

Final Report of the Working Group
on Shortening Stock Settlement Cycle in the Japanese Market

June 30, 2016

Working Group on Shortening Stock Settlement Cycle

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Material 12-4 “Street Side Sub-Working Group” Member List

*The materials above are not included in this referential translation. (only in Japanese version)

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I. Introduction

Partly because of rising consciousness in reduction of settlement risks triggered by Lehman Shock and other events, in most of jurisdictions, major overseas markets are at the stage of either having moved to T+2 stock settlement cycle or making decision on the migration timing¹. In light of these situations, the “Working Group on Shortening Stock Settlement Cycle” (hereinafter referred to as “WG”) was established in July 2015 under the “Council on Securities Delivery and Clearing/Settlement Systems Reform,” and has conducted cross-industrial detailed studies towards realization of the implementation of T+2 stock settlement cycle.

In light of status of implementation and review of T+2 at major overseas markets, WG was determined to set the target schedule for the implementation of T+2 settlement cycle in Japan which will not be largely behind U.S., and confirmed that it is important to present detailed policies and the like towards T+2 as soon as possible to ensure that broad range of parties involved and investors in the stock market would have sufficient time for preparation. As specific study schedule, it was decided to aim at summarizing key aspects related to T+2 settlement flow and setting the target implementation time within 2015, and coordination of other remaining tasks by June 2016.

WG, and Street Side Sub-WG and Customer Side Sub-WG, subordinate groups of WG, proceeded with their studies based on the said schedule, and had published, on December 29, 2015, the interim report presenting key aspects related to T+2 settlement flow, policies on key tasks surrounding T+2 settlement cycle and the target schedule for implementation of T+2 settlement cycle.

After the publication of the interim report, remaining tasks have been reviewed mainly at Street Side Sub-WG, Customer Side Sub-WG, and Stock Lending Practice Review Group and Practice Review Group concerning Settlement Failure, subordinating groups of Customer Side Sub-WG², and WG compiled the study results at WG, including those included in the interim report, as the final report.

¹ See Material 1 “Status of Shortening Stock Settlement Cycle Overseas”

² See Material 2-1 “Establishment of Street Side Sub-WG and Customer Side Sub-WG” and Material 2-2 “Establishment of Stock Lending Practice Review Group and Practice Review Group concerning Settlement Failure” for positioning of these meeting bodies.

II. Study Items and Policies for Realization of T+2

At 1st WG Meeting, using the tasks raised in “Report of the Study Group on the Shortening of the Stock Trading Settlement Cycle (T+2)”³(hereinafter referred to as “Study Group Report”) published in March 2015 as base, study items are sorted out, and points, including direction, responsible body and study timing in respect of the policies in dealing with each item, were clarified⁴. Based on such clarification, the items that were to be studied were studied at the Customer Side Sub-WG and the Street Side Sub-WG as well as the Stock Lending Practice Review Group and the Practice Review Group concerning Settlement Failure under the Customer Side Sub-WG⁵.

1. Study at Customer Side Sub-WG

At the Customer Side Sub-WG, tasks related to transactions, etc. with customers were studied based on the method in proceeding with study confirmed at 1st WG meeting and 1st Joint Sub-WG. Specifically, study on mainly 3 points, namely transactions with non-residents, stock lending transactions and rules on settlement failure, were conducted, and the member shared understanding as to prospect of occurrence of settlement failure after the implementation of T+2 settlement cycle and the like which are closely related with these studies.

(1) Prospect of Occurrence of Settlement Failure and the Like

Non-resident transactions at Japanese equity market account for approx. 60% these days. Then, as an impact of the implementation of T+2 settlement cycle was reviewed, it was the common understanding that if no measure is taken, increase in the

³ Japan Securities Dealers Association, Tokyo Stock Exchange and Japan Securities Clearing Corporation set up, as its secretariat, the Study Group within the securities industry in August 2014, to study expected effect of realization of T+2 settlement cycle, issues and the like expected towards realization, and the study results were published as a report from the Study Group in March 2016.

Japan Securities Dealers Association Website:

[“http://www.jsda.or.jp/shiraberu/minasama/20150313173226.html”](http://www.jsda.or.jp/shiraberu/minasama/20150313173226.html)

⁴ See Material 3 “Illustration of How to Deal with Major Tasks Raised in Report from Study Group” (material presented at 1st WG meeting)

⁵ See Material 4 “Study Schedule and Study Items at Sub-WG and Practice Review Group”

settlement failure is envisaged, because many related parties, both domestic and foreign, stand between the parties in transactions with non-residents, including overseas brokers and global custodians,⁶ and transactions with non-residents tend to be influenced by time differences and difference of holidays⁷.

For an implementation of T+2 settlement cycle, to secure the same level of settlement progress rate (settlement failure ratio) as current settlement cycle, it was considered important to promote prompt and accurate operational processing in T+2 settlement cycle by keeping parties involved, including those overseas, informed of T+2 settlement cycle and to strive for further refinement of the stock lending market as a countermeasure for increasing number of settlement failures, and it was also considered important, after taking these measures, to have common understanding in the fact that broader range of investors would be affected by the settlement failure⁸. With these understandings, tasks towards T+2 were to be studied.

(2) Transactions with Non-Residents

Using the tasks raised in the Study Group Report as base, studies on the transactions with non-residents were conducted as follows⁹:

- (i) Dealing with Time Difference with Europe and US, and Holidays in Foreign Countries
 - a. Study Items

⁶ As a typical case where a non-resident trades in Japanese stocks, etc., there is a case, for example, where a non-resident places buy/sell order to a Japanese securities firm via local broker, and gives an instruction to a Japanese sub-custodian through global custodian for settlement (See Material 5 “【Transactions with Non-Resident】 Current T+3 Settlement Flow and Expected Settlement Flow when Shortening Settlement Cycle by 1 day Based on Current Flow” (Material Presented at 2nd Customer Side Sub-WG Meeting)).

⁷ In association with the implementation of T+2 settlement cycle for exchange transaction, it is anticipated that (i) the number of settlement failure in transactions with non-residents would increase and (ii) T+2 trade which currently is a main stream of stock lending transaction will move to T+1 trades, and needs for T+0 stock lending transactions would increase (see II.1.(3) below). In these situations, as a result of simulation of prospect of an occurrence of settlement failures at JSCC after the implementation of T+2 settlement cycle, there is a possibility of increase of the settlement failure to a certain level even under environment where sufficient liquidity is secured for both T+1 stock lending transaction and T+0 stock lending transaction, and under environment where sufficient liquidity is not secured, the settlement failure could further increase.

⁸ It was acknowledged that if affected by the settlement failure, impact on subsequent transactions is anticipated, and if the settlement failure occurs on a record date, there is a concern of such an impact that shareholders' rights, such as dividends and voting rights, cannot be acquired.

⁹ As to the task raised in the Study Group Report “Measures for Domestic Fund Outsourcing Management to Overseas Managers,” it was decided that they will be studied together with the transactions with non-residents, as they share common issues in terms of tasks associated with time difference.

In transactions with non-residents, settlement instructions are typically issued by both overseas broker, etc. side placing buy/sell order and global custodian, etc. side managing balance of stocks, etc.

