



Outline of the Grand Design for Shortening of JGB Settlement Cycle (T+1)

November 26, 2014

Working Group on Shortening of JGB Settlement Cycle

1 About the Grand Design

- The Working Group on Shortening of JGB Settlement Cycle (WG) released the “Grand Design for Shortening of JGB Settlement Cycle (T+1)” to illustrate an overview of the policy for the domestic market participants^(*) to set T+1 as the standard settlement cycle for outright transactions of Japanese government bonds (JGBs).
- The Grand Design proposes to revise the operational framework and to develop market infrastructures for T+1 implementation. In addition, in view of the further globalization of JGBs, the Grand Design calls for deliberation on the transaction scheme that takes into account international standards.
- Market participants are expected to deepen their understanding of the proposals in the Grand Design and to start preparing for T+1 implementation.
- The target timing of T+1 implementation will be determined in the spring of 2015, after the examination of the cost on the market infrastructure providers and the market participants.

* Retail transactions (over-the-counter sales at financial institutions and redemption before maturity of JGBs for individuals) are out of the scope of T+1 implementation.

2 Benefits and Purposes of Shortening the JGB Settlement Cycle for JGBs

- Shortening the settlement cycle to T+1 contributes to the “Reduction of settlement risks” as well as the “Enhancement of liquidity, stability and efficiency of the JGB market and the money market” and “Maintenance and strengthening of competitiveness among global markets ” through the development of necessary market infrastructure.

1. Reduction of settlement risks

2. Enhancement of liquidity, stability and efficiency of the JGB market and the money market

3. Maintenance and strengthening of competitiveness among global markets

Reduction of JGB settlement risks that materialized upon the failure of Lehman Brothers

Respond to the global needs of JGBs by adopting internationally accepted transaction methods.

Develop market infrastructure to enable T+1 for outright transactions (T+0 for GC repo transactions)

- To realize T+1 settlement for outright transactions, it is essential to develop the market infrastructure that enables T+0 settlement for GC repos (repo for the purpose of lending and borrowing cash) in a swift and efficient manner.

| | US | UK | France | Germany | Japan |
|--|------------------|---|--------------|--------------|--------------|
| Settlement Cycle <() for GC Repos> | T+1 (T+0) | T+1 (T+0) | T+2 (T+1) | T+2 (T+1) | T+2 (T+1) |
| Collateral allocation function provider | 2 clearing banks | Central Securities Depository (Euroclear, Clearstream) | | | None |

