

B.2.2 Japan Securities Clearing Corporation – s. 147

Headnote

Application under section 147 of the Securities Act (Ontario) (Act) for an order exempting Japan Securities Clearing Corporation from the requirement in subsection 21.2(0.1) of the Act to be recognized as a clearing agency.

Applicable Legislative Provisions

Securities Act, R.S.O. 1990, c. S.5, as am., ss. 21.2(0.1), 147.

**IN THE MATTER OF
THE SECURITIES ACT,
R.S.O. 1990, CHAPTER S.5,
AS AMENDED
(the OSA)**

AND

**IN THE MATTER OF
JAPAN SECURITIES CLEARING CORPORATION**

**ORDER
(Section 147 of the OSA)**

WHEREAS the Ontario Securities Commission (**Commission**) has received an application (**Application**) from the Japan Securities Clearing Corporation (**JSCC**) pursuant to section 147 of the OSA requesting an order exempting JSCC from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA in order to provide its central counterparty (**CCP**) clearing service for interest rate swaps (**IRS**) to Ontario-resident entities (**Order**);

AND WHEREAS on September 29, 2023, the Commission issued an order that exempted JSCC on an interim basis (**Interim Order**) from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA, until the earlier of (i) September 28, 2024, and (ii) the effective date of a subsequent order exempting JSCC from the requirement to be recognized as a clearing agency under section 147 of the OSA;

AND WHEREAS the Interim Order will be replaced by this Order;

AND WHEREAS JSCC has represented to the Commission that:

- 1.1 JSCC is a joint-stock company formed under the *Companies Act* of Japan on July 1, 2002, and is a majority-owned subsidiary of the Japan Exchange Group, Inc., a publicly traded company listed on the Tokyo Stock Exchange, Inc.
- 1.2 JSCC is licensed as a CCP to perform clearing services (“Financial Instruments Obligation Assumption Services”), including IRS clearing services, under the *Financial Instruments and Exchange Act* (Japan) (**FIEA**). JSCC is obligated under the FIEA to conduct its IRS clearing business in accordance with its IRS Business Rules, which are subject to approval by the Prime Minister of Japan. The IRS Business Rules set out the rights and obligations in relation to the IRS clearing business, including the risk-management framework, to ensure the stable performance of JSCC’s clearing operations. The FIEA and Cabinet Office Order on the Regulation of Over-the-Counter Derivatives Transactions requires certain types of IRS and credit default swaps denominated in Japanese yen to be cleared in a licensed clearinghouse. In addition, these laws and regulations require certain over-the-counter (**OTC**) derivative contracts to be reported to (i) trade repositories licensed in Japan or (ii) those incorporated in a foreign jurisdiction and designated by the Prime Minister.
- 1.3 JSCC is regulated and supervised by the Japanese Financial Services Agency (**JFSA**) and is subject to the oversight of the Bank of Japan in respect of its IRS clearing activities. Pursuant to the FIEA, changes to JSCC’s articles of incorporation, reductions to its stated capital and the acquisition by any person of 20% or more of the outstanding shares of JSCC are subject to approval by the JFSA. The FIEA also imposes on JSCC a duty of confidentiality and a prohibition on unfairly differential treatment of its clearing participants. The JFSA has the power under the FIEA to take certain actions in respect of JSCC as a regulated CCP, including to conduct inspections, to require reporting, to make business improvement orders and to rescind the CCP’s license in certain circumstances. JSCC is also subject to oversight by the Bank of Japan of financial market infrastructures, as provided in the *Bank of Japan Act*.
- 1.4 JSCC is of the opinion that it fully observes the international standards applicable to financial market infrastructures described in the April 2012 report named *Principles for financial market infrastructures* (**PFMIs**) as discussed in its PFMI Disclosure Report dated as of March 31, 2024.

