Sales Representatives Manual

Volume 2

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JSDA

Japan Securities Dealers Association

Volume 2

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1 Overview of the Japan Securities Dealers Association

The Japan Securities Dealers Association (hereinafter the "JSDA") is the juridical person (authorized financial instruments firms association) that has received authorization from the Prime Minister under Article 67-2, Paragraph 2 of the Financial Instruments and Exchange Act (hereinafter the "FIEA"), and is organized from persons that are registered with the Prime Minister under FIEA, Article 29 and carry on a type I financial instruments business under FIEA, Article 28, Paragraph 1, and financial institutions registered with the Prime Minister under FIEA, Article 33-2 (hereinafter referred to as "registered financial institutions").

1 1 Types of Association Members

There are three categories of Association Members. These are:

(1) Regular Members: Among the financial instruments business operators, those who conduct the type I financial instruments business [(Note 1)] (excluding the following types of business) (excluding those who only conduct the business set forth in (2)(a) to (c))

(a) Business related to OTC financial futures transactions, etc.;

(b) Business related to transactions set forth in FIEA, Article 2, Paragraph 22, Item 4 (limited to transactions pertaining to a currency), [(Note 2)] or OTC derivatives transactions of crypto-and other assets (meaning crypto-and other assets prescribed in FIEA, Article 1, Paragraph 4, Item 20) or financial indicators (prices and interest rates of crypto-and other assets and numerical values calculated based on them), or intermediary, brokerage or agency service thereof; or

(c) Business related to electronically recorded transferable rights or the rights prescribed in FIEAEO, Article 1-12, Item 12

(2) Specified Business Members:

Among financial instruments business operators, those who only conduct any of the following in the type I financial instruments business:

(a) Business related to specified OTC derivatives transactions, etc.; [(Note 3)] or

(b) Type I small amount electronic offering handling business prescribed in FIEA, Article 29-4-2, Paragraph 9 (limited to the business relating to the securities set forth in Item 1 of the said paragraph). [(Note 4)]

(c) Business related to commodity-related market derivatives transactions brokerage, etc. [(Note 5)]

(3) Special Members: Registered financial institutions

(Notes) 1. From among financial instruments businesses, meaning those conducting any of the following acts in the course of trade: (i) with regard to securities with high market liquidity, (a) sale and purchase, market derivatives transactions or foreign market derivatives transactions, (b) intermediary, brokerage or agency service for sale and purchase, market derivatives transactions or foreign market derivatives transactions, (c) intermediary, brokerage or agency service for entrustment of sale and purchase, market derivatives transactions or foreign market derivatives transactions, (d)

brokerage for clearing of securities, etc., (e) secondary distributions, and (f) handling of public offerings, secondary distributions or private placements; (ii) (a) intermediary, brokerage or agency service in commodity-related market derivatives transactions, (b) intermediary, brokerage or agency service for entrustment of commodity-related market derivatives transactions, or (c) brokerage for clearing of securities, etc. with regard to commodity-related market derivatives transactions; (iii) OTC derivatives transactions or the intermediary, brokerage or agency service thereof, or brokerage for clearing of securities, etc., (iv) underwriting of securities, (v) so-called PTS (proprietary trading system) business, or (vi) securities, etc. management business (FIEA, art. 28, para. 1).

2. Index option transactions related to financial indicators pertaining to currency, such as currency binary option transactions.
3. OTC derivatives transactions, etc. which do not fall under any of the following:
   (i) Transactions relating to the rights set forth in FIEA, Article 2, Paragraph 2 which are deemed to be securities under the said Paragraph;
   (ii) Securities-related derivatives transactions;
   (iii) OTC financial futures transactions;
   (iv) Index option transactions related to financial indicators pertaining to a currency; or
   (v) OTC derivatives transactions of crypto-and other assets (meaning crypto-and other assets prescribed in FIEA, Article 1, Paragraph 4, Item 20) or financial indicators (prices and interest rates of crypto-and other assets and numerical values calculated based on them).

   Interest or currency swap transactions, credit derivative transactions, weather derivative transactions, and disaster derivative transactions, etc. fall under this category.
4. This includes equity-based crowdfunding business pursuant to the provisions of the laws and regulations effective as of November 1, 2024
5. Those conducting intermediary, brokerage or agency services in commodity-related market derivatives transactions, or intermediary, brokerage or agency services for entrustment of commodity-related market derivatives transactions, on a regular basis

1 2 Purposes

The purposes of the JSDA are to ensure fair and smooth sale and purchase or other transactions of securities, etc. conducted by Association Members and sound development of the financial instruments business and thereby contribute to investor protection (Articles of Association, art. 6).

2 Main Functions of the Japan Securities Dealers Association

To achieve the above-mentioned purposes, the JSDA engages in the following functions:

2 1 Self-Regulatory Functions

(1) Enactment and Implementation of Self-Regulatory Rules

By enacting and enforcing the various self-regulatory rules to which the Association Members are subject, together with seeking to make financial instruments trading fairer and more efficient, the JSDA strives for the protection of investors.

(2) Implementation of Inspections and Monitoring

The JSDA periodically conducts inspections of the Association Members to verify the status of their compliance with the laws and regulations, self-regulatory rules, etc. that apply to their business activities as well as the coordination of their internal administration systems, etc. Further, the JSDA monitors the status of management as well as the separate management of customer assets on the part of Regular Members.

(3) Issuance of Disciplinary Measures

The JSDA instigates strict disciplinary measures against Association Members or their officers and employees who violate the laws and regulations, self-regulatory rules, etc. in an attempt to prevent recurrences.

(4) Implementation of Qualification Examinations and Qualification Renewal Training and Registration of Sales Representatives

In view of the public nature of the Association Members as an intermediary in financial and capital markets and the importance of its social mission, the JSDA implements the Sales Representatives Qualification Examination and the Internal Administrator Qualification Examination, and Sales Representatives Qualification Renewal Training in addition to performing the administrative tasks related to the registration of sales representatives under a delegation of authority from the Prime Minister.

(5) Implementation of Educational Training

The JSDA holds training based on self-regulatory rules and other various educational training programs and provides support such as dispatching of lecturers to internal training seminars held by its Association Members, etc. to improve the quality of officers and employees of Association Members.

(6) Acceptance of Complaints/Requests for Consultations, Mediation Concerning Financial Instruments Transactions

The JSDA accepts complaints or requests for consultations from customers concerning Association Member or financial instrument intermediary service providers and performs the “medication” prescribed in the FIEA to help resolve disputes between customers and Association Members concerning financial instrument transactions.

The JSDA outsources the acceptance of complaints and requests for consultation and mediation activities to the Financial Instruments Mediation Assistance Center (FINMAC).

(7) Implementation of Activities as an Authorized Personal Information Protection Organization

The JSDA implements activities to secure the adequate handling of personal information of Association Members as an authorized personal information protection organization under the “Act on the Protection of Personal Information.”

(8) Improvement and Expansion of the Bond Markets

The JSDA constantly endeavors to improve the bond OTC market such as enacting and reviewing the systems and practices in the OTC bond transactions in order to make the trading in bond, etc. fair and efficient.

(9) Reform of Systems for Transactions of Listed Securities, Etc. Outside the Financial Instruments Exchange Market and Management of Such Systems

The JSDA reforms necessary systems for transactions of listed share certificates, etc. outside the financial instruments exchange market, in order to make the system regarding the off-exchange trades of listed share certificates, etc. fair and efficient as well as to secure the protection of investors.

The JSDA engages in providing useful information to its Association Members and investors, by compiling and publicizing the data on the status of off-exchange trades as reported by its Regular Members, as well as publicizing the information on quotations and contracted trades by way of the proprietary trading system (PTS) relating to listed share certificates, etc.

(10) Development and Management of Systems Related to Unlisted Securities, Etc.

With a view to ensuring proper management of business and protection of investors in relation to equity-based crowdfunding and shareholders community systems, etc., the JSDA develops necessary systems concerning investment solicitation of unlisted securities, etc. such as establishing rules to be observed by Regular Members, etc.

The JSDA also engages in providing useful information to its Association Members and investors, by compiling and publicizing the data on the status of use of these systems as reported by its Regular Members, etc.

2 2 Functions to Encourage Sound Development of the Financial Instruments Business and Financial Instruments Markets

(1) Research and Study of the Finance and Capital Markets; Expression of a Formal Opinion

In order to build a market highly trusted by investors and to contribute to Japan's economic growth and development, the JSDA carries out studies with respect to system issues, tax issues, etc. concerning the financial instruments business and the financial instruments market as well as presents its opinion to the government and other related parties for their realization.

(2) Development of Common Infrastructure for the Financial Instruments Market

The JSDA focuses on the development of a common infrastructure such as systems, etc. for the financial instruments market to improve the credibility and revitalize the financial instruments market.

(3) Announcement of Statistic Materials, Etc. Concerning the Stock Market and the Bond Market

The JSDA collects and sums up various information concerning the stock market and the bond market, and provides materials, etc. that are useful for its Association Members and investors. It also announces over-the-counter trading reference prices for bonds and over-the-counter price quotations for corporate bonds targeting individual investors every business day.

(4) Activities of Promoting Knowledge and Education in Financial Instruments, Etc.

In order to raise awareness of and enlighten the public concerning knowledge of financial instruments, etc., and for the publicity on the part of all levels of people, the JSDA focuses on the development of programs to promote knowledge and education both in the academic world as well as for the general public. In July 2024, these activities were basically transferred to the Japan Financial Literacy and Education Corporation (J-FLEC).

(5) Public Awareness Activities

The JSDA also engages in public awareness activities for announcing system reforms and new systems that are important to investors and its Association Members, and for responding to important challenges to the securities industry as a whole appropriately.

(6) Sharing of Opinions with Related Organizations, Etc. and Mediating Opinions

The JSDA promotes various measures for the communication and mediation of opinions between Association Members or with related organizations.

(7) Assistance Regarding Elimination of Anti-Social Forces

The JSDA provides assistance to the efforts of its Association Members, etc. in order to eliminate anti-social forces from financial instruments transactions and financial instruments markets.

(8) Assistance Regarding Business Continuity of the Financial Instruments Markets as a Whole

The JSDA manages and operates an information service website specialized in business continuity plans (BCP), "Securities Market BCP Web," in order to collect and provide information for its Association Members and financial instruments markets of securities exchanges with regard to the common infrastructure organizations from which they can seek help in the event of disasters.

2 3 International Functions/International Relations

In response to the globalization of the financial instruments and capital markets, the JSDA participates in international conferences such as the International Council of Securities Associations (ICSA), the Asia Securities Forum (ASF) and International Organization of Securities Commissions (IOSCO) to exchange information with related overseas organizations and foster international exchange, as well as promotes the Japan market to foreign countries, responds to inquiries from overseas, collects information, etc.