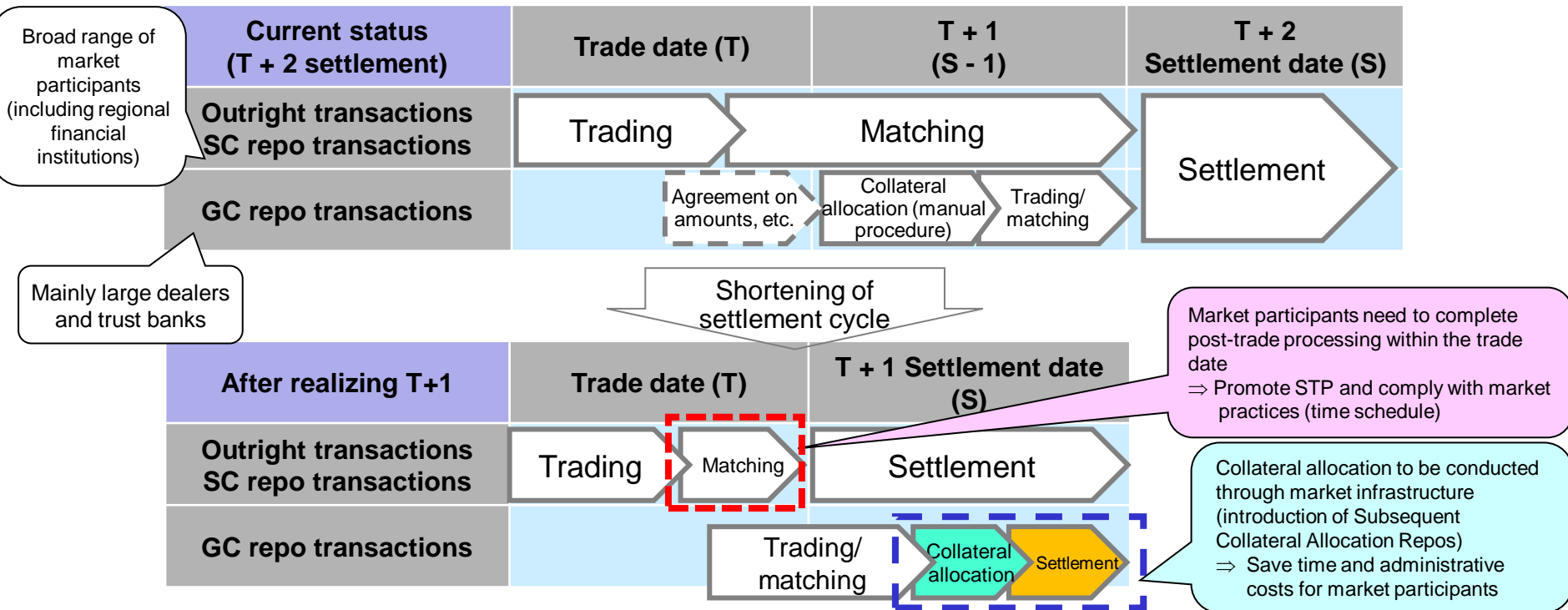
3 Basic Picture of the T + 1 Mechanism

(1) Measure for T + 1 outright and SC repo transactions

Promote STP (Straight Through Processing) in post-trade processing and use of CCP (central counterparty) among the broad range of market participants.

(2) Measure for T + 0 GC repo transactions

Develop market infrastructure to enable swift and efficient T+0 GC repo transactions.



- Outright transactions
- SC (Special Collateral) repo transactions
- GC (General Collateral) repo transactions

- Outright purchases that do not hold repurchase or resale conditions
- Repo transactions conducted mainly for lending and borrowing of bonds
- Repo transactions conducted mainly for lending and borrowing of funds

- In view of the demand for JGBs to grow globally, it is necessary that the JGB market develop a globally-accepted transaction framework to enhance its international competitiveness.