- 1.5 JSCC is recognized by the European Securities and Markets Authority as a Third Country CCP under the European Market Infrastructure Regulation and is subject to an order issued by the U.S. Commodity Futures Trading Commission that exempts JSCC from the requirement to register as a Derivatives Clearing Organization under the U.S. *Commodity Exchange Act*. In Australia, JSCC has received designation as a “prescribed facility” under the Corporations Amendment (Central Clearing and Single Sided Reporting) Regulation 2015. JSCC has obtained from the Hong Kong Securities and Futures Commission authorization to provide Automated Trading Services, as well as designation as a central counterparty, which can be used for the observance of mandatory clearing obligations under the Securities and Futures Ordinance. JSCC has obtained recognition as a Foreign Central Counterparty under the Financial Market Infrastructure Act from the Swiss Financial Market Supervisory Authority to offer IRS Clearing Services to those trading entities. JSCC has obtained temporary recognition from the Bank of England for the provision of all its clearing services in the U.K. as a Third Country CCP under the *Central Counterparties (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018*, to provide services to clearing participants and trading facilities established in the U.K.
- 1.6 Entities that satisfy the participant criteria set forth in JSCC’s Interest Rate Swap Clearing Business Rules (**IRS Business Rules**) are eligible to apply for qualification as clearing participants in JSCC’s IRS clearing business (**Clearing Participants**). Each Clearing Participant must enter into a Clearing Participant Agreement with JSCC, and the IRS Business Rules are binding on Clearing Participants by virtue of the Clearing Participant Agreement.
- 1.7 JSCC has a single clearing model for IRS and a single category of IRS Clearing Participant. JSCC’s participation criteria cover financial integrity, the regulated status of an applicant, and the appropriateness of the applicant’s management structure and business execution structure to meet and continue to meet the standards set out by JSCC. The IRS Business Rules impose additional obligations on a Clearing Participant that engages in clearing on behalf of its customers.
- 1.8 JSCC anticipates that banks, pension plans, asset managers, insurance companies and other entities that have a head office or principal place of business in Ontario and that are “local customers” as defined in National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions (NI 94-102)* may be interested in using JSCC’s customer clearing services in respect of certain OTC IRS derivatives (each an **Ontario Customer**). JSCC also anticipates that entities that have a head office or principal place of business in Ontario may be interested in becoming Clearing Participants (each, an **Ontario Clearing Participant**) in JSCC’s IRS clearing service.
- 1.9 Each Clearing Participant is required to provide JSCC with, and maintain on a daily basis for so long as it is a Clearing Participant, eligible collateral with a collateral value sufficient to satisfy its margin and clearing fund requirements as calculated by JSCC in accordance with the IRS Business Rules.
- 1.10 JSCC will only offer Ontario Customers an individual segregated account structure for client clearing. JSCC segregates each Clearing Participant’s proprietary positions and margin from the positions and margin of each customer of the Clearing Participant. The positions and margin of each Ontario Customer will be segregated in individual customer accounts with JSCC at all times, regardless of whether or not the Ontario Customer is an affiliate of the Clearing Participant. A Clearing Participant must deposit the full amount of customer margin with JSCC without delay when it receives margin from a customer unless otherwise agreed by the customer. The IRS Business Rules do not allow for the netting of positions recorded in different customer accounts. JSCC will not permit any Ontario Customer to clear through any “indirect intermediary” as defined in NI 94-102 or permit any Ontario Customer to on-board any indirect client that would clear through the Ontario Customer.
- 1.11 The IRS Business Rules (including in particular the default procedures contained within them) govern the processes that apply to Clearing Participants in the case of a Clearing Participant default. Clearing Participants remain responsible for the credit risk of their customers. JSCC has established a financial safeguards system to provide optimal risk management protections including the establishment of a segregated financial safeguard waterfall for cleared IRS that is designed to ensure that JSCC has sufficient resources to cover defaulting Clearing Participant losses in a wide range of potential stress scenarios including the extreme scenario where the two largest Clearing Participants (including any affiliated entities) default at the same time.
- 1.12 Upon the default of a Clearing Participant, JSCC will take action to contain losses by halting clearing of new transactions from the defaulter and liquidating the defaulter’s positions. JSCC’s methods for disposing of positions vary according to the nature of the product cleared. For JSCC’s IRS clearing business, an auction involving non-defaulting Clearing Participants is used. In addition, hedge transactions may be promptly executed for the defaulter’s portfolio to minimize the risk of losses prior to the disposal of the defaulter’s positions. For the IRS clearing business, hedge transactions are executed based on the advice of the IRS Default Management Committee.
- 1.13 A Clearing Participant must successfully complete simulated default tests to demonstrate they have the appropriate expertise and operational processes in place prior to beginning clearing operations. Once live, all Clearing Participants are required to participate in fire drills regularly to confirm their operational readiness to manage a Clearing Participant default.

