

(Tentative translation)

The Japanese Government Securities Guidelines for Real Time Gross Settlement

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(Enforced on MAY 1, 2018)

Japan Securities Dealers Association

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I. General

1. Purpose

While the necessity of addressing settlement risks in financial transactions has been growing globally in recent years, the Bank of Japan introduced “Real Time Gross Settlement” (hereinafter referred to as “RTGS”) for settlements of government securities (also referred to as “JGB”) through the Bank of Japan Financial Network System (hereinafter referred to as the “BOJ-NET”) JGB Services and for fund settlements through the BOJ-NET Fund Transfer System (hereinafter referred to as the “BOJ-NET FTS) on January 4, 2001.

With the introduction of RTGS in government securities transactions, market participants were required to adopt new settlement procedures completely different from conventional ones and to properly respond to increasing burdens of settlement operations. To discuss these issues, Japan Securities Dealers Association (JSDA) set up a “study group concerning the introduction of RTGS for government securities” composed of securities firms, banks, trust banks and life insurance companies, and released recommendations on new market practices underlying these Guidelines.

Based on those recommendations, JSDA published “The Japanese Government Securities Guidelines for Real Time Gross Settlement” (hereinafter referred to as the “Guidelines”) in August, 2000. The Guidelines lay out the practices that market participants must follow to realize a smooth transition to RTGS subject to compliance with the rules on RTGS in the BOJ-NET JGB services, to reduce settlement risks in the environment following the launch of RTGS, and to ensure efficient settlements in government securities transactions. After their initial release, the Guidelines have been reviewed and updated on an ongoing basis.

In May 2009, “The Working Group concerning Review of Fails Practice for Bond Trading” was established as a subordinate organization of JSDA’s Bonds Committee, in the wake of outbreak of the global financial crisis in 2008. With the intention of further instilling the Fails Practice while preventing frequent occurrence of Fails, the working group discussed to review the ongoing Fails Practice and other bond settlement procedures, taking into consideration global trends in offshore settlements in yen and others. Such discussions covered review of the scope of delivery-versus-payment (DVP) settlements eligible for being processed under the Fails Practice. In April 2010, the

working group published its final report, based on which JSDA amended these Guidelines in June 2010, with effect from November 1, 2010.

In September 2009, “The Working Group on Shortening of JGB Settlement Cycle” was established as a subordinate organization of “The Council on Reform of Delivery and Clearing/Settlement of Securities” and “The Forum on Reform of Securities Clearing and Settlement System,” both of which were set up by JSDA. This working group had discussions on the shortening of the settlement cycle for JGB with a view to reducing settlement risks in JGB transactions and published an interim report in December 2010. Then, given that the standard settlement cycle would be shortened to T+2 from T+3 for JGB outright transactions, the working group drew up a proposal for digitization of the trade matching process for bilateral netting and rules for payments netting of transactions with different face values in March 2011. Based on this proposal, Section IV of the Guidelines, “Guidelines concerning bilateral netting,” was revised in June 2011, with effect from April 23, 2012.

In December 2013, these Guidelines were thoroughly amended in line with the second phase launch of the new BOJ-NET. The amended Guidelines were enforced from the date of the second phase launch of the new BOJ-NET (October 13, 2015).

In November 2014, the Working Group on Shortening of JGB Settlement Cycle released a report entitled “Grand Design for Shortening of JGB Settlement Cycle (T+1).” Based on this report, JSDA amended these Guidelines in November 2015, which amendment will take effect from May 1, 2018.

JSDA hopes these Guidelines will help all market participants achieve more efficient JGB transactions under RTGS.

These Guidelines will not in any way restrict the rights of market participants permitted by law.

2. Effective date of the amended Guidelines

These Guidelines as amended will take effect on MAY 1, 2018, from which T+1 settlement will be launched as the standard settlement cycle for JGB outright transactions.

II. Guidelines for ensuring smooth settlements

1. Limitation on the size of each settlement

(1) The upper limit on the size of each settlement through the BOJ-NET JGB services

Each market participant shall be required to set an upper limit on the size of each settlement processed through the BOJ-NET JGB services at five billion Japanese yen in face value. This is because reducing the value of government securities and funds necessary for each settlement is essential in order to curb accumulation of unsettled balances during the daytime and to eliminate “gridlock” situations in settlements.

However, this requirement will not preclude transactions with face value exceeding the specified upper limit.

(2) How to handle transactions with face value exceeding the upper limit

- i. If a market participant trades JGB at the face value exceeding five billion yen, this transaction shall be split into multiple portions in order that each settlement in the BOJ-NET JGB services will not exceed five billion yen.
- ii. For the purpose of preventing confusion arising from splitting the transaction value into multiple settlement amounts, the market participants concerned shall create vouchers and process accounting documentation corresponding to the post-split settlement amounts.

(3) Exclusion of application of settlement ceiling

The limitation on the size of settlement does not apply to the following transactions in light of their nature:

- i. Transactions with the Bank of Japan (such as purchase and sales operations for treasury bills or long-term government bonds and payments for newly issued government securities)
- ii. Transactions with the fiscal loan fund and the national debt consolidation fund
- iii. Transactions relating to pledge or release of collateral (transactions for proprietary accounts called Proprietary Ledger II or IV in the JGB Book-Entry System)

2. Message flow for JGB settlement and cancellation of application for delivery-versus-payment transfer of JGB

(1) Message flow

Settlements among market participants are, in principle, subject to the message flow described as follows. First, a market participant who is to deliver JGB (hereinafter referred to as the “delivering participant”) transmits an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) on the settlement date. Then, a market participant who is to receive the JGB to be delivered (hereinafter referred to as the “receiving participant”) transmits a settlement instruction (for money transfer).