- From such perspective, as described below, the WG aims to align the standard agreement used in Japanese repo market to a more globally accepted form of repurchase agreement (the “*Gensaki*”.)

Policy to promote *Gensaki* upon T+1 implementation (Outline)

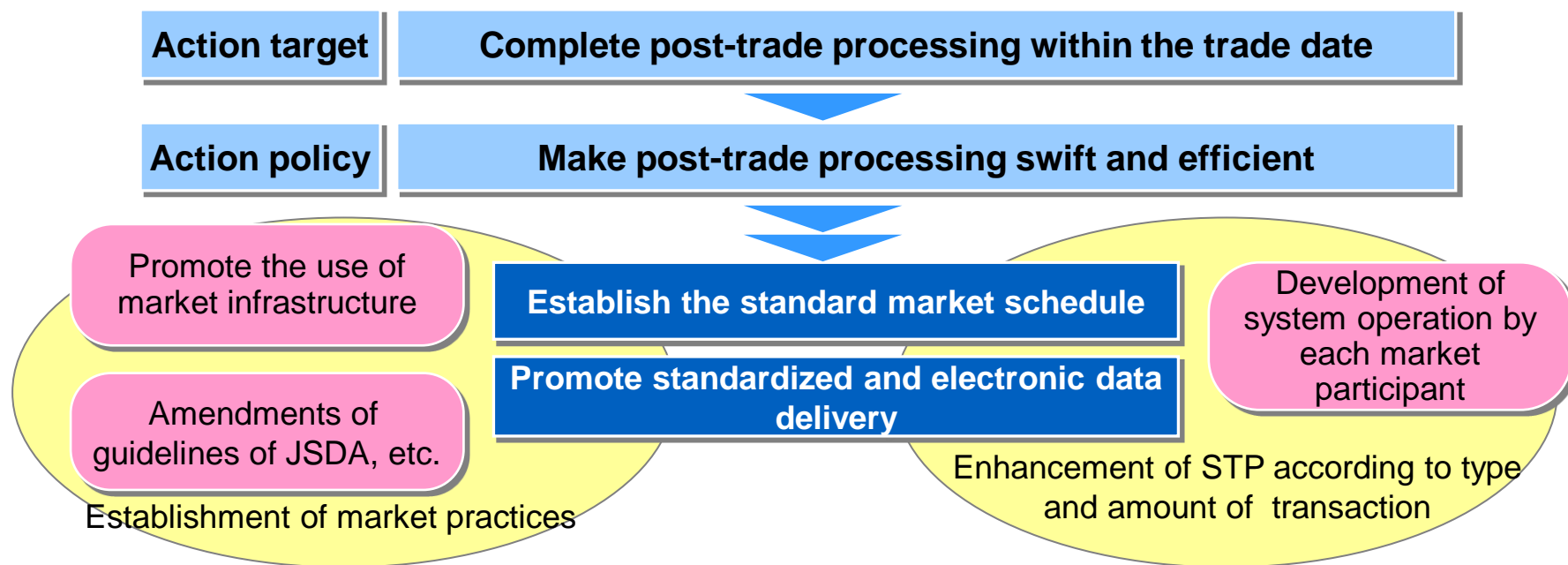
- The new GC Repos under the Subsequent Collateral Allocation Method (using CCP) will adopt the *Gensaki* in its standard agreement. Participants in the new scheme will take necessary preparatory actions such as revising contracts, and will gain understanding and approval from beneficiaries.
- The WG will facilitate to form a consensus among market participants for shifting the standard agreements used in other types of repo transactions such as SC repo transactions to a *Gensaki*, and will discuss when and how to smoothly implement the transformation of the market.

