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Practical cross-border insights into derivatives law

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Expert Analysis Chapter

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1 Documentation and Formalities

1.1 Please provide an overview of the documentation (or framework of documentation) on which derivatives transactions are typically entered into in your jurisdiction. Please note whether there are variances in the documentation for certain types of derivatives transactions or counterparties; for example, differences between over-the-counter ("OTC") and exchange-traded derivatives ("ETD") or for particular asset classes.

The ISDA Master Agreement is the most common framework agreement used to document derivatives transactions between financial institutions or between a financial institution and a major business company.

Most Japanese financial institutions have also developed their own original template of a Japanese derivatives master or individual agreements to meet the needs of their domestic customers who are not familiar with the ISDA Master Agreement but wish to enter into derivatives transactions with the financial institutions. The general structure of such Japanese derivatives agreements follows that of the ISDA Master Agreements.

In the case of the parties executing the ISDA Master Agreements, there is no unique practice in Japan with respect to the set of documentation used in practice for specific types of derivatives transactions, such as foreign exchange transactions and currency option or commodity transactions.

1.2 Are there any particular documentary or execution requirements in your jurisdiction? For example, requirements as to notaries, number of signatories, or corporate authorisations.

With respect to the formality of the signing, neither notarisation nor signatures by multiple signatories are required.

1.3 Which governing law is most often specified in ISDA documentation in your jurisdiction? Will the courts in your jurisdiction give effect to any choice of foreign law in the parties' derivatives documentation? If the parties do not specify a choice of law in their derivatives contracts, what are the main principles in your jurisdiction that will determine the governing law of the contract?

Irrespective of whether the parties enter into the ISDA Master Agreement or Japanese derivatives agreements (see question 1.1 above), the parties will designate the law of a specific jurisdiction as the governing law of such agreement. In practice, Japanese law is most commonly specified as the governing law if all the parties are located in Japan. If one of the parties is located in a jurisdiction other than Japan, the law of another jurisdiction such as English law or New York State law is often specified. Under the Act on General Rules for Application of Laws, the Japanese courts give effect to any choice of law by the parties unless the result of the application of such law is contrary to the public order or good morals of Japan.

Where the parties fail to agree on the choice of law, under the aforementioned Act, the law of the jurisdiction most closely connected to an agreement will be the governing law of such agreement. If one of the parties provides a characteristic performance under the relevant agreement, the aforementioned Act presumes that the principal place of business of such party is the locale most closely connected to such agreement (e.g. in the case of a sales and purchase agreement of goods, a delivery of goods is the characteristic performance and thus the seller's principal place of business is presumed to be most closely connected to such agreement). With respect to derivatives transactions, as both parties owe monetary obligations against one another, there is an obscurity as to which is the most closely connected jurisdiction to the relevant agreement.

2 Credit Support

2.1 What forms of credit support are typically provided for derivatives transactions in your jurisdiction? How is this typically documented? For example, under an ISDA Credit Support Annex or Credit Support Deed.

Credit support for derivatives transactions is typically provided by bilateral provision of collateral under the ISDA Credit Support Annex ("CSA"). Since the variation/initial margin rules were introduced, the 2016 Japanese Law VM CSA and 2016 Japanese Law Phase One IM CSA/Trust Scheme Annex to the Japanese Law IM CSA have typically been used. Where the ISDA 2018 Credit Support Annex for Initial Margin (IM) (Security Interest – New York Law) or the ISDA 2018 Credit Support Deed for Initial Margin (IM) (Security Interest – English Law) is used, the Japanese Security Collateral Provider Provisions for the ISDA 2018 Credit Support Annex for Initial Margin (IM) (Security Interest – New York Law) and the Japanese Security Collateral Provider Provisions for the ISDA 2018 Credit Support Deed for Initial Margin (IM) (Security Interest – English Law) will be typically incorporated therein, respectively, to ensure the application of the amended Netting Act (please see question 2.2 below). In addition, where the ISDA 2016 Credit Support Annex for Variation Margin (VM) governed by New York law

or the ISDA 2016 Credit Support Annex for Variation Margin (VM) governed by English law is used, certain amendments will be typically made to the Annex to construe the security created thereunder as a "loan for consumption" (*shouhi taishaku*) under Japanese law for which the Netting Act will be also applicable.

