Submitted Electronically to the CPMI Secretariat and the IOSCO Secretariat

20 January 2022
The CPMI Secretariat (cpmi@bis.org)
The IOSCO Secretariat (consultation-06-2021@iosco.org)

Re: Client Clearing: access and portability.

Dear Sir or Madam,

Japan Securities Clearing Corporation("JSCC") would hereby respectfully submit its comments to the public consultation of the CPMI-IOSCO – A discussion paper on client clearing: access and portability (November 2021)[1].

1. Background of JSCC

Established in 2002 by Japanese securities exchanges as a cross-market, central clearing organization for the Japanese securities market, JSCC is organized under the Companies Act of Japan as a kabushiki kaisha (i.e., a joint-stock corporation).

JSCC holds a license for "financial instruments obligation assumption service" (i.e. financial instruments clearing) under the Financial Instruments and Exchange Act of Japan ("FIEA") and a license for "business of assuming commodity transaction debts" under the Commodity Derivatives Act of Japan ("CDA") to conduct clearing business as a CCP, and JSCC's business is governed by the FIEA, CDA and other Japanese laws. Currently JSCC operates four segregated clearing businesses - the Listed Products Clearing Business, the CDS Clearing Business, the IRS Clearing Business, and the OTC JGB Clearing Business which includes clearing of JGB repo transactions. Each of JSCC's clearing businesses has its own separate share structure, business rules, financial resources for default management, and JSCC's own capital contributions for default resources and to manage on-going business operations.

[1] A discussion paper on client clearing: access and portability: https://www.bis.org/cpmi/publ/d200.htm

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Clearing Businesses of JSCC and the Relevant Domestic Regulatory Framework

Product	Market/Exchanges	Law	Supervisory Authority
Cash Products	Japanese Securities Exchanges, PTS[2]	FIEA	Financial Services Agency
Listed Financial Derivatives	Osaka Exchange		
Listed Commodity Derivatives			
	TOCOM	CDA	Ministry of Economy, Trade and Industry
	Osaka Dojima Exchange		Ministry of Agriculture, Forestry and Fisheries
Credit Default Swap	OTC Market	FIEA	Financial Services Agency
Interest Rate Swap			
OTC JGB			

JSCC maintains a broad membership and product range, with Clearing Participants domiciled in Japan, the EU, US, Switzerland, UK, HK. To facilitate clearing services to non-Japanese users, JSCC has sought and maintains a proper regulatory status in a number of foreign jurisdictions.

[2] PTS("Proprietary Trading System") is a trading facility permitted to trade equities listed in the Japanese stock exchanges, which was introduced under the Japanese regulatory regime in 1998.

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Licence on JSCC as CCP in non-Japanese jurisdiction

Country / Region	Relevant Clearing Business	Relevant Authority	Types of License
EU	All	ESMA	Recognition as a Third Country CCP under EMIR
Australia	IRS	ASIC Reserve Bank of Australia	Designation as a Prescribed Facility under Corporations Regulations 2001(Statutory Rules No.193, 2001)
US	CDS IRS	CFTC	Order of exemption from Registration as a Derivatives Clearing Organization under the Commodity Exchange Act
Hong Kong	IRS	SFC	Authorization to Provide Automated Trading Services, and Designation as a Central Counterparty, that can be Used for the Observance of Mandatory Clearing Obligations, under SFO
Switzerland	IRS	FINMA	Recognition as Foreign Central Counterparty under Financial Market Infrastructure Act
UK	All	Bank of England	Temporary Recognition as a Third Country CCP under The Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018

2. JSCC's Response to Each Question

Access (Section 2)

Design of direct and sponsored access models

1. *Do you agree with the observation in the discussion paper that the direct and sponsored access models are designed for and generally used more by larger and/or more sophisticated clients?*

JSCC's Response:

We agree with the observation generally.

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Given the seemingly small take up of the sponsored model, we believe that only a small subset of large clients, who themselves may not face significant difficulty in accessing CCPs have the required business scale to potentially use the direct and sponsored access models. It would be beneficial for clients of all sizes to have greater access to CCPs in addition to the existing client clearing model, but in our view the sponsored model alone may not resolve the issues for clients, large or small, to access CCPs.