3 Challenge for Cross-Border Transactions

- Outright transactions with non-residents (currently settled on T+2 or T+3 cycle) involve various parties both inside and outside of Japan. Therefore, it is difficult to uniformly shorten the settlement cycle of cross-border transactions.
- However, in view to responding to various needs of the investors, it is desirable that the market participants launch initiatives to enable swift T+2 settlement in cross-border transactions. Such initiatives could include following measures that improve post-trade processing.
 - (1) Encourage overseas market participants in the trade/post-trade chain to deliver settlement instructions to sub-custodian banks in Japan by one day prior to the settlement date.
 - (2) Promote the use of the Pre-Settlement Matching System of Japan Securities Depository Center (JASDEC) by sub-custodians, especially securities companies, and other financial institutions in Japan.
- Discussion will be continued with regard to coordination with overseas contract matching mechanisms, taking into account the needs of the market participants as well as the costs and benefits.

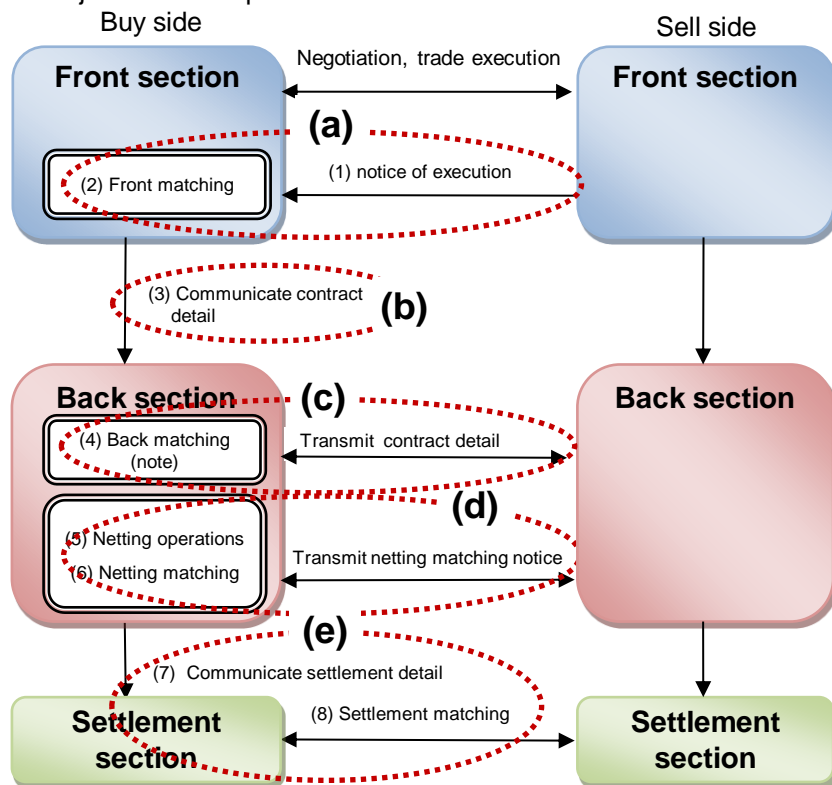
4-1 Introduction of T + 1 for Outright Transactions and SC Repo Transactions

