**Customer Protections for Cleared Interest Rate Swap Trades under Trust Arrangement (Comparison between JSCC rules and CFTC regulations)**

|  | | **JSCC** | | **CFTC** |  |
| --- | --- | --- | --- | --- | --- |
| 1 | Segregation of Customer Collateral | * Customer collateral is deposited at JSCC and is held in each customer’s individual segregated account which is segregated from (i) JSCC’s own assets, (ii) the clearing members’ collateral, and (iii) the fellow customers’ collateral. Deposit with and withdrawal from JSCC of customer collateral is made by customers through a clearing broker acting as the payment agent.[[1]](#footnote-2) | Business Rules[[2]](#footnote-3)  Articles 59.2, 75, 76.4 and 87.1  Financial Instruments and Exchange Act of Japan Article 156-11[[3]](#footnote-4) | * Customer money, securities and property (“customer property”) must be legally segregated from that of other customers, the FCM and the DCO, but customer property may be held by a DCO or FCM in an operationally commingled account with the collateral of all customers. | CFTC Rules 22.3, 22.15, 39.15, 39.16  CEA Section 4d(a) and 4d(b)  CEA Section 5b(f) |
| 2 | Bankruptcy Remoteness of Customer Collateral | * JSCC has established a trust arrangement whereby the customer collateral is deposited in accounts on behalf of customers (the “Trust Accounts”).[[4]](#footnote-5) The collateral in the Trust Accounts is legally remote from a bankruptcy of (i) JSCC, (ii) clearing members, and (iii) the trust bank. * Article 25 of the Trust Act of Japan[[5]](#footnote-6) is construed as the legal basis for the bankruptcy remoteness of collateral in the Trust Accounts from the trustee’s assets. JSCC has obtained a legal opinion from an independent law firm (Linklaters Tokyo[[6]](#footnote-7)) concerning the bankruptcy remoteness of the collateral in the Trust Accounts from JSCC’s bankruptcy estate in cases of JSCC's insolvency. * Fees and costs arising from the trust arrangement, if applicable, would be passed onto clearing members by JSCC[[7]](#footnote-8) and would not be deducted from the customers’ collateral. | Business Rules  Article 87.1  Handling Procedures  Articles 44.2 and 44.3  Trust Act of Japan, Article 25 | * FCMs and DCOs must segregate customer property from other assets. In the case of an FCM bankruptcy, customer property is entitled to priority under the U.S. Bankruptcy Code and the CEA and will be paid to customers before any property becomes available to satisfy claims of an FCM’s other customers. | U.S. Bankruptcy Code, Section 766  CFTC Rule 190.08 |
| 3 | Treatment of Customer Collateral in the Event of a JSCC, Trust Bank or Clearing Broker Bankruptcy | * Should JSCC go bankrupt, the trust bank would return customer collateral directly to each customer, in accordance with the payment instructions provided by an independent attorney at law, who is appointed in advance as part of the trust arrangement and acts as an agent for all of the customers. * Should the trust bank default, or its creditworthiness deteriorate, JSCC may substitute another trust bank. The procedure for this is detailed in the trust agreement. * If a clearing member defaults, the customers of the defaulting member may port their positions and collateral, which are held in each customer’s individual segregated accounts at JSCC, to brokerage account(s) held by non-defaulting clearing member(s).   + Customers must obtain the prior consent from the non-defaulting clearing member(s) to which they wish to port their positions.   + The application for porting must be submitted within two (2) business days from the clearing member’s default. However, in certain circumstances, JSCC can extend the application deadline by up to four (4) additional business days.   + No court approval is required. * If the clearing member defaults, customers also have the option to claim directly to JSCC for the return of their customer collateral. JSCC would return customer collateral directly to each customer, after deducting the outstanding amount of obligations that arise from the customer’s own swap trades. | Business Rules Articles 76.1(1)(a), 76.4, 94.1 and 94.3  Rules on Default Settlement, Articles 8.1 and 8.2  Financial Instruments and Exchange Act of Japan Article 156-11-2.1 | * The customer of an insolvent FCM is afforded priority over other creditors of the FCM in the distribution of the FCM’s customer property. * If an FCM defaults, the DCO will generally transfer the cleared positions of the FCM’s non-defaulting customers to another FCM. * If an FCM defaults, the trustee, the DCO or the FCM must notify the CFTC whether such entity intends to transfer open customer positions to another FCM. * The trustee will inform the Bankruptcy Court of customer positions and collateral to be transferred by the DCO as part of a bulk transfer to another FCM. Once approved by the Bankruptcy Court, the DCO is free to transfer customer positions and collateral in a single bulk transfer. * Generally, customer accounts that are in deficit are not included in a bulk transfer and will be liquidated. If the DCO is unable to do so, the DCO will unwind the defaulting FCM’s customer positions. * Any remaining collateral will be distributed per the trustee’s instructions. * If a CCP defaults, it would be subject to the same regime described above for FCMs. | Subchapter IV of Chapter 7 of the  U.S. Bankruptcy Code  Part 190 of the CFTC Regulations  (CFTC Rules 190.02, 190.06)  CFTC Rule 39.16 |
| 4. | Delivery of Customer Collateral to the Trust Bank | * Customer collateral is delivered to JSCC or the clearing member (as payment agent) via such entity’s BOJ account. Such customer collateral is at all times segregated (as described above). During the very brief period in which the customer collateral remains at the BOJ, subject to transit to the trust bank, such collateral is not bankruptcy remote. * However, the period of time in which customer collateral is subject to this transit process can be effectively managed by the customer or its agent, since (i) clearing members are required by JSCC rules to deliver all customer collateral to JSCC[[8]](#footnote-9) without delay and by the deadline of each margin call (11:00 and 15:30), and (ii) the exact time (11:30, 15:30 and 16:30)[[9]](#footnote-10) at which JSCC delivers customer collateral to the trust bank are prescribed. Thus, if a customer delivers collateral to its clearing member immediately before the prescribed time, the time period in which the collateral remains in transit during the settlement process can be shortened, which would mitigate the risk of loss to the customer due to a bankruptcy of JSCC. | Business Rules Articles 63(2), 66.1, 70.1, 72.1 and 72.2  Handling Procedures Article 43.2 | * Customer funds are at all times legally segregated from the funds of other customers and the proprietary funds of the DCO or FCM and are afforded priority under the U.S. Bankruptcy Code. | U.S. Bankruptcy Code and Part 190 of the CFTC Regulations |

