

Act on Close-Out Netting of Specified Financial Transactions Conducted by Financial Institutions

(Act No. 108 of June 15, 1998)

(Purpose)

Article 1 This Act aims to ensure the stable settlement of specified financial transactions and to promote the use of these transactions by clarifying the handling of close-out netting of specified financial transactions entered into by financial institutions in bankruptcy and similar proceedings, thereby contributing to increased confidence in Japan's financial system both at home and abroad and to the sound development of the national economy.

(Definitions)

Article 2 (1) In this Act, the term "specified financial transaction" means a transaction in which the parties promise to pay and receive the monies calculated based on something such as a fluctuation or intermarket difference in an interest rate, currency value, quotation on a financial instruments market (meaning a "financial instruments market" as prescribed in Article 2, paragraph (14) of the Financial Instruments and Exchange Act (Act No. 25 of 1948)), or other such indicator (hereinafter referred to as "interest rate fluctuation or something similar" in this paragraph) or any other such transaction that is carried out using an interest rate fluctuation or something similar, which constitutes an over-the-counter derivatives transaction as prescribed in Article 2, paragraph (22) of that Act any other transaction prescribed by Cabinet Office Order.

(2) In this Act, the term "financial institution" means a juridical person set forth in the following:

(i) a bank as prescribed in Article 2, paragraph (1) of the Banking Act (Act No. 59 of 1981) or long-term credit bank as prescribed in Article 2 of the Long-term Credit Bank Act (Act No. 187 of 1952);

(ii) a financial instruments business operator as prescribed in Article 2, paragraph (9) of the Financial Instruments and Exchange Act (but only a person engaged in type I financial instruments business as prescribed in Article 28, paragraph (1) of that Act (unless it is a type I small amount electronic public offering business operator under Article 29-4-2, paragraph (9) of that Act)); or

(iii) any other juridical person that has received operational or business licensing or registration pursuant to the laws and regulations of Japan or has been incorporated pursuant to a special Act, and that is prescribed by

Cabinet Order as a juridical person that conducts a substantial volume of specified financial transactions on its own account or on customer accounts.

- (3) In this Act, the term "bankruptcy and similar proceedings" means bankruptcy proceedings, rehabilitation proceedings, or reorganization proceedings.
- (4) In this Act, the term "close-out netting event" means a petition for the commencement of bankruptcy proceedings, rehabilitation proceedings, or reorganization proceedings.
- (5) In this Act, the term "master agreement" means a written agreement that is prepared to enable a financial institution seeking to carry out specified financial transactions and its counterparty to continuously carry out two or more specified financial transactions between themselves, that provides for the means of performing the obligations associated with the specified financial transactions carried out between the parties to the agreement and other basic matters related to those specified financial transactions.
- (6) In this Act, the term "close-out netting" means that, regardless of the intentions of the parties carrying out specified financial transactions based on a master agreement, if a close-out netting event occurs with respect to one of them, the net total amount arrived at by combining the values at the time of the event that are calculated pursuant to Cabinet Office Order for each one of all of the specified financial transactions that are being carried out based on that contract when that event occurs, becomes a single claim or a single obligation that exists between the parties.

(Relationship Between Close-Out Netting and Bankruptcy and Similar Proceedings)

Article 3 If a person subject to an order commencing bankruptcy proceedings, an order commencing rehabilitation proceedings, or an order commencing reorganization proceedings (hereinafter referred to as an "order commencing bankruptcy or other such proceedings" in this Article) is a financial institution or its counterparty that had been carrying out specified financial transactions pursuant to a master agreement that includes a close-out netting provision, the occurrence of a close-out netting event in association with the order commencing bankruptcy or other such proceedings causes the assets and claims specified in the relevant of the following items and prescribed in the Act set forth in that item which those parties hold in connection with all the specified financial transactions that they were carrying out pursuant to the master agreement to become a single claim that the person subject to the order holds based on the relevant provisions of that agreement or a single claim that the other party holds based on the relevant provisions of that agreement:

- (i) Bankruptcy Act (Act No. 75 of 2004): assets that belong to a bankruptcy estate or bankruptcy claims;