- To achieve T + 1 in outright and SC repo transactions, it is necessary to “complete post- trade processing within the trade date.” For such purpose, it is essential “to establish the standard market schedule” and “to promote standardized and electronic data delivery” according to type and amount of transactions.
- In the Grand Design, specific guidelines for market participants in implementing the T+1 cycle are compiled and the policy for developing market practices related to T+1 is clarified. The WG and other committees will consider necessary market practices based on the policy prescribed in the Grand Design.



Reference: Action Policy for Outright Transactions and SC Repo Transactions

Major settlement process of Transactions that do not use CCP



(Note) There may be cases where the Pre-Settlement Matching System of JASDEC is used.

| Orientations of measures | Measures taken by market participants |
|--|--|
| Promotion of STP in front matching | a Streamline and expedite front-section operations by opting out of notice of execution and electronic data management |
| Adoption of STP in communicating contract detail | b Streamline and expedite communication of contract detail to back section |
| Automation of netting processing | c Expedite back matching operations |
| | d Streamline or opt out of netting operations |
| | e Streamline settlement matching operations |

Policy for Developing Market Practices

- (1) In “The Japanese Government Securities Guidelines for Real Time Gross Settlement”;
 - Recommend the use of electronic method
 - Revise the deadlines (excluding T + 0 transactions)
- (2) In other practical guidelines;
 - Recommend the adoption of electronic method for delivering/receiving notice of execution and its standardization
 - Recommend the use of the Pre-Settlement Matching System of JASDEC

4-2 Introduction of T + 0 for GC Repo Transactions

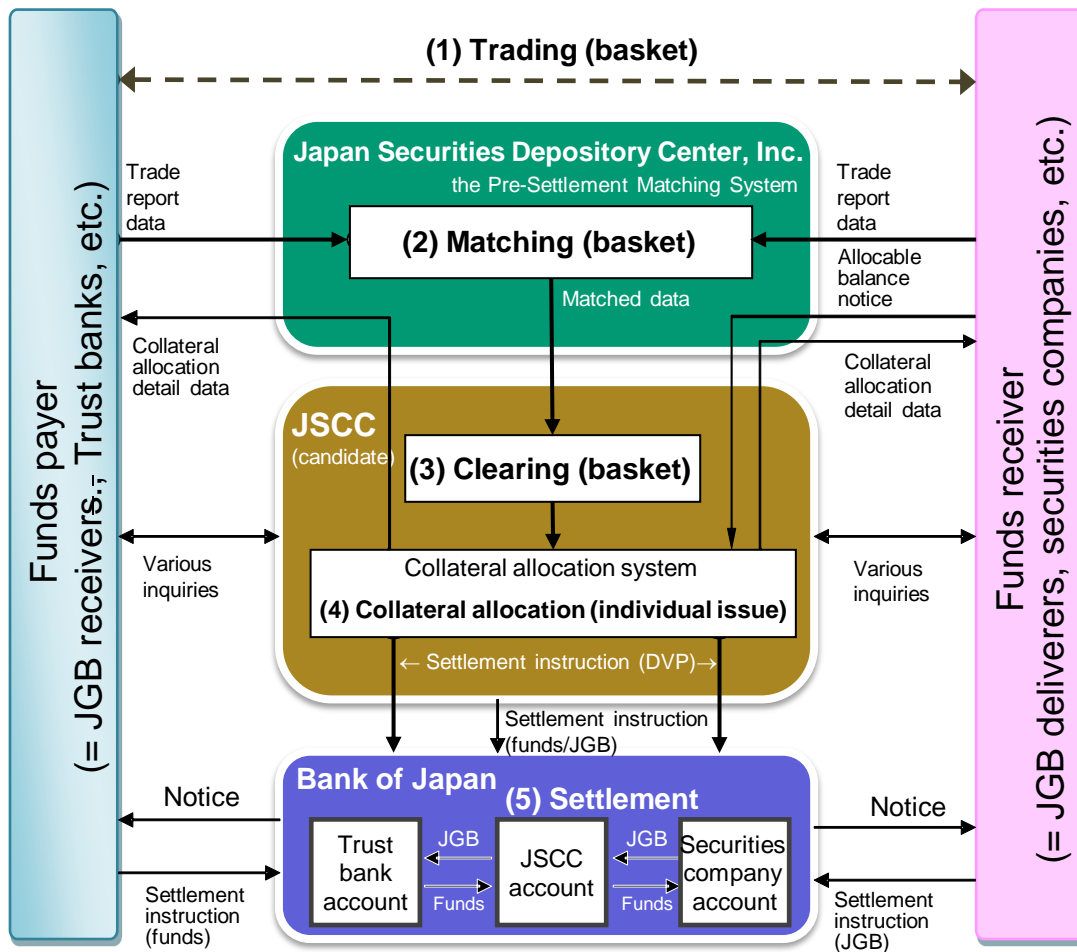
- With a view to conducting GC Repo transactions in a swift and efficient manner, a new GC repo transactions scheme (the “GC repos under Subsequent Collateral Allocation Method”) will be introduced. In the new scheme, parties will agree on the amount of fund to be delivered without specifying collateral, and the allocation of collateral will be conducted by a third-party market infrastructure from the inventory of the JGB delivering party, just before the settlement.
- Advantages of GC Repos under Subsequent Collateral Allocation Method are as follows:

(Main advantages of GC Repos under Subsequent Collateral Allocation Method)

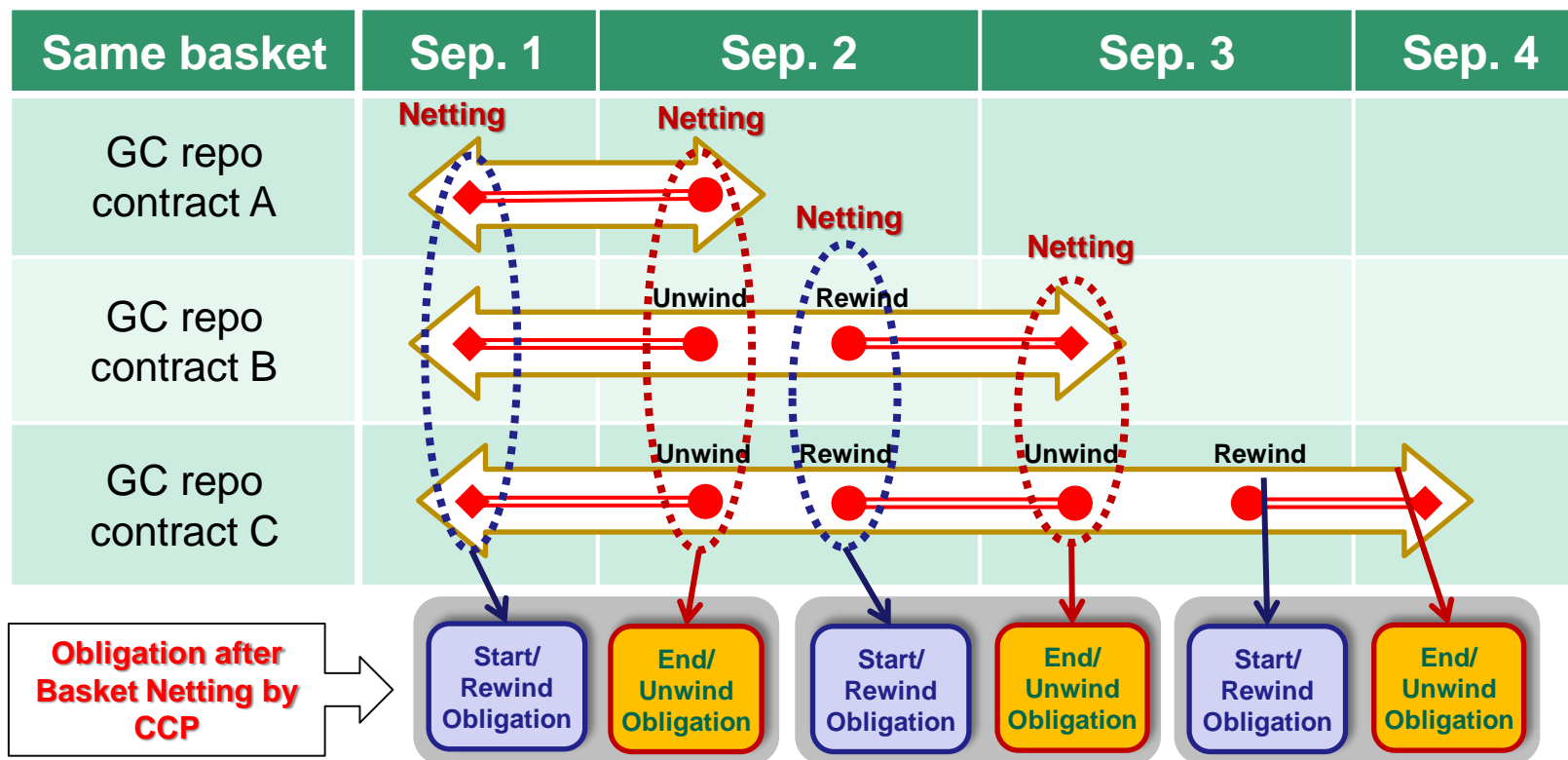
- Contract based on the delivery amount of fund and not the face value of the collateral expedites the process for the investors to fix the amount of excess funds.
 - Substitution mechanism through the unwind/rewind method improves the convenience of term-funding.
 - Provision of the matching and collateral allocation function by the market infrastructure reduces administrative costs.
 - While it does not affect the contracting time of outright transactions and SC Repo transactions, the new method provides an environment where GC Repo transactions can be regularly executed in the morning of settlement day (transactions can also be conducted in the afternoon of settlement day).
- The above mentioned market infrastructure is envisioned to be Japan Securities Clearing Corporation (JSCC), a CCP.

