September 13, 2013

Comments on European Securities and Markets Authority`s **“**Draft Regulatory Technical Standards on contracts having a direct, substantial and foreseeable effect within the Union and non-evasion of provisions of EMIR**”**

Japanese Bankers Association

We, the Japanese Bankers Association (“JBA”), would like to express our gratitude for this opportunity to comment on the “Draft Regulatory Technical Standards on contracts having a direct, substantial and foreseeable effect within the Union and non-evasion of provisions of EMIR” （“consultation paper”） proposed in 17 July 2013 by the European Securities and Markets Authority`s (“ESMA”).

Furthermore, on September 3, 2013, the ESMA published its advice to the European Commission (EC) on the equivalence of the regulatory regimes for OTC derivatives clearing, central counterparties (CCPs), and trade repositories (TR) of non-EU countries, including Japan. We highly appreciate the initiatives undertaken by regulatory authorities in each jurisdiction to resolve various issues arising from overlaps and inconsistencies in the requirements across jurisdictions. We hope that our comments below will be fully taken into consideration in your further work.

<General Comment>

Effective date of the EMIR and equivalence assessment

This consultation paper focuses on the application of EMIR to transactions entered into between counterparties established in non-EU jurisdictions. This however gives rise to a concern that the application of EMIR may create an excessive burden before the settlement of ongoing discussions about the cross-border application of the requirements to the third country entities and the equivalence assessment. In particular, the risk mitigation techniques which will enter force from September 15, 2013 for non-centrally cleared derivatives would impose an excessive burden on third country entities. The application of EMIR including this risk mitigation techniques should be postponed, at least until the details of cross-border application and equivalence assessment are determined.

Specifically, these early enforcement of the EMIR requirements may call for third country entities to invest a considerable effort for compliance purposes, and moreover, some of the entities may fail to comply with the early-enforced requirements. Such situations may lead to unexpected market instability that may affect even on EU entities, such as declining the market liquidity. In this respect, sufficient time shall be granted prior to commencing the application of the EMIR.

In addition to this issue on the early enforcement, there would be also an issue associated with the

identification of counterparty status for transactions. In particular, third country entities need to identify the status of their counterparties in order to determine whether they are in the scope of the EMIR. However, Identifying the status of all EU entities may be challenging for the third country entities. There is an additional concern that third country entities may take responsibilities for the results of such identification needed in their daily business and this would be a significant burden. To address this issue, it is requested to establish a framework requiring that EU entities, which are directly subject to the EU requirements and need to be sufficiently knowledgeable on these requirements, should notify their own status to their counterparty.

With respect to the equivalence assessment to the EMIR, such assessment should be carried out on a jurisdiction-by-jurisdiction basis using a comprehensive approach and from standpoints of whether EU and non-EU regulations are broadly aligned and the objectives of the assessed regulation are consistent with those set for the G20 commitment. Furthermore, the equivalence assessment shall take into account other factors including the specifics of requirements to be introduced in a phase-in manner and the necessity of differing requirements in light of varying market practice in non-EU jurisdictions.

If a third country regulation is not deemed to be equivalent to the EMIR, the non-application of this consultation paper is permitted for a contract entered into with an entity established in a non-equivalent jurisdiction, provided that certain minimum thresholds are met. Such thresholds are "OTC derivative contracts covered by a guarantee of an EU financial whose gross notional outstanding is €8 billion, or 5% of the total OTC derivative exposure." The efforts for confirming whether these thresholds are met (i.e. (i) carrying out a complete survey for identifying counterparties which are guaranteed by EU financials and daily measurement and monitoring, and (ii) performing daily measurement and monitoring to identify status of guarantees issued by such EU financials) may entail considerable time and costs. It is therefore requested to remove such thresholds, or establish a framework to allow third country entities to rely on the representation made by their counterparties.

Regarding transactions concluded between EU branches of third countries entities, this consultation paper states that such transactions should be captured by this draft Regulatory Technical Standards (see para. 32-36, page 12-13). Irrespective of whether a regulation is determined to be equivalent to the EMIR Regulation, the majority of risks associated with transactions entered into by a EU branch of a third country entity shall ultimately be attributed to its head office located in the non-EU jurisdiction, and hence the effect of such transactions on the EU is considered to be limited. Given this, the application of EMIR for transactions between EU branches of third countries entities shall be limited such as the clearing (The Dodd–Frank Wall Street Reform and Consumer Protection Act in U.S. does not impose any requirements on transactions between U.S. branches of non-U.S. firms.)

<Specific Comments>

The following discusses our specific concerns and measures that may contribute to resolving such concerns.

(Q1 and Q2)

The EMIR should not be applied to third countries entities until the equivalence assessment is completed for their jurisdiction. Further, the identification of whether a counterparty is guaranteed by an EU guarantor is practically difficult, and hence the development of a framework which allows entities to rely on the representation by their counterparty is warranted.

In addition, this consultation paper stipulates that, if an OTC derivative contract entered into by a third country entity covered by a guarantee issued by an EU financial exceeds the two thresholds, then such contract will be subject to the EMIR. We, however, are of an opinion that contracts entered into by third country entities shall be exempted from the EMIR, regardless of whether exceeding the thresholds, for the following reasons: (i) Third country entities are subject to the regulations in their own jurisdictions; (ii) it is practically difficult for third country entities to confirm whether the guarantee is issued by an EU financial or whether exceeding the thresholds, and (iii) although the regulatory obligations are primarily assumed by a third country entity guaranteed by the EU financial, the counterparty of such third country entity may be indirectly responsible for the obligations that may require mutual agreements and confirmation.

(Q3)

As discussed in the General Comment, the majority of risks associated with transactions entered into by a EU branch of a third country entity shall ultimately be attributed to its head office located in the non-EU jurisdiction, in particularly, small amount transactions are considered to have a limited effect on the liquidity of the EU markets. Certain thresholds therefore shall be set for determining whether such transactions have “a direct, substantial and foreseeable effect.”

Further, more substantive requirements for transactions concluded between EU branches of third countries entities should be specified, for example, clarifying whether the scope of such transactions shall include only substantive transactions booked at the branch, or include transactions which the branch executes on behalf of the head office located in a third country as a local contact entity, and not booked at the branch.

(Q9and Q10)

It is understood that, in order to prevent the evasion of any of the provisions of EMIR, the consultation paper (para. 51 and 52 in page 19-20) has taken an approach to apply the anti-evasion provision of EMIR. It is however requested to clarify that a bona-fide third party Counterparty C which has not been involved in a negotiation on an arrangement to be entered into for evasion

purposes shall not be accountable for such an arrangement, and various obligations (such as portfolio reconciliation and clearing obligations) shall not be imposed on such Counterparty C.

In addition, it is difficult to determine whether an arrangement "lacks economic justification," or its "primary purpose is to abuse of any provision of EMIR" in order to prevent the evasion of EMIR. Given that transactions entered into between G20 members are subject to local derivative regulations established in accordance with the local applicable legislative system, the anti-evasion provision of EMIR should not be applied merely on the grounds that an arrangement "lacks economic justification" and other similar reasons.