3 Organs of the Japan Securities Dealers Association

(1) Central Organs

The body with ultimate decision-making authority is the General Assembly, while the Board of Governors is the body with responsibility for decision-making and oversight concerning matters specific to overall operations of

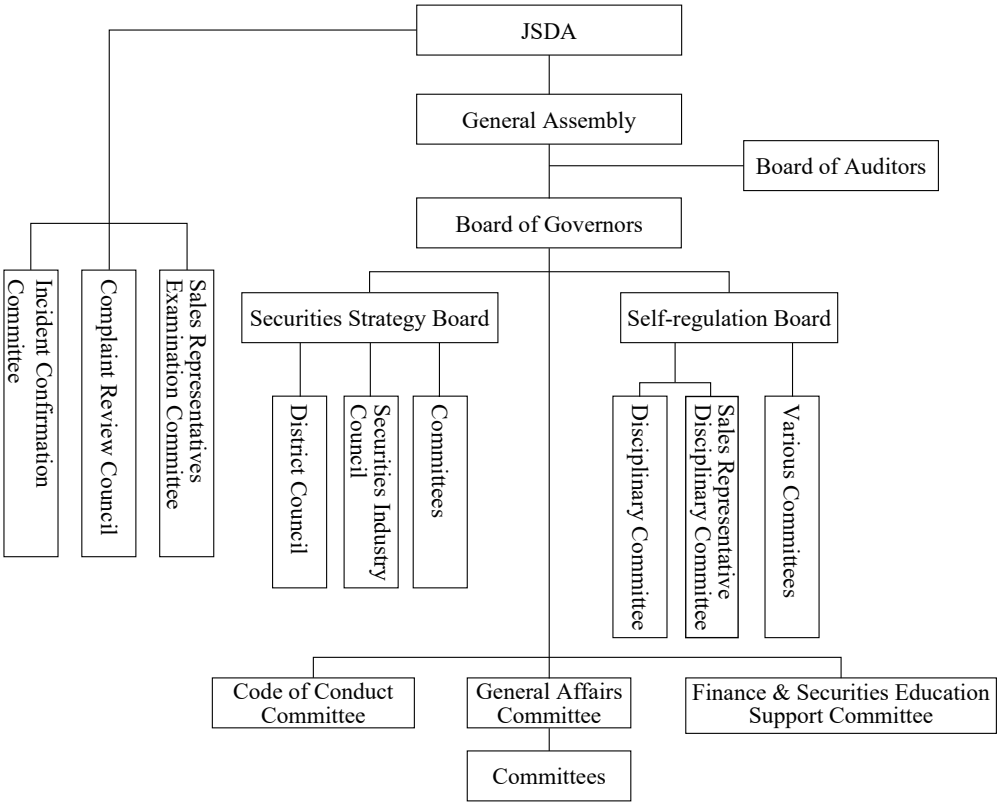
the JSDA. The Self-Regulation Board, Securities Strategy Board, Code of Conduct Committee, and Finance and Securities Education Support Committee are established under the Board of Governors and functioning as the bodies responsible for decision-making concerning self-regulatory functions, securities strategy functions, functions regarding the code of conduct, and functions for promoting knowledge and education in financial instruments and securities, respectively. The General Affairs Committee, established by a delegation of authority from the Board of Governors, functions as the deliberative body for general affairs matters such as budgeting or settlement and organization management, etc. of the JSDA.

(2) Local Organs

There are nine district offices nationwide. The district office performs work, etc. related to the Securities Strategy Board (Tokyo, Osaka, Nagoya, Hokkaido, Tohoku, Hokuriku, Chugoku, Shikoku, and Kyushu).

(3) Affiliated Bodies

There is also an Incident Confirmation Committee, a Complaint Review Council, and a Sales Representatives Examination Committee.



4 Various Rules of the Japan Securities Dealers Association

The establishment of business rules for Association Members is the most important aspect of the self-regulatory measures of the JSDA.

For this reason, the JSDA is given the authority to establish the Self-Regulatory Rules, the Uniform Business

Practice Rules, the Disputes Mediation Rules, the Association Management Rules and other rules under Article 8 in the Articles of Association of the JSDA.

From among these, the Self-Regulatory Rules is prescribed to promote fair practices regarding securities trades and other transactions conducted by Association Members (to prevent Association Members from conducting improper profit taking acts and) to promote the duty of good faith in transactions.

As described below, rules are established for investment solicitation and customer management by Association Members, acceptance, etc. of deposit of securities and reports to customers, internal administrator system, matters concerning an application for confirmation of incidents, matters to ensure compliance by financial instruments intermediary service providers, services standards of employees, qualification of sales representatives and registration, representation of advertisements, etc. and provision of premiums, etc., protection of personal information, over-the-counter securities, equity-based crowdfunding, shareholders community, Phoenix Issues, trading of listed share certificates outside a financial instruments exchange, underwriting of securities, announcement of over-the-counter trading reference prices for bonds and the trading price, foreign securities transactions, CFD transactions and so forth.

On the other hand, the Uniform Business Practice Rules are prescribed to unify the practice for the trades and other transactions, etc. in securities by Association Members and acts related thereto to increase the efficiency of processing transactions and to eliminate disputes arising from ambiguity or disunity thereof.

In addition, the Dispute Mediation Rules are prescribed to solve the customers' complaints regarding the business operations conducted by Association Members, to mediate the resolution of disputes between customers and Association Members concerning sale and purchase and other transactions, etc. in securities, and to resolve disputes between Association Members.

4 1 Customer Management and Internal Administration, Etc. by Association Members

1 Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members

The purpose of these Rules is to ensure appropriate solicitation and management of customers, etc. by Association Members for the sale and purchase or other transactions of securities, etc. (art. 1)

The provisions of these Rules are thus greatly important since they have a direct relationship to the daily responsibilities of the sales representative. Therefore, these Rules, along with the Rules Concerning Employees of Association Members, form the fundamental standards by which sales representatives carry out their duties.

(1) Fundamental Attitude Toward Executing Functions

Association Members must, in carrying out its business, always put the best interests of the investors before everything else in business activities, giving top priority to securing the confidence of the investors and complying with the FIEA and other laws and regulations, and they must endeavor to solicit investments that meet customers' intentions and actual situation, by fully understanding the customers' investment experience, purpose of investment, financial condition, etc. (art. 3, para. 1 and para. 2).

When conducting sale of securities, etc. (including securities, securities-related derivatives transactions, etc., specified OTC derivatives transactions, etc. and commodity-related market derivatives transactions brokerage, etc.;

hereinafter the same shall apply in these Rules) that are new for an Association Member (including new securities-related derivatives transactions, etc., new specified OTC derivatives transactions, etc. and commodity-related market derivatives transactions brokerage, etc.; hereinafter the same shall apply in these Rules), the Association Member shall fully understand the characteristics and risks of such securities, etc. and must not sell them if it is impossible to assume that there will be any customer who is suitable for trading such securities (art. 3, para. 3).

Association Members must also endeavor to adequately explain and have the customer understand the essential matters of sale and purchase or other transactions of securities, etc. (art. 3, para. 4).

Article 3, Paragraph 3 requires that the securities, etc. to be sold must be reasonable investment targets for at least a certain scope of customers (reasonable basis suitability). The "Concept of Article 3, Paragraph 3 of the Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members (Guidelines for Reasonable Basis Suitability)" has been provided as guidelines regarding the verification of the target customers and the development of a system for securing appropriate solicitation of customers.

In connection with Article 3, Paragraph 4, the "Concept of Article 3, Paragraph 4 of the Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members (Guidelines for Explanation of Essential Matters)" has been provided as guidelines regarding essential matters when selling various financial products and the assumed amount of loss based on the assumption of the worst-case scenario.

The reason for this rule is that the sound development of the capital market depends on financial instruments business operators maintaining the trust of the general investors in the broad sense.

Hence, this fundamental attitude has been stipulated here as one of the rules to be followed by Association Members, and the rules prescribe that Association Members must conduct their solicitation activities in compliance with the principle of suitability, so as to protect investors, and the duty of financial instruments business operators to provide an explanation concerning the transaction.

It goes without saying that these provisions should be the fundamental attitude of sales representatives when carrying out their work responsibilities.

(2) Thorough Enforcement of the Principle of Self-Responsibility

The principle of self-responsibility is that investments are to be made by the customer based on the customer's own judgment and own responsibility, so Association Members should not engage in excessive or overly aggressive solicitation. In order to cultivate a healthy attitude toward investments on the part of customers, "Association Members shall, in soliciting investment, make customers understand that investment in securities should be made based on the customer's own judgment and own responsibility" (art. 4), and it is also necessary for customers to have a clear understanding of this principle.

(3) Maintenance, Etc. of Customer Cards

In order to promote appropriate customer management, Association Members must be equipped with customer cards stating the following information regarding customers who conduct sale and purchase or other transactions, etc. of securities (excluding professional investors) (art. 5, para. 1):

(i) Name or appellation;
(ii) Address or domicile, and mailing address;

(iii) Date of birth (limited to cases where the customer is a natural person; the same in (iv) below);
(iv) Occupation;
(v) Purpose of investment;
(vi) Asset condition;
(vii) Experience of investments;
(viii) Type of transaction; and
(ix) Other matters deemed necessary by each Association Member.
(Note) Among Specified Business Members, those conducting a business purely related to commodity-related market derivatives transactions brokerage, etc. and holding a license granted under Article 190, Paragraph 1 of the Commodity Derivatives Transaction Act as of March 1, 2020 (hereinafter referred to as "Special Commodity Futures Members") may include the following information in a customer card in addition to the information indicated above:
(i) Name or appellation;
(ii) Address or domicile, and mailing address;
(iii) Date of birth (limited to cases where the customer is a natural person; the same in (iv) below);
(iv) Occupation;
(v) Income;
(vi) Asset condition;
(vii) Amount of funds available for investment;
(viii) Whether the customer has experience investing in commodity-related market derivatives transactions or other transactions, and degree of such experience;
(ix) Purpose of concluding a contract for commodity-related market derivatives transactions; and
(x) Other matters deemed necessary by each Association Member.

(4) Solicitation Commencement Standards

When soliciting sale (limited to solicitation made by visit or telephone to customers who do not request the solicitation of such sale, and those made at the headquarters or other sales or business office of an Association Member to customers who do not request the solicitation of such sale) of products set forth in each of the following items (i) through (iv) to a customer (limited to individuals and excluding professional investors), the Association Member shall establish the solicitation commencement standards for each sale set forth in each of the following items (i) through (iv), and shall not solicit customers who do not meet such standards (art. 5-2).