Any settlement deviating from this principle requires mutual agreement between the delivering and receiving participants in advance.

(2) Cancellation of application for delivery-versus-payment transfer of JGB

An application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) transmitted by a market participant may be cancelled solely by this market participant. If a market participant has mistakenly cancelled an application for delivery-versus-payment of JGB transmitted by any other market participant, the market participant first mentioned shall immediately inform the market participant who is the counterparty and take appropriate steps.

3. Adoption of Cut-off Time and Reversal Time

(1) Adoption of Cut-off Time

- i. The Cut-off Time means the deadline for government securities settlements set before the end time of the BOJ-NET JGB services, as determined by market participants for the purpose of recognizing Fails¹, etc. with the aim of facilitating completion of daily settlements.
- ii. Market participants shall, in principle, complete all transmissions of applications for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) by the Cut-off Time.
- iii. The Cut-off Time is 2:00 p.m. (applicable to the government securities subject to principal and interest payment due on the same day, other than those transferred to or from deposit (*kyotaku*) accounts).

(2) Adoption of Reversal Time

- i. The Reversal Time means the period during which market participants are

¹ For details of Fails, see Section III. 1.

allowed to resolve Fails, if they have agreed to extend the delivery deadline beyond the Cut-off Time, or correct other errors in settlement procedures if such errors are found.

- ii. The Reversal Time is the period from the Cut-off Time to the close of the core hours for the BOJ-NET JGB services, i.e., from 9:00 a.m. to 4:30 p.m. (hereinafter referred to as the “Core Hours”).

However, the last 30 minutes before the close of the Core Hours shall be used mainly for correcting errors in settlement procedures.²

With regard to error corrections or other operations for the government securities subject to principal and interest payment due on the same day (excluding those transferred to or from deposit (*kyotaku*) accounts), the Reversal Time is up to 3:00 p.m., which time is the deadline for inputting book-entry transfers.

4. Guiding principles for market participants applicable on the settlement date

(1) Guiding principles to be observed by 12:00 noon on the settlement date

- i. A delivering participant shall transmit an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) as early as possible after the start of the Core Hours. Then, the receiving participant shall promptly confirm the settlement information and transmit a settlement instruction (for money transfer).
- ii. If a market participant is to pay for newly issued JGB, the market participant shall make the payment as soon as possible after the start of the Core Hours in order to ensure smooth settlement of the new JGB on the issuance date.
- iii. If a delivering participant has any unsettled position in government securities, this market participant is not allowed to transmit an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) which is conditional on receipt of government securities from a third party.
- iv. Messages to be transmitted through the BOJ-NET JGB services shall be promptly sent in each instance, rather than waiting for a certain number of messages to pile up and sending them together.
- v. The BOJ-NET JGB services do not allow any market participant to designate

² In accordance with the operating schedule for the Core Hours under the BOJ-NET JGB services, the period from 2:00 p.m. to 4:30 p.m. is specified as the Reversal Time. The period from 4:00 p.m. to 4:30 p.m. in the Reversal time shall be used mainly for correcting errors in settlement procedures.

the time for settlement.

- vi. If an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) contains an error, the market participant receiving an advice communicating that the application as aforesaid has been received shall promptly inform the sender of the application and confirm the content originally contemplated by the application together with the sender, and then both parties shall promptly take necessary steps to complete the settlement.
- vii. In general, large-size settlements need to be preferentially processed for the purpose of minimizing potential effects of Fails and facilitating the progress of other subsequent settlement operations. However, such prioritized processing of large-size settlements may cause gridlock in other settlements across the entire system. The market participants concerned shall therefore keep close watch on actual situations and flexibly carry out settlement procedures.
- viii. Market participants are encouraged to finish settlements by 12:00 noon for smooth completion of daily settlements.
- ix. Notwithstanding the provision of paragraph viii above, in case of general collateral (GC) repos called “Subsequent Collateral Allocation Repo” (meaning a contract executed without specifying collateral, followed by collateral allocation to be made by Japan Securities Clearing Corporation (JSCC) after its assumption of the obligation of clearing and settlement of the contract executed), the recommended time schedule is as follows.

If a contract is executed before the second deadline for notification to request JSCC to assume the clearing and settlement obligation, the parties to the contract are encouraged to complete its settlement by the second settlement deadline on the same day prescribed by JSCC.

If a contract is executed after the second deadline for notification as aforesaid, the parties to the contract shall endeavor in good faith to ensure efficient settlement operation on the settlement date.

(2) Guiding principles to be observed from 12:00 noon to the Cut-off Time on the settlement date

- i. A market participant whose settlement remains unfinished at 12:00 noon shall confirm its details, inform the market participant as the counterparty causing the gridlock, and request this market participant to promptly transmit an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) or a settlement instruction (for money transfer).

- ii. If any settlement is expected to be completed near the Cut-off Time, the delivering participant shall inform the receiving participant as early as possible to facilitate the settlement, and make maximum efforts to avoid a situation where an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) is transmitted without prior notice.
- iii. Market participants shall keep to the Cut-off Time, fully recognizing that it is necessary to secure a reasonable length of the Reversal Time to ensure that settlements are efficiently completed.

(3) Guiding principles to be observed after the Cut-off Time on the settlement date

Market participants shall take necessary steps in good faith to complete their settlements through use of the Reversal Time.