For example, in the cross-border context, too broad registration requirements in the relevant jurisdictions could potentially undermine the incentives for parties – clients, CCSPs, and CCPs – to take up the direct and sponsored access models. In our view, the ultimate purpose on the discussion for the sponsored model, which is a modified client clearing model especially because sponsored clients would not be required to contribute to the mutualized loss sharing in CCPs as is the case under the existing client clearing model, is the promotion of buy-side client access to CCPs, in reflection of the current concerns surrounding CCP access for buy side clients[3]. We understand that in some jurisdictions, offshore CCPs are not required to obtain a license as a CCP to accept entities from the relevant jurisdiction as clients of a clearing participant. In this context, it is desirable that the client's home country regulator should not require the offshore CCP to obtain a local CCP license to use a sponsored model. However, if an offshore CCP is required to obtain a license to operate a sponsored clearing model, then each sponsored clients' regulator should take a substantially deferential approach in the supervision and regulation to the home country regime of the offshore CCP. We believe such an approach would be sensible and prudent in light of the reduced obligations of sponsored clients against the offshore CCP, compared to the obligations arising from being a clearing participant.

Likewise, considering the reduced responsibilities of offshore CCSPs from the existing client clearing model against their clients for which they act as a sponsor, the home country regulator of each client should consider exempting a broker license, or at least take a substantially deferential approach in the supervision and regulation to the home country regime of the offshore CCSP.

Unless these are not appropriately addressed by regulators globally, the direct and sponsored access models would not be widely used, at least on cross border base.

2. *Could there be any other solutions that would facilitate access, either through greater use of such access models by small and medium-sized clients, or through some other solution?*

[3] For example, this issue is highlighted for OTC derivatives in the following paper from FSB.
Incentives to centrally clear over-the-counter (OTC) derivatives: A post-implementation evaluation of the effects of the G20 financial regulatory reforms - final report(19 November 2018):
https://www.fsb.org/2018/11/incentives-to-centrally-clear-over-the-counter-otc-derivatives-2/

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JSCC's Response:

We would welcome the introduction of more client access models, as long as they are appropriately tailored to each CCP's risk governance framework.

For example, in JSCC's clearing service for OTC JGBs, which includes JGB repo clearing, a mutualized loss sharing structure for trust accounts of trust bank clearing participants differs from that of other clearing participants, such that the loss amount is allocated to trust accounts and other clearing participants based on the amount of bilateral transactions each category had with the defaulting clearing participant. Any resulting losses would be absorbed in a different loss sharing waterfall. The purpose of this structure is to facilitate an access of trust accounts to JSCC's clearing service, which otherwise may not be able to access a CCP as a clearing participant due to their particular business model. If requested, we are willing to provide details of these arrangements to CPMI-IOSCO.

Challenges related to direct and sponsored access models

4. *Do you agree that direct and sponsored access models have the potential to diversify the risk profile of the direct clearing participant basis of a CCP by introducing new types of direct participants? Why/why not?*

JSCC's Response:

JSCC is in agreement that direct and sponsored access models could diversify the risk profile of the direct clearing participant, especially as some of the responsibility could be transferred from clearing participants to clients. And more importantly, the introduction of a sponsored access model has the potential to facilitate increased buy side access to clearing by providing an alternative client clearing model. However, the diversification effect would be limited, as the introduction of sponsored access models would not solve all of the various issues associated with the access to clearing by clients, as explained in the response to #1.

On the other hand, where sponsored clients are exempted from depositing default fund as a mutualized loss-sharing financial resource, as necessary, CCPs may consider whether they need to establish additional safeguards to protect against the default of a sponsor, who would contribute to the CCP's default fund on behalf of its sponsored clients.

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7. *Do you think that the number of sponsors is limited? Are you concerned about sponsor concentration risk? If so, is this because it is difficult to find a sponsor? Are there any other reasons?*

JSCC's Response:

Given the limited take up the sponsored access models, by both clients and CCSP, we believe more education, research, and wider industry discussion would be necessary for all relevant parties – clients, CCSP, and CCPs - to make well-informed decisions on the future approach to new and innovative client clearing access models.

8. *Do you think that CCP rules adequately address the issue of sponsor default? If so, what are the CCP rules that adequately address this issue? If not, what kind of CCP rules are required to address this issue?*

JSCC's Response:

While JSCC does not yet provide a sponsored access model, if introduced, JSCC would establish a robust default management procedure to manage a potential sponsor default, through the proper risk governance and regulatory approval. Once established, these procedures would be tested regularly as part of JSCC's default fire drills. Any new client access model should not be riskier than the existing client clearing model.