- (ii) Civil Rehabilitation Act (Act No. 225 of 1999): assets that belong to a rehabilitation debtor at the time of commencement of rehabilitation proceedings or rehabilitation claims; and
- (iii) Corporate Reorganization Act (Act No. 154 of 2002) or Act on Special Treatment of Corporate Reorganization Proceedings and Other Insolvency Proceedings of Financial Institutions (Act No. 95 of 1996): assets that, at the time of commencement of reorganization proceedings, belong to a stock company or to a cooperative structured financial institution as prescribed in Article 2, paragraph (2) of the Act on Special Treatment of Corporate Reorganization Proceedings and Other Insolvency Proceedings of Financial Institutions or to a mutual company as prescribed in paragraph (6) of that Article; or reorganization claims as prescribed in the main clause of Article 2, paragraph (12) of the Corporate Reorganization Act or in the main clause of Article 4, paragraph (12) or in the main clause of Article 169, paragraph (12) of the Act on Special Treatment of Corporate Reorganization Proceedings and Other Insolvency Proceedings of Financial Institutions.

Article 4 (1) If a counterparty to specified financial transactions with a person that has become subject to an order commencing reorganization proceedings (limited to a financial institution or counterparty to a financial institution that had been carrying out specified financial transactions pursuant to a master agreement that includes a close-out netting provision; hereinafter the same applies in this Article) comes to hold a single claim pursuant to the provisions of the preceding Article (hereinafter referred to as a "claim after close-out netting" in this Article), and that counterparty holds a security right associated with the claim after close-out netting under a contract that is meant to establish a security right and that the person subject to the order commencing reorganization proceedings and the counterparty have entered into prior to the filing of the petition for the commencement of reorganization proceedings (such a contract is limited to one with a clause stipulating that if a petition for commencement of reorganization proceedings is filed against either party to specified financial transactions under a master agreement, the property that is the subject of the security right may be vested in the security right holder as payment of a debt), the property that is the subject of the security right (limited to the property specified by Cabinet Office Order such as securities to be deposited by a party engaged in specified financial transactions to ensure the performance of obligations to the counterparty; hereinafter referred to as "property subject to close-out netting" in this Article) vests in the counterparty at the time the petition for the commencement of reorganization proceedings is filed.

(2) In the case referred to in the preceding paragraph, if the value of the property

subject to close-out netting that vests in the counterparty (meaning the value calculated pursuant to Cabinet Office Order; the same applies in the following paragraph) exceeds the amount of the claim after close-out netting, the counterparty must pay an amount of money equivalent to the amount in excess without delay to the person subject to the order commencing reorganization proceedings; provided, however, that part of the property subject to close-out netting may be substituted for all or part of that money.

- (3) If property subject to close-out netting vests in the counterparty of a person subject to an order commencing reorganization proceedings pursuant to the provisions of paragraph (1), the value of the property subject to close-out netting (or the amount of the claim after close-out netting, if that value exceeds the amount of that claim after close-out netting) is to be deducted from the amount of the claim after close-out netting.
- (4) The provisions of the preceding three paragraphs (excluding the proviso to paragraph (2)) apply mutatis mutandis if the person subject to an order commencing reorganization proceedings and its counterparty to specified financial transactions have entered into a contract that is meant to establish a security right prior to the filing of the petition for the commencement of reorganization proceedings (such contract is limited to a contract with a clause stipulating that if a petition for the commencement of reorganization proceedings is filed against either party to specified financial transactions under a master agreement, the security right holder is entitled to dispose of the property that is the subject of the security right). In this case: in paragraph (1), the phrase "vests in the counterparty at the time the petition for the commencement of reorganization proceedings is filed" is deemed to be replaced with "vests in a third party at the time the counterparty transfers that property to that third party after the petition for the commencement of reorganization proceedings is filed and before the reorganization proceedings commence"; in paragraph (2), the phrase "vests in the counterparty" is deemed to be replaced with "vests in the third party" and the phrase "the value of...(meaning the value calculated pursuant to Cabinet Office Order" is deemed to be replaced with "the transfer value...(or the value calculated pursuant to Cabinet Office Order, if the transfer value is unjustifiably low in light of the value so calculated)"; and in the preceding paragraph, the phrase "the counterparty of a person subject to an order commencing reorganization proceedings" is deemed to be replaced with "the third party" and the term "value" is deemed to be replaced with "transfer value".