In light of time difference and difference of holidays with these overseas parties, acceleration of the settlement instruction is expected to become more important after the implementation of T+2 settlement cycle. So, measures therefor were studied.

b. Policies

Policies to promote acceleration of settlement instruction include, domestically, measures such as to check operations and systems at parties involved, and, overseas, measures such as acceleration of allocation between overseas brokers and customers placed orders (account allocation instruction) and arrangement to send settlement instruction to Pre-Settlement Matching System of Japan Securities Depository Center, Inc. (hereinafter referred to as "JASDEC") regardless of whether or not there is sufficient balance for delivery. For smooth and steady implementation of these measures, it was decided to broadly disseminate information on T+2 settlement cycle through market infrastructures and domestic parties involved in transactions with non-residents (such as brokers (securities firms) and sub-custodians) to enhance awareness of the involved parties.

Moreover, common materials are to be prepared in English and disseminated overseas as early as possible (same applies to (ii) and (iii) below).

(ii) Establishment of Market Standards and Uniform Platform

a. Study Item

To enhance operational efficiency, studies on standardization of procedures for processing settlement instructions for transactions with non-residents and settlement information data (format) and sharing settlement information, including non-residents' accounts, were conducted.

To complete pre-settlement matching at earlier timing, studies on the establishment of operational rules and structures were conducted.

b. Policies

Although various standardization and sharing of settlement information among parties involved, including overseas parties, are considered helpful for acceleration and enhancement of accuracy of settlement instructions and prompt action to be taken in the event of pre-settlement unmatched, effort of uniform measures for transactions with non-residents, in which diverse range of parties are involved across countries, is unrealistic, therefore it seems that there is no other option than to leave the action up to the parties involved. To promote smooth implementation of these actions, it was decided to broadly disseminate information on T+2 implementation to parties involved, including those located overseas, through market infrastructures and domestic related parties related to transactions of non-residents, such as brokers (securities firms) and sub-custodians, to enhance awareness of the involved parties.

(iii) Flexible Treatment related to Settlement and Strengthen Communication with Investors

a. Study Items

To ensure a completion of settlement as scheduled even if an unmatched in the pre-settlement matching is finally left unsolved, studies on flexible treatment, such as non-DVP settlement after pre-settlement matching cutoff time as well as partial settlement, were conducted.

Moreover, studies on strengthening communication with non-resident investors towards early resolution of unmatched in pre-settlement matching were conducted.

b. Policies

While, in association with the implementation of T+2 settlement cycle, flexible treatment in the settlement process by involved parties is considered to become more important, judgment of each firm would still need to be respected on such case-by-case treatments. Taking account of these points, the Practice Review Group concerning Settlement Failure conducted studies on the response to partial settlement and the like, including their needs.

As a result, because flexible response to partial settlement and the like would promote linked settlement and be effective in reduction of the settlement failure ratio, it was decided to coordinate such partial settlement and the like as

necessary on a bilateral basis.

As to strengthening of communication with investors, it was decided that information on T+2 implementation is to be broadly disseminated to the parties involved, including those located overseas, through the market infrastructures and domestic related parties for transactions with non-residents, such as brokers (securities firms) and sub-custodians, and that taking account of the impact of occurrence of the settlement failure in Japan, an establishment of the structure for avoiding settlement failure (such as acceleration of settlement instruction, early initiation of pre-settlement matching and response to inquiry (early resolution of pre-settlement unmatched, partial settlement, etc.)) should be promoted.

(3) Acceleration of Stock Lending Transaction Handling & Improvement of Trade Environment

In terms of the settlement cycle, there are currently three types of stock lending transactions, namely T+2, T+1 and T+0 transaction, which are traded for purposes of short coverage on the seller side in exchange transaction, avoidance of settlement failure and response to incurrance of settlement failure (fail coverage).

Out of those transactions, the prevailing settlement cycle of the stock lending transactions for short coverage is T+2. However, in association with the implementation of T+2 settlement cycle for exchange transaction, the main stream of those transactions is expected to migrate to T+1 transactions.

Moreover, in association with the implementation of T+2 settlement cycle for exchange transaction, as needs for T+0 stock lending transactions for such purposes as fail coverage are expected to increase, the schedule for the operational process is expected to become tighter.

Under these anticipations, using the tasks raised in the Study Group Report as base, following studies were conducted:

(i) Dealing with Stock Lending Transactions by Trading Parties

a. Study Items

(a) Migration of T+2 Stock Lending Transactions to T+1 Cycle

As a result of migration of T+2 stock lending transactions which is the main stream of stock lending transactions for short coverage to T+1 cycle, trading and operational process within shorter timeline would become necessary. So, studies on revision of processing timing between trading parties and the like were conducted.

(b) Dealing with T+0 Stock Lending Transactions

Main stream of the settlement cycle in the stock lending market is T+2 and T+1. While needs for T+0 stock lending transactions are expected to increase, studies on the policies on how to deal with T+0 stock lending transactions, were conducted together with trading parties which are currently not participating in T+0 stock lending transactions.

b. Policies

(a) Migration of T+2 Stock Lending Transactions to T+1 Cycle

Currently, except for transactions between brokers, cutoff time for trading T+1 stock lending transactions are mainly during the morning (specifically, around 10:30) on the trading day of the stock lending transactions (Day T)¹⁰. When the main stream of stock lending transaction migrates to T+1 transaction in association with the implementation of T+2 settlement cycle for exchange trades, hours available for stock lending trades would become tight if it is scheduled on the basis of current cutoff time for T+1 stock lending transactions. So, it was confirmed important to build operational procedures for smooth implementation of T+1 stock lending transactions.

The Stock Lending Practice Review Group conducted studies on the measures to make T+1 stock lending transactions more convenient, such as revision of cutoff time, on the premise of the concept that such measures are a matter of business judgment on the part of each individual firm.

As a result, it was decided that hours available for stock lending execution should be secured as much as possible through standardization and enhancement of efficiency of the operational process¹¹, and shortening of

¹⁰ See Material 6 “Lending DVP Settlement Flow” (material presented at 2nd Customer Side Sub-WG meeting)

¹¹ Aiming at enhancement of efficiency of operational process for lending DVP, including T+0 lending

post-execution processing hours¹².

(b) Dealing with T+0 Stock Lending Transactions

In association with the implementation of T+2 settlement cycle for exchange transaction, needs for T+0 stock lending transaction for fail coverage, etc. are expected to increase. It was confirmed that making those transactions more convenient would become extremely important from the viewpoint of reduction of the risk of settlement failure, and the Stock Lending Practice Review Group conducted studies on the improvement of the market environment for T+0 stock lending transactions.

As a result, in order to enhance liquidity of T+0 stock lending transactions, it is important to increase number of participants in the stock lending market. So, it was decided to promote market participation by a broad range of participants on the premise of the concept that it is up to each individual firm's business judgment.

To complete settlement within limited timeframe, standardization and enhancement of efficiency of the operational process would be necessary, and along with the facilitation of use of Lending DVP, revision of the system processing details for Lending DVP, including its need, is to be continuously reviewed.

In addition, from viewpoint of securing hours available for execution of T+0 stock lending transactions, possible extension of available time for T+0 stock lending trading was discussed. However, as there were cautious comments on the extension of settlement cutoff time, they are subject to ongoing study (See "II. 3. (1) Revision in Settlement Cutoff Time and the Like in Clearing & Settlement Infrastructures, etc" for detail).

(ii) Establishment of Uniform Rules on Cutoff Time, etc.

a. Study Items

Currently, cutoff time and other procedures for stock lending transactions differ by each firm, and there is no standard guideline or the like.

transactions, revision of system processing details for lending DVP at JASDEC is to be continuously reviewed, including its needs.

¹² Specific cutoff time is to be continuously reviewed.