Additional considerations

13. Please provide additional comments with regard to access to client clearing more generally.

JSCC's Response:

We have seen only very limited interest in a sponsored access model for OTC derivative clearing services, where the issues in client's access to CCPs were highlighted in the past discussion paper, due to some of the regulatory reforms introduced after the GFC[4].

While OTC derivatives are global in nature, we find it particularly troubling that some jurisdictions require the extra-territorial application of their laws and regulations directly to offshore CCPs and CCSPs, without any regulatory deference.

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[4] 2018 FSB report

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For example, while the CFTC established an exemption regime for non-U.S. CCPs[5], it only permits such non-U.S. exempt CCPs to clear for U.S. clearing members and their affiliates (which are usually large financial groups) acting in their proprietary capacity, and not for their U.S. customers' accounts[6] [7]. This creates certain legal conflicts with the home country rules of the non-U.S. CCPs, in defiance of their comparable customer protection regime.

Therefore, to facilitate the access to swap clearing for clients, irrespective of whether it is mandatory or voluntary clearing, it would be desirable that these client clearing regimes should be reviewed, with a view to giving more deference to the home country regime of offshore CCPs.

Porting (Section 3)

Risks from not porting

14. Are there any additional risks or potential harm associated with not porting following a clearing participant default, which were not described in the discussion paper? If so, please describe such additional risks and/or harm.

JSCC's Response:

The paper captures the risks associated with the forced liquidation of client accounts, following the default of a clearing participant, which could exacerbate already stressed market conditions. However, CCPs are obliged to liquidate client accounts in a timely manner, if they are not ported non-defaulting clearing participants. This prevents the CCP from being exposed to further market risk resulting from the non-liquidated positions, without being able to identify the exact loss amount to be absorbed by the CCP's loss sharing structure.

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[5] CFTC Press Release - CFTC Unanimously Approves Final Rule for Granting Exemptions from Derivatives Clearing Organization Registration(November 18, 2020):
https://www.cftc.gov/PressRoom/PressReleases/8312-20

[6] While the CFTC has finalized in 2020 alternative compliance framework under which non-U.S. DCOs may comply their home country regulatory regime if it is found as comparable by the CFTC, in relation to swap customer clearing, this framework would still apply the U.S. Bankruptcy Code and Part 190 to the operations of these non-U.S. DCOs, and their clearing brokers must be registered with the CFTC as FCMs to clear for U.S. customers.

[7] For the purpose of the discussion on the CFTC regime, "Customer" refers to an entity not affiliated with a clearing participant which is acting as a clearing broker for that entity.

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19. Are some client accounts not suitable for porting?

JSCC's Response:

As discussed in the discussion paper, net omnibus account structures would not be suitable for porting, as positions and collaterals are netted across different clients in a net omnibus account. However, if CCPs are permitted to treat the account as if it belongs to a single owner and port the account to a non-defaulting CCSP without any consent from each end client in the account, the porting process would be more applicable and effective.

20. Does holding excess collateral and the ability to make direct payments improve the probability that a client will be ported successfully or are there impediments to using this collateral?

JSCC's Response:

Holding excess collateral and having the ability to make direct payments to a CCP would improve the probability of successful client portability.

21. What is your view of a client consent mechanism that could be used to facilitate porting, if permitted under applicable law?

JSCC's Response:

Please see our response to question 19.

Notable issues to consider when developing a porting protocol

27. Are there additional regulatory requirements that could impede porting? Can such impediments be addressed or mitigated through action prior to the CCSP's default?

JSCC's Response:

Some of the regulatory obligations applied to CCSPs receiving the client porting, such as the capital requirements in relation to the portfolio to be received, or registration requirements in multiple jurisdictions (as per the defaulting clearing broker in our response to question #1), should be waived or

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at least temporary exempted. These exemptions should be considered irrespective of the model of client access to CCPs – traditional client clearing model or a sponsored access model.

We are at your disposal to address any questions or requests for additional information. Should you have any questions on the attachments or any other requests, please do not hesitate to contact Tetsuo Otashiro, Head of Clearing Planning, at +81-50-3361-0928 or by email to t-otashiro@jpx.co.jp.

Yours sincerely,

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