2.2 Where transactions are collateralised, would this typically be by way of title transfer, by way of security, or a mixture of both methods?

Under the Corporate Reorganization Law (*kaisha kousei hou*), a security interest will be treated as a reorganised security interest (*kousei tanpo ken*) exercisable only in accordance with the reorganisation plan under the corporate reorganisation procedure (*kaisha kousei tetsuzuki*). To prevent such inconvenience, a "loan for consumption" scheme is commonly used in Japan. Under such structure, close-out netting of exposures may be made outside the corporate reorganisation procedure pursuant to the Act on Close-Out Netting of Specified Financial Transactions Conducted by Financial Institutions, etc. (the "Netting Act") (as for the effect of close-out netting under the Netting Act, please see question 5.1 below). However, the Netting Act was amended on May 1, 2020 and certain security interest collateral arrangements will also be exercisable outside the corporate reorganisation procedure and, hopefully, it will be especially useful for regional banks, insurance companies or other non-mega-sized financial institutions, to which corporate reorganisation procedures might be practically applicable, to comply with initial margin rules (please see question 2.4 below).

2.3 What types of assets are acceptable in your jurisdiction as credit support for obligations under derivatives documentation?

Typically, Japanese government bonds ("JGBs"), foreign government bonds and cash are used as credit support assets. Under the Japanese margin rules (as detailed in question 2.4 below), eligible assets are limited to cash, government bonds, central bank bonds, bonds issued by governmental agencies, public banks and other entities, corporate bonds having certain ratings or above, certain domestic or foreign investment trusts, and certain other prescribed types of assets.

2.4 Are there specific margining requirements in your jurisdiction to collateralise all or certain classes of derivatives transactions? For example, are there requirements as to the posting of initial margin or variation margin between counterparties?

Under the Financial Instruments and Exchange Act (the "FIEA") and its subordinate rule (the "FIEA Cabinet Office Ordinance"), non-centrally cleared OTC derivatives may be subject to Japanese initial/variation margin rules that implement the BCBS/IOSCO framework. Japanese margin rules apply to Financial Instruments Business Operators (*kinyushohin-torihiki-gyosha*) conducting Type I Financial Instruments Businesses or Registered Financial Institutions (*touroku-kinyu-kikan*) including banks, securities companies, insurance companies or similar (collectively, a "Dealer").

There are some exemptions from these margin rules. With respect to both variation and initial margins, the margin rules will not be applicable if a Dealer's average aggregated notional amounts of certain OTC derivatives on a single-entity basis for a certain retrospective year are less than JPY 300 billion or if the counterparty is neither a Dealer nor a foreign derivatives dealer whose average aggregated notional amounts of OTC derivatives on a single-entity basis for a certain retrospective year are equal to or exceed JPY 300 billion.

Also, initial margin rules will not be applicable if a Dealer's average aggregated notional amounts of certain OTC derivatives and forward foreign exchange transactions (typically, physically settled foreign exchange forwards and swaps, not including those that may be settled by netting) on a group basis for a certain retrospective three-month period do not exceed JPY 1.1 trillion or if the counterparty is neither a Dealer nor a foreign derivatives dealer whose average aggregated notional amounts of certain OTC derivatives and forward foreign exchange transactions (typically, physically settled foreign exchange forwards and swaps, not including those that may be settled by netting) on a group basis for a certain retrospective three-month period exceed JPY 1.1 trillion.