In connection with Article 5-2, the "Concept of Article 5-2 of the Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members (Guidelines for Solicitation Commencement Standards)" has been provided as guidelines regarding solicitation commencement standards to ensure solicitation is conducted in a manner that is suitable for each investor's age and experience in trading, financial conditions (major income source and financial assets), and purpose and policy for investment, etc.

(i) Sale of complex structured bonds similar to OTC derivatives transactions;
(ii) Sale of complex investment trusts similar to OTC derivatives transactions;
(iii) Sale of leveraged investment trusts; and
(iv) Sales of corporate bonds subject to rules as prescribed in Article 2, Item 2 of the Rules Concerning Dealing, etc. of Private Placement, etc. of Corporate Bonds (limited to the cases that meet the dealing, etc. of private placement, etc. as prescribed in Item 3 of said Article).

The "complex structured bonds similar to OTC derivatives transactions" refer to structured bonds whose redemption or interest conditions are determined by the derivatives transaction prescribed in Article 2, Paragraph 20 of the FIEA or commodity derivatives transactions prescribed in Article 2, Paragraph 15 of the Commodity Derivatives Act, or by a method that has an effect similar to those of the above two, and that fall under either of the following; provided, however, that if the bonds are government securities, or if the bonds meet either of the following criteria due to the deterioration of the credit condition of the issuer of such bond or, in the case such bond has a structure to reflect the credit condition of a single entity, such bonds shall be excluded (art. 2, item 7):

(a) The redemption price can be less than the face value (excluding those structured in such manner that the fluctuation rate of the redemption price is consistent with the value that is calculated by multiplying the change rate of a specific indicator or price (hereinafter referred to as the "Base Indicator" in these Rules) throughout the period from issuance to redemption by a pre-defined value (limited to one time or minus one time), or there is a condition that the redemption is made with other securities by the automatic exercise of derivatives transactions;
(b) Interest is not determined at the time of issuance, and the currency used for redemption payment and that used for purchase payment are different (excluding those structured in such manner that the fluctuation of interest is consistent with the change rate of the interest indicator);
(c) Interest is not determined at the time of issuance, and the currency used for interest payment and that used for purchase payment are different (excluding those structured in such manner that the fluctuation of interest is consistent with the change rate of the interest indicator); or
(d) Interest becomes zero or very close to zero depending on the conditions (excluding those structured in such manner that the fluctuation of interest is consistent with the change rate of interest indicator).

"Complex investment trust similar to OTC derivatives transactions" refers to an investment trust that will have the same nature of product or effect as that of a complex structured bond similar to OTC derivatives transactions by managing it with such structured bonds (art. 2, item 8).

"Leveraged investment trust" refers to an investment trust that is managed to match the change rate of net asset value per unit of the investment trust assets of such investment trust to the value that is calculated by multiplying the change rate of the Base Indicator by a pre-defined factor (limited to two times or minus two times) (excluding those listed in an exchange financial instruments market or a foreign financial instruments market or those to be listed in these markets, and those fall under the category of complex investment trust similar to OTC derivatives

transactions) (art. 2, item 9).

(5) Sales by Solicitation to Aged Customers

Where an Association Member sells securities, etc. to aged customers (limited to individuals; excluding professional investors) by solicitation, the Association Member must establish internal rules that include the definition of aged customers, the securities, etc. subject to sale, an explanation method, delivery method, etc. in light of its business type, size, customer distribution and customer attributes, social conditions, and other conditions, and strive to make proper investment solicitation (art. 5-3).

(6) Transaction Commencement Standards

Association Members must always give sufficient consideration to carrying out transactions in the way most suitable for the investor's investment objectives and actual status. And particular care must be exercised in carrying out the following enumerated transactions, etc. that are of nature of being high risk/high return which present both the possibility of achieving large gains but also present the possibility of losing the entire amount invested. Consequently, respective standards for commencing these transactions must be established, and Association Members shall enter into a contract for the said transaction, etc. with customers who meet the said standards (art. 6, para. 1):

(i) Margin transactions;
(ii) Foreign stocks margin transactions (meaning foreign stocks margin transactions prescribed in Article 2, Item 23 of the "Rules Concerning Foreign Securities Transactions" (hereinafter referred to as the "Foreign Securities Rules"; hereinafter the same applies in these Rules);
(iii) Sale and purchase or other transactions in share option certificates (including securities or certificates issued by a foreign country or foreign entity that have a nature of share option certificates; and excluding share option certificates in connection with allotment of share options without contribution as prescribed in Article 277 of the Companies Act that are listed or to be listed in a financial instruments exchange market; hereinafter the same shall apply in these Rules) (excluding sales other than the margin transactions in the customer's account);
(iv) Sale and purchase or other transactions in investment equity subscription right certificates (including foreign investment securities that are similar to investment equity subscription right certificates; and excluding investment equity subscription right certificates that are related to the allotment of investment equity subscription rights without contribution prescribed in Article 88-13 of the Act on Investment Trusts and Investment Corporations and are currently listed or scheduled to be listed in a financial instruments exchange market; hereinafter the same shall apply in these Rules) (excluding sale other than the margin transactions in the customer account);
(v) Securities-related derivatives transactions, etc.;
(vi) Specified OTC derivative transactions, etc.;
(vii) Commodity-related market derivatives transactions brokerage, etc.;
(viii) Sale and purchases or other transactions in OTC handled securities (OTC handled securities set forth in the "Rules Concerning OTC Securities," Article 2, Item 4) (excluding sales other

than margin transactions in the customer's account);
(xi) Transactions related to the equity-based crowdfunding business prescribed in Article 2, Item 2 of the "Rules Concerning Equity-Based Crowdfunding Business," etc.;
(x) Transactions of shareholders community issues prescribed in Article 2, Item 5 of the "Rules Concerning Shareholders Community";
(xi) Sale and purchases or other transactions in security tokens* (excluding sales other than margin transactions in the customer's account); and
(xii) Other transactions deemed necessary by each Association Member (excluding the sales other than margin transactions on the customer's account).

*** The term "security token" refers to securities prescribed in Article 2, Item 1 of the Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members, which fall within the category of electronically recorded transferable rights that must be indicated on securities, etc. prescribed in Article 1, Paragraph 4, Item 17 of the Cabinet Office Ordinance on Financial Instruments Business (hereinafter referred to as "FIBCOO").**

These transaction commencement standards must be established with respect to the investment experience of the customer, the assets of the customer under custody for safekeeping, and other matters deemed necessary by each Association Member (art. 6, para. 2).

(7) Delivery, Etc. of Alert Documents

When an Association Member enters into a contract with a customer (excluding professional investors; hereinafter the same shall apply in (7)) on the sale of the securities, etc. that are set forth below, it shall deliver an alert document to the customer in advance; provided, however, that this provision shall not apply if the Association Member has delivered an alert document relating to the sale of securities, etc. that are similar to those to be sold this time within one year before executing a contract of sale of securities, etc. set forth in (i) to (iii) below, or if the customer agrees not to receive the prospectus pursuant to the provision of Article 15, Paragraph 2, Item 2 of the FIEA (art. 6-2, para. 1):

(i) Securities-related derivatives transactions, etc. (excluding transactions that are prescribed in Article 116, Paragraph 1, Item 3, (a) or (b) of the FIBCOO;
(ii) Specified OTC derivatives transactions, etc.;
(iii) Commodity-related market derivatives transactions brokerage, etc.;
(iv) Complex structured bonds similar to OTC derivatives transactions; and
(v) Complex investment trust similar to OTC derivatives transactions.

The alert document prescribed Article 6-2, Paragraph 1 must clearly and correctly indicate the following matters (art. 6-2, para. 2):

(i) The fact that the "no solicitation without a request" rule applies, if applicable;
(ii) Alert regarding associated risks;
(iii) The fact that a customer can use a complaint processing and dispute resolution framework

provided by a designated dispute resolution organization (the designated dispute resolution organization prescribed in Article 156-38, Paragraph 1 of the FIEA) that conducts the dispute resolution business (the dispute resolution business prescribed in Article 156-38, Paragraph 11 of the FIEA) relating to the sale of securities set forth in Article 6-2, Paragraph 1, Items 1 through 5, and the contact information of such designated dispute resolution organization; and

(iv) The fact that a customer can use a complaint processing and dispute resolution framework provided by a designated dispute resolution organization (excluding the designated dispute resolution organizations prescribed in item (iii)) that conducts the dispute resolution business relating to the sale of securities set forth in Article 6-2, Paragraph 1, Items 1 through 5 or a specified nonprofit corporation "Financial Instruments Mediation Assistance Center (FINMAC)" to which the JSDA delegates the complaint and dispute resolution business as prescribed in Article 78-2, Paragraph 1 of the Articles of Association, and the contact information on such organizations (limited only to the case where there is no designated dispute resolution organization as prescribed in item (iii)).

When entering into a contract on sale of securities set forth in Article 6-2, Paragraph 1, Items 1 through 5 with a customer, an Association Member must explain the matters set forth in Article 6-2, Paragraph 2, Items 1 through 4 in advance in a manner and to an extent necessary to enable the customer to understand such matters in light of the knowledge, experience, and assets of the customer and the customer's purpose for entering into the contract (art. 6-2, para. 3).

If an Association Member enters into a contract of sale of securities within one year from the date of delivery of an alert document (including the date when the alert document is deemed to have been delivered under Article 6-2, Paragraph 4) for securities that are similar to the securities to be sold this time (limited to those set forth in Article 6-2, Paragraph 1, Item 1, Items 3 through 5 (for those set forth in Item 1, excluding the OTC derivatives transactions, etc. prescribed in Article 3, Item 5 of the Articles of Association)), the alert document shall be regarded to be delivered on such date of conclusion of the contract, and the provision in *proviso* of Article 6-2, Paragraph 1 shall apply (art. 6-2, para 4).

(8) Confirmation in Accepting an Order for Margin Transactions

Each time an Association Member accepts an order from its customer for margin transactions (excluding foreign stocks margin transactions; hereinafter the same applies in (13)), it must confirm matters including whether the customer intends to conduct standardized margin transactions (including PTS Standardized Margin Transactions prescribed in Article 2, Item 11 of the Rules Concerning Sale and Purchase, Etc. of the Listed Share Certificates, Etc. Conducted Outside of a Financial Instruments Exchange Market) or negotiable margin transactions (including PTS Negotiable Margin Transactions prescribed in Article 2, Item 12 of the same Rules) (art. 7, para. 1).

When a Regular Member accepts an order from its customer for foreign stocks margin transactions, it must comply with the provisions of Article 42 of the Foreign Securities Rules (art. 7, para. 2).

(Note) Two types of margin transactions

There are two types of margin transactions, "standardized margin transactions" and "negotiable margin transactions," with regard to issues listed on financial instruments exchanges. They are subject

to different restrictions in terms of the scope of issues available and the due date for repayment, etc.

