THE GENERAL INSURANCE ASSOCIATION OF JAPAN

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15 March, 2013

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

International Organization of Securities Commissions
C/O Oquendo 12
28006 Madrid
Spain

Dear Secretariats,

We are pleased to have an opportunity to comment on the "near-final proposal on margin requirements for non-centrally cleared derivatives" issued by The Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO).

Our Association, the General Insurance Association of Japan, was originally established in 1917 and reestablished in 1946 by all the domestic non-life insurance companies, for the purpose of promoting the sound development of the non-life insurance industry in Japan. The 26 member companies of the association account for 95 percent of the total general insurance premiums in Japan. As such, the comments attached reflect viewpoints of the non-life insurance industry in Japan. We would much appreciate it if you would take our views into consideration in preparing the margin requirements for non-centrally cleared derivatives.

If you would like to clarify points discussed in this letter, please feel free to contact us at g-kikaku@sonpo.or.jp.

Yours sincerely,

Yuichiro Kominami
Chairman
Finance Committee
The General Insurance Association of Japan

The following are comments from the General Insurance Association of Japan with respect to the "near-final proposal on margin requirements for non-centrally cleared derivatives" issued by The Basel Committee on Banking Supervision and the International Organization of Securities Commissions (IOSCO) on 15 February 2013.

General Remarks

1. The currently proposed requirements demand that, not only on the occasion of the introduction of such requirements but also in the course of their operation afterwards, market participants incur a substantial cost in terms of the implementation of procedures for the regulatory authorities' approval, etc. of their internal models, the development of contracts based on agreements of the parties, the development of in-house systems for tabulating consolidated exposures and notional amounts and exchanging margin at high frequency. Therefore, it is essential that a sufficient preparatory period be set prior to the introduction of the requirements. We are also of the view that both the initial margin and the variation margin should be introduced in a phased manner.

2. In addition, in order to achieve reduction of systemic risk and promotion of central clearing, both of which are objectives of the requirements, it is necessary that a specific means of achieving the objectives intended by the requirements be demonstrated under the bankruptcy legal system of each country, and that the central clearing system which is yet to be fully developed reach its full growth. Furthermore, it is also required that international cooperation be achieved for such bankruptcy legal system and central clearing system. We believe that the requirements should be introduced cautiously in keeping with the development of the system and the progress of international cooperation therefor.

3. Moreover, in view of the substantial cost required for dealing with the requirements and of their repercussions on business activities, from the perspectives of maintaining the balance between costs and benefits, it would not seem entirely reasonable to impose uniformly stringent requirements on all of the non-centrally-cleared derivatives. In particular, foreign exchange (FX) forwards and swaps are essential transactions arising from real demand such as foreign currency funding needs associated with business activities of corporations and hedging of foreign currency-denominated assets and liabilities. For non-life insurance companies which have the need to hedge FX risks by virtue of their business attributes, FX forwards and swaps represent critical business tools. Therefore, we strongly request that FX forwards and swaps about which opinions are currently being solicited under the public comment procedure be kept outside the scope of the proposed requirements. At the same time, in light of the main purport of the requirements, other transactions which are based on real demand and are hence deemed not to create systemic risk (e.g., derivatives for Alternative Risk Transfers of a non-life insurance product) should be kept outside the scope of the requirements.

Specific Comments

Q1. Given the particular characteristics of physically-settled FX forwards and swaps, should they be exempted from initial margin requirements with variation margin required as a result of either supervisory guidance or national regulation? Should physically-settled FX forwards and swaps with different maturities be subject to different treatments?

4. We are of the view that FX forwards and swaps are fundamentally based on real demand such as foreign currency cash flows and hedging of foreign currency-denominated assets and liabilities and that, given their particularity and impacts on overall business activities, they should be kept outside the scope of the requirements irrespective of the length of their maturities.