In addition, any transaction entered into by and between group companies will also be exempted. A Dealer itself will be exempted from Japanese margin rules if it complies with an equivalent rule(s) overseas as designated by the commissioner of the Japanese Financial Services Agency (the "JFSA") (currently, the rules of the US, Canada, Australia, Singapore, Hong Kong and certain European countries have been so designated). As for variation margins, in addition to the above statutory rules, the JFSA's Supervisory Guidelines provide that a financial institution subject to such Guidelines (including a Dealer whose average aggregated notional amount is less than JPY 300 billion or who is otherwise exempted from the margin rules under the FIEA Cabinet Office Ordinance) is required to make efforts to: (a) enter into contracts for variation margins such as the ISDA Master Agreement and CSA; and (b) calculate the current exposures and exchange variation margins with sufficient frequency in light of, among others, the scale of transactions and the risk characteristics and on an *ad hoc* margin-call basis.

2.5 Does your jurisdiction recognise the role of an agent or trustee to enter into relevant agreements or appropriate collateral/enforce security (as applicable)? Does your jurisdiction recognise trusts?

A trust may be validly established in Japan under the Trust Act. A security trustee can claim enforcement of a security interest entrusted to it and can receive distributions from the proceeds of the sale and other disposition of the collateral, but to date security trusts remain uncommon in Japan.

A security agent may also be feasible in Japan, but it may not be engaged in the collection of third parties' loans or other receivables if such constitutes legal work for legal matters unless such agent is a lawyer/an incorporated law firm or a licensed servicer company. As a result, the role of a security agent is still fairly limited in Japan.

2.6 What are the required formalities to create and/or perfect a valid security over an asset? Are there any regulatory or similar consents required with respect to the enforcement of security?

Under Japanese conflict of law rules, the creation, perfection or enforcement of security interests as proprietary rights (*bukken*) over JGBs, Japanese corporate debt securities or other securities may be governed by Japanese law.

To create and perfect a valid pledge over book-entry JGBs, the amount of such collateral shall be credited and recorded in the pledgee's ledger of the proprietary account of the pledgee with the Bank of Japan or the custodian.

To create and perfect a pledge (*shichiken*) over dematerialised corporate debt securities in book-entry form (*furikae-shasai*) under the Book-Entry Transfer Act, the amount of such collateral shall be credited and recorded in the pledgee's ledger (*shichiken ran*) of the proprietary account of the pledgee with the Japan Securities Depository Center, Inc. (*hofuri*) or the custodian.

As for the enforcement of security, in general, it shall be enforced by court-supervised statutory auction or other enforcement procedure under the Civil Execution Act. In the case of regulated assets, the relevant authorities' consent might be required under the applicable regulatory laws.

3 Regulatory Issues

3.1 Please provide an overview of the key derivatives regulation(s) applicable in your jurisdiction and the regulatory authorities with principal oversight.

The JFSA is responsible for regulating non-commodity derivatives and commodity derivatives listed on a financial instruments exchange market under the FIEA. In general, those who enter into non-commodity derivatives transactions or engage in intermediary activities thereof, and those who engage in intermediary activities of the aforementioned listed commodity derivatives as a business, are required to register with the JFSA as a "Type I Financial Instruments Business Operator". If banks and insurance companies enter into or engage in these transactions or activities, although these firms have a banking or insurance licence, additional registration with the JFSA as a "Registered Financial Institution" is required. The JFSA delegates a part of its power to other governmental bodies such as the Securities and Exchange Surveillance Commission and Local Finance Bureaus.

Commodity derivatives are separately regulated by the Ministry of Economy, Trade and Industry (the "METI") and the Ministry of Agriculture, Forestry and Fisheries (the "MAFF") under the Commodity Derivatives Act (the "CDA"). Those who enter into commodity derivatives or engage in intermediary activities thereof are required to obtain a licence as a Commodity Derivatives Business Operator from the METI and the MAFF. The CDA provides for a limited list of commodities of which derivatives transactions require a licence, while derivatives transactions of commodities falling out of the list do not require a licence (e.g. carbon credit derivatives).

3.2 Are there any regulatory changes anticipated, or incoming, in your jurisdiction that are likely to have an impact on entry into derivatives transactions and/or counterparties to derivatives transactions? If so, what are these key changes and their timeline for implementation?