(9) Requisition of the Confirmation Document from the Customer

When an Association Member enters into a contract with a customer (excluding professional investors; hereinafter the same shall apply in (9)) for sales and purchases or other transactions in share option certificates, investment equity subscription right certificates or covered warrants (excluding sale of securities other than margin transactions in the customer account) or for securities-related derivatives transactions, etc., specified OTC derivatives transactions, etc. or commodity-related market derivatives transactions brokerage, etc. for the first time, it shall collect a confirmation document regarding such transactions, etc. from the customer in order for the customer to understand the risks involved in the financial instruments transaction, fees, and other details described in the documents related to such a contract that are set forth in the provisions of Article 117, Paragraph 1, Item 1 (a) through (d) of the FIBCOO (hereinafter referred to as "Documents to Be Delivered Prior to Conclusion of Contract") as well as to confirm that the transaction is made according to the customer's own judgment and responsibility (art. 8, para. 1).

When an Association Member enters into a contract with a customer for sale of OTC derivatives transactions, etc. (the OTC derivatives transactions, etc. prescribed in Article 3, Item 5 of the Articles of Association, and limited to securities-related derivatives transactions (excluding transactions that fall under all the requirements in Article 3, Items 1-(a), (c), and (d) of "Rules Concerning CFD Transactions" and transactions prescribed in Article 116, Paragraph 1, Item 3-(a) or (b) of the FIBCOO) and specified OTC derivatives transactions, etc.), it shall obtain a confirmation document on such OTC derivatives transactions from the customer for the purpose of ensuring that the customer understands the matters set forth below and conducts the OTC derivatives transactions, etc. on its own judgment and responsibility (art. 8, para. 2):

(i) Details of important matters set forth in Article 3, Paragraph 4;

(ii) The contract is tradable by the customer in consideration of the loss amount that can be acceptable by the customer and the assumed loss amount based on the amount of possible loss from the contract (including the termination clearance fee (expected amount) due to any early cancellation), and the effect of such loss amount on the customer's business management or assets;

(iii) The contract can work as an effective hedge tool for continuing the customer's business operation until the transaction is closed in consideration of the business condition and the competitiveness in the market (limited to the case that such contract with the customer (excluding retail customers) is for hedging purposes);

(iv) The contract does not make the forecasting of the customer's business more difficult (limited to the case where such contract with the customer (excluding retail customers) is for hedging purposes);

(v) If the customer does not accept the solicitations of OTC derivatives transactions, etc., such non-acceptance will not affect loan transactions with the customer in the future (only for the case where the Association Member conducts a loan transaction with such customer (excluding retail customers)).

When an Association Member enters into a contract on sale of complex structured bonds similar to OTC derivatives transactions, or complex investment trust similar to OTC derivatives transactions, it shall obtain a confirmation document on such sale from the customer for the purpose of ensuring that the customer understands the matters set forth below and purchases such product based on its own judgment and responsibility (art. 8, para. 3):

(i) Details of important matters set forth in Article 3, Paragraph 4;
(ii) The contract is tradable by the customer in consideration of the loss amount that can be acceptable by the customer and the assumed loss amount based on the amount of possible loss from the contract (including the sale proceeds at the time of early sale (expected amount)), and the effect of such amount of loss on the customer's business management or assets;
(iii) If the customer does not accept the solicitation of complex structured bonds similar to OTC derivatives transactions, or a complex investment trust similar to OTC derivatives transactions, such non-acceptance will not affect loan transactions with the customer in the future (only for the case where the Association Member conducts a loan transaction with such customer (excluding retail customers)).

When an Association Member intends to conclude with a customer a contract related to sale and purchases or other transactions in security tokens (excluding sales other than margin transactions in the customer's account) for the first time, the Association Member shall collect a confirmation letter regarding the transaction from the customer, in order to confirm that the customer understands the important matters set forth in Article 3, Paragraph 4 and that the transaction is to be conducted based on the customer's judgment and responsibility (art. 8, para. 4).

When an Association Member intends to conclude a contract related to securities-related derivative transactions, etc. that are binary option transactions, etc. (binary option transactions, etc. as prescribed in Article 2, Item 7 of the "Rules Concerning Binary Option Transactions") with a customer, the Association Member shall collect the confirmation letter prescribed in Article 12 of the Rules Concerning Binary Option Transactions in lieu of the confirmation document prescribed in Article 8, Paragraphs 1 and 2 (art. 8, para. 5).

(10) Exceptions to Confirmation, Etc. of Intent

In the event that a Special Member conducts financial instruments intermediary service as a registered financial institution (acts set forth in the provisions of Article 33, Paragraph 2, Item 3 (c) and Item 4 (b) of the FIEA (excluding those related to the rights set forth in each Item of Article 2, Paragraph 2 of the FIEA that are regarded as the securities pursuant to the provisions of the said Paragraph); hereinafter the same shall apply in these Rules), if either a Regular Member or a Special Member confirms the customer intention regarding margin transactions (the distinction between standardized margin transactions (including PTS Standardized Margin Transactions) and negotiable margin transactions (including PTS Negotiable Margin Transactions) etc.) described in (8) above or collects the confirmation document described in (9) above (hereinafter referred to as "Confirmation of Intentions, etc." in these Rules), other Association Member concerned may not prepare the Confirmation of the Intentions, etc. (art. 9).

(11) Prevention of Confusion with Deposits, Etc.

When a Special Member handles securities as set forth in the provisions of Article 33, Paragraph 2, Items 1 through 4 of the FIEA (excluding government bonds securities, etc. (the securities set forth in Article 2, Paragraph 1, Items 1 and 2 of the FIEA, and the securities set forth in the same Paragraph, Item 3 and Item 5 (limited to those for which the redemption of the principal and interest payment are guaranteed by the government); hereinafter the same shall apply in these Rules) and securities index consisting of government bond securities only) as the registered financial institutions business,(Note) it must provide the customers (excluding professional investors; the same shall apply hereinafter in (11)) with explanations of the matters set forth in (i) to (vi) below to prevent the customer from mistaking the securities for deposits, etc. by an appropriate method such as distributing documents or other means, depending on the business methods and based on the knowledge, experience and asset condition of the customer (art. 10, para. 1 and para. 2):

(Note) "Registered financial institution business" refers to, among the acts prescribed in Article 33-2 of the FIEA, the acts set forth in Item 1 (excluding those relating to the rights set forth in the items of Article 2, Paragraph 2 of the FIEA which shall be deemed to be securities pursuant to the provisions of the said Paragraph), Item 2 (excluding those relating to the rights set forth in the items of Article 2, Paragraph 2 of the FIEA which shall be deemed to be securities pursuant to the provisions of the said Paragraph), or Item 3 (limited to those relating to specified OTC derivatives transactions and commodity-related market derivatives transactions brokerage, etc.), or securities, etc. management business (Articles of Association, art. 5, item 3).

(i) It is not a deposit (or not an insurance policy in the case of an insurance company);
(ii) It is not covered by the insurance payment prescribed in the provisions of Article 53 of the Deposit Insurance Law (or not subject to the contracts for compensation prescribed in the provisions of Article 270-3, Paragraph 2, Item 1 of the Insurance Business Law in the case of an insurance company);
(iii) It is not covered by the payment to general investors pursuant to Article 79-56 of the FIEA under the Investors Protection Fund prescribed in the provisions of Article 79-21 of the FIEA (limited to cases where a Special Member keeps the securities for custody);
(iv) Repayment of the principal is not guaranteed
(v) Party to the contract; and
(vi) Other matters that are useful to prevent customers from mistaking it for deposits, etc.

When a Special Member handles the securities as set forth in Article 10, Paragraph 1 in its business outlet or office, the Special Member must post the matters set forth in Items (i) through (iv) above in a location visible to customers using the counters that handle the securities. However, such matters may be posted in a location other than the above-mentioned location if the Special Member gives the explanation under Article 10, Paragraph 1 to the customer before handling the securities and delivers or presents a document containing the explanation (including matters displayed on screens of tablet terminals, etc.) before the execution of the contract (art. 10, para. 3).

(12) Prudent Utilization of Margin Transactions, Share Option Certificates Transactions, Investment Equity Subscription Right Certificates Transactions, and Derivatives Transactions, Etc.

An Association Member shall operate its business in a prudent manner depending on the scale and actual business of each company in the execution of a contract for margin transactions, sales and purchases or other transactions in share option certificates or investment equity subscription rights certificates, securities-related derivatives transactions, etc., specified OTC derivatives transactions, etc. and commodity-related market derivatives transactions brokerage, etc. and always restrain itself from pursuing such transactions to an excessive level (art. 11, para. 1).

Furthermore, an Association Member shall endeavor to adequately understand the open interest, profit and loss, customer margin, assets under custody of the securities-related derivatives transactions, etc., the specified OTC derivatives transactions, etc. and commodity-related market derivatives transactions brokerage, etc. of the customers, as well as to manage the evaluation of the profits or losses of customers who repeatedly conduct such transactions, etc. in a comprehensive manner (art. 11, para. 2).

Multiple trades in the area of high-risk, high-return derivatives transactions by customers require an Association Member's special attention and care regarding the evaluation of the profits or losses of customers beyond that required for independent or single contract.

(13) Prevention of Excessive Solicitation, Etc.

(i) Prohibition from Recommendation in a Concentrated Manner Which Represents a Subjective or Arbitrary Supply of Information

An Association Member must be prohibited from recommending to its customers the securities of specific issues or the option related to the sale and purchase of such securities in a concentrated manner, which represents a subjective or arbitrary supply of information (art. 12, para. 1).

(ii) Self-Restraint in Soliciting Margin Transactions in Restricted Issues, Etc.

An Association Member shall refrain from soliciting for margin transactions (excluding reversing trade conducted for the settlement of margin transactions) with respect to the issues set forth in each of item (a) or (b) below for which a financial instruments exchange, Approved Member (meaning the Approved Member prescribed in Article 2, Item 5 of the Rules Concerning Sale and Purchase, Etc. of the Listed Share Certificates, Etc. Conducted Outside of a Financial Instruments Exchange Market; the same shall apply in these Rules), or a securities finance company has taken the measures stated therein (art. 12, para. 2):

(a) Issues with respect to which a financial instruments exchange or Approved Member has restricted or prohibited margin transactions; or

(b) Issues with respect to which a securities finance company has restricted or suspended an application for the use of lending stocks, etc.

An Association Member must, when it accepts an order for a margin transaction from a customer with respect to the issues listed in either item (a) or (b) above, or the issues for which measures listed in either item (a) or (b) below have been taken by a financial instruments exchange, an Approved Member or a securities finance company, explain to the customer the fact that such measures are in effect and the contents thereof (art. 12, para.