In association with the implementation of T+2 settlement cycle for exchange transaction, in light of the anticipation that the operational processing schedule for stock lending transactions would become tighter, studies on the establishment of market rules for smooth operational processing were conducted.

b. Policies

It was confirmed that an establishment of certain market rules in respect of cutoff time and the like for stock lending transactions are useful for smooth processing of the stock lending transactions, and the Stock Lending Practice Review Group conducted study on the details thereof.

As a result, as described in II. 1. (3) (i) b. (a) above, it was decided that hours available for stock lending execution are to be secured as much as possible, and the detailed cut-off time is subject to ongoing study.

For other points, such as standardization of market price used for the calculation of collateral value (see II. 1. (3) (iii) below), prioritization of stocks to be returned when there are multiple loan balance legs and balance management upon occurrence of corporate action, guidelines are to be compiled and made available to parties involved. Agreements, such as Master Agreement on the Borrowing and Lending Transactions, are to be refined.

(iii) Revision of Handling of Market Price and the Like in Calculation of Collateral Value in Stock Lending Transactions

a. Study Items

(a) Market Price As Of Time to be Adopted

Currently, “as of” times of the market price to be used for the calculation of collateral value related to stock lending transaction differ depending on the settlement cycle of stock lending transactions. Specifically, while the market price on the trade date is generally used for T+2 stock lending transactions, for T+1 and T+0 stock lending transactions, use of the market price on the business day immediately preceding the trade date, which is the value available at the time of execution, is typical for prompt reconciliation of the cash collateral after execution.

In light of this point, studies on the market price as of time to be adopted in respect of T+1 and T+0 stock lending transactions were conducted.

(b) Types of Market Price to be Adopted

Currently, the types of market price to be adopted for the calculation of collateral value in respect of stock lending transactions differ depending on the business type of trading parties. Specifically, while the market price in the “automatic calculation of settlement amount function”¹³ for Lending DVP is generally adopted for stock lending transactions between brokers, different market price may be used in other stock lending transactions, in which case it is typical to conduct difference adjustment using “amount adjustment data”¹⁴.

In light of this point, studies on the market price to be adopted after the implementation of T+2 settlement cycle for exchange transaction were conducted.

(c) Market Price Distribution Method and the Like

In the “automatic calculation of settlement amount function” for Lending DVP, the market price on the trade date is adopted for T+2 stock lending transactions of which pre-settlement matching has been completed within the trade date. So, such market price is distributed at 7:00 a.m. on the next business day following the trade date.

In light of this point, the studies on the market price distribution method and timing after the implementation of T+2 settlement cycle for exchange transaction were conducted.

b. Policies

(a) Market Price As Of Time to be Adopted

For prompt reconciliation of collateral value after trade execution even after the implementation of T+2 settlement cycle for exchange transaction, market price “as of” time to be adopted for T+1 and T+0 stock lending transactions will principally remain unchanged, i.e., the market price on the business day

¹³ Function of automatically calculating collateral requirement (DVP settlement amount) using market value information used by JASDEC DVP Clearing Corporation for the calculation of securities collateral value.

¹⁴ Data to be entered by parties to the stock lending transaction to adjust settlement amount related to stock lending transactions. There are two input method, namely “gross input method” and “net input method.”

immediately preceding the trade date, which is the market price known at the time of trade execution¹⁵.

(b) Type of Market Price to be Adopted

By standardizing the market price to be adopted to the one in the “automatic calculation of settlement amount function” of the pre-settlement matching system related to stock lending transactions, certain benefit, such as realization of prompt processing, can be expected because of, for example, elimination of needs for exchange of “amount adjustment data.” The Stock Lending Practice Review Group conducted studies, including a possible arrangement of handling of the market price for stock lending transactions between trust banks, etc. and brokers.

As a result, to standardize the market price adopted for the calculation of collateral value and the like to the one in the “automatic calculation of settlement amount function” for Lending DVP, it was decided to put such effect into writing as guidelines and make them available to parties involved.

(c) Market Price Distribution Method and the Like

As described in (a) above, as the market price on the business day immediately preceding the trade date of the stock lending transaction is to be adopted for both T+1 and T+0 stock lending transaction, in principle, the market price is known at the time of pre-settlement matching and is distributed promptly at the time of the pre-settlement matching. So, the direction of not revising distribution method and timing was made clear at first. However, as comments requesting revision of market price distribution method¹⁶ were received in relation to the standardization of the market price to be adopted (see II. 1. (3) (iii) b. (b) above) at the meeting of the Stock Lending Practice Review Group, it was decided that the distribution method would be subject to ongoing study.

(4) Rules on Settlement Failure

¹⁵ See Material 7 “Handling of Market Price related to Calculation of Collateral Value in Stock Lending Transactions” (material presented at 2nd Customer Side Sub-WG meeting)

¹⁶ Specifically, there were comments requesting distribution via file transmission in addition to existing CSV file output.

As described in 1. (1) above, increase of settlement failure, especially related to transactions with non-residents, is anticipated in association with the implementation of T+2 settlement cycle.

In awareness of these anticipations, the following studies were conducted using the tasks raised in the Study Group Report as base.

a. Study Items

As an increase in the number of settlement failures related to transactions with non-residents is anticipated, studies on the measures for avoidance of such settlement failures and measures upon occurrence of a settlement failure¹⁷ were conducted. Also, the measures concerning settlement failures related to domestic trades¹⁸ were revisited.

b. Policies

(a) Measures for Avoidance of Settlement Failure and Measures upon Occurrence of Settlement Failure

Revisiting measures for avoidance of settlement failure and measures upon occurrence of settlement failure is considered helpful for smooth processing. For this purpose, the Practice Review Group concerning Settlement Failure studied the operational guidelines, including rules on settlement failures, together with their necessity.

As a result, certain effect can be expected from the establishment of rules on

¹⁷ At the time of launch of DVP settlement of non-exchange stock transaction deliveries in 2004, Study Group on Non-Resident Transactions (study group on settlement practices and the like voluntarily formed by 11 securities firms and 6 sub-custodians) put in place the operational guidelines for transactions with non-residents after launch of DVP settlement of non-exchange stock transaction deliveries, including settlement matching cutoff time, wherein it was clarified that rules on the settlement failure related to transactions with non-residents would not be established due to following reasons:

- There are various causes for settlement failures in transactions with non-residents; and
- Upon occurrence of settlement failures around a record date in the transactions with non-residents, the issue has been resolved through negotiation between the trading parties overseas. Although it is not put into writing, it has become an conventional practice

¹⁸ At the time of launch of DVP settlement of non-exchange stock transaction deliveries in 2004, when Study Group on Trust & Securities Settlement Operations (study group comprised of 9 trust banks and 6 securities firms established as a forum for operational review related to settlement operations of domestic transactions) discussed standard handling related to domestic transactions, handling concerning the settlement failure was summarized to a certain extent. Although such handling was not a rule having compelling force and was put in place as settlement practice between settlement parties, in reality, it has been rarely used.

the settlement failure in the settlement for non-exchange stock transaction deliveries in terms of avoidance of settlement failure and prompt remedial measure for customer's economic loss incurred as a result of counterparty's settlement failure. So, such rules are decided to be compiled as guidelines on settlement of non-exchange stock transaction deliveries, and points were sorted out separately for measures for avoidance of settlement failure and handling upon occurrence of settlement failure.

The measures for avoidance of settlement failure¹⁹ were decided to be subject to ongoing study having in mind situations, such as awareness building for overseas investors, and on an assumption of including these measures into the guidelines.

As to handling in an unavoidable case of occurrence of a settlement failure on a record date, although the parties have already been making their utmost efforts in remedy to minimize economic loss of the receiving party, to be consistent with the "Guidance for Clearing Participants upon Occurrence of Settlement Failures on a Record Date" established by Japan Securities Clearing Corporation (hereinafter referred to as "JSCC") (see II. 2. (1) (i) b. (a) below), it was decided that the guidelines will contain the basic policy to refer to the said Guidance²⁰.