A bill to amend the Payment Services Act and FIEA passed the Diet in 2019 in relation to the overhaul of crypto assets regulations. The amendment took effect in 2020 and derivatives transactions of crypto assets are generally regulated as a type of derivatives transaction thereunder.

3.3 Are there any further practical or regulatory requirements for counterparties wishing to enter into derivatives transactions in your jurisdiction? For example, obtaining and/or maintaining certain licences, consents or authorisations (governmental, regulatory, shareholder or otherwise) or the delegating of certain regulatory responsibilities to an entity with broader regulatory permissions.

Under the FIEA and subordinate rules, certain types of OTC derivatives designated by the JFSA commissioner must be cleared through a central counterparty licensed by the JFSA. Currently, the JFSA commissioner has so designated: (i) certain credit default swaps; and (ii) certain plain vanilla Yen interest rate swaps. Financial Instruments Business Operators and Registered Financial Institutions are required to clear these designated derivatives through the Japan Securities Clearing Corporation.

3.4 Does your jurisdiction provide any exemptions from regulatory requirements and/or for special treatment for certain types of counterparties (such as pension funds or public bodies)?

The FIEA and CDA and subordinate rules thereunder set out several exemptions from the registration requirements mentioned in question 3.1 above. As an example, the registration requirements for OTC derivatives (except for those related to securities or crypto assets) are not applicable when, among others, the counterparty is a derivatives professional such as: (i) a certain type of financial institution; (ii) a qualified institutional investor; or (iii) a joint-stock company with its stated capital of JPY 1 billion (equivalent or more). With respect to securities or crypto asset-related OTC derivatives under the FIEA, the scope of the exemption is generally more limited and depends on whether the transaction is conducted onshore or offshore.

4 Insolvency / Bankruptcy

4.1 In what circumstances of distress would a default and/or termination right (each as applicable) arise in your jurisdiction?

The circumstances of distress triggering a default and/or termination right of a derivatives contract will depend on how the contract provides for the events of default triggering such right. Thus, such triggering circumstances vary from contract to contract, but typically include, among others, (a) the filing of an application by a party with respect to itself for commencement of the bankruptcy proceedings, the civil rehabilitation proceedings, the corporate reorganisation proceedings and the special liquidation proceedings under the relevant insolvency laws of Japan (the "Japanese Insolvency Laws"), (b) the general and continuous inability of a party to such contracts to pay its debts (*shiarai-funo*), (c) admitting in writing its inability to pay its debts as they become due (*shiharai-teishi*), and (d) the status of such party's negative net assets (*saimu-choka*).

4.2 Are there any automatic stay of creditor action or regulatory intervention regimes in your jurisdiction that may protect the insolvent/bankrupt counterparty or impact the recovery of the close-out amount from an insolvent/bankrupt counterparty? If so, what is the length of such stay of action?

The Japanese Insolvency Laws do not provide for any such automatic stay of creditor action or regulatory intervention. Under the Deposit Insurance Act (the "DIA"), however, the Prime Minister has the power to suspend the application of termination provisions and netting provisions for certain financial agreements including derivatives contracts for a period of time that the Prime Minister so designates (the "Designated Period") with respect to a failed financial institution subject to certain recovery and resolution proceedings under the DIA. While the DIA has no explicit provisions for the length of the Designated Period, it is unlikely that such period will considerably exceed two business days in light of the responses of the JFSA to public comments with respect to the DIA.

4.3 In what circumstances (if any) could an insolvency/bankruptcy official render derivatives transactions void or voidable in your jurisdiction?

An insolvency/bankruptcy official could render derivatives transactions void or voidable, among others, where the entering into the relevant derivatives contract is (a) prejudiced to the creditors of a party due to, among others, such party's condition of negative net assets, and such party is aware of the same, or (b) made after a suspension of payments is made or after filing for a petition seeking the commencement of the bankruptcy proceedings under the Bankruptcy Act, a civil rehabilitation proceeding under the Civil Rehabilitation Act or a corporate reorganisation proceeding under the Corporate Reorganization Act (collectively, the "Bankruptcy Proceedings" and individually, a "Bankruptcy Proceeding"), except, among others, where the other party is not aware at the time of entering into such contract that entering into such derivatives contract would be prejudiced to the creditors of the insolvent party, such suspension of payments or such filing of the relevant Bankruptcy Proceeding, as the case may be.