(4) Settlements outside the Core Hours

The guiding principles described in paragraphs (1) to (3) are not intended to preclude market participants from processing settlements before or after the Core Hours.

5. Facilitation of settlements for customer accounts in the BOJ-NET JGB services

In light of risk reduction and smooth settlements, market participants are required to note the following guiding principles with regard to settlements for their customer accounts, etc.

(1) Transition to DVP settlement

With the aim of reducing settlement risks, indirect participants using the BOJ-NET JGB services and direct participants not having a current account with the Bank of Japan are also recommended to introduce delivery-versus-payment (DVP) settlement by means of DVP through customer accounts or settlements through fund transfer agencies. In this regard, indirect participants refer to Indirect Participants and Foreign Indirect Participants (as defined in the BOJ rules) and customers who are allowed to indirectly use the JGB Book-Entry System, and direct participants refer to those allowed to directly participate in the JGB Book-Entry System.

(2) Confirmation of back-office procedures

For settlements of funds for customer accounts, related back-office procedures need to be confirmed between each direct participant and its respective customer who is to

request settlements on an individual basis.

If a market participant and any of its customers enter into a certain agreement for fund settlements for the customer's account, both of them shall pay attention so as not to go against the trend for promoting transition to RTGS or not to have either party accept extremely unfavorable conditions.

(3) Proper use of the message fields in the BOJ-NET JGB services

- i. In order for direct participants in the BOJ-NET JGB services to smoothly respond to inquiries and identify the customers who request the market participants to perform settlements for their respective accounts, the direct participants shall properly use the message fields provided in the BOJ-NET JGB services.³
- ii. Some examples of using the message fields are illustrated as follows.
 - A) Transactions with financial institutions, security firms or nonresidents are subject to the rules described in paragraph iii below.
 - B) With regard to transactions with indirect participants or customers other than those mentioned in paragraph A), specific codes or numbers are not designated under these Guidelines; instead, their data are input in accordance with the manner to be agreed upon between the direct participants acting as the parties to the contract to be settled.
- iii. Mapping input fields

In the message fields provided in the BOJ-NET JGB services, relevant codes and values are input in the formats specified as follows.

“11.3 Party2” in “11.0 Delivering Settlement Parties” or “12.3 Party2” in “12.0 Receiving Settlement Parties” when using the BOJ-NET JGB services through computer connection (“CPU-to-CPU connection”) or through the file upload and download function (“ULDL”) in the ISO 20022 format

- “Message (Person Associated with Delivering Participant 1)” and “Message (Person Associated with Receiving Participant 1)” on the input screen

A) “Any BIC” field (12.16.1)

- If the customer is a nonresident, its BIC code is specified in the BIC field.

³ Market participants may use the message column not only for DVP settlement but also for free of payment (FOP) settlement.

B) “Identification (Non-BIC)” field (12.16.3) and “Issuer” field (12.16.4)

- In the Identification (Non-BIC) field, a customer’s 4-digit bank identification code is specified if the customer is a financial institution, and a customer’s 4-digit securities identification code is specified if the customer is a securities firm.
- In the Issuer field, “BA” is input if the customer is a financial institution, and “SC” is input if the customer is a securities firm.
- If the customer is a nonresident not bearing a BIC code or other similar nonresident, its identification code or something equivalent is specified in the Identification (Non-BIC) field and “NR” is input in the Issuer field.
- For mapping of a fund code, the fund code is specified in the Identification (Non-BIC) field and “FN” is input in the Issuer field.

iv. Other special instructions

- When inputting values in the message fields, one-byte alphanumeric or kana characters are used in principle and line break codes are not allowed.
- When using a BIC code for transactions with a securities firm or financial institution as the counterparty, prior agreement between both parties is required.

v. When a direct participant is processing any settlement for its proprietary account, its own identification code is not input in the message field.

(4) Proper use of trading IDs in the BOJ-NET JGB services

- i. With the aim of enabling market participants acting in the capacity of a delivering participant, receiving participant or other settlement party to easily identify the contracts to be processed, and in terms of conformity with the ISO 20022 message formats, market participants shall use a trading ID, which is an input/output item newly introduced in the new system.
- ii. A trading ID is used, for example, as illustrated below.

The content of a trading ID can be specified at the discretion of a sender of an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) or money transfer.

However, after an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) has been transmitted to the Bank of Japan, the reference number assigned to an advice/acknowledgement of application for delivery-versus-payment transfer of JGB and the reference

number assigned to a message designating the settlement based on the application for delivery-versus-payment transfer of JGB are used as the key to identify the settlement in question and verify its uniqueness.

(5) Setting the type of a transaction

When inputting data in the “Transaction Type” fields (9.0 Settlement Parameters, 11.32.16 Securities Transaction Type, 11.32.18 Proprietary) through CPU-to-CPU connection or ULDL, a value “TRFR” is input in “11.32.19 Identification” and a value “BOJ” is input in “11.32.20 Issuer.” This setting enables data output in the same way as transmitted through the BOJ-NET terminal.

(6) Restriction on use of data items in ISO 20022-compliant formats

If a telegraph format contains non-mandatory fields or fields for such items that are unavailable on the BOJ-NET terminal screen, those fields may not be used in principle.