(b) Other

Measures for delivery of dividend equivalent upon occurrence of settlement failure on a record date shall be taken based on the said Guidance.

Also, policies were presented to the effect that the remedial measures for rights upon occurrence of a settlement failure on a record date will be studied at the "Practice Review Group concerning Settlement Failure" and that JASDEC is to flexibly deal with "additional transfer"²¹ which is the remedial measure

¹⁹ Specifically, possible measures would be (i) awareness building for overseas investors and global custodians to promote establishment of a structure for avoidance of settlement failures (See II. 1. (2) (iii) b.), (ii) acceleration of settlement instructions through efforts of domestic parties (check status through advance monitoring of settlement matching status) and (iii) making sure transmission of settlement instruction compatible for STP processing.

²⁰ It was decided that, after compiling measures for avoidance of settlement failure and measures upon occurrence of settlement failure as guidelines, an amendment, abolition and the like of the handling concerning the settlement failure established in the past (see footnote 18) would be discussed.

²¹ Transfer process to be conducted at JASDEC when a settlement failure occurs on a record date at JSCC

currently in place as much as possible²².

2. Study at Street Side Sub-WG

At the Street Side Sub-WG, tasks related to transactions between brokers, including exchange transactions, and stock lending transactions, etc. were studied based on the method in proceeding with study confirmed at 1st WG meeting and 1st Joint Sub-WG meeting. Specifically, mainly studies on rules on settlement failure, operational flow expected after the implementation of T+2 settlement cycle, treatment of margins in margin transactions, operational flow related to stock lending application and the like were conducted.

(1) Revision of Rules on Settlement Failure

(i) Study on Method of Adjustment of Rights between Clearing Participants upon Occurrence of Settlement Failure on Record Date, etc.

a. Study Items

(a) Guidance related to Rights Adjustment

As to a settlement failure occurred on a record date in the settlement of exchange transactions cleared by JSCC, studies on whether or not existing rules related to rights adjustment, which relies on individual arrangements between the Delivering Clearing Participant (the participant caused the settlement failure) and the Receiving Clearing Participant (the Participant affected by the settlement failure), need to be revised, as well as whole concept of the rules (e.g., standardized processing, setting principles or putting into guidelines, etc.), were conducted. Furthermore, although the settlement failure on the last day of the application period for TOB issue is not currently subject to

and procurement of stock subject to the settlement failure cannot be completed by the settlement cutoff time, on condition of, among others, "existence of remaining balance at transferor" and "transfer request is made in writing or the like based on an agreement between delivering member and receiving member during the record date (by 17:00)." This is an exceptional process taken in light of the fact that there is an eventuality to be affected by settlement failure and a settlement failure on a record date has significant impact on the rights, such as voting rights and dividends, and also in light of consensus formed among related parties to the effect that treating failed transaction as if transferred on the record date is appropriate for the entire settlement framework

²² See II. 3 (5) below for remedial measure in case "additional transfer" is not possible

an individual arrangement between the Delivering Clearing Participant and the Receiving Clearing Participant, studies on whether or not such event should also be covered under the said rules in the same manner as a record date were conducted.

Moreover, studies on abolition of “Written Promise to deliver Dividends or Rights, etc.” currently delivered in hard copy to notify the effect of passing of rights from the Delivering Clearing Participant to the Receiving Clearing Participant upon occurrence of a settlement failure on a record date were conducted.

(b) Clarification of Tax Treatment related to Processing of Settlement Failure on Record Date

In the course of processing settlement failure on a record date, there will be payment/receipt of cash, such as dividends, and deliveries of stock certificates, etc. between the Clearing Participants or between a Clearing Participant and an investor which is its customer. So, studies on clarification of tax treatment were conducted to enable smooth operational processing among the parties involved upon occurrence of settlement failures.

b. Policies

(a) Guidance related to Rights Adjustment

As to rights adjustment related to settlement failures occurring on a record date, while maintaining a concept of enabling flexible treatment eventually positioning it as a matter of individual arrangements between the Clearing Participants, to establish the guidance setting forth the method of clearing rights to be observed by the Delivering Clearing Participant and the Receiving Clearing Participant as much as possible when there is no specific requirement according to individual case (“Guidance for Clearing Participants upon Occurrence of Settlement Failure on a Record Date”) (hereinafter referred to as the “Guidance”), Street Side Sub-WG continued its study and detailed its contents.

As to a settlement failure occurred on the last day of the application period for TOB issue, although members shared awareness of existence of possible issues upon occurrence, from viewpoint of restriction and elimination of unfair conducts by intentionally causing settlement failure, it was decided that

settlement failures on such date should be prevented through CCP's interview of the background and measures taken on the part of Clearing Participants and that it is not included in the Guidance.

Also, directions of abolishing hard copy delivery of "Written Promise to deliver Dividends or Rights, etc.", and considering use of system screen and voucher on JSCC Clearing System at the same timing as the implementation of T+2 settlement cycle, were confirmed.

(b) Clarification of Tax Treatment related to Processing of Settlement Failure on Record Date

Legal characteristics and expected processing flow related to processing of a settlement failure for rights adjustment were clarified, and it was decided to proceed with the study for clarification of tax treatment on the part of buying customer of the Receiving Clearing Participant in respect of major cases of processing settlement failure.

(ii) Study on Method of Rights Adjustment between Clearing Participant and Investor (Customer) upon Occurrence of Settlement Failure on Record Date

a. Study Items

In parallel with the studies mentioned in (i) above, at the Practice Review Group concerning Settlement Failure under the Customer Side Sub-WG, it was made a basic policy to refer to the Guidance as the market rules in Japan upon occurrence of a settlement failure on a record date in settlement of non-exchange stock transaction deliveries (see II. 1. (4) b. (a) above). In association with this, there were requests for due consideration, in the process of the establishment, to make the Guidance easy to get the understanding of investors (overseas investors which are not familiar with Japanese rules in particular).

b. Policies

It was decided to respond to above request in the following manner:

- Upon publication of the Guidance, English version will also be prepared and made available.
- When JSCC solicits comments from Clearing Participants on the amendment to the Guidance in the future, ask Clearing Participant to

review the proposed amendments having in mind a possibility of the Guidance being used as a basis in a negotiation between a Clearing Participant and a customer.

(iii) Claim Economic Loss against Delivering Participant (Participant Caused Settlement Failure)

a. Study Items

(a) Rate of Delay Penalty related to Settlement Failure and Method of Counting Fail Charges

Studies on whether or not it is necessary to change the rate of delay penalty related to settlement failures were conducted. Also, studies on whether or not change of fail charge counting method from business day basis to calendar day basis would become necessary were conducted.

(b) Buy-in Scheme

Studies on whether or not it would become necessary to revise the existing buy-in scheme (buy-in execution timing and format), from viewpoint of deterrence of settlement failures, and in association with the implementation of T+2 settlement cycle, were conducted.

b. Policies

(a) Rate of Delay Penalty related to Settlement Failure and Method of Counting Fail Charges

It was decided to maintain current rate of delay penalty to be charged upon occurrence of ordinary settlement failure.

As to a settlement failure on a record date, while necessity of revision of the rate level were to be judged based on the status of study at the Stock Lending Practice Review Group and the Practice Review Group concerning Settlement Failure and other factors, as no specific discussion point was raised in respect of a necessity of revision, it was decided to maintain current rate.