B.2: Orders

- 1.14 JSCC currently offers portfolio margining (also known as cross-margining) of (a) cleared IRS, (b) certain Japanese Government Bond futures contracts (**JGB Futures**), and (c) certain Japanese interest rate futures contracts (together with JGB Futures, the **Cross-Margined Instruments**) in each case, in customer accounts in accordance with the IRS Business Rules (the **Cross-Margin Service**). JSCC proposes to make its Cross-Margin Service available to Ontario Clearing Participants and Ontario Customers that use JSCC's IRS clearing services and the applicable clearing services for Cross-Margined Instruments.
- 1.15 By combining positions in both IRS and Cross-Margined Instruments into a single portfolio for margin purposes, JSCC's portfolio-margining service allows the overall risk of that portfolio to be determined. Because IRS and Cross-Margined Instruments experience pricing changes that are correlated with variations in Japanese yen interest rates, which may result in offsetting changes in the aggregate potential future exposure of a portfolio of positions, portfolio-margining can result in a margin requirement that is more proportionate to the aggregate risk of the portfolio. Thus, the benefit of JSCC's portfolio-margining of IRS and Cross-Margined Instruments for Ontario Customers and Ontario Clearing Participants, through the margin savings on the same basis as is available to entities outside Ontario, may be significant.
- 1.16 Pursuant to the Interim Order, the Commission exempted JSCC on an interim basis from the requirement to be recognized as a clearing agency under section 21.2 of the Act with the condition that JSCC's activities in Ontario would be limited to providing customer clearing services for IRS transactions for and on behalf of Ontario Customers clearing IRS transactions through a Clearing Participant that is resident outside of Ontario and is a "clearing intermediary" that is a "direct intermediary" as defined in NI 94-102. JSCC applied for the Interim Order to permit a bank listed in Schedule I of the *Bank Act* (Canada) (Schedule I Bank) to clear IRS transactions through a Clearing Participant resident outside of Ontario.
- 1.17 JSCC would provide its services to Ontario Customers and Ontario Clearing Participants without establishing an office or having a physical presence or employees in Ontario or elsewhere in Canada.
- 1.18 JSCC submits that it does not pose a significant risk to the Ontario capital markets and is subject to an appropriate regulatory and oversight regime in a foreign jurisdiction.

AND WHEREAS JSCC has agreed to the terms and conditions as set out in Schedule "A" to this order;

AND WHEREAS JSCC is required to comply with National Instrument 24-102 *Clearing Agency Requirements*;

AND WHEREAS based on the Application and the representations that JSCC has made to the Commission, in the Commission's opinion the granting of the Order to exempt JSCC from the requirement to be recognized as a clearing agency would not be prejudicial to the public interest;

AND WHEREAS JSCC has acknowledged to the Commission that the scope of and the terms and conditions imposed by the Commission attached hereto as Schedule "A" to this Order, or the determination whether it is appropriate that JSCC continue to be exempted from the requirement to be recognized as a clearing agency, may change as a result of the Commission's monitoring of developments in international and domestic capital markets, JSCC's activities, or as a result of any changes to the laws in Ontario affecting trading in or clearing and settlement of derivatives or securities;

IT IS HEREBY ORDERED by the Commission that pursuant to section 147 of the OSA, JSCC is exempt from the requirement to be recognized as a clearing agency under subsection 21.2(0.1) of the OSA;

PROVIDED THAT JSCC complies with the terms and conditions attached hereto as Schedule "A".

DATED this 23th day of September, 2024.

"Aaron Ferguson"
Manager, Trading and Markets
Ontario Securities Commission

SCHEDULE "A"

Terms and Conditions

Unless the context requires otherwise, the terms used in this Schedule "A" have the meanings ascribed to them in Ontario securities law (including terms defined elsewhere in this order).

COMPLIANCE WITH ONTARIO LAW

1. JSCC must comply with Ontario securities law (as defined in the OSA).
2. JSCC's IRS clearing services must comply with National Instrument 94-102 *Derivatives: Customer Clearing and Protection of Customer Collateral and Positions (NI 94-102)*, except where and to the extent that JSCC has obtained an order exempting JSCC from the requirements of NI 94-102 and complies with the terms of such order.