6. Points to note in ensuring smooth settlements

- (1) If market participants execute a contract which is to be settled on or after the business day immediately following the contract date, the market participants are strongly encouraged to finish their trade matching by 5:30 p.m. on the business day immediately preceding the settlement date.⁴ This recommended practice is not intended to preclude trade matching after 5:30 p.m. on the business day immediately preceding the settlement date. In this case, however, both parties to the contract shall endeavor in good faith to ensure efficient settlement operation on the settlement date.
- (2) Market participants are expected to process their back-office operations in conformity with the Practical Guidelines for Computerization and Standardization of Post-Trade Processing of JGB Transactions.

In addition, market participants are expected to establish their own system allowing for computerized processing of settlement data, checking JGB balances and fund balances via the BOJ-NET, and prompt data input and processing. (Connecting their computer to the BOJ-NET is considered as an effective approach.)

⁴ In the case of trade matching with use of the Pre-Settlement Matching System (PSMS) operated by Japan Securities Depository Center, Incorporated (JASDEC), the trade matching is deemed to have been successfully completed when the data of the relevant sale and purchase contract is approved or its corresponding data is identified in the PSMS.

- (3) The Bank of Japan offers a function called “simultaneous processing of DVP and collateralization” (SPDC) in response to a possible increase in demand for funds as a result of transition to RTGS. Each market participant shall take necessary steps to prevent delays in settlements resulting from shortage of funds by such means as utilizing SPDC.

Market participants intending to utilize SPDC should note that they need to secure funds covering a collateral shortage (to be determined as a result of collateral valuation) in advance.

- (4) Market participants shall refrain from transmitting an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) if it causes a deficit in the balance of government securities.
- (5) Some settlements through processing government securities and funds separately (FOP settlement) or by means of transfer of government securities by documentation involve higher settlement risks than DVP settlements. Moreover, such types of settlements are expected to require burdensome workload because the timing of each settlement needs to be judged based on comprehensive management of JGB balances and fund balances. Therefore, market participants prepared to process DVP settlement will use the DVP settlement as much as possible.
- (6) If an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) is postdated, it shall be ensured that a deficit in the balance will never occur on the settlement date.
- (7) When processing change of a recipient of interest distributions that has been designated in advance, it shall be ensured that a deficit in the balance will never occur in connection with interest calculation.
- (8) When requesting change of a recipient of interest distributions on a real-time basis, such a request shall be promptly input.
- (9) When completing or cancelling the process of changing a recipient of interest distributions (Completion/Cancellation: Completion), it shall be processed after confirming that other necessary processes for such change have been completed by both the receiving participant and the delivering participant.
- (10) If a transaction being conducted is governed by applicable rules concerning message formats, trading IDs or other matters relating to settlement procedures prescribed by the Bank of Japan or Japan Securities Clearing Corporation, those rules shall apply, regardless of what is specified in this Guideline.

III. Guidelines concerning Fails

1. Definition of a Fail

A Fail means a situation whereby a receiving participant is unable to receive government securities to be delivered by its delivering participant while the predetermined settlement date has passed.

2. Good-faith efforts to resolve Fails

Fails are unwanted situations. Frequent occurrence of Fails may undermine the primary objective of facilitating smooth transactions and securing market liquidity.

Market participants shall therefore make all possible efforts to avoid Fails. If a Fail unavoidably occurs, the market participants concerned shall act in good faith to resolve the Fail as soon as possible.

If a receiving participant facing a Fail caused by a delivering participant asks for explanations about situations leading to the Fail, the delivering participant shall endeavor to provide sufficient explanations.

3. Premises for the guidelines concerning Fails

(1) In light of the policy on costs arising from Fails described below, market participants must recognize that an approach using Fails is applicable only in the case where DVP settlement is adopted (including such settlements whereby government securities and corresponding funds are settled on the same day under a contract executed by preserving both parties' claims and obligations in a reliable manner).

DVP settlements referred to above include DVP settlements provided by Euroclear, Clearstream or other foreign organizations.

(2) Transactions subject to the guidelines concerning Fails are purchase and sale transactions and repo transactions (meaning initial sale contracts and repurchase contracts in conditional purchase and sale transactions and lending and returning in lending transactions; hereinafter the same applies).

(3) Delivery in purchase and sale transactions and repo transactions shall be conducted by the method specified in Article 4 of the Rules Concerning Handling of Short Selling, and Borrowing and Lending Transactions of Bonds, in the case of short sale in purchase and sale transactions, and by the method specified in Article 11 of the Rules Concerning Handling of Short Selling, and Borrowing and Lending Transactions of Bonds or Article 13 of the Rules Concerning Handling of

Conditional Sale and Purchase of Bonds, etc., in the case of repo transactions.

- (4) Market participants shall not exercise the right of cancellation on the grounds of the occurrence of a Fail.
- (5) Receiving participants are not allowed to leave their relevant contracts unsettled on the grounds of fund shortage.
- (6) In the event of failure to successfully complete settlements other than the cases of Fails specified in these Guidelines, the market participants concerned shall resolve those situations by their own.

4. Understanding of costs arising from Fails

- (1) A delivering participant causing a Fail will become unable to receive funds payable by its receiving participant. As a result, the delivering participant will be forced to incur funding costs for holding the government securities, and give up profits that could otherwise be earned by investing such funds. Moreover, accrued interest to be received by the delivering participant will be limited to the amount attributable to the period up to the scheduled settlement date.
- (2) On the other hand, the receiving participant facing a Fail will be entitled to receive interest accrued from the scheduled settlement date to the date of actual receipt of the government securities and will be able to invest funds remaining in its hand due to the failure of settlement.
- (3) In a low interest rate environment, economic rationality as described in paragraphs (1) and (2) may not work effectively, and even Fails may probably occur frequently. Therefore, the receiving participant facing a Fail is entitled to receive a Fails Charge (meaning a certain monetary burden imposed on a delivering participant responsible for a Fail; hereinafter the same applies) from the delivering participant causing the Fail.
- (4) Therefore, the operation of the Fails Practice does not require particular penal provisions and a scheme of payment of default interest, etc. is not introduced in the Fails Practice.