To further promote efforts in resolution of settlement failures before holidays, the method of counting number of days subject to fail charge was decided to be changed to calendar day basis.

(b) Buy-in Scheme

Because procurement timing when the participant to bear costs related to buy-in executes offsetting purchase at the market would be accelerated by 1 day as a result of the implementation of T+2 settlement cycle, it was decided to accelerate it by 1 business day to the 2nd day following the date of buy-in request.

(2) Transactions Outside Stock Exchanges, Transactions between Brokers, etc.

a. Study Items

As to transactions outside of exchanges and transactions between securities firms, the Proprietary Trading System (hereinafter referred to as "PTS") eligible for clearing at JSCC adopts T+3 settlement cycle similarly as in the case of exchange transactions, and for other transactions outside of exchanges and transactions between brokers, settlement cycle is to be decided according to the separate bilateral arrangement between the parties. Studies on treatment of these transactions after the implementation of T+2 settlement cycle were conducted.

b. Policies

WG Secretariat gave explanation of the contents of the Study Group Report published in March 2015, the establishment of this WG, details of the studies and process to date to Chi-X Japan Limited and SBI Japannext Co., Ltd. which are PTSs covered by JSCC's clearing, and sounded out WG's intention to arrange migration timing keeping pace with other transactions in the course of making decision on the T+2 migration target timing in the future. As a result, WG received positive response from each PTS, and it was decided that the Secretariat continues its efforts in making arrangements towards realization going forward.

On the other hand, while it is desirable to realize T+2 settlement cycle for other transactions outside of exchanges, it was decided that, rather than putting it into self-regulatory rules, it should remain up to the separate OTC trading parties.

(3) Study on Necessity of Introduction of Give-Up Framework in Cash Equity Market

a. Study Items

As a measure for prevention of settlement failure in association with shortening settlement cycle, studies on whether or not it would be necessary to introduce give-up framework for cash equity market were conducted.

b. Policies

As to give-up framework for cash equity market, mainly because of the reasons that (i) benefit of the give-up framework would be nothing more than a possible enhancement of efficiency in back office operations at brokers and is considered limited, and (ii) certain amount of initial cost for operations and systems and study on rules are considered to become necessary, it was confirmed that it cannot be said that there are high demand for study in association with the implementation of T+2 settlement cycle.

Benefit of the give-up framework will be enjoyed by Clearing Participants through concentration of settlement as a result of use by many participants. However, under current circumstances, such expectation is considered small at this moment. So, it was decided to be out of the scope of the study of this WG.

(4) Settlement Cycle of Convertible Bonds (CBs)

a. Study Items

Current settlement cycle of CBs is T+3 in normal cases, and when the scheduled settlement day (T+3) counted according to the normal settlement cycle falls on a record date (i.e., the day before coupon payment date on which transfer at JASDEC will be suspended, final application date of old conditions at the time of change of conversion conditions and the date of expiration of interim redemption request period), it is T+4, or if both such scheduled settlement day (T+3) and the next business day (T+4) fall on the record dates, it is T+5. Studies on the arrangement of these settlement cycles after shortening settlement cycle were conducted, including possibility of realization of settlement on the said record dates.

b. Policies

As to CBs, it was decided to maintain current settlement arrangement related to record date because of the following reasons: shortening with small impact on Participants' operations and systems would be desirable as listed issues of CBs are very limited; and it is difficult to realize abolition of settlement skip at early stage through abolition of suspension of transfer on the day before coupon payment date; and adoption of different settlement cycle by type of record date may cause confusion on the part of Participants and investors. In light of this, the settlement cycle will be shortened by 1 business day in all cases, resulting in T+2 settlement cycle in normal cases, T+3 or T+4 settlement cycle if affected by above-mentioned record dates.

(5) Settlement Schedule for Underlying Security upon Exercise of Securities Option

a. Study Items

Under current practice, the settlement day related to transactions of the underlying securities of options to be executed as a result of the exercise of securities option is the fifth day counting from (and including) the exercise date, in normal cases, and the fourth day counting from (and including) the exercise date when the exercise date falls on the day before the ex-dividend, etc. date. WG conducted study on the treatment of the above settlement days after shortening stock settlement cycle.

b. Policies

For securities option, shortening with small impact on the operations and system of the participant is desirable. So, treatment related to ex-dividend, etc. date, for transactions of the underlying securities of the option is decided to be unchanged. In light of this point, settlement cycle is decided to be shortened by 1 business day in all cases, to the 4th business day counting from (and including) the exercise date in a normal case, and 3rd day from (and including) the exercise date in the case where the exercise date falls on a day before an ex-dividend, etc. date.

(6) Settlement Cycle of BOJ Investment Securities for Capital Contribution

a. Study Items

BOJ investment securities for capital contribution are settled via physical delivery of the securities certificates on T+3 in normal cases and T+4 in case where the trade date falls on an ex-dividend date. WG conducted studies on the treatment and settlement cycle after shortening stock settlement cycle to confirm operational feasibility if the settlement cycle is changed to T+2.

b. Policies

As BOJ investment securities for capital contribution are the only securities traded on the exchange which are settled via physical delivery of securities certificates, it was confirmed that going paperless would be desired because costs are incurred in relation to operational burden and time required for checking genuineness and existence of defect and for delivery. Moreover, it is considered that various laws and ordinances need to be revised in order to realize dematerialization which is a way of paperless process. So, it was decided to request that competent authorities consider revision of the relevant laws and ordinances.

Together with the above studies, considering a situation where paperless operation would be difficult to be realized due to legal restraint and there is no other option than to continue physical delivery, studies on the settlement cycle under such assumption was also conducted. As a result of such studies, it was considered desirable to adopt the same treatment as stock, etc. from viewpoint of easiness to understand for investors and shortening settlement cycle with small impact on operation and systems of participants. So, it was decided that the settlement cycle would be shortened by 1 business day from current practice, to T+2 in normal cases and T+3 in case where the trade date falls on an ex-dividend date.

In addition, as a result of the requirement for a notification of Individual Number (Social Security and Tax Number) upon transfer of title to the securities certificates from 2016, in the case where the trade date of BOJ investment securities for capital contribution falls on the last trading day with rights related to dividends or the immediately preceding days, it was confirmed that the time

schedule for the operations related to the transfer of title to the securities to receive dividends have become tighter. After shortening settlement cycle, as such operation schedule is anticipated to be even more tighter, WG is to make inquiry on the interpretation of the articles of laws and ordinances related to the requirements for tax purposes in the notification of the Individual Number and to discuss treatment based on the results of such inquiry.

(7) Treatment of Customer Margin and Additional Margin in Margin Transactions

a. Study Items

Under current practice, the cut-off time for deposit of customer margin and additional margin is 3rd day from (and including) the day such margin provision becomes necessary. Studies on the effect and operational impact of shortening such cut-off time to the next business day following the day such margin provision becomes necessary after the shortening of settlement cycle were conducted.

b. Policies

While there are opinions to the effect that margin deposit cut-off time should be shortened in association with shortening of settlement cycle, the views on a possible reduction in convenience because of the payment schedule on customer side would become tighter, and on a difficulty in dealing with transactions with non-residents were presented. Moreover, as to additional margin, a concern on an impact on the market due to concentration of position liquidation to one day was expressed.

In light of the studies at this Sub-WG, after consultation with administrative agencies, the cut-off time for deposit of customer margin was decided to be at noon on the 3rd day from (and including) the day on which it becomes necessary, because while pre-settlement deposit is considered desirable from viewpoint of its positioning as collateral and avoidance of excessive speculation arising from the possible deposit of profit from margin transaction itself as customer margin, time for customers' and brokers' operational process needs to be secured as much as possible.

