November 6, 2014

Comments on Consultation Paper *"Clearing Obligation under EMIR (no. 3)"*
issued by the European Securities and Markets Authority

Japanese Bankers Association

We, the Japanese Bankers Association (JBA), would like to express our gratitude for this opportunity to comment on consultation paper, *Clearing Obligation under EMIR (no.3)* (the "Consultation Paper"), issued by the European Securities and Markets Authority (ESMA) on October 1, 2014.

We respectfully expect that the following comments will contribute to your further discussion on this issue.

○Comments on specific questions provided in the Consultation Paper

> Q3: In view of the criteria set in Article 5(4) of EMIR, do you consider that the determination of this class addresses appropriately the objective of reduction of the systemic risk associated to NDF derivatives?

（Comment）

- While illiquid currencies such as African or South American currencies are out of scope, the 12 currencies included in the scope cover almost all interbank NDF transactions.
- From our point of view, essentially all NDF must be cleared. However, as FX NDF transactions comprise only a small portion of FX transaction volume, the overall impact on the systemic risk posed by FX will be relatively small and it would be possible to address this issue appropriately.

> Q4: For the currency pairs proposed for the clearing obligation on the NDF class, do you consider there are risks to include longer maturities, up to the 2 year tenor?

（Comment）

- Our concern in relation to the tenors included in the scope of the clearing obligation is the application to contracts which originally have a longer maturity (e.g. beyond 2 years).
- We do occasionally enter into longer maturity NDF (e.g. 3 years) at the request of clients. Are these contracts required to be cleared once the remaining maturity reaches 2 years? We assume that this is not the case, as this would create a significant operational burden and operational risk, as well as creating difficulties in pricing longer tenor contracts.

Q6: Do you agree with the proposal to keep the same definition of the categories of counterparties for the NDF classes than for the credit and the interest rate classes? Please explain why and possible alternatives.

（Comment）

- The Consultation Paper proposes to group a counterparty in Category 1, regardless of the asset class, if the counterparty is a clearing member of a product subject to the clearing obligation under EMIR. Japanese banks would therefore also be subject to the clearing obligation at the implementation of the proposed regulation.
- However, while being a key player in the JPY interest rate OTC derivatives market, Japanese banks do not have the same level of volume for NDFs, and construction of related infrastructure including the development of a legal framework has not yet progressed in Japan.
- Given such situation, we consider that grouping Japanese banks in Category 1 for NDF clearing obligation purposes on the grounds that Japanese banks are clearing members for JPY interest rate OTC derivatives at the Japan Securities Clearing Corporation (JSCC) would be inconsistent with the current state and practices of Japanese markets.

Q7: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

（Comment）

- As noted in the Consultation Paper, only a small fraction of NDF transactions are cleared. Consequently, the progress of developing NDF clearing capabilities by market participants is considerably different from that for interest rate OTC derivatives, over 95% of which were cleared at the time of publishing the Consultation Paper. Given this, it is not realistic to promote mandatory clearing along the same timeline as interest rate swaps. Japanese banks often enter into NDFs with European financial institutions (including locally incorporated entities of U.S. banks in Europe), and hence the implementation of this obligation would have a significant impact on Japanese banks.
- Our concern in relation to the start dates for the obligation relate to the prohibition under the Financial Instruments and Exchange Act in Japan for Japanese banks to clear FX NDF outside of Japan. Currently no CCP in Japan clears FX NDF and no CCP outside Japan is approved by the JFSA to clear these products. Until this issue is rectified, Japanese banks will not be able to comply with the mandatory clearing requirement under EMIR without breaching Japanese law.
- This is also an issue in relation to the frontloading period. ESMA proposes that the frontloading period effectively begins on the date of publication of the final RTS in the Official Journal, as this is the date on which there is certainty for market participants regarding application of the clearing

obligation. However, if the conflict between EMIR and Japanese law is not resolved when the final RTS are published then uncertainty would remain for Japanese banks as to whether they would ultimately be able to clear transactions entered into in the frontloading period when the clearing obligation applies (6 months later for Category 1 or 12 months later for Category 2).

- Japanese banks would either have to cease trading in these products with in-scope counterparties to be certain not to ultimately breach either EMIR or Japanese law, or continue trading in the hope that the situation will be resolved by the time the obligation applies to their transactions. In either case, for Japanese firms there would remain uncertainty.
- As such, we urge ESMA to consider this issue and to delay the start of the frontloading period (and ultimately the application of the clearing requirement) until there is certainty for Japanese banks that they will be able to comply with EMIR without breaching Japanese law.

Q8: Do you have comments on the minimum remaining maturities for NDF?

（Comment）

- As discussed in our Comment to Question 7, we have concerns over the start date of the frontloading period as a result of the conflict between the EMIR obligation and Japanese Law.
- Common practice in the NDF currency market for spot transactions is generally T+2, but that standard is T+1 for some currencies (e.g. PHP, RUB). According to the specified maturities (3D-2Y), clearing would not be required for short date trades in some currencies, which is not consistent with the majority of currencies. Further, NDF liquidity swaps in which the first leg fixing date is the trade date would be exempted, which is also not consistent as well.