SCOPE OF PERMITTED CLEARING SERVICES IN ONTARIO

3. JSCC's activities in Ontario will be limited to providing CCP clearing services for IRS transactions for and on behalf of Ontario Clearing Participants and Ontario Customers (**Permitted Clearing Services**).
4. Prior to first admitting a Clearing Participant that is an Ontario-resident entity, JSCC shall obtain a legal opinion that confirms the closeout netting and collateral enforcement provisions of the IRS Business Rules are effective in respect of such proposed Ontario-resident Clearing Participant under applicable laws of Ontario and the federal laws of Canada applicable therein.

REGULATION OF JSCC

5. JSCC must maintain its license as a CCP to perform clearing services in Japan ("Financial Instruments Obligation Assumption Services"), including IRS clearing services under the FIEA. JSCC is regulated and supervised by the JFSA and is subject to the oversight of the Bank of Japan in respect of its IRS clearing activities and will continue to be subject to the regulatory oversight of the JFSA and the Bank of Japan or any successors.
6. JSCC must continue to comply with its ongoing regulatory requirements as an entity licensed to perform IRS clearing services under the FIEA or any comparable successor legislation, and with the ongoing regulatory requirements of the JFSA, as applicable. For so long as JSCC maintains its existing licenses, authorizations, and recognition or exemption orders in certain jurisdictions outside Japan as described in representation 1.5 above, JSCC must continue to comply with its ongoing regulatory requirements as a CCP in such jurisdictions pursuant to such licenses, authorizations, and recognition or exemption orders.

GOVERNANCE

7. JSCC must promote within JSCC a governance structure that minimizes the potential for any conflict of interest between JSCC and its shareholders that could adversely affect the Permitted Clearing Services or the effectiveness of JSCC's risk management policies, controls and standards.

REPORTING REQUIREMENTS

Reporting with JFSA

8. JSCC must promptly provide staff of the Commission with the following information, to the extent that it is required to provide or submit such information to JFSA or any successor:
 - (a) details of any material legal proceeding instituted against JSCC;
 - (b) notification that JSCC has failed to comply with an undisputed obligation to pay money or deliver property to an Ontario Clearing Participant or an Ontario Customer for a period of thirty days after receiving notice from the applicable Clearing Participant of JSCC's past due obligation;
 - (c) notification that JSCC has instituted a petition for a judgment of bankruptcy or insolvency or similar relief, or to wind up or liquidate JSCC or has a proceeding for any such petition instituted against it;
 - (d) notification that JSCC has initiated its recovery plan;
 - (e) the appointment of a receiver or the making of any voluntary arrangement with creditors;
 - (f) the entering of JSCC into any resolution regime or the placing of JSCC into resolution by a resolution authority;

B.2: Orders

- (g) material changes to the IRS Business Rules where such changes would impact the Permitted Clearing Services used by Ontario Clearing Participants or Ontario Customers;
- (h) new services or clearing of new types of products in the Permitted Clearing Services to be offered to Ontario Clearing Participants or Ontario Customers or services or types of products that will no longer be available to Ontario Clearing Participants or Ontario Customers; and
- (i) any new category of membership in respect of the Permitted Clearing Services if JSCC expects that category of membership would be available to Ontario Clearing Participants or Ontario Customers;

Financial Statements

- 9. JSCC must promptly provide staff of the Commission with the following information:
 - (a) English translations of interim financial statements, if available; and
 - (b) English translations of annual audited financial statements, within 30 days of providing the Japanese version of any such statements to the JFSA.

Prompt Notice

- 10. JSCC must promptly notify staff of the Commission of any of the following:
 - (a) any material change to its business or operations;
 - (b) any material change or proposed material change in JSCC's status as an entity licensed to perform "Financial Instruments Obligation Assumption Services" under the FIEA or in its regulation and supervision by JFSA or any successor;
 - (c) any material problems with the clearing and settlement of transactions that could materially affect the safety and soundness of JSCC;
 - (d) the admission of any new Ontario Clearing Participant or Ontario Customer;
 - (e) any event of default by, or removal from Permitted Clearing Services of, an Ontario Clearing Participant or an Ontario Customer;
 - (f) any material system failure of a Permitted Clearing Service used by an Ontario Clearing Participant or an Ontario Customer, including cybersecurity breaches; and
 - (g) any default by a Clearing Participant clearing Cross-Margined Instruments on behalf of an Ontario Clearing Participant that uses the Cross-Margin Service.