Also, as to additional margin, from viewpoint of making the structure easy to

understand, the cut-off time for deposit is decided to be at noon on the third day from (and including) the day provision becomes necessary similarly as in the case of customer margin.

(8) Study of Operational Flow related to Stock Lending Application for Bidding

(i) Dealing with Implementation of T+1 Settlement Cycle by Securities Finance Company for Procurement of Over-lent Issues

a. Study Items

(a) Acceleration of Lending Data Publication Time and Impact on Bidding

Currently, bidding for procurement of over-lent issues is held on the next business day following the stock lending application. Specifically, in the bidding held by Japan Securities Finance Co., Ltd. (hereinafter referred to as "JSF"), application in the stock lending transactions as well as stock lending for bidding from the participants (hereinafter referred to as the "Lending Participants") is made during the period from 8:30 a.m. to 10:30 a.m. (or to 11:00 a.m. on the last business day of March and September), and lending data to which bid results and settlement data, such as mark-to-market difference, is reflected is published (distribution of bid results) at or after 11:00 a.m.

As operational schedule related to the settlement on the part of the Lending Participants would become tighter after the implementation of T+2 settlement cycle, studies on the measures for securing appropriate and fair bidding on over-lent issues that would not cause rise of premium charge, and, at the same time, promoting acceleration of publication of lending data were conducted.

(b) Impact related to Shortening Procurement Period for Over-lent Issues after Implementation of T+2 Settlement Cycle

Under current procedures, when there are issues failing to procure through the bidding, the securities finance company has negotiations for procurement with the stock lenders, such as the owner or institutional investors, and ask the Transfer Account Management Institution, which is the custodian of stocks, to perform transfer to the securities finance company in time for JSCC settlement cut-off time on the day T+3.

After the implementation of T+2 settlement cycle, the procurement negotiation and account transfer should be done by the settlement cut-off on the day T+2, which is 1 business day shorter, and thus it is anticipated that procurement of over-lent issues by the securities finance companies would become more difficult. From this point of view, studies on the countermeasures therefor were conducted.

b. Policies

(a) Acceleration of Lending Data Publication Time and Impact on Bidding

When bidding schedule is moved forward, negative effects, such as rise of premium charge and increase in issues failing to procure due to decrease in number of bidders, are anticipated. In light of this, it was decided not to move forward bidding schedule. On the other hand, at the end of March and September when handling of bidding tends to be delayed, and when issues failing to procure through the bidding occur, publication of lending data by securities finance companies should be made by 1:00 p.m. at the latest by means of revision of operational flow, etc. at the securities finance company (JSF)²³.

(b) Impact related to Shortening Procurement Period for Over-lent Issues after Implementation of T+2 Settlement Cycle

Regarding operational flow for stock procurement in case of issues failing to procure through the bidding, it was confirmed at both Sub-WGs that more close cooperation between the Transfer Account Management Institution (such as securities firms and trust banks) and the securities finance companies would become necessary for smooth transfer process, as the transfer schedule becomes tight²⁴. In light of such circumstances, it was decided that the securities finance company (JSF) will continue its separate consultation with the Transfer Account Management Institutions and institutional investors on the operational flow, etc., to contribute to smooth transfer process.

As to the situation where procurement of over-lent issues by the securities

²³ See Material 8 “Lending Schedule (after Implementation of T+2 Settlement Cycle)”

²⁴ See Material 9 “Transfer Schedule related to Procurement of Over-lent Issues Becomes Tighter”

finance companies would become more difficult, it was confirmed that closer cooperation among exchanges, securities firms and securities finance companies would become necessary for more appropriate management and operation of stock lending transactions. In light of this, the securities finance company (JSF) will continue its separate consultation with parties involved.

(ii) Lending Application for Over-lent Issues due to Correction at Next Morning

a. Study Items

As to correction of lending transaction at next morning arising from trade correction of the standardized margin transactions, under current practice, when the outstanding stock loans exceed the outstanding loan (i.e. net over-lent) published on the previous business day, the securities finance company does not accept additional lending applications (sale) for their issues. However, as procurement at stock lending market would become more difficult as a result of the implementation of T+2 settlement cycle, studies on whether or not an addition of such lending application can be permitted were conducted.

b. Policies

If a correction of lending transactions at next morning which would increase over-lent issues is accepted, the Lending Participant may not be able to deal with it as the publication of the over-lent issues and number of shares, which would be conditions for bidding, would be just before the start of bidding, and negative effect, such as hike in premium charge and increase of issues failing to procure, would be anticipated. So, it was decided not to accept such correction.

3. Studies at Joint Sub-WG (Customer Side / Street Side)

In light of study results on each of the discussion items at the Customer Side Sub-WG and Street Side Sub-WG described above, studies on revision, etc. in settlement cut-off time and the like in clearing & settlement infrastructures and the like were conducted at the joint Sub-WG (Customer Side / Street Side) and Stock Lending Practice Review Group.

(1) Revision in Settlement Cut-off Times and the Like in Clearing & Settlement Infrastructures, etc.

a. Study Items

In light of shortening the period to the settlement by 1 day as a result of the implementation of T+2 settlement cycle, studies on the revision in the settlement cut-off times on the settlement day and the like in the clearing and settlements infrastructures, etc. were conducted using the tasks raised in the Study Group Report as base²⁵.

b. Policies

Items that need to be considered in the discussion of revision in various settlement cut-off times were sorted out as follows:

(a) Cut-off Time for Pre-Settlement Matching for Transactions with Non-Residents (0:20 p.m.)

Currently, the cut-off time for pre-settlement matching for transactions with non-residents is set at 40 minutes before the settlement cut-off time for exchange transactions (1:00 p.m.) to secure time for coverage via stock lending transactions, etc. if the pre-settlement matching and corresponding settlement cannot be performed in time for the cut-off time. Even after the implementation of T+2 settlement cycle, the time for such process should be secured in the same manner.

(b) Settlement Cut-off Time for Exchange Transactions (1:00 p.m.)

If the settlement cut-off time for exchange transactions (1:00 p.m.) is to be extended, the advantage would be an increase in time to deal with coverage on the side of Clearing Participants associated with the settlement failure caused by delivering customers. However, disadvantages, such as subsequent additional payment operation schedule becoming much tighter and operation to cover settlement failure against buying customer when suffered by settlement failure becoming much tighter, are anticipated.

(c) Cut-off Time for Lending DVP Settlement (1:30 p.m.)

The cut-off time for Lending DVP settlement (1:30 p.m.), is set at 30 minutes before the cut-off time for non-exchange DVP settlement (2:00 p.m.) to secure

²⁵ See Material 10 "Current Settlement Cut-off Times, etc. on Day S (Settlement Day)" (material presented at 1st Joint Sub-WG meeting, 3rd Customer Side Sub-WG meeting and 4th Joint Sub-WG meeting)

time for amount adjustment data, etc. Even after the implementation of T+2 settlement cycle, it is necessary to secure time for such process in the same manner as current practice.

On the other hand, viewpoint of securing available time for execution through an extension of settlement cut-off time needs to be taken into account, because, while increase in demand for T+0 stock lending transactions for fail coverage is expected in association with the implementation of T+2 settlement cycle for exchange transaction, if trade volume increases as a result of increase in the number of market participants for T+0 stock lending transactions, it may be possible that current available time for execution would become insufficient for T+0 stock lending transactions to function sufficiently.

(d) Cut-off Time for Non-Exchange DVP Settlement (2:00 p.m.)