5. Handling of Fails Charges

- (1) Preparations before the introduction of Fails Charges, as well as practical operations for calculation, claim for payment, payment and receipt and other handling of Fails Charges, shall be governed by the Practical Guidelines for Handling of Fails Charges (hereinafter referred to as the “Guidelines for Fails Charges”), as established separately.

- (2) Market participants are entitled to claim Fails Charges in connection with all transactions subject to DVP settlement.
- (3) If market participants intend to introduce Fails Charges, an agreement shall be established in advance between the two parties intending to conduct or conducting mutual transactions. Such an agreement shall be established by means of prior notice prescribed in the Guidelines for Fails Charges or by other methods.
- (4) Fails Charges shall be calculated by the following formula. (For the definitions of the terms used in the calculation formula and other details, see the Guidelines for Fails Charges.)

$$\sum_{\text{Fail period}} 1/365 \times \max(3\% - \text{Reference rate}, 0) \times \text{Amount of funds delivered}$$

6. Handling of Fails around the Cut-off Time

- (1) If it is confirmed at the Cut-off Time that an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) has not been successfully transmitted for any contract, this situation shall be treated as a Fail, except where otherwise agreed upon between the parties to the contract.

Market participants may recognize a Fail for any contract at the time of confirming that an application for delivery-versus-payment transfer of JGB (settlement instruction category: JGB) has not yet been transmitted, even before the Cut-off Time, if it is agreed upon between both parties in advance. In this regard, it must be noted that a Fail shall be recognized for all contracts remaining unsettled just before the close of the Core Hours(*), regardless of any prior agreement between the two market participants to the contrary.

(*). If both parties agree to execute contracts during the period from the close of the Core Hours to the end time of the BOJ-NET JGB services, the “close of the Core Hours” in the foregoing sentence shall be read as the “end time of the BOJ-NET JGB services.”

- (2) When facing a situation falling under paragraph (1), the market participants concerned shall respond in good faith to avoid frequent occurrence of Fails.

7. Payment and receipt when interest payment or redemption occurs before resolving a Fail

- (1) If interest is paid before a Fail is resolved, the receiving participant shall demand that the delivering participant pay an amount equivalent to interest that would otherwise be payable. Then, the delivering participant shall pay the amount to the receiving participant.

(2) If the securities are redeemed before a Fail is resolved, the receiving participant shall demand that the delivering participant pay an amount equivalent to interest that would otherwise be payable and the principal amount to be repaid. Then, the delivering participant shall pay such amounts to the receiving participant on condition that the delivering participant shall receive the amount to be settled under the original contract for the relevant securities from the receiving participant.

In case where the securities are redeemed prior to resolution of Fails,, the contract between the two parties shall be deemed to be closed when the payments specified above have been completed.

IV. Guidelines concerning bilateral netting

1. Standard netting scheme

If market participants intend to use the netting scheme described below, an agreement to perform netting pursuant to these Guidelines shall be established in advance between the two parties intending to conduct or conducting mutual transactions, which agreement is not necessarily required to be in writing.⁵

(1) Netting structure

If there are such outstanding obligations due on the same day between two market participants that can pair with each other (whereby each participant is to deliver government securities and pay funds to the other), the two market participants shall offset their respective delivery and payment obligations for each security or fund and then settle the net balance between them. Unless and until such net balance is settled, the rights and obligations under the original contracts to be netted shall remain effective as they are. (This netting method is hereinafter referred to as “bilateral payments netting.”)

(2) Volume to be netted

Bilateral payments netting may be performed for two offsetting transactions for the same issue of JGB with the same face value. (Netting for such paired transactions is hereinafter referred to as a “pair off.”)

(3) Settlement methods that can be covered by netting

Bilateral payments netting may be performed for transactions subject to DVP settlement.

(4) Deadline for trade matching for netting

To perform bilateral payments netting for certain contracts, exchange of the information necessary for trade matching shall be completed by 4:30 p.m. on the business day immediately preceding the delivery date under those contracts, and their trade matching shall be completed on the same day from 4:30 p.m. to 4:45 p.m..

(5) Types of transactions eligible for netting

Bilateral payments netting may be performed for a combination of purchase and sale transactions (including conditional purchase and sale), a combination of cash-collateralized securities lending and borrowing transactions, and a combination of any of the foregoing transactions⁶.

⁵ JSDA has obtained a legal opinion that bilateral netting prescribed by these Guidelines is valid under Japanese laws.

⁶ In this context, the term “conditional purchase and sale” refers to initial sale transactions and repurchase transactions in conditional purchase and sale transactions, and the term “cash collateral

(6) Form of holding securities

Securities eligible for bilateral payments netting shall be book-entry transfer government securities.

(7) Transaction accounts eligible for netting

Bilateral payments netting shall be performed between the accounts of the same type and shall not be performed between different types of accounts.

(8) Pairing method

Pairing for bilateral payments netting shall be made in descending order of the amount to be delivered.

If there are multiple contracts with the same delivery amount, how to select the contracts to be paired shall be determined by the market participants concerned.