4.4 Are there clawback provisions specified in the legislation of your jurisdiction that could apply to derivatives transactions? If so, in what circumstances could such clawback provisions apply?

There are no clawback provisions under the Japanese Insolvency Laws besides an insolvency/bankruptcy official's power to render derivatives transactions void or voidable as referred to in question 4.3 above.

4.5 In your jurisdiction, could an insolvency/bankruptcy-related close-out of derivatives transactions be deemed to take effect prior to an insolvency/bankruptcy taking effect?

There are no express provisions under which an insolvency/bankruptcy-related close-out of derivatives transactions could be deemed to take effect prior to an insolvency/bankruptcy taking effect. However, the close-out netting provisions provided for in a derivatives contract are enforceable even if an insolvency proceeding commences with respect to a party to such contract, if all the requirements under Article 3 of the Netting Act or Article 58 of the Bankruptcy Act are satisfied (see question 5.1 below).

4.6 Would a court in your jurisdiction give effect to contractual provisions in a contract (even if such contract is governed by the laws of another country) that have the effect of distributing payments to parties in the order specified in the contract?

We understand that in certain repackaged bonds incorporating a swap transaction, the related transaction agreements typically provide for a waterfall provision, which has the effect of distributing payments by the issuer of such bonds to its creditors (namely, (i) the trustee, (ii) the paying agents and other agents, (iii) bondholders of such repackaged bonds, and (iv) the swap counterparty) in the priority order. A competent court may restrict the enforceability of such waterfall provision pursuant to the relevant Japanese Insolvency Laws if an insolvency proceeding has commenced with respect to the issuer of such repackaged bond. On the other hand, such waterfall provision (regardless of whether the transaction agreements are governed by Japanese law) would be held enforceable by such court even if an insolvency proceeding has been initiated in respect of a creditor of the issuer, such as a swap counterparty to the issuer (which is typically the sponsor of the transaction and the most subordinated creditor), unless such waterfall provision is deemed unfair and unequitable in light of the principles of the relevant Japanese Insolvency Laws.

5 Close-out Netting

5.1 Has an industry-standard legal opinion been produced in your jurisdiction in respect of the enforceability of close-out netting and/or set-off provisions in derivatives documentation? What are the key legal considerations for parties wishing to net their exposures when closing out derivatives transactions in your jurisdiction?

A UK law firm's Tokyo office has produced a legal opinion addressed to ISDA, in respect of the enforceability of close-out netting. The key legal considerations for parties wishing to net their exposures when closing out derivatives transactions is to ensure that the relevant transaction will satisfy all the requirements under Article 3 of the Netting Act. Such requirements are as follows: (i) at least one party to the transaction falls within certain qualified financial institutions; (ii) the transaction falls under certain financial transactions, including OTC derivatives transactions as defined in the FIEA; (iii) the close-out netting provisions are provided for in a master agreement prescribed in the Netting Act, under which we believe ISDA Master Agreements fall; (iv) the close-out netting becomes automatically effective regardless of both parties' intention upon the occurrence of a close-out event as defined in the Netting Act (e.g. the filing of an application for the commencement of a Bankruptcy Proceeding) (a "Close-out Event"); and (v) the close-out amount must be calculated by the actual conditions of interest rates, currency rates, quotations on financial instruments markets and other indices.

If requirement (i) or (ii) is not met, the parties should consider whether the transaction will fulfil the conditions of Article 58 of the Bankruptcy Act, which provides for early termination of transactions with respect to a product having a price quoted on an exchange or otherwise having a price in the market, and recognises netting of claims and obligations regarding damages arising from such transactions calculated in accordance with the terms of the master agreement governing such transactions.

5.2 Are there any restrictions in your jurisdiction on close-out netting in respect of all derivatives transactions under a single master agreement, including in the event of an early termination of transactions?

