etc. are providing financial support to the special financial instruments business operators, and the suspension thereof is likely to cause significant hindrance to the business operations of the special financial instruments business operators
- Regarding designated parent companies:
  - Introduction of obligations to submit business reports on the whole group and capital adequacy requirements on a consolidated basis related to the whole group for the highest positioned entity in the corporate group
  - Establishment of supervisory provisions, such as orders to take actions
  - Establishment of supervisory provisions, such as orders for production of reports and inspections, for the parent company and the subsidiary companies

## 2. Introduction of consolidated prudential regulations of insurance companies

- Introduction of prudential standards (a solvency margin standard) on a consolidated basis for groups led by an insurance company or insurance holding company.

### **III Other measures for the protection of investors**

- Establishment of the right for the FSA, Japan to file a petition for commencement of bankruptcy proceedings in regard to all financial instruments business operators.

- In cases where there are facts constituting the grounds for commencement of bankruptcy proceedings, the scope of financial instruments business operators for which the FSA, Japan may file a petition for commencement of bankruptcy proceedings shall expand from some of the financial instruments business operators (securities companies) to all of the financial instruments business operators.
- Establishment of the right for the FSA, Japan to file a petition for the appointment of a new trustee in the event of rescission of the license for trust business.
- In cases where the license or registration for trust business is rescinded, the FSA, Japan may file a petition for the appointment of a new trustee.
- Establishment of dual liability in cases of violation of an injunction issued by a court
- A juridical person may also be sentenced to a penal provision for violating an injunction issued by a court.

G20 Pittsburgh Summit  
 "OTC derivative contracts should be cleared through central counterparties by end -2012 at the latest" and "should be reported to trade repositories."

#### IV Effective date