(9) Entry into effect of netting for contracts with the same delivery amount

If the delivery amounts to be netted for both contracts are equal to each other and both parties therefore does not need to pay and receive any difference amount in the bilateral payments netting operation, this netting shall take effect at 8:30 a.m. on the settlement date, which is the start time for settlements through the BOJ-NET on the said settlement date (or at 7:30 a.m. if the period of the BOJ-NET JGB services on the said settlement date is extended).

(10) Designation of the account used for fund settlement

For fund settlement for bilateral payments netting, market participants shall, in principle, designate their current accounts with the Bank of Japan.

2. Alternative netting based on the standard netting scheme

- (1) With a view to reducing the settlement volume across the entire market with the aim of enhancing back-office efficiency and mitigating the burden of providing funds, market participants may adopt an alternative netting scheme if both parties agree to do so, on condition that priority is given to use of the standard netting scheme. The alternative netting scheme in this context means a scheme for netting for contracts for the same issue with different face values which is designed by adopting the scheme of “bilateral payments netting” defined in Section IV.1 “Standard netting scheme” and then modifying the conditions described in paragraphs (2) and (8) of Section IV.1 (hereinafter referred to as “bilateral payments netting between different face values”).

However, when using this alternative scheme, the conditions described in paragraphs (3) to (7), (9) and (10) of Section IV.1 shall be fulfilled in the same way

securities borrowing and lending transactions" refers to borrowing and lending of relevant securities.

as required under the standard netting scheme, with a view to ensuring settlement efficiency.

(2) Bilateral payments netting between different face values pursuant to paragraph (1) shall be performed by either one-to-one netting or consolidated netting described as follows, to be adopted based on mutual agreement between the market participants concerned, rather than following the condition of Section IV.1(8).

i. One-to-one netting between different face values

When pairing contracts to perform one-to-one netting between different face values, the following steps shall be taken for the contracts that have not been covered by any pair off under the standard netting scheme.

- A) For the contracts not covered by any pair off, pairing is made in descending order of the face value.
- B) If there are multiple contracts with the same face value, pairing is made in descending order of the amount to be delivered.
- C) If there are multiple contracts bearing the same delivery amount and the same face value, pairing is made in chronological order of the contract date.
- D) If there are multiple contracts bearing the same delivery amount, the same face value and the same contract date, how to select the contracts to be paired is determined by the market participants concerned.

ii. Consolidated netting between different face values

Consolidated netting between different face values is bilateral payments netting between different face values performed by settling the difference obtained by calculating the total amount to be settled for the contracts for the same issue that have not been covered by any pair off under the standard netting scheme.

When pairing contracts to perform consolidated netting between different face values, the following steps shall be taken.

- A) For all the contracts not covered by any pair off, the total amount to be delivered by the delivering participant and the total amount to be received by the receiving participant are calculated for each issue⁷.
- B) All the contracts constituting the total amount to be delivered or the total amount to be received calculated under paragraph A), whichever is the greater, are sorted in accordance with the following steps.
 - (a) Sorting in descending order of the face value

⁷ The total amount to be delivered and the total amount to be received are calculated based on the face values of relevant securities.

- (b) Sorting in descending order of the amount to be delivered, if there are multiple contracts with the same face value
 - (c) Sorting in chronological order of the contract date, if there are multiple contracts bearing the same delivery amount and the same face value
 - (d) Sorting by the method to be determined by the market participants concerned, if there are multiple contracts bearing the same delivery amount, the same face value and the same contract date
- C) The contracts sorted pursuant to paragraph B) are added up in the sorting order specified therein until the aggregate amount reaches the total amount to be delivered or the total amount to be received calculated under paragraph A), whichever is the smaller.
 - D) The total amount to be delivered or the total amount to be received as calculated under paragraph A), whichever is the smaller, and the total amount obtained under C) are offset.
 - E) All other contracts not covered by consolidated netting between different face values under paragraph D) are settled on a gross basis.
- (3) In order to further encourage market participants to adopt netting with a view to reducing the settlement volume across the entire market, market participants may adopt another alternative netting scheme incorporating modifications of the conditions described in Section IV.1(3) to (5), based on their mutual agreement, on condition that priority is given to use of the pairing off procedure in bilateral payments netting under the standard netting scheme.⁸
- When using this alternative scheme, the conditions described in paragraphs (6) to (10) of Section IV.1 shall be fulfilled in the same way as required under the standard netting scheme, with a view to ensuring settlement efficiency.
- (4) The legal validity of the alternative netting schemes specified in these Guidelines has been confirmed, as is the case with the standard netting scheme.

3. Operational procedures in netting

(1) Instructions for pairing and sorting

If the market participants concerned have mutually agreed to adopt the netting scheme, pairing off or pairing and sorting for bilateral payments netting between different face values may be processed, without being required to give notice in each instance.

⁸ For example, market participants may perform netting for pair offs in FOP settlements or uncollateralized securities lending transactions.

(2) Pre-settlement matching notice for netting

If a delivering participant and a receiving participant agree to perform netting for the contracts selected by them, each of them shall issue a pre-settlement matching notice listing the contracts to be netted and send this notice to the other party by 5:00 p.m. on the business day immediately preceding the delivery date. The form of pre-settlement matching notice is separately specified in the Practical Guidelines for Computerization and Standardization of Post-Trade Processing of JGB Transactions.

(3) Deadline for pre-settlement matching

Pre-settlement matching for netting shall be completed by 5:30 p.m. on the business day immediately preceding the delivery date.