There are no restrictions on netting in respect of all derivatives transactions under a single master agreement if all the requirements under Article 3 of the Netting Act or Article 58 of the Bankruptcy Act are met as discussed in question 5.1 above.

5.3 Is Automatic Early Termination ("AET") typically applied/disapplied in your jurisdiction and/or in respect of entities established in your jurisdiction?

AET is typically applied in respect of entities established in Japan. This is because the Netting Act requires close-out netting to become automatically effective regardless of both parties' intention upon the occurrence of a Close-out Event in order to ensure that the close-out netting provisions are enforceable even if a party to the derivatives contract is subject to an insolvency proceeding under the relevant Japanese Insolvency Laws.

5.4 Is it possible for the termination currency to be denominated in a currency other than your domestic currency? Can judgment debts be applied in a currency other than your domestic currency?

It is possible for the termination currency to be denominated in a currency other than Japanese Yen. After close-out netting, however, if the non-defaulting party has a claim against the defaulting party (i.e. the insolvent party), such claim must be filed with the competent court in the relevant insolvency proceedings, and will be evaluated in Japanese Yen referring to the prevailing foreign exchange rate at the time of the commencement of such insolvency proceeding. Additionally, judgment debts can be applied in a currency other than Japanese Yen. Even where a creditor obtains a judgment in a currency other than Japanese Yen, however, a debtor may effect payment in Japanese Yen at the foreign exchange rate prevailing at the time of the closing of oral arguments in the fact-finding proceeding.

6 Taxation

6.1 Are derivatives transactions taxed as income or capital in your jurisdiction? Does your answer depend on the asset class?

For the purpose of income tax imposed on a corporation, essentially, all types of profits and losses are aggregated in calculating the taxable income of a corporation regardless of whether they are income gains/losses or capital gains/losses. Therefore, profits and losses derived from derivatives transactions are also included in the taxable income of a corporation for the purpose of corporate income tax.

For the purpose of income tax imposed on an individual: (i) income is classified into 10 categories, including business income, capital gains and miscellaneous income; (ii) the amount of income is calculated for each of these categories of income; and (iii) these amounts are aggregated and the amount of income tax is calculated at a progressive rate. Income derived from derivatives transactions is normally treated as miscellaneous income or business income, rather than capital gains, for the purpose of calculating the taxable income of an individual. In addition, income derived from certain derivatives transactions is subject to individual income taxation without being aggregated with other income, and a different tax rate is applied to such income (see question 6.3 below).

6.2 Would part of any payment in respect of derivatives transactions be subject to withholding taxes in your jurisdiction? Does your answer depend on the asset class? If so, what are the typical methods for reducing or limiting exposure to withholding taxes?

Interest accruing in connection with guarantee deposits (i.e. cash collateral) provided for OTC derivatives transactions carried out by foreign financial institutions is, in principle, subject to withholding tax in Japan. However, foreign financial institutions can be exempt from such withholding tax by submitting an application form for withholding tax exemption to the competent local tax office via the payer of the interest. Other than the above interest amounts, generally, payments in respect of derivatives transactions are not subject to withholding tax in Japan regardless of whether the payee is a resident or non-resident of Japan.

6.3 Are there any relevant taxation exclusions or exceptions for certain classes of derivatives?

For the purposes of individual income tax, income derived from certain market futures trading and option transactions, OTC futures trading and option transactions, and acquisition of covered warrants is not aggregated with other income for the purpose of calculating the amount of individual income tax. Such income is subject to individual income tax separately from other income at the rate of 20.315% (15.315% for national tax and 5% for local tax).

7 Bespoke Jurisdictional Matters

7.1 Are there any material considerations that should be considered by market participants wishing to enter into derivatives transactions in your jurisdiction? Please include any cross-border issues that apply when posting or receiving collateral with foreign counterparties (e.g. restrictions on foreign currencies) or restrictions on transferability (e.g. assignment and novation, including notice mechanics, timings, etc.).