3):

(a) Issues with respect to which the financial instruments exchange or Approved Member has increased the rate of margin for margin transactions (including restrictions on the use of securities in substitution for margin, etc.); or
(b) Issues with respect to which a securities finance company has issued a notice for alert with respect to the use of lending stock, etc.

An Association Member is not required to explain the matters prescribed in Article 12, Paragraph 3 in the following cases (art. 12, para. 4):

(a) The customer is a person engaging in the investment management business prescribed in Article 28, Paragraph 4 of the FIEA;
(b) The customer's transaction is conducted via an account regarding which the person engaging in the investment management business as prescribed in (a) gives instructions; or
(c) The customer has notified the Association Member of the intention not to request the explanation under Article 12, Paragraph 3 in the future, and the Association Member finds that the customer fully understands that the issues in which the customers intend to conduct margin transactions may be subject to the measures set forth in (a) or (b) above relating to Article 12, Paragraph 2 or the measures set forth in (a) or (b) above relating to Article 12, Paragraph 3.

(iii) Self-Restraint, Etc. in Soliciting Securities Option Transactions

An Association Member shall refrain from soliciting for securities option transactions with respect to these issues for which a financial instruments exchange has taken measures of restriction or prohibition of the securities option transactions (art. 12, para. 5).

Also, an Association Member must, when it accepts an order for a securities option transaction from a customer with respect to the issues set forth in Article 12, Paragraph 5 or the issues set forth in any of items (a) or (b) below for which the measures stated therein have been taken by a financial instruments exchange, explain to the customer about the fact that these measures are in effect and the contents thereof (art. 12, para. 6):

(a) Issues with respect to which a financial instruments exchange has alerted caution with respect to the open interest related to securities option transactions; and
(b) Issues with respect to which a financial instruments exchange, relating to securities option transactions, has taken measures for advancing the date on which the margin is offered, increasing the rate of such margin (including the restrictions on the use of securities in substitution for margin, etc.) or accepting a deposit prior to the settlement date of the purchase price.

(iv) Self-Restraint, Etc. in Soliciting Foreign Stocks Margin Transactions

When handling foreign stocks margin transactions, a Regular Member must comply with the provisions of Article 44 of the Foreign Securities Rules (art. 12, para. 7).

(14) Prohibition Against Soliciting Investments in Over-the-Counter Securities

An Association Member must not solicit customers to invest in Over-the-Counter securities (OTC securities prescribed in the provisions of Article 2, Item 1 of the "Rules Concerning Over-the-Counter Securities") other than the cases under the provision of the "Rules Concerning Over-the-Counter Securities" (art. 12-2).

(15) Prohibition on the Acceptance of Orders for Transactions Under a Fictitious Name or Name-Lending

Where an order for sale and purchase or other transactions of securities, etc. is placed by a customer, any Association Member must not accept such an order knowing that the transaction is being made under a false name (art. 13, para. 1). Financial institutions including Association Members are required to conduct identity verification of a customer upon transaction under the "Act on Prevention of Transfer of Criminal Proceeds" (hereinafter referred to as the "Criminal Proceeds Transfer Prevention Act") (See 4.2 1 (2) (ii) Prohibition Against "Acceptance of So-Called Transactions Under Fictitious Name" of this Chapter for details).

Furthermore, when a customer applies for a name transfer of stocks, any Regular Member must not lend its name (art. 13, para. 2).

(16) Prohibition of Divulgation, Etc. of Information about the Customer

An Association Member must not divulge or leak information about the customers (including information about prospective customers and customers of underwriting and investment banks, excluding publicly known information; the same shall apply in (16) below) (art. 13-2, para. 1).

In addition, an Association Member must not wrongfully acquire information about a customer of another Association Member or information about a customer of the financial instruments intermediary service of a financial instruments intermediary service provider (meaning the financial instruments intermediary service provider prescribed in Article 3, Item 9 of the Articles of Association); and must not use wrongfully acquired information about customers in its business and divulge or leak wrongfully acquired information about customers (art. 13-2, para. 2).

(17) Establishment of Internal Administration System to Prevent Transfer of Criminal Proceeds

An Association Member shall appoint a person responsible for the notification of doubtful transactions pursuant to the provisions of Article 8, Paragraph 1 of the Criminal Proceeds Transfer Prevention Act, and shall endeavor to establish an internal administration system designed to prevent transfer of criminal proceeds and fund provision to terrorist organizations (art. 14).

(18) Maintenance, Etc. of Insider Registration Cards

An Association Member must ask any customer that makes a sale and purchase, etc. of the specified securities, etc. of a listed company, etc. prescribed in FIEA, Article 166 for the first time to submit a form declaring that the customer is categorized into any of the persons set forth in Article 15, Paragraph 1, Items 1 through 10 (hereinafter referred to as an "officer, etc. of a listed company, etc." in these Rules), and based on the declaration, it must prepare an insider registration card before making such a sale and purchase, etc. of the specified securities of a listed company, etc., by stating the following matters therein (art. 15, para. 1 and para. 2):

(i) Name or appellation;
(ii) Address or domicile, and a mailing address;

(iii) Date of birth (limited to the case where the customer is a natural person);
(iv) Company name, title, and section; and
(v) Name and issue code of the listed company, etc. in which the customer falls under the officer, etc. of the listed company, etc.

Further, an Association Member must make a promise with a customer to notify without delay to the Association Member when there is any change in whether the customer falls under the officer, etc. of the listed company, etc. or not. And when an Association Member receives the notice of a change, it must revise the insider registration card without delay (art. 15, para. 3 and para. 4).

An Association Member must develop a system to control and manage insider trading by establishing internal rules on the prevention of insider trading and other means (art. 15, para. 7).

These provisions do not apply to Special Commodity Futures Members until the day specified separately by the JSDA.

(19) Reconciliation with J-IRISS

An Association Member must reconcile the name, date of birth, and address of a customer who conducts sale and purchase, etc. of the specified securities, etc. of a listed company, etc. prescribed in FIEA, Article 166 (excluding legal entities) that are included in a customer card, with the data in J-IRISS (a reconciliation system of the JSDA) at least once a year, and, based on the result of the reconciliation, it must confirm whether or not the customer falls under the category of officer, etc. of a listed company, etc., and prepare the insider registration card without delay (art. 15-2, para. 1 and para. 2).

If an Association Member receives information from J-IRISS as a result of the reconciliation prescribed in Article 15-2, Paragraph 1, it shall not use such information for any purpose other than the preparation of insider registration card (art. 15-2, para. 3).

These provisions do not apply to Special Commodity Futures Members until the day specified separately by the JSDA.

(20) Establishment of System for Management of Discretionary Trading

An Association Member must—in order not to lack in investor protection, hamper fair transactions and undermine trust in the Association Member—establish an adequate system for the management of sale and purchase or other transactions of securities, etc. that are effected on the basis of the contracts set forth in Article 123, Paragraph 1, Item 13 of the FIBCOO (hereinafter referred to as “Discretionary Trading” in these Rules) (art. 16).

(21) Ensuring the Safety of Transactions

An Association Member must, in accepting an order from a new customer or a customer for a large-lot transaction, endeavor to ensure the safety of the transaction by such means as having the customer concerned deposit the whole or a part of the money for purchasing securities or securities for sale with the Association Member concerned in advance (art. 17).

(22) Proper Management of Transactions Pertaining to Customer Orders

An Association Member must, when it conducts sale and purchase or other transactions of securities, etc.,

clearly distinguish the transactions ordered by customers from the transactions executed on its own account, and, in sale and purchase or other transactions of securities, etc., must properly manage the transactions ordered by customers by immediately preparing, keeping and maintaining order slips with respect to the customers' orders and by inputting numbers, etc. designed to distinguish them from transactions conducted on its own account via a terminal (art. 18, para. 1 and para. 2).

Furthermore, an Association Member must establish internal rules, which prescribe the proper operation and management of a time-recording machine, elimination of improper operation of computers, etc. in order to contribute to the proper management of the transactions ordered by customers as prescribed in Article 18, Paragraphs 1 and 2 (art. 18, para. 3).

(23) Best Execution Duty

An Association Member must develop a system that is sufficient to properly fulfill the best execution duty prescribed in the provisions of Article 40-2 of the FIEA (art. 19).

(24) Provision of Facilities to Customers, Including Guarantees by Regular Members

A Regular Member must conduct proper management of the provision of facilities to customers, such as guarantees and mediation, etc. (including all acts, irrespective of the form, by which a Regular Member or its officer or employee takes part in the customer's borrowing of money or securities) incidental to the customer's borrowing of money or securities in relation to sale and purchase or other transactions of securities, etc. so that the facilities are not excessive in light of the value of the transaction conducted by the customer and other factors (art. 20).

(25) Prohibition of Provision of Facilities to Customers, Including Loan Extensions by Special Members

When a Special Member conducts or solicits the conduct of a transaction related to the registered financial institution business to a customer (including professional investors), it must not promise to provide any special benefits in connection with loans or guarantees to the customer (art. 21).

(26) Prohibition, Etc. of Special Members' Automatic Credit Extension

A Special Member shall not make an automatic credit extension to customers for the purpose of covering losses or putting up an initial margin or additional margin for the transactions related to the registered financial institution business and must take the measures set forth in item (i) or (ii) below. In addition, a Special Member must not extend any loan that will clearly be used for putting up the initial margin or additional margin (art. 22, para. 1):

(i) A Special Member shall newly set up an exclusive account for securities futures transactions, etc. in JGBs, etc. (transactions set forth in Article 2, Paragraph 21, Item 1 of the FIEA in connection with the securities as set forth in the provisions of Article 2 of the FIEA, or actions set forth in the provision of Article 2, Paragraph 8, Item (2) or (3) in connection with the transactions mentioned above; hereinafter the same shall apply in these Rules) (hereinafter referred to as "Account for Bond Futures Transactions" in these Rules), and shall be prohibited from extending an overdraft to that account; and

(ii) Any Special Member shall not make an automatic transfer from a person's account with an overdraft to the same person's Account for Bond Futures Transactions.

A Special Member must, in order to confirm the customer's intention with respect to the deposit of money in relation to securities futures transactions, etc. in JGBs, etc. appoint in advance a person in charge of the customer concerned in relation to the processing of money deposited into Account for Bond Futures Transactions, and shall have the customer concerned or a treasurer of the customer registered. Each time any money is put into the account, the Special Member shall obtain the customer's prior approval by telephone, etc. (art. 22, para. 2).

When a Special Member conducts transactions related to the financial instruments intermediary service as a registered financial institution and the outstanding amount in the transaction account opened for the Special Member by the customer is not sufficient, it must not conduct the transactions related to the financial instruments intermediary service by the registered financial institution by making an automatic credit extension or by promising to do so (art. 22, para. 3).