(4) How to send pre-settlement matching notices

The method agreed upon by both parties is used.⁹

(5) Principle of cross-checking pre-settlement matching notices

Pre-settlement matching notices shall be cross-checked by both parties.

(6) Objection notice

If either party has any objection to the pre-settlement matching notice received from the other party, both parties shall complete their matching by 5:30 p.m. on the business day immediately preceding the delivery date by sending a correct matching notice.

(7) Departments responsible for pre-settlement matching

In general, the duties of pre-settlement matching are assigned to departments engaged in back-office operations. However, market participants may appoint other departments to control pre-settlement matching procedures and inform other relevant market participants according to circumstances.

4. Pre-settlement confirmation, pre-settlement notice, and their relation with pre-settlement matching notice

Market participants may exchange pre-settlement confirmations (cf. Model Form 1) and pre-settlement notices (cf. Model Form 2) at their option. Such correspondence may help confirm the mutually agreed-upon conditions, descriptions of the account to be used for fund settlement, contact persons, and other details of the scheme of standard netting or alternative netting adopted by relevant market participants.

The points to note when exchanging pre-settlement confirmations or pre-settlement notices are as follows.

⁹ Examples of specific sending methods are given in the Practical Guidelines for Computerization and Standardization of Post-Trade Processing of JGB Transactions.

- (1) Pre-settlement confirmations and pre-settlement notices between two market participants shall, in principle, be sent to each other. If there is any discrepancy between the content mutually verified in advance and the confirmation or notice actually sent, the two parties shall recheck the content.
- (2) Each pre-settlement confirmation, pre-settlement notice or pre-settlement matching notice is supposed to contain a statement, “Netting is based on ‘IV. Guidelines concerning bilateral netting’ of The Japanese Government Securities Guidelines for Real Time Gross Settlement of JSDA.” Therefore, any of these documents allows the market participants concerned to readily confirm their agreement to adopt the standard or alternative netting scheme.

If pre-settlement matching notice is sent electronically, it may be difficult in practical operations to declare in the notice that netting is based on these Guidelines. It is therefore determined appropriate that the market participants concerned make it a practice to exchange pre-settlement confirmations and pre-settlement notices in advance wherein the method of sending pre-settlement matching notice and both parties’ adherence to these Guidelines are confirmed. In addition, since it is practically difficult to affix signatures or seals on pre-settlement matching notices, exchanging pre-settlement confirmations or pre-settlement notices is a recommendable solution for market participants who prefer to rely on written instruments bearing the signatures or seals set by the parties concerned for the purpose of confirming their agreement.

- (3) The practice of exchanging pre-settlement confirmations or pre-settlement notices may possibly cause discrepancies between the descriptions in such notice and those in a pre-settlement matching notice to be subsequently exchanged. In this case, the pre-settlement matching notices shall prevail over the pre-settlement confirmations because the former indicates the latest confirmation between the two parties just before the intended settlement. If, however, the parties cannot reach agreement on the content of the pre-settlement matching notices, the settlement shall be processed in accordance with the pre-settlement confirmations.

5. Netting other than bilateral payments netting

Some market participants may agree to perform netting under a non-standard netting scheme other than the standard netting scheme or alternative netting schemes specified in these Guidelines when such non-standard scheme is expected to reduce settlement volumes and thus contribute to enhancing back-office efficiency and mitigating the

burden of providing funds.¹⁰ If market participants intend to introduce any non-standard netting scheme, the points listed below must be noted.

- (1) When market participants perform netting, they need to assume the possibility of Fails or failure to complete fund settlement. Therefore, market participants shall consider and establish the procedure to identify the contracts to be treated under a Fail or fund settlement failure which may occur and how to address the Fail or fund settlement failure.
- (2) When market participants set a mutually agreeable netting scheme in place, due regard shall be given to operational efficiency, as well as to reduction of settlement risks, which the promotion of RTGS primarily aims for.
- (3) If market participants intend to perform netting other than bilateral payments netting, they shall ascertain and accurately recognize the legal validity of their netting scheme.

(Supplementary Provisions)

Establishment of the Guidelines: August 29, 2000.

Enforcement of the Guidelines: January 4, 2001.

Enforcement of the 1st Amendment: June 10, 2002.

Enforcement of the 2nd Amendment: January 19, 2004.

Enforcement of the 3rd Amendment: November 1, 2010.

Enforcement of the 4th Amendment: April 23, 2012.

Enforcement of the 5th Amendment: October 13, 2015

This Amendment will take effect as from the date to be specified by JSDA. The target effective date is scheduled to fall in the first half of fiscal 2018, which is the target date of starting application of the T+1 settlement cycle to JGB transactions.

¹⁰ For example, one conceivable method is obligations netting; in the case where multiple receivables and payables may arise between two market participants that are supposed to be performed on the same day, whenever a new receivable is created, it is immediately offset against then outstanding payables without awaiting the maturity date; in this way, a net amount finally payable and receivable between the two parties on the maturity date is calculated by offsetting and consolidating all outstanding obligations due on the same day.