Under Japanese law, a security interest created under a security document governed by a foreign law might not be recognised as valid or enforceable unless such security interest constitutes a statutory pledge or another statutory security interest governed by Japanese law since no new category of security interest may be established by agreement outside the law (*bukken houtei shugi*) unless the courts specifically recognise a new category of security interest, such as an assignment by way of security (*joto tanpo*). As an alternative, if such security interest is treated as a "loan for consumption" of property, it may be settled by a close-out netting under the Netting Act. Therefore, when a non-Japanese party is intending to execute a security document governed by a foreign law with a Japanese counterparty and receive JGBs or other Japanese law-governed collateral to validly secure the relevant swap transactions thereunder, it will typically amend such security document governed by a foreign law, or separately execute a Japanese CSA covering such security interest, to the effect that such security interest constitutes a Japanese statutory security interest or an "assignment by way of security" or a "loan for consumption" of property. Under the Foreign Exchange and Foreign Trade Law, making a payment or other transfer of money to persons of foreign countries is not restricted unless such country is subject to economic sanctions, in which case approval by the Japanese government will be required. There are no particular restrictions on the transferability of the rights and obligations under derivatives transactions. Only the mutual consent or agreement of the relevant parties will be necessary for the transfer of the rights and obligations under derivatives transactions. For such transfer, either ISDA's 2002 Novation Agreement form or ISDA's 2004 Novation Confirmation will be available. From a practical perspective, the former form is simpler and more commonly used.

8 Market Trends

8.1 What has been the most significant change(s), if any, to the way in which derivatives are transacted and/or documented in recent years?

The OTC derivatives market reforms led by the G20 have significantly affected derivatives transactions and documentation in recent years in Japan, as in other jurisdictions. Among others, industry effort has been made to address the central clearing and

margin requirements explained in questions 2.4 and 3.3 above. Reducing systemic risks without impairing the functions of the OTC derivatives market has been, and will be, a key issue going forward.

It had been thought that the discontinuation of Japanese Yen LIBOR at the end of 2021 would materially impact derivatives and financial products referencing the Japanese Yen LIBOR. As a result of industry-wide efforts and the initiatives of the ISDA working group that led to the IBOR fallbacks protocol, to our knowledge, the transition from Japanese Yen LIBOR to O/N RFR Compounding (Fixing in Arrears) has occurred successfully as of the end of 2021 with respect to almost all relevant transactions.

8.2 What, if any, ongoing or upcoming legal, commercial or technological developments do you see as having the greatest impact on the market for derivatives transactions in your jurisdiction? For example, developments that might have an impact on commercial terms, the volume of trades and/or the main types of products traded, smart contracts or other technological solutions.

We expect that further development of online contract platforms and other technological solutions will streamline contract creation, negotiation, review, execution and post-execution management processes. In the long term, smart contracts have the potential to innovate wide varieties of financial products including derivatives.

The recent development of carbon credit transactions is also noteworthy. Among all, the Tokyo Stock Exchange conducted a carbon credit market demonstration from September 2022 to January 2023, where over 180 participants traded "J-Credits", which are currently existing carbon credits operated by the government. Following the verification of the demonstration that was conducted from the perspectives of the trade efficiency and the price discovery function of the market, the exchange may formally start operating an official carbon credit market in the near future. Voluntary carbon credits operated by private sectors were not traded during this demonstration; however, the government also understands the importance of initiatives by private sectors – in December 2022, the JFSA released Q&As clarifying the scope of voluntary carbon credits, of which certain licensed financial institutions are permitted to engage in spot or derivatives transactions of such voluntary carbon credits (as explained in question 3.1 above, carbon credit derivatives do not require licences under CDA; however, under other regulatory laws that are applicable to certain types of financial institutions, such as the Banking Act, which is applicable to licensed banks, there are some limitations on the scope of carbon credit transactions handled by such financial institutions). While the current focus is mostly on spot transactions of carbon credits, derivatives transactions of carbon credits will also become important in accordance with the development of spot transactions of carbon credits.

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