(27) Complete Management of Information on Non-Disclosed Loans, Etc.

When a Special Member conducts the financial instruments intermediary service as a registered financial institution, it must develop internal rules to manage and control the information on nondisclosed loans (that is prescribed in the provisions of Article 1, Paragraph 4, Item 13 of the FIBCOO) of the customer who is an issuer of the securities and to prevent any unfair transactions associated with such information as well as to thoroughly disseminate them for complete understanding among the officers and employees (including all the staff members who are in charge of such business if the accounting consultant is a corporation; hereinafter the same shall apply in these Rules) for the purpose of full compliance (art. 23).

(28) Notification of Profits and Losses from Investment Trusts, Etc.

An Association Member must notify a customer of any profits and losses (total return) from an investment trust, etc. which it takes custody of as entrusted by the customer or which it manages via entries or records in a book-entry account registry, as provided for in the appended table (art. 23-2).

(29) Establishment of a System for Management of Customers

An Association Member must establish internal rules concerning customer due diligence, transaction commencement standards, the prevention of excessive solicitation, and the establishment of a control system for discretionary trading, etc. for the purpose of ensuring the adequate management of customers in sale and purchase or other transactions of securities, etc., and ensures that its officers and employees comply with such rules (art. 24, para. 1).

Furthermore, an Association Member must develop a system to manage customers pursuant to the internal rules, and endeavor to accurately understand the conditions of any sale and purchase or other transactions of securities, etc. conducted by the customers and the business activities conducted by its officers and employees (art. 24, para. 2).

(30) Establishment of a System for Management of Insider Trading

An Association Member must endeavor to establish the system for management of insider trading by such means as establishing internal rules concerning the management of unpublished information relating to issuing companies which have been acquired in regard to the business operations by its officers and employees, management of customers, and management of the sale and purchase of securities, etc. with a view to preventing insider transactions (art. 25).

(31) Proper Management of Transactions Under Trust Accounts

An Association Member must accurately understand the situation of customers' transactions utilizing accounts based on trust contracts (including the contracts of specified pecuniary trusts and contracts of specified non-pecuniary trusts), and endeavor to manage them appropriately (art. 26).

(32) Establishment, Etc. of Internal Inspection Rules

An Association Member must establish internal rules with respect to the internal inspection and audits concerning observance of the FIEA and other laws and regulations, investment solicitations and customer management, etc., and shall also endeavor to establish the internal administration system and operate it properly (art. 27).

(33) Establishment of an Organization to Deal with Customer Complaints and Disputes

An Association Member must endeavor to establish an internal administration system by prescribing the departments, etc. to deal with customer complaints and disputes with customers and to deal with them properly (art. 28).

(34) Documents Delivery Using Electromagnetic Methods

In substitution for the delivery, etc. of the alert document prescribed in Article 6-2, under the provisions of Articles 2 and 3 of the "Rules Concerning Handling of Documents Delivery, etc. through Electromagnetic Methods" (hereinafter referred to as the "Rules Concerning Electromagnetic Documents Delivery, etc."), an Association Member may use methods employing electronic information processing systems or other information technologies to provide the information on the matters that should be included in the alert document. In such a case, the Association Member shall be regarded as having submitted, etc. such alert document (art. 29, para. 1).

If an Association Member needs to collect a confirmation document as prescribed in the provisions of Article 8, it may receive the information on the matters that should be described in such a confirmation document by a method using electromagnetic organization or other means using information and telecommunications technologies pursuant to the "Rules Concerning Electromagnetic Documents Delivery, etc." instead of obtaining such documents physically, and in such a case, the Association Member is considered to have collected the said confirmation document (art. 29, para. 2).

2 Rules Concerning Establishment of Confidential Corporate Information Management System by Association Members

The purpose of Rules Concerning the Establishment of a Confidential Corporate Information Management System by Association Members (hereinafter referred to as the "Rules") is to establish a management system, etc. of confidential corporate information by Association Members by prescribing necessary measures such as internal rules, for the purpose of preventing an unfair transaction using confidential corporate information that is acquired by Association Members during the course of the business (art. 1).

The provisions of Articles 3 through 7 do not apply to Special Commodity Futures Members until the day specified separately by the JSDA.

(1) Identification of Management Section of Confidential Corporate Information

An Association Member must designate the Management Section* (art. 3).

* The term "Management Section" as used in the Rules means a section that comprehensively manages the Confidential Corporate Information (or a responsible person if the Confidential Corporate Information is managed in each business outlet or office) (art. 2, item 2).

(2) Establishment of Internal Rules

An Association Member must establish internal rules for the management of Confidential Corporate Information that prescribe matters set forth in each of item (i) through (vii) below, for the purpose of preventing conduct of an unfair transaction using such information (art. 4):

(i) Matters concerning the procedures at the time of acquiring the Confidential Corporate Information;
(ii) Matters concerning the information management procedures for a person, etc. who acquired the Confidential Corporate Information;
(iii) Matters concerning the identification of the Management Section and its information management procedures;
(iv) Matters concerning the communication procedures of Confidential Corporate Information;
(v) Matters concerning the extinction or deletion procedures of Confidential Corporate Information;
(vi) Matters concerning prohibited actions; and
(vii) Other matters the Association Member deems necessary.

(3) Procedures at the Time of Acquiring the Confidential Corporate Information

An Association Member must establish procedures that are necessary to manage the Confidential Corporate Information such that officers and employees who acquire the Confidential Corporate Information immediately report such acquisition to the Management Section (art. 5).

(4) Management of Confidential Corporate Information

An Association Member must manage the Corporate Section* so that the Confidential Corporate Information is not communicated to other sections that do not need such information for their business, such as through physically isolating the Corporate Section from other sections, managing the documents that describe the Confidential Corporate Information or information that could be the Confidential Corporate Information in an isolated environment from other sections, or managing such electronic files that contain the Confidential Corporate Information or information that could be the Confidential Corporate Information in a way that people cannot view them easily (art. 6).

Even when information that an Association Member's officer or employee has acquired in the course of their duty or due to their position does not fall within the category of Confidential Corporate Information, if such information is found to have a significant influence on investors' investment decisions, the Association Member must exercise due care to avoid harming fairness and impartiality of the market by providing such information to investors.

* The term "Corporate Section" as used in the Rules means, among sections mainly conducting business (meaning the financial instruments business and incidental business or the registered financial institution business), sections with a high possibility of acquiring confidential corporate information mainly in their business activities (art. 2, item 3).

(5) Enhancement of Management Systems

An Association Member must conduct regular inspection or monitoring to check whether or not the Confidential Corporate Information is managed properly pursuant to the internal rules (art. 7).

(6) Concept of the Rules

The JSDA shall prescribe matters related to the operation, etc. of the Rules by Association Members in the "Guideline for 'Rules Concerning Establishment of Confidential Corporate Information Management System by Association Members'" (art. 8).

3 Rules Concerning Acceptance, Etc. of Deposit of Securities

The purpose of these Rules is to ensure appropriate management of customers by Association Members, by prescribing matters relating to acceptance by an Association Member of a deposit from a customer of securities, a report to a customer, and reconciliation of the balance of credits and liabilities (art. 1).

Deposit contracts are governed by Article 657 of the Civil Code. A deposit contract is an agreement under which one party promises to hold an item in custody for the other party, and the contract is established by accepting the item to be held.

Even when Association Members accept the deposit of securities or certificates issued in connection with the deposited commodities as prescribed in Article 2, Paragraph 8, Item 16 of the FIEA, such as warehouse receipts; they must comply with the provisions of these Rules such as the restrictions on the acceptance, etc. of the deposit of securities (art. 2); the conclusion of a safe custody contract (art. 3); and the treatment of deposited securities in the account (art. 5); which apply *mutatis mutandis* to them. However, these provisions do not apply to Special Commodity Futures Members until the day specified separately by the JSDA.

(1) Restrictions on the Acceptance, Etc. of Deposits

The cases in which an Association Member can engage in the acceptance, etc. a deposit of securities (when a Special Member is concerned, referring to securities that are related to the registered securities business; when a Specified Business Member is concerned, referring to securities that are related to the specified business) from a customer are limited to the following cases (or only case (iv) applied to Specified Business Member) (art. 2):

(i) In case of a simple deposit contract

These are cases where the Association Member is entrusted with the custody of securities from customers and keep them in custody separately for each customer.

(ii) In case of a mandate contract

These are cases where the Association Member receives a mandate to act as standing agent with respect to such clerical functions for securities from customers.

(iii) In case of a commingled deposit contract (limited to a commingled deposit contract relating to

bonds and investment trusts beneficiary certificates, transfer settlement to be conducted by the Japan Securities Depository Center Inc., a financial instrument exchange and a settlement house, and sale and purchase or other transactions in foreign securities and foreign certificates)

Commingled deposits refer to cases where all securities of the same issue deposited by multiple customers are commingled and held in custody. Upon the return of such securities, each customer receives an amount of securities from out of the pool corresponding to the amount he or she deposited (in this case, the deposited securities are the jointly owned by multiple persons, and this distinguishes commingled custody contracts from the securities lending depository contracts described below).

(iv) In case of the depositor being a pledgee

Cases where the Association Member is a pledgee refer to cases where, for example, the Regular Member receives a deposit of securities from the customer in lieu of a cash margin in a margin transaction, or where the Regular Member holds securities from the customer as collateral for an advance of funds.

(v) In case of the contract of deposit for consumption

A deposit for consumption refers to custody arrangements under which the custodian agrees to consume the deposited securities, and replace them at a later date with items of the same type, quality and quantity (same issue name and same quantity).

(2) Safe Custody Contracts

(i) Conclusion of the Safe Custody Contract

In the case where a Regular Member or a Special Member accepts from a customer the deposit of securities under a simple deposit contract or a commingled deposit contract, the Regular Member must conclude with the said customer a contract concerning the deposit of securities (hereinafter referred to as "safe custody" in these Rules) under the terms and conditions of safe custody master agreement (in the case of a Special Member, meaning the custody rules in the business methods manual relating to the registered financial institution business; hereinafter the same shall apply in these Rules) (art. 3, para. 1).