The settlement cut-off time for non-exchange DVP settlement (2:00 p.m.) is set taking account of such factors as securing time for fund settlement by DVP participants, securing time for funding by bank as liquidity provider for JASDEC DVP Clearing Corporation upon default of a DVP participant and relation with investment of surplus at secured call loan market to be made upon fixing of cash flow after securities and fund settlement by trust banks.

(e) Cut-off Time for FOP Settlement (3:30 p.m.)

If the cut-off time for FOP settlement (3:30 p.m.) will be extended, certain advantages, such as an increase in responding time for borrowing stocks to secure rights by delivering participant or receiving participant when the settlement failure occurs at JSCC (or is anticipated to occur). However, under current practice, borrowing of stock to secure rights is performed and transfer is completed promptly after the occurrence of settlement failure (or before occurrence of settlement failure). So, effect of a possible extension of the cut-off time from 3:30 p.m. is considered limited. Moreover, there may be an impact on the subsequent system processing at JASDEC or participants and timing of reporting to customers.

At the meeting of the Stock Lending Practice Review Group, while there were

comments to the effect that the settlement cut-off time should be extended from viewpoint of securing available time for trade execution in T+0 stock lending transactions, other comments to the effect that the settlement failure reduction effect would be limited solely from an extension of the settlement cut-off time, and that discussion on acquiring liquidity resulting from increase in number of market participants in T+0 stock lending transactions would be necessary, together with clarification of disadvantages arising from an extension of the settlement cut-off time, were presented.

In light of these comments and above-mentioned points of consideration, various settlement cut-off times should remain unchanged at the time of the implementation of T+2 settlement cycle. In light of future environmental changes such as treatment of remittance and funding and investment of surplus upon introduction of *Zengin-net* 24 hour service, and paying attention to avoid system development overlap, extension of settlement cut-off times to achieve satisfactory effect is to be subject to ongoing study.

Moreover, at the meeting of the Street Side Sub-WG, on an assumption of setting the settlement cut-off time for exchange transactions at 1:00 p.m., the expected operational flow²⁶ up to Day T+2, which also needs to be studied, was discussed, and the feasibility of the operational flow was confirmed. Specifically, the cut-off time for application for error correction at Tokyo Stock Exchange and other exchanges is to be extended from 1:00 p.m. (current) on the day before the settlement day to 2:00 p.m. on that day (after the implementation of T+2 settlement cycle) to secure sufficient time for operational process in error correction after the implementation of T+2 settlement cycle, and it was also decided that the group will proceed with studies in a direction of optimizing contents and distribution timing of reports concerning settlement quantity and amount distributed from JSCC via clearing system at the same timing as the implementation of T+2 settlement cycle.

(2) Treatment of Non-Exchange Traded Securities

a. Study Items

²⁶ See Material 11 "Expected Operational Flow up to Day T+2"

In an implementation of T+2 settlement cycle for domestic exchange traded stocks, etc., studies on whether or not it is appropriate to implement T+2 settlement cycle for other products such as straight bonds (referring to issues registered in JASDEC's book-entry transfer system such as Corporate Bond and Municipal Bond; the same applies hereinafter), foreign securities and investment trusts, as well as scope of securities and transactions subject to T+2 settlement cycle and implementation timing were conducted.

b. Policies

(a) Appropriateness of Implementation of T+2 Settlement Cycle for Non-Exchange Traded Securities and Scope of Securities and Transactions subject to T+2 Settlement Cycle

In light of simplicity (same settlement cycles among products) and convenience (convenience at the time of trading in different products) for customers, and scope of T+2 settlement cycle at other major overseas markets, it was decided that efforts should be made to shorten settlement cycle to T+2 for JGB retail trading, straight bonds and foreign securities, which are currently settled in T+3 settlement cycle, in the same manner as domestic exchange traded stock, etc.²⁷ Although the T+2 settlement cycle is desirable after the date of migration to T+2 settlement cycle, in principle, as there is no uniform rule as to settlement day even today (see (c) below for foreign securities), it was decided that the delivery date can be set between the trading parties, and explicit standardization should not be promoted.

For investment trusts, on the other hand, as settlement cycles differ significantly depending on product, and there are restrictions due to settlement cycle of composite products, it was decided that no uniform treatment should be adopted.

(b) Implementation Timing

For sake of simplicity and convenience for customers, the group will proceed with its discussions in a direction of a migration to T+2 settlement cycle at the same

²⁷ In light of the current practice wherein the settlement cycle for CP is T+1 to T+3 according to an agreement between the trading parties, the settlement cycle for CP is not covered under this study on shortening settlement cycle, and is decided to remain up to agreement between trading parties rather than setting uniform measure.

timing as the implementation of T+2 settlement cycle for domestic exchange traded stocks, etc. However, the detailed implementation timing was to be decided in light of necessary study at related working groups at, JSDA, etc.

(c) Measures Required for Migration, Method of Publication of Migration Date

i. Straight Bonds / JGB retail trading

The migration date is to be notified from the relevant organization, etc. to the market participants and the like.

ii. Foreign Securities

The “Rules concerning Foreign Securities Transaction” of Japan Securities Dealers Association stipulates as follows: “The delivery date in sale and purchase of the Foreign Securities shall be the fourth business day counting from the contract date except for cases where a different treatment is separately agreed on with the customers.” It was decided that the related working group in JSDA is to discuss the amendment and the effective date of the amendment to this provision, and then try to give notification of the amendment as necessary.

(d) Tasks to be Dealt with by Entire Industry for Implementation of T+2 Settlement Cycle for Non-Exchange Traded Securities

For the implementation of T+2 settlement cycle for straight bonds, it was decided to promote participation in the pre-settlement matching system of JASDEC on the part of related organizations to promote higher level of STP.

It was also decided that, if, in the course of the works toward preparation for the implementation of T+2 settlement cycle for non-exchange traded securities among parties involved in the market, there arises any matter that requires revision of the JASDEC’s Book-Entry System for Corporate Bond and Municipal Bond or the JSDA’s guidelines concerning book-entry transfer of straight bonds and other rules, related conference bodies at the related organizations should study the tasks, as necessary.

(3) Handling of Trade Reports

a. Study Items

Studies on handling of the delivery of trade reports (referring to the document set forth in Article 37-4, Paragraph 1 of the Financial Instruments and Exchange Act; the same shall apply hereinafter) after the implementation of T+2 settlement cycle were conducted.

b. Policies

It was decided that, in delivery of trade reports after the implementation of T+2 settlement cycle, each firm will make efforts to enhance efficiency of operational process as much as possible, and continue to deliver trade reports to customers promptly.

(4) Measures for Further Enhancement of Efficiency in Clearing, Settlement Frameworks and Operations

a. Study Items

After the implementation of T+2 settlement cycle, according to the Practice Review Groups study results, settlement failure ratio is presumed to rise and there remain possibility that settlement failures may not be controlled sufficiently. In order to reduce occurrence of settlement failures as much as possible and to maintain the same level of settlement failure ratio as today's level, it is desirable to take more fundamental measures. From such viewpoints, as detailed measures, Sub-WG members requested to seek possibility of striving for enhancement of efficiency of clearing/settlement scheme and operations by building a structure that enables netting between DVP settlement of non-exchange stock transaction and DVP settlement of exchange stock transaction.

b. Policies

In response to the above-mentioned request, it was decided that parties involved will study on the measures in parallel with the study on implementation of T+2 settlement cycle.

(5) Other

Under current practice, the measure to be taken upon occurrence of a settlement failure on a record date is limited to remedy of economic loss through individual

negotiation between the parties²⁸. A broad range of study, not limited to operational aspect, were considered to be necessary for the remedy of the beneficial rights of shareholders, such as voting rights.