4-2 Overview of GC Repos under Subsequent Collateral Allocation Method

Systems and operational process from trading to settling a GC Repo under Subsequent Collateral Allocation Method

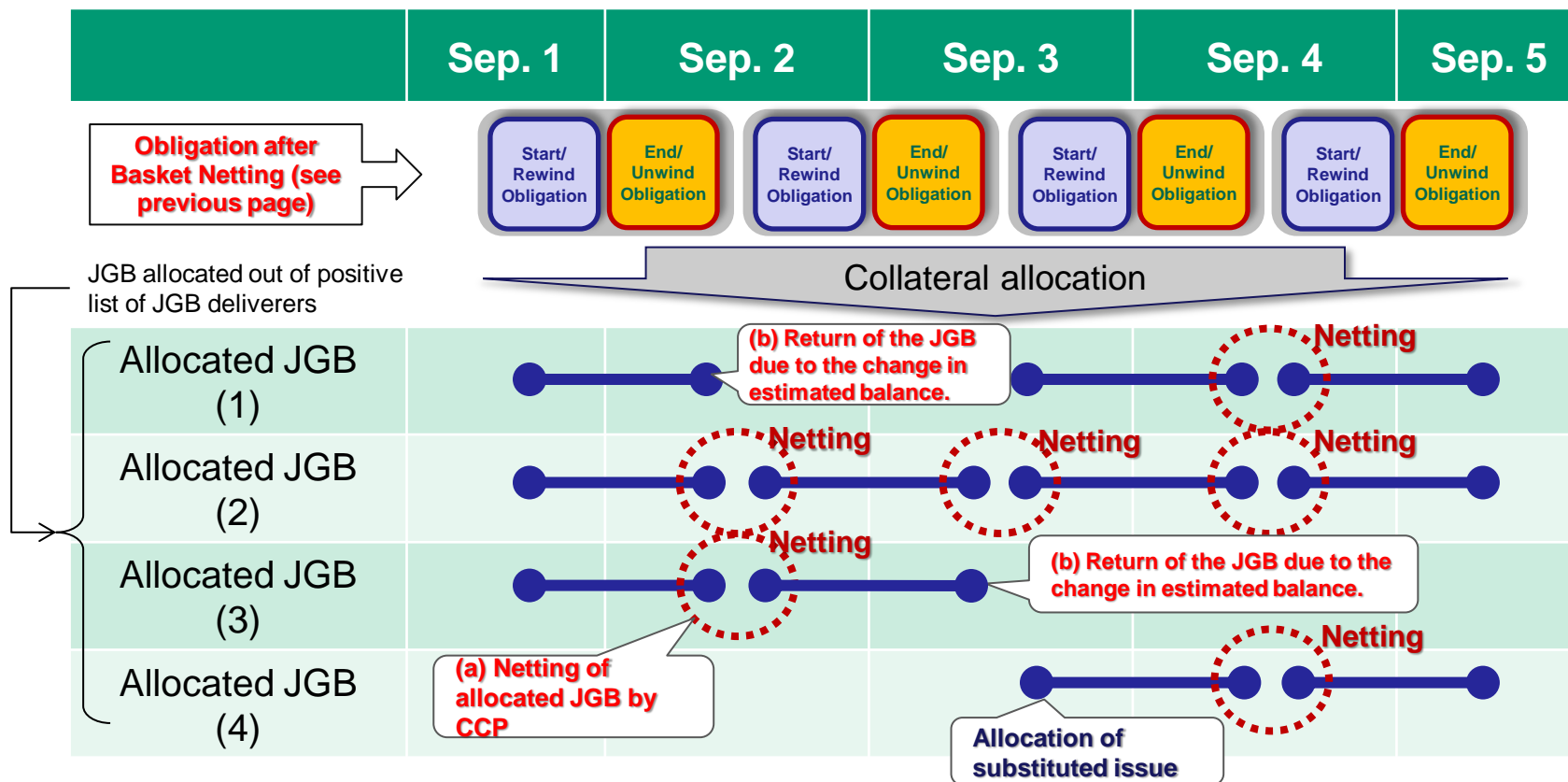


- Japan Securities Clearing Corporation (JSCC), a clearing house, is currently the candidate of the provider of the market infrastructure in charge of clearing, collateral allocation, settlement data creation of the GC Repo under Subsequent Collateral Allocation Method.
- The transactions will be conducted in the form of ○○ million yen (amount of fund basis) per JGB type (basket).
- Funds receivers notify JSCC of the inventory JGBs that can be used as collateral in GC repo transactions as allocable balance. Then, JSCC allocates those inventory securities to the netting results (amount) of GC repo transactions, creates settlement instruction data based on the allocation results, and transmits such data to the Bank of Japan for settlement.
- Daily Collateral Netting, which includes term-fund transactions, is expected to reduce the settlement volume.
- Collateral substitution procedure of term-funding transactions is not required (since the collateral allocation takes place every day).



- GC repo transactions A, B and C are executed on September 1. On the trading date of September 1, the provider of clearing and collateral allocation system (System Provider) clears the obligations related to concerning repos and the obligations related to unwind and/or rewind obligations arising from on-going term transactions. The obligations with the same basket and the same delivery day shall be netted to make a single obligation of Start/Rewind Obligation or End/Unwind Obligation between the System Provider and the concerned market participants (Basket Netting).
- End/Unwind Obligation, Start/Rewind Obligation are netted respectively, every day afresh, each time of clearing (in the example above, when another GC repo transaction is conducted on September 2, Basket Netting is conducted additionally at the time of clearing).
- Collateral allocation is conducted daily against netting results of the Start/Rewind Obligation which is to be settled on the day, on which the collateral allocation for End/Unwind Obligation of the following business day is based to be the same issue and quantity (see next page.)