Figure: Timeframe for Procedural Steps for Post-Trade Matching and Netting

Step	Contracts settled under the standard cycle of T+1 or longer		Other contracts (including those settled on a T+0 basis)	
Business day immediately preceding the settlement date				
With netting				
Exchange of information necessary for trade matching	4:30 p.m. ^(※1)	IV.1.(4)		
Trade matching	Around 4:30 p.m.–4:45 p.m.	IV.1.(4)		
Exchange of trade matching notices	5:00 p.m.	IV.3.(2)		
Pre-settlement matching for netting	5:30 p.m.	IV.3.(3)		
Without netting				
Trade matching	5:30 p.m.	II.6.(1)		
Settlement date				
Core Hours	9:00 a.m.–4:30 p.m.	II.3.(2)ii	9:00 a.m.–4:30 p.m.	II.3.(2)ii
Target deadline for finishing settlements	12:00 noon	II.4.(1)viii	12:00 noon	II.4.(1)viii
Cut-off Time	2:00 p.m.	II.3.(1)iii	2:00 p.m.	II.3.(1)iii
Reversal Time	2:00 p.m.–4:30 p.m. ^(※2)	II.3.(2)ii	2:00 p.m.–4:30 p.m. ^(※2)	II.3.(2)ii

(※1) If the information necessary for trade matching cannot be received by this deadline, the parties may opt to give up bilateral netting for the relevant contracts.

(※2) For government securities subject to principal and interest payment due on the same day (excluding those transferred to or from deposit (kyotaku) accounts), the Reversal Time will be closed at 3:00 p.m., which is also the deadline for error corrections and inputs of transfer data.

Reference information: Settlement Timeframe Specified by Japan Securities Clearing Corporation (JSCC)

Transaction type	Contracts to be settled	Settlement between a Clearing Participant as the delivering party and JSCC	Settlement between JSCC and a Clearing Participant as the receiving party
Outright transactions SC repos	Contracts supposed to be initially settled	1:30 p.m.	2:00 p.m.
	Contracts for which a Fail has been resolved		
Subsequent Collateral Allocation Repos	Contracts with collateral designated by the first deadline; contracts with end/unwind obligation	10:30 a.m.	11:00 a.m.
	Contracts for which a Fail has been resolved		
	Contracts with collateral designated by the second deadline	1:30 p.m.	2:00 p.m.
	Contracts with collateral designated by the third deadline	3:30 p.m.	4:00 p.m.

(Model form of "Prior confirmation for Japanese Government Securities netting")

Date of Notice:[]

To:[]

Name of company: _____

Department: _____

Contact person:

(person in charge) _____ [Seal]

Contact number: _____

Prior confirmation for Japanese Government Securities netting

We hereby give a prior confirmation to your company based on "IV.Guidelines concerning bilateral netting" in "The Japanese Government Securities Guidelines for Real Time Gross Settlement" of Japan Securities Dealers Association, confirming the following items for Japanese Government Securities netting agreed upon between two companies.

Description

1. Outlines of netting

Method of netting	Netting based on standard netting scheme and operational procedures defined in the Guidelines Section IV.1		
	Bilateral payments netting between different face values based on the standard netting scheme defined in paragraphs (1) and (2) of Section IV.2	One-to-one netting between different face values	
		Consolidated netting between different face values	
Alternative netting based on the standard netting scheme defined in paragraph (3) of Section IV.2			

2. Items required to confirm in alternative netting based on the standard netting scheme defined in paragraph (3) of Section IV.2 (Following items may be left in blank in case of the other nettings)

Settlement type	A set of DVP settlements	
	A set of FOP settlements	
	A set of DVP settlements, a set of FOP settlements, and the relation among these settlements	
Transaction types	A set of purchase and sale transactions (including conditional purchase and sale transactions), securities lending transactions in contrary form with cash collateral, and the relation among these transactions	
	A set of purchase and sale transactions (including conditional purchase and sale transactions)	
	Securities lending transactions in contrary form with cash collateral	
	Others (for example: between uncollateralized securities lending transactions)	
Specification of original transactions applicable to netting	Transactions that their trade-matching shall be completed by the deadline for trade-matching(from 4:30pm to 4:45pm)on the business day immediately preceding the delivery date for those contracts	
	Transactions that their trade-matching shall be completed by xx O'clock of the xxth business day before the settlement Details of modification are as follows; (Example: Deadline for cancellation of netting, deadline for comparison, and deadline for objection)	

3. Transaction account applicable to netting

	All transaction accounts of our company shall be applied to netting due to the above items unless it is separately designated by our company.
	Transaction accounts applicable to netting are as follows;

4. How to send pre-settlement matching notices

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5. Other remarks (Column for supplementation and postscript)

(e.g. Request related to data for pre-settlement matching notices)

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(Model Form of "Prior notice and modification notice for Japanese Government Securities netting")

Date of Notice: []

To: []

Name of company: _____

Department: _____

Contact person:

(person in charge) _____ [Seal]

Contact number: _____

Prior notice and modification notice for Japanese Government Securities netting

We hereby give a notice to your company in advance based on "IV.Guidelines concerning bilateral netting" in "The Japanese Government Securities Guidelines for Real Time Gross Settlement" of Japan Securities Dealers Association, confirming the following items (newly/alterably) for Japanese Government Securities netting agreed upon between two companies.

Description

1. Account for funds settlement

Current account at the BOJ	
1	Name of Company/ Financial Institution
2	Account name
3	Account number

2. Person in charge, Contact person, and Contact telephone number etc.

1	Department	
2	Person in charge	
3	Contact person	
4	Contact telephone number (1)	
5	Contact fax number (1)	
6	Contact telephone number (2)	
7	Contact fax number (2)	

3. Column for supplementation

This column can be used at option.

<Example for filling out the form>Market participants should use their current account at the BOJ in principle, and can use this column to confirm the account when they use an account of financial institution. In case data is sent electronically by using Web services etc., market participants should use this column for necessary information.