III. Target Schedule

1. Target Schedule in Interim Report for Implementation of T+2 Settlement Cycle

At the time of publication of the interim report, it was decided that studies on such points as an refinement of stock lending market for avoidance of settlement failures and revision of rules on settlement failure upon occurrence of a settlement failure shall be continued, and it was considered difficult to determine specific implementation timing for the T+2 settlement cycle at that time. On the other hand, shared view on the target schedule among parties involved are considered to contribute to smooth and efficient study, and the target schedule for the implementation of T+2 settlement cycle was proposed to be “as early as possible in 2019.”

When setting the above target schedule for the implementation, the processes and the period of time required before the implementation of T+2 settlement cycle were assumed as follows:

- (i) Study on tasks at WG and report study results (by June 2016)
- (ii) System development and establishment of internal structure on market participants side (approx. 2 years)
- (iii) Implementation of necessary scheme and rule revisions at market infrastructures, etc. and preparation for comprehensive running test, etc. (approx. 2 years)
- (iv) Implementation of comprehensive running test (approx. 6 months)

The market is in the process of preparation for JGB T+1 settlement cycle scheduled for the first half of 2018. From viewpoint of settlement stability of the Japanese market as a

²⁸ Under the Japanese legal framework, a person having account balance on the record date is registered on the shareholder registry and becomes a shareholder entitled to exercise the right of shareholders. Therefore, a separation of the account balance as of the record date and the shareholder entitled to exercise the rights of shareholders is not expected in a practical operation. Because of this, remedy of rights upon occurrence of the settlement failure on a record date stays nothing more than remedy of economic loss.

whole, it was decided that smooth implementation and stable operation of JGB T+1 settlement cycle (including coupon payment and redemption process) should be confirmed in advance to the migration of Stocks, etc. settlement cycle to T+2.

2. Target Schedule for T+2 Implementation and Expected Implementation Date in light of Studies after Publication of the Interim Report

WG has been working on its studies on remaining items since the publication of the interim report. The results of these studies are as described in this report. Considering these study results, as it appears that there is no need, at this stage, to revise the target schedule for T+2 implementation presented in the interim report, the parties involved in the market are to proceed with its preparation maintaining the target schedule as “as early as possible in 2019.” However, it was decided that a revision of the said target schedule will be discussed as necessary in light of the future study status/results and status of preparation at the parties involved in the market.

From now on, WG is to study items that require further study and each party involved in the market is to proceed with its necessary preparations. In the course of this process, it is important to take firm steps in these works with a shared view on the expected implementation date based on the current target schedule. The specific T+2 implementation date is required (i) to be after the confirmation of stable operation of JGB T+1 settlement cycle, and (ii) to secure time schedule with at least 3 consecutive non-business days. Possible schedule to satisfy above requirements are right after the consecutive non-business days in April or May 2019. In light of this point, WG decided that, based on current target implementation schedule, implementation date is expected to be right after the consecutive non-business days in April or May 2019, and that the parties will proceed with the necessary works going forward targeting this implementation date.²⁹

Actual scheduled implementation date of T+2 settlement cycle is to be set about 1 year before the scheduled implementation date, after the confirmation of status of preparation

²⁹ Consecutive non-business days for 3 days or more in the first half of 2019 will be as follows:
Jan. 12 (Sat.) to 14 (Mon.), Feb. 9 (Sat.) to 11 (Mon.), April 27 (Sat.) to 29 (Mon.) and May 3 (Fri.) to 6 (Mon.)

at the parties involved in the market and in light of comments of members of this WG as well as wide range of market stakeholders³⁰. When setting the scheduled implementation date, discussion points related to the migration, such as whether it should be set on trade date basis or delivery date basis, are to be considered.

3. Illustration of Upcoming Schedule

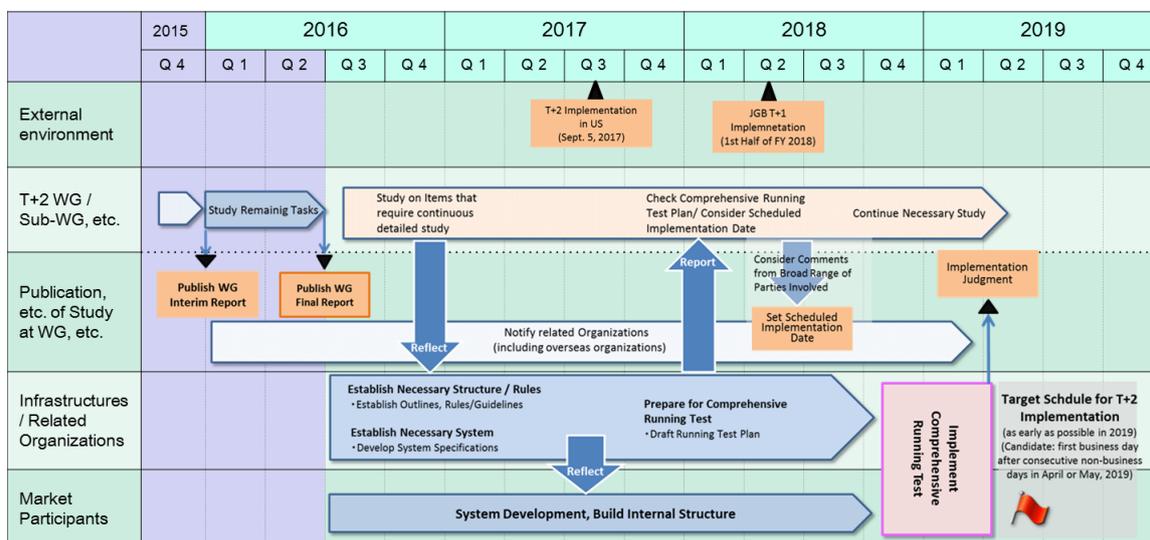
It was decided that, after the publication of this final report, WG, Sub-WG and Practice Review Groups are to proceed with their study on the items which require further study and, in parallel with these studies, each party involved in the market is to proceed with the following preparation:

- The market infrastructures and related organizations will develop system specifications to be changed and required rules and guidelines in light of this report and the above-mentioned study results,;
- Each market participant will start preparation for building necessary internal structure and systems.

Also, the market infrastructures will proceed with their preparation for comprehensive running test, in which market participants participate, and WG is to check the proposed implementation plan of the comprehensive running test drafted by the market infrastructures. Whether or not to implement T+2 settlement cycle on the scheduled implementation date is to be judged based on the results of such test. The said schedule is illustrated as follows:

³⁰ Upon determination of the scheduled implementation date and judgment of whether or not to implement, each market infrastructure will make organizational decisions, etc., as necessary.

Illustration of T+2 Implementation Timing for Stocks, etc.



IV Conclusion

As described above, the international standards for the settlement cycle for stocks, etc. have moved to T+2. From viewpoint of maintenance and enhancement of international competitiveness of the market, it is necessary to make efforts towards realization of T+2 settlement cycle in Japan as promptly as possible. On the other hand, as mentioned in the interim report, the T+2 settlement cycle should be implemented on the premise of a reduction of settlement risks as a whole and a realization of the measures for securing stableness of the settlement process, in light of the risk of settlement failure and operational risk which may emerge as a result of the implementation of T+2 settlement cycle³¹. WG and the related organizations will continue necessary studies including those mentioned in this final report to be studied further and responses towards the realization of T+2 settlement cycle, securing the settlement stability in the market.

End of Document

³¹ See Page 2 of WG Interim Report