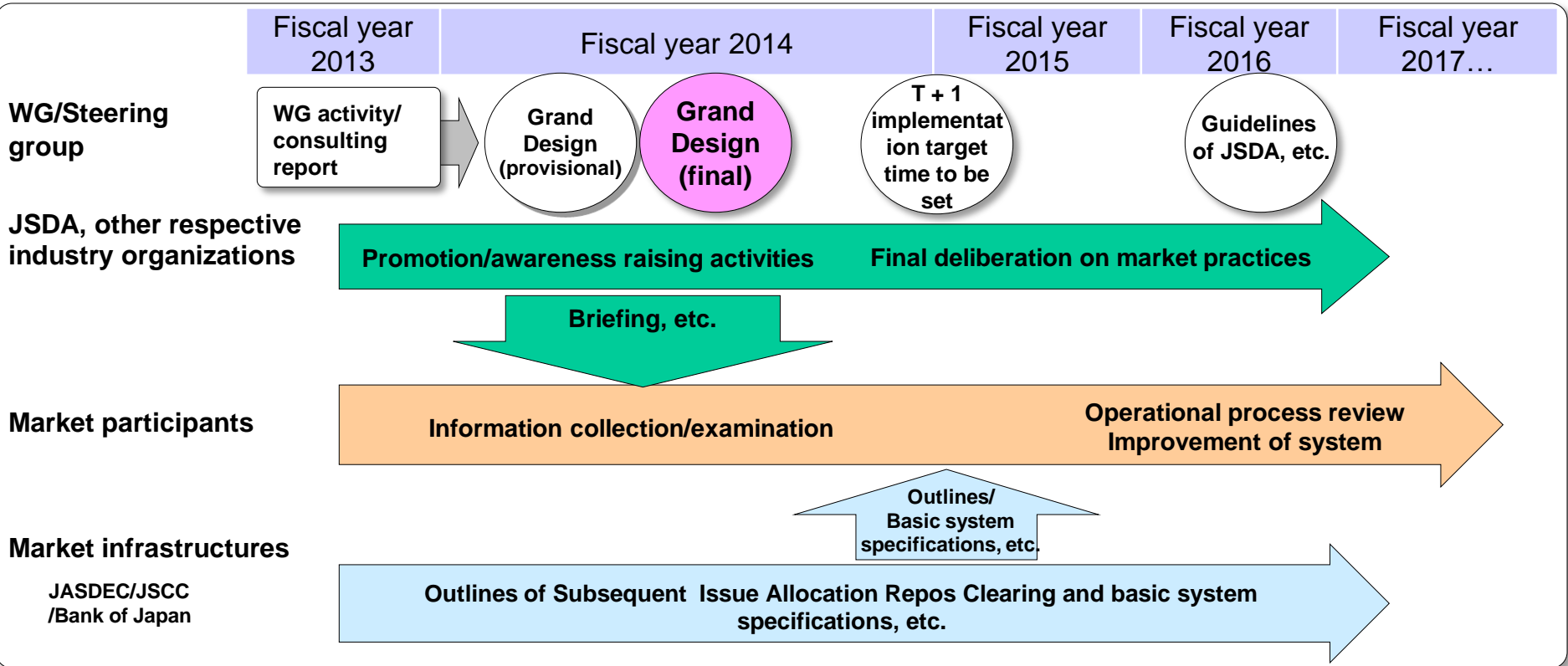
Reference: Collateral Allocation and Netting of Allocated Issue (JGB)



- JGB deliverer daily submits a list of JGBs that can be used as collateral by issue and the balance in the form of the “Allocable Balance Notice (positive list.)” The list consists of JGBs that are returned (unwound) to the JGB deliverer (i.e., JGBs used as the collateral for End/Unwind Obligation of the previous day), excluding issues that are scheduled to be used for other settlements
- The System Provider allocates collaterals to the Start/Rewind Obligation which is to be settled on the day based on the submitted positive list. When the collateral is allocated to the Start/Rewind Obligation (rewind) with the same balance of issue as the returned JGB, no settlement is required as the issues are individually netted (a). Issues that are expected to be used for other settlements will not be allocated to the Start/Rewind Obligation since it is excluded from the submitted positive list, and they will be returned to the JGB deliverers (b).
- This mechanism is paired with the Basket Netting mentioned earlier and makes it possible to conduct netting of allocated issues in the rolling transactions (repeated contracting of ended transactions).

5 Next Steps

- With the announcement of the Grand Design, JSCC has disclosed the basic functions as the “Outlines of Subsequent Issue Allocation Repos Clearing.” Based on the Grand Design and the Outlines, market participants are expected to examine the specific measures required for the T+1 implementation, as well as to obtain cost estimates for securing budgets.
- Considering the cost on the market infrastructure providers and the market participants, the WG will aim to form a consensus among related parties on the timing T+1 implementation in the spring of 2015.



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