The terms and conditions of safe custody master agreement are appropriate for the business practices, services and separate custody system of each Regular Member or Special Member. The following enumerated items must be provided for in the safe custody master agreement pursuant to the rules (with regard to the items which are not necessarily included in safe custody contract with a customer in the consideration of the business scope, etc. of the Regular Member (this would be the case, for example, with item C. below for a Regular Member who does not handle bonds at all) may be dispensed with) (art. 3, para. 2):

(a) The method and location of keeping securities to be held in custody;
(b) Matters agreed by the customer regarding commingled deposit;
(c) Treatment of bonds in the case of redemption by lot;
(d) Matters to be reported to a Regular Member or Special Member and procedures for reporting changes in those matters;
(e) Treatment in the account of securities in custody;
(f) Treatment of pledge;
(g) Treatment of notifications, etc. to the actual shareholders, etc.;
(h) Matters to be notified to the customer;

(i) Explanation of agency services, etc. for name transfer, etc.;
(j) Matters related to the receipt of redemption payments, etc. on the customer's behalf;
(k) Handling of the restitution and return of securities held in custody or its equivalent;
(l) Administration fee for safe custody;
(m) Matters related to the cancellation of safe custody contract;
(n) Matters related to exemptions; and
(o) Procedures for revising the safe custody master agreement.

With respect to the procedures for entering into the safe custody contract, the Regular Member or Special Member must receive an application for opening a safe custody account submitted by the customer (art. 3, para. 3), and have the customer report his/her name, date of birth and address, and register his/her seal, etc.

In the case where a Regular Member or Special Member has received from a customer an application for opening the safe custody account and accepted it, the Regular Member or Special Member must open the safe custody account and notify the said customer to that effect without delay (art. 3, para. 4).

In the case where a Regular Member or Special Member accepts from a customer under a commingled deposit contract the deposit of bonds which may be redeemed by lot, the Regular Member or Special Member must establish internal rules for handling of such bonds and obtain the prior consent from the customer (art. 4).

When the foregoing procedures are completed, and the custody account of the customer is opened, the Regular Member or Special Member must perform all receipts, custody and deliveries of the securities deposited by the said customer under a simple deposit contract or a commingled deposit contract within such account (art. 5).

(ii) Exception from Application of Safe Custody Contract

It is not necessary to enter into a safe custody contract with respect to the deposit of following securities (art. 6):

(a) Securities under a cumulative investment contract;
(b) Securities under a standing proxy contract; and
(c) Securities that are prescribed in Article 2, Paragraph 1, Item 15 of the FIEA, rights that are recognized as securities pursuant to the provisions of Article 2, Paragraph 2 of the FIEA and foreign securities that are prescribed in Article 2, Paragraph 1, Item 1 of the Foreign Securities Rules.

(Note) Nowadays, with the increased progress of the dematerialization (digitization) of securities issued in Japan, a securities settlement system has been established where every process concerning securities, from issuance to redemption, can be dealt with under the book-entry transfer system.

This book-entry transfer system is based on the "Act on Transfer of Bonds, Shares, etc." (hereinafter referred to as the "Book-Entry Transfer Act"). Securities which shall be dealt with under the book-entry transfer system are required to be managed in accordance with the Book-Entry Transfer Act and the business regulations, etc. specified by the book-entry transfer institution (with respect to national government bonds, the Bank of Japan is designated as the book-entry

transfer institution, and with respect to shares, general bonds and investment trusts, etc., the Japan Securities Depository Center, Inc.).

An Association Member that intends to serve as an account management institution must conclude a book-entry account management agreement based on the business regulations, etc. specified by the book-entry transfer institution, to clarify the rights and obligations between itself and the customer.

In other words, digitized securities (book-entry transfer national government bonds, book-entry transfer shares, book-entry corporate bonds, book-entry transfer beneficial interest in investment trust, etc.) shall be managed by the book-entry account registry kept by the Association Member that serves as the account management institution, and safe custody of such securities shall not be made.

(iii) Safe Custody Master Agreement

The safe custody master agreement clarifies the relationship among the rights/obligations of the Regular Member or Special Member, acting as trustee, and the customer, who is the depositor, concerning the "custody" of securities, and contain detailed provisions governing the segregation and custody, etc. of the securities in custody.

The mandatory contractual matters (for Regular Members) that are listed in the aforementioned (i)(a) through (o) are constituted mainly by the following sample elements:

(Note) The details of the "safe custody master agreement" below are based on the reference forms of the JSDA (amended on March 8, 2022).

(a) Keeping of securities in custody: In general, this is to be determined by each Regular Member in conformity with the provisions concerning the separate custody prescribed in Article 43-2 of the FIEA as appropriate in view of the actual condition of each Regular Member. However, an overview of the custody methods that were commonly used is as follows:
- In general, securities in custody shall be kept by Regular Members;
- Securities in custody subject to the book-entry settlement of a financial instruments exchange will be commingled at the settlement corporation for such financial instruments exchange; and
- Bonds or the beneficiary certificates of investment trusts are sometimes commingled with the same issues held by other customers unless the customer requests otherwise.

(b) Matters requiring consent: As regards securities that are commingled, the depositor will be treated as having consented to the following items:
  i) The depositor will acquire joint ownership or quasi-joint ownership over securities of the same issue as the securities deposited according to the number or amount of the securities deposited; and
  ii) When the depositor deposits new securities, or when securities already in custody are returned, no consultation will be made with the other customers who deposited securities of the same issue.

(c) Matters to be notified: The seal impression and the stated address, personal name, etc. in the custody account application form will be treated as the registered seal, address and personal name.

(d) Matters to be communicated to the customer of a Regular Member:
  i) In cases of a change in the name of the registered holder or submission—the date thereof;

ii) In cases where the bonds in a commingled deposit account were selected for redemption by lot—the amount of the redemption;
iii) Final redemption date; and
iv) Reports for the reconciliation of balance; however, where the transaction balance statements (*) are periodically sent out, the reports under the transaction balance statement.

(Note) The statement may be omitted if the customer is a professional investor and if a system has been established that allows prompt answers to customer inquiries, the statement may be omitted. Further, notations in statements for balance reconciliation may be omitted in connection with some of the matters to be stated in the document to be delivered upon conclusion of contract, etc. concerning individual derivatives transaction.

* Transaction balance statements

While Documents to Be Delivered Prior to Conclusion of Contract (transaction statements) are documents for reporting contracts for securities transactions, etc., transaction balance statements are documents for reporting the status of delivery and settlements and the balance of securities or money based on the contract reports.

Rules for delivery: In principle, transaction balance statements are delivered periodically, at least once on the last day of each period set by dividing one year into periods of three months or shorter ("periodical statements"), or if customers make requests, on each occasion of the execution of a contract for financial instruments transaction or the delivery of securities or money ("transaction-based statements").

Matters to be contained: Transaction balance statements must contain details of the transactions conducted during each period, such as the securities (*e.g.,* shares, bonds, investment trusts) traded, and the positions in margin transactions or futures/options transactions; and the records of acceptance and delivery of money and of securities in these transactions as well as the balances thereof at the end of the period. In the case of transaction-based statements (only in cases where the delivery of securities and money based on the contract for financial instruments transactions has been completed), transaction balance statements must also contain the following: the name of the customer; the date of delivery and the issue name of the securities; and the balance of the securities and money after the completion of the delivery of securities and money in relation to the sale and purchase or other transaction of securities or the derivatives transaction.

(e) Acting as agent with respect to the procedures for changes in the name of the registered holder, consolidation or split of shares, allotment of shares without contribution, exercise of share options under a bond with share option, representation with respect to repurchase demands to the issuing company of shares less than one unit, etc.: The Regular Member can act as agent upon the customer's request.
(f) Receiving the redemption money: The Regular Member can receive the redemption money as agent and pay it when requested by the customer.
(g) Returning the securities in custody: The return of securities in custody is based on the procedures in

place at each Regular Member.

(h) Procedures for amending the matters to be notified: Changes in the name, address, etc. of the customer are based on the procedures in place at each Regular Member.

(i) Fees: Fees may be set by each Regular Member as appropriate in accordance with its fee schedule.

(Note) The Regular Member and the customer can agree to the amount of custody account management fees, the standing proxy fees, the fee of the change in the name of registered holder, and the cumulative investment account management fees, etc. to be imposed and collected.

(j) Release from liability: Regular Members shall not be liable for any damages occurring in the following cases:

i) Cases where the securities in custody are returned, if the Regular Member determines that there is no difference between the seal impression affixed to the requisite documentation of the Regular Member and the registered seal;

ii) Cases where the securities in custody are not returned, if the Regular Member determines that there is a difference between the seal impression affixed to the requisite documentation of the Regular Member and the registered seal;

iii) When a change in the name of the registered holder or a submission of some kind is required, and notwithstanding the fact that the Regular Member sent out notification thereof prior to the deadline, cases where no request for such procedures is received by the prescribed deadline;

iv) Cases where the securities in custody are originally defective or there are facts constituting the grounds for such defect; and

v) Cases where due to a natural disaster or other force majeure, the return of the securities in custody is delayed.

(3) Standing Proxy Contract

When a Regular Member is entrusted by a customer with administration relating to standing proxy service concerning securities, such as receiving and forwarding dividends, exercising voting rights, exercising or disposing of share options or other securities-related transactions, the Regular Member must collect from the customer a document proving the proxy (art. 7).

(4) Contract of Deposit for Consumption

When accepting from a customer, etc. the deposit of securities under the contract of deposit for consumption, a Regular Member or Special Member must prepare a document proving the said contract in duplicate and deliver one copy thereof to the said customer and retain the other copy (art. 8, para. 1).

However, in the case where a Regular Member or Special Member accepts from a customer the deposit of any share certificates, etc. under contract of deposit for consumption, the Regular Member or Special Member shall comply with “Rules Concerning Handling of Borrowing and Lending Transactions for Share Certificates, Etc.” (art. 8, para. 2).

(5) Notice of Reconciliation and Document to be Delivered upon Conclusion of Contract (In Case of Regular Members)

(i) Reporting by Notice of Reconciliation

A Regular Member must report to a customer on the balance of credits and liabilities for the said customer by a notice of reconciliation in such category and at such frequency as prescribed in each item below.

However, this shall not apply to the case where the customer is one to whom a transaction balance statement, which is prescribed in FIBCOO, Article 98, Paragraph 1, Item 3 (a) is delivered regularly, and the transaction balance statement includes the matters to be set forth in a notice of reconciliation (art. 9, para. 1):

(a) Customers who conduct sale and purchase in securities
..... Once a year or more

(b) Customers who conduct securities-related derivatives transactions, specified OTC derivatives transactions or commodity-related market derivatives transactions
..... Twice a year or more

(c) Customers with a positive balance of money or securities who have not conducted deliveries or transactions set forth in (a) and (b) above for one year or more
..... From time to time

(Note) Securities-related derivatives transactions mean the securities-related derivatives transactions prescribed in FIEA, Article 28, Paragraph 8, Item 6 (excluding those relating to the rights set forth in FIEA, Article 2, Paragraph 2 which are deemed to be securities under the said Paragraph; the same shall apply hereinafter).