Q2. Should re-hypothecation be allowed to finance/hedge customer positions if re-hypothecated customer assets are protected in a manner consistent with the key principle? Specifically, should re-hypothecation be allowed under strict conditions such as (i) collateral can only be re-hypothecated to finance/hedge customer, non-proprietary position; (ii) the pledgee treats re-hypothecated collateral as customer assets; and (iii) the applicable insolvency regime allows customer first priority claim over the pledged collateral.

5. No comment.

Q3. Are the proposed phase-in arrangements appropriate? Do they appropriately tradeoff the systemic risk reduction and the incentive benefits with the liquidity, operational and transition costs associated with implementing the requirements? Are the proposed triggers and dates that provide for the phase-in of the requirements appropriately calibrated so that (i) the largest and most systemically-risky covered entities would be subject to the margining requirements at an earlier stage so as to reduce the systemic risk of non-centrally cleared derivatives and create incentive for central clearing, and (ii) the smaller and less systemically risky covered entities would be allowed more time to implement the new requirements? Should the phase-in arrangements apply to the exchange of variation margin, in addition to the exchange of initial margin as currently suggested? Or, given that variation margin is already a widely-adopted market practice, should variation margin be required as soon as the margin framework becomes effective (on 1 January 2015 as currently proposed) so as to remove existing gaps and reduce systemic risk? Do differences of market circumstances such as readiness of market participants and relatively small volumes of derivatives trading in emerging markets require flexibility with phase-in treatment, even for variation margin?

6. The latest consultative paper envisions that all transactions, irrespective of their size, will be subject to the variation margin requirements with effect from January 2015. However, within the framework of ISDA-CSA, the trade practice of exchanging variation margins at a mutually agreeable threshold and frequency has already been firmly established. Under the ISDA-CSA framework, counterparties agree

on the threshold and frequency, by comprehensively taking into account the transaction type/size, the creditworthiness of the counterparty, the cost associated with the transfer of collateral and the company's own risk tolerance. As a result, in some transactions, collateral is not transferred at the comprehensive discretion of the trading entities. If variation margin is to be exchanged at a threshold of zero and a sufficiently high frequency (e.g., daily) as indicated in the latest consultative paper, a variety of work including the conclusion of new contracts, review of existing contracts and amendment of in-house systems would come up, and a considerable amount of time and cost would be necessary to deal with the requirements. Furthermore, it should also be borne in mind that, with respect to over-the-counter derivatives, we would be required to migrate to central clearing, amend reporting duties and otherwise concurrently perform additional work to deal with the requirements. Therefore, the variation margin requirements should be introduced with a sufficient preparatory period and in a phased manner beginning with market participants with a larger transactional size, as in the case of the initial margin.

7. With respect to daily operations, collateral exchange at a stringent threshold and at a considerable frequency would cause trading entities to bear a considerable burden, and some of the trading entities may find such a burden too arduous for them to continue to conduct transactions. Therefore, more relaxed terms of threshold and frequency should be indicated, and trading entities should be allowed to negotiate for and determine a mutually agreeable threshold and frequency within the limits of such terms.

8. Given the objective of reduction of systemic risk, we believe that the requirements will fully generate the desired effects if only the market participants with a trading size large enough to be subject to QIS are made subject to them. Therefore, in view of the costs versus benefits for the overall financial system, setting the level of exchange of the initial margin in and after 2019 any lower than is necessary should be avoided. We would like to be shown the reasonable grounds for why the latest lower limit was set at 8 billion euros.

9. Considering attributes of the requirements, the introduction of the requirements is inextricably linked to the development of the central clearing system in each country. In addition, in order for the requirements to function properly, it is critical that the consistency of the system with the bankruptcy legal system of each country be specifically indicated and that international cooperation be facilitated. Therefore, the requirements should not be introduced just because a schedule for introduction is in place, but should be introduced at the stage where the relevant systems have been developed and their functionality fully verified.

Q4. The BCBS and IOSCO seek comment on the accuracy and applicability of the QIS results discussed above.

10. No comment.