Quarterly Reporting

- 11. JSCC must maintain and submit the following information to the Commission in a manner and form acceptable to the Commission on a quarterly basis within 30 days of the end of each calendar quarter, and at any time promptly upon the request of staff of the Commission:
 - (a) current lists of all Ontario Clearing Participants and Ontario Customers and the legal entity identifier (**LEI**), if any, of each such Ontario Clearing Participant and Ontario Customer;
 - (b) a list of all Ontario Clearing Participants and Ontario Customers against whom disciplinary or legal action has been taken in the quarter by JSCC with respect to activities at JSCC, or to the best of JSCC's knowledge, by JFSA or any other authority in Japan that has or may have jurisdiction with respect to the relevant Ontario Clearing Participant or Ontario Customer's clearing activities at JSCC, provided that the Commission will maintain the confidentiality of the identity of any such Ontario Clearing Participant and Ontario Customer, unless (i) required by a court of competent jurisdiction, law, regulation or memorandum of understanding with a regulatory authority to release such identity, (ii) disclosure is permitted by or consistent with the purposes of the OSA, or (iii) such identity is publicly available;
 - (c) a list of all investigations by JSCC in the quarter relating to Ontario Clearing Participants and Ontario Customers, provided that the Commission will maintain the confidentiality of the identity of any such Ontario Clearing Participant and Ontario Customer, unless (i) required by a court of competent jurisdiction, law, regulation or memorandum of understanding with a regulatory authority to release such identity, (ii) disclosure is permitted by or consistent with the purposes of the OSA, or (iii) such identity is publicly available;

- (d) quantitative information in respect of the Permitted Clearing Services used by the Ontario Clearing Participants and Ontario Customers broken down by each Clearing Participant (identified by LEI) that (i) is an Ontario Clearing Participant, or (ii) is not an Ontario Clearing Participant but provides the Permitted Clearing Services to an Ontario Customer, if applicable, including the following:
 - i. the end of quarter level, maximum and average daily open interest, number of transactions and notional value of transactions cleared during the quarter for each Ontario Clearing Participant and Ontario Customer, by product type;
 - ii. the percentage of end of quarter level and average daily open interest, number of transactions and the notional value cleared during the quarter for all Clearing Participants that represents the end of quarter and average daily open interest, number of transactions and the notional value of transactions cleared during the quarter for each Ontario Clearing Participant and Ontario Customer, by product type;
 - iii. the aggregate total margin amount required by JSCC on the last trading day during the quarter for each Ontario Clearing Participant and Ontario Customer; and
 - iv. the percentage of the total margin required by JSCC, on the last trading day of the quarter, for all Clearing Participants that represents the total margin required for each Ontario Clearing Participant and Ontario Customer;
- (e) the IRS clearing fund contribution, for each Ontario Clearing Participant on the last trading day of the quarter, and its proportion to the total IRS clearing fund contributions;
- (f) the percentage of IRS positions, in terms of notional value and number of transactions, held by each Ontario Clearing Participant that are cross-margined as of the last trading day of the quarter;
- (g) the notional value and number of transactions of Cross-Margined Instruments positions that are cross-margined via JSCC's portfolio-margining service with the IRS positions maintained by each Ontario Clearing Participant as of the last trading day of the quarter; and
- (h) a summary of risk management analysis related to the adequacy of the required margins and the IRS clearing fund requirement, including but not limited to stress testing and back testing results.

INFORMATION SHARING

- 12. JSCC must promptly provide such information as may be requested from time to time by, and otherwise cooperate with, the Commission or its staff, subject to any applicable privacy or other laws that would prevent the sharing of such information and subject to the application of solicitor-client privilege.
- 13. Unless otherwise prohibited under applicable law, JSCC must share information relating to regulatory and enforcement matters and otherwise cooperate with other recognized and exempt clearing agencies on such matters, as appropriate.