Specified OTC derivatives transactions mean OTC derivatives transactions prescribed in FIEA, Article 2, Paragraph 22 (excluding those that fall under the FIEAEO, Article 1-8-6, Paragraph 1, Item 2) which do not fall under any of the following: (i) transactions relating to the rights set forth in FIEA, Article 2, Paragraph 2 which are deemed to be securities under the said Paragraph; (ii) securities-related derivatives transactions; (iii) OTC financial futures transactions (meaning the OTC financial futures transactions prescribed in FIBCOO, Article 79, Paragraph 2, Item 2); or (iv) transactions prescribed in FIEA, Article 2, Paragraph 22, Item 4 (limited to transactions related to the financial indicators (limited to those referred to in Paragraph 24, Item 3 of the said Article) set forth in Paragraph 25, Item 1 or Item 4 of the said Article).

Commodity-related market derivatives transactions mean commodity-related market derivatives transactions prescribed in FIEA, Article 2, Paragraph 8, Item 1 (market derivatives transactions involving financial instruments (limited to gold, silver, platinum, palladium, crude oil, ribbed smoked sheet (or RSS), technically specified rubber (TSR), soybeans, red beans or corn) or financial indicators (limited to the prices of gold, silver, platinum, palladium, crude oil, RSS, TSR, soybeans, red beans or corn, and the figures calculated based thereon)).

The matters to be stated on the notice of reconciliation are the latest balances of the following monies or securities (excluding those relating to the cashing of MMFs and medium-term government bond funds, etc.) (art. 9, para. 2):

i) Latest balance of advance money, loaned money, deposited money, or borrowed money;
ii) Latest balance of securities deposited under a simple deposit contract, a mandate contract, a commingled deposit contract or a contract of deposit for consumption and securities administered as records in a transfer account or registration, etc. (excluding those that are set forth in iii) below);
iii) Latest balance of money or securities as the object of pledge;
iv) Latest balance of outstanding account relating to margin transactions (this information may be omitted if the notice of reconciliation is delivered at the same time as the delivery of the notice relating to margin transactions.);
v) Latest balance of securities relating to "when-issued" transactions; and
vi) Latest balance of outstanding account relating to securities-related derivatives transactions, specified OTC derivatives transactions and commodity-related market derivatives transactions (the latest balance of outstanding account relating to securities-related derivatives transactions may be omitted if the notice of reconciliation is delivered at the same time as the delivery of the notice relating to securities-related derivatives transactions).

If a customer is a professional investor and a Regular Member has established a system which enables a prompt reply to the said customer, the Regular Member is allowed to omit a report. Furthermore, among the matters to be included in a notice of reconciliation, matters stated in a document to be delivered upon conclusion of a contract relating to individual derivatives transactions, etc. (limited to such document delivered to a customer) or in a written contract in which terms on the relevant derivative transaction, etc. are stated (limited to such contract executed with a customer) may also be omitted in the notice of reconciliation (art. 9, para. 4 and para. 5).

Furthermore, even if there is no current balance of money or securities in the customer's account but there was an outstanding balance at the time of or within less than a year after the most recent report, a Regular Member must make a report to the said customer by the notice of reconciliation to the effect that there is no balance at present (art. 10).

(ii) Preparation and Delivery of the Notice of Reconciliation

The notice of reconciliation shall be prepared in a Regular Member's inspection, auditing, or administration department (art. 11, para. 1).

A Regular Member must conspicuously indicate the matters set forth in the following items concerning the notice of reconciliation to be delivered to a customer. With regard to the notice of reconciliation concerning the registered financial institutions' acts of financial instrument intermediation of a Special Member, the Special Member may indicate the responsible person in the Special Member's inspection, audit or administration department, in addition to the contact information listed on below, on the same notice of reconciliation (art. 11, para. 2):

(a) A customer shall, upon receipt of the notice of reconciliation, confirm the contents of the descriptions therein;
(b) In the case where there is a mistake in or a doubt about the descriptions of the notice of

reconciliation, an inquiry shall be made directly to the responsible person in a Regular Member's inspection, audit, or administration department without delay; and

(c) Contact information relating to the preceding item (b) above.

In addition, in the case where a Regular Member delivers the notice of reconciliation to a customer, the Regular Member shall mail it to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such notice is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and a Regular Member make the arrangement under the provisions of the rules prescribed by the JSDA (art. 11, para. 3 and para. 4).

Further, in the case where a Regular Member has received an inquiry from a customer about the balance of money or securities listed in (i) i) through vi) above, the Regular Member's inspection, audit, or administration department must accept such inquiry and make a reply without delay to the said customer about the balance. Also, in the case where the inquiry is related to the financial instruments intermediary service, the Regular Member shall, when necessary, request a Special Member in charge of the financial instruments intermediary service on an entrustment basis or a financial instrument intermediary service provider to make a report and shall investigate (art. 12).

(iii) Delivery of the Document to Be Delivered upon Conclusion of Contract

Just as in the case of the notice of reconciliation mentioned above, in order to ensure direct contact with the customer, when a Regular Member delivers a document to be delivered upon conclusion of a contract to a customer, the Regular Member, in general, must mail that document to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such document is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and a Regular Member make the arrangement under the provisions of the rules prescribed by the JSDA (art. 13, para. 1).

Also, in the case where a customer is a juridical person or an organization equivalent thereto, if the chief manager or an employee authorized by the chief manager of a Regular Member has brought a document to be delivered when concluding a contract to the office of the said customer and delivered it directly to the said customer, the document concerned shall be deemed to have been delivered by mail (art. 13, para. 2).

(6) Notice of Reconciliation and Document to Be Delivered upon Conclusion of Contract (In Case of Special Members)

(i) Report by Notice of Reconciliation

A Special Member must report to a customer by a notice of reconciliation in such category and at such frequency as set forth in each of the following items.

However, this shall not apply to the case where the customer is the one to whom a transaction balance statement is delivered regularly or who is notified in the form of transaction book, and also the transaction balance statement or the transaction book includes the matters to be set forth on a notice of reconciliation (art. 17, para. 1):

(a) Customers who conduct securities-related market derivatives transactions, transactions in bonds with options, securities-related over-the-counter derivative transactions, specified

OTC derivative transactions and commodity-related market derivatives transactions ..... Twice a year or more

(b) Customers who have a positive balance of securities concerning registered financial institution business (excluding customers who conduct the transactions listed in (a) above) ..... Once a year or more

(c) Customers who have a positive balance of money or securities concerning registered financial institution business and who have not conducted deliveries or transactions set forth in item (a) above for more than a year ..... From time to time

The matters to be stated on the notice of reconciliation are the balances of the following cash or securities relating to the registered financial institution business (art. 17, para. 2):

i) Latest balance of advance money or deposited money;

ii) Latest balance of securities deposited under a simple deposit contract, a mandate contract or a commingled deposit contract or securities administered as records in a transfer account or registration, etc. (excluding items iii) through vi));

iii) Latest balance of margin and collateral securities for securities-related market derivatives transactions and commodity-related market derivatives transactions;

iv) Latest balance of cash collateral or collateral securities for securities-related OTC derivatives transactions (limited to the ones relating only to the relevant transactions);

v) Latest balance of margin and collateral securities for transactions in bonds with options;

vi) Latest balances of cash collateral and collateral securities for specified OTC derivatives transactions (limited to the ones relating only to the relevant transactions) (these balances may be omitted if a document containing them has been delivered to the customer); and

vii) Latest balance of outstanding account relating to transactions in bonds with options, securities-related market derivative transactions, securities-related OTC derivatives transactions, specified OTC derivatives transactions or commodity-related market derivatives transactions (the latest balance of outstanding account relating to securities-related market derivatives transactions may be omitted if the notice of reconciliation is delivered at the same time as the delivery of the notice relating to securities-related derivatives transactions).

If a customer is professional investor and a Special Member has established a system which enables a prompt reply to the said customer, the Special Member is allowed to omit a report. Furthermore, among the matters to be included in a notice of reconciliation, matters stated in a document to be delivered upon conclusion of a contract relating to individual derivatives transactions, etc. (limited to such document delivered to a customer) or in a written contract in which terms on the relevant derivative transaction, etc. are stated (limited to such contract executed with a customer) may also be omitted in the notice of reconciliation (art. 17, para. 5 and para. 6).

Furthermore, even if there is no current balance of money or securities in the customer's account but there was an outstanding balance at the time of or within less than a year after the most recent report, a Special

Member must make a report to the said customer by the notice of reconciliation to the effect that there is no balance at present (art. 10 applied *mutatis mutandis* pursuant to art. 16).

(ii) Preparation and Delivery of the Notice of Reconciliation

The notice of reconciliation shall be prepared in a Special Member's inspection, audit, or administration department (art. 11, para. 1 applied *mutatis mutandis* pursuant to art. 16).

A Special Member must conspicuously indicate the matters set forth in the following items concerning the notice of reconciliation (art. 11, para. 2 applied *mutatis mutandis* pursuant to art. 16):

(a) A customer shall, upon receipt of the notice of reconciliation, confirm the contents of the descriptions therein;
(b) In the case where there is a mistake in or a doubt about the descriptions of the notice of reconciliation, an inquiry shall be made directly to the responsible person in the Special Member's inspection, audit, or administration department without delay; and
(c) Contact information relating to item (b) above.

In addition, in the case where a Special Member delivers the notice of reconciliation to a customer, the Special Member must mail it to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such notice is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Special Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 11, para. 3 and para. 4 applied *mutatis mutandis* pursuant to art. 16).

Further, in the case where a Special Member has received an inquiry from a customer about the balance of money or securities listed in (i) i) through vii) above, the Special Member's inspection, audit, or administration department must accept such inquiry and make a reply without delay to the said customer about the balance. Also, in the case where the inquiry is related to the financial instruments intermediary service, a Special Member shall, when necessary, request the financial instruments intermediary service provider who conducts entrustment of financial instrument intermediary service to make a report and shall investigate (art. 12 applied *mutatis mutandis* pursuant to art. 16).

(iii) Delivery of the Document To Be Delivered upon Conclusion of Contract

Just as in the case of the notice of reconciliation mentioned above, in order to ensure direct contact with the customer, when a Special Member delivers a document to be delivered upon conclusion of a contract to a customer, the Special Member, in general, must mail that document to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such document is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Special Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 13, para.1 applied *mutatis mutandis* pursuant to art. 16).

Also, in the case where a customer is a juridical person or an organization equivalent thereto, if the chief manager or an employee authorized by the chief manager of a Special Member has brought a document to be delivered upon conclusion of contract to the office of the said customer and delivered it directly to the said customer, the document concerned shall be deemed to have been delivered by mail (art. 13, para. 2 applied

mutatis mutandis pursuant to art. 16).

(7) Notice of Reconciliation and Document to Be Delivered upon Conclusion of Contract (In Case of Specified Business Members)

(i) Report by Notice of Reconciliation

A