1. A defaulting clearing broker cannot act as an agent, and in such a case, a customer can request return of their collateral directly from JSCC. [↑](#footnote-ref-2)
2. Article 156-7.1 of Financial Instruments and Exchange Act of Japan (“FIEA”) requires central counterparties (“CCPs”) to operate their clearing business pursuant to their business rules. Article 156-12 of FIEA requires the JFSA’s approval for changes to business rules. JSCC’s rule books for the IRS clearing are available at JSCC website (<https://www.jpx.co.jp/jscc/en/rule/rule_irs.html>). [↑](#footnote-ref-3)
3. JSCC maintains the segregation of customer collateral in accordance with the collateral segregation requirements under the FIEA regime (Article 156-11 of FIEA, Article 18 of Cabinet Office Order on Financial Instruments Clearing Organization) and the JFSA’s Comprehensive Guidelines for Supervision of Financial Market Infrastructure (“JFSA Guidelines”) (III-3-6 ).

   An English translation of Cabinet Office Order on Financial Instruments Clearing Organization is available on the Ministry of Justice website: (<http://www.japaneselawtranslation.go.jp/law/detail/?ft=1&re=01&dn=1&ia=03&co=01&x=0&y=0&ky=%E9%87%91%E8%9E%8D%E5%95%86%E5%93%81%E5%8F%96%E5%BC%95%E6%B8%85%E7%AE%97%E6%A9%9F%E9%96%A2&page=4>).

   An English translation of JFSA Guidelines is available on the JFSA website: (<https://www.fsa.go.jp/en/news/2014/20140327-1/01.pdf>) [↑](#footnote-ref-4)
4. Alternatively, clearing members and customers may elect to custody their own JPY cash collateral at the Bank of Japan. This document describes the protections when choosing the trust arrangement. [↑](#footnote-ref-5)
5. An English translation of the Trust Act is available at the Ministry of Justice website, here: (<http://www.japaneselawtranslation.go.jp/law/detail/?id=2476&vm=04&re=01>) [↑](#footnote-ref-6)
6. The official name is *Gaikokuho Kyodo-Jigyo Horitsu Jimusho Linklaters*. [↑](#footnote-ref-7)
7. JSCC passes the fees and costs to the special clearing fees. [↑](#footnote-ref-8)
8. This can be exempted if the clearing member obtains the customer’s consent. In such a case, the clearing member must deliver to JSCC the substituted collateral (i.e. eligible collateral that is different from the collateral originally delivered to the clearing member) in an amount not less than the value of the collateral originally received from the customer (Article 73.1 and 73.2 of the Business Rules). [↑](#footnote-ref-9)
9. These deadlines are prescribed in the operational procedures that are distributed to all clearing members. [↑](#footnote-ref-10)