

Points to Note for Post-Trade Processing (Settlement Matching) of JGB Transactions

The Japan Securities Dealers Association (JSDA) is a self-regulatory industry association that formulates and publicizes market guidelines to ensure smooth JGB settlement.

Domestic JGB transactions are settled in accordance with these guidelines, and settlement fails – failure to deliver the agreed upon securities – are subdued.

On the other hand, with regard to cross-border JGB transactions with non-residents engaged as trading parties, **settlement fails or deferrals in some cases are observed, mainly due to discrepancies, non-arrival or delay of settlement instructions to domestic custodians (including the Bank of Japan and securities firms).**

Given that the standard settlement cycle of domestic JGB transactions between residents will be shortened from T+2 to T+1 (effective May 1, 2018), further cooperation to avoid settlement fails among relevant parties shall be essential for smooth operations of the whole JGB market, including cross-border JGB transactions which are NOT within the scope of the T+1 initiative.

Taking this opportunity, JSDA has summarized the points to note for post-trade processing (settlement matching) with regards to cross-border JGB transactions. Please be informed as follows:

- ✓ PLEASE REVIEW THE POST-TRADE PROCESSING OF JGB TRANSACTIONS, AND **SEND SETTLEMENT INSTRUCTIONS AS EARLY AS POSSIBLE SO THAT DOMESTIC CUSTODIANS CAN COMPLETE SETTLEMENT MATCHING (INCLUDING AMENDMENT, IF NECESSARY) BY THE PRECEDING BUSINESS DAY OF THE SETTLEMENT DATE (S-1) IN JAPAN TIME.**
- ✓ PLEASE THOROUGHLY AGREE ON SETTLEMENT DETAILS BETWEEN TRADING COUNTERPARTIES WHEN EXECUTING ORDERS, AND **CAREFULLY AVOID ANY DISCREPANCIES BETWEEN THE SETTLEMENT INSTRUCTIONS SENT TO EACH CUSTODIAN.**

Typical causes and solutions for unmatched or mismatched transactions are described below for your reference.

1) NON-RECEIPT OF SETTLEMENT INSTRUCTIONS

<CAUSE>

Settlement instructions from non-residents not received in time by domestic custodians for some reason, including time difference and shortage of funds/securities of trading parties.

<SOLUTION>

It is encouraged to send settlement instructions to custodians without delay. In case processing is delayed for some reason, related parties are encouraged to liaise closely to quickly resolve such delay.

<REFERENCE>

II.6.(1) of the “Japanese Government Securities Guidelines for Real Time Gross Settlement” (JSDA/Version: March 9, 2016, hereinafter referred to as “RTGS Guidelines¹⁾”), which will be effective on May 1, 2018, stipulates that “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.” Quick pre-settlement matching is desirable for cross-border transactions as well.

¹ <http://www.jsda.or.jp/en/rules-guidelines/guidelines/>

2) DISCREPANCY IN ACCOUNT INFORMATION

<CAUSE>

Insufficient checking between related parties, or registration errors, of standing settlement instruction (SSI).

<SOLUTION>

Related parties are encouraged to thoroughly check SSI, and to establish procedures to avoid registration errors.

3) DISCREPANCIES IN ITEMS ON SETTLEMENT INSTRUCTION

<CAUSE>

Errors generated during the process before sending settlement instructions, resulting in mismatch of items such as cash amount, face value, and settlement date.

<SOLUTION>

Related parties are encouraged to thoroughly check the accuracy of settlement instruction items, and to ensure accurate operations.

4) UNAWARENESS OF THE MARKET PRACTICE OF SPLITTING LARGE FACE VALUE DOWN TO JPY 5 BILLION

<CAUSE>

Non-compliance with the Japanese market practice (stipulated in the aforementioned guidelines) to split JGB transactions with face value exceeding JPY 5 billion into multiple instructions with JPY 5 billion or less.

<SOLUTION>

Market participants, including non-residents, are encouraged to recognize and thoroughly comply with the above market practice in applicable transactions.

<REFERENCE>

II.1 (1) of the RTGS Guidelines stipulates that “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.”

5) BILATERAL NETTING (“PAIR-OFF”)

<CAUSE>

Failure to reach agreement on “pair-off” by cut-off time, or delays of one of the two settlement instructions for “pair-off”.

<SOLUTION>

Trading parties are encouraged to follow their own rules, and to establish prompt communication.

<REFERENCE>

IV.1.(4) of the RTGS Guidelines stipulates that “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.” Early confirmation of settlement target is encouraged for non-resident transactions as well.

TOPICS

1. THE STANDARD SETTLEMENT CYCLE OF DOMESTIC JGB TRANSACTIONS WILL BE “T+1”

Effective May 1, 2018, the standard settlement cycle of domestic JGB transactions between residents will be shortened from T+2 (two business days) to T+1 (one business day), as announced by JSDA. Some necessary reform on the JGB domestic market rules will also be implemented.

For further information, please refer to the following materials released by the JSDA.

- “Target Implementation Date for Shortening of JGB Settlement Cycle to T+1” (February 2017)
<http://www.jsda.or.jp/en/activities/research-studies/content/TargetImplementationDate.pdf>
- “Target Implementation Timing for Shortening of JGB Settlement Cycle to T+1” (June 2015)
http://www.jsda.or.jp/en/activities/research-studies/files/Target_Implementation_Timing.pdf
- “Outline of the Grand Design for Shortening of JGB Settlement Cycle (T+1)” (November 2014)
http://www.jsda.or.jp/en/activities/research-studies/files/grand-design_english.pdf

It should be noted that the settlement cycle of cross-border JGB transactions, with or between non-residents, is NOT within the scope of the current shortening initiative, given that such transactions usually involve various parties in different time zones.

Meanwhile, the shift to a T+1 cycle for domestic transactions may also increase the demand for a shorter (T+2) settlement cycle for cross-border transactions. In light of that, it is widely considered desirable for market participants to launch initiatives to accommodate T+2 settlement in cross-border transactions, and to promote the use of the Pre-Settlement Matching System (PSMS) of Japan Securities Depository Center (JASDEC) by sub-custodians, securities companies, and other financial institutions in Japan.

2. THE BANK OF JAPAN TO START USING THE PSMS FOR ITS JGB CUSTODY SERVICES

The Bank of Japan (BOJ) will start to use the PSMS and revise its operational process for the JGB custody services that it provides to its overseas customers (foreign central banks and international organizations), in order to accommodate T+2 JGB settlement.

This will enable market participants (counterparties of the BOJ’s overseas customers) to settle JGB transactions under the T+2 settlement cycle, regardless of whether the relevant counterparty uses the PSMS.

The T+2 JGB settlement for those overseas customers is expected to start on June 2018. For further information, please refer to the following announcement by the BOJ and JASDEC.

- “New Operational Process for Japanese Government Bond (JGB) Settlement for Foreign Central Banks and International Organizations” (September 2017)
http://www.boj.or.jp/en/announcements/release_2017/rel170928b.htm/
http://www.jasdec.com/en/download/news/20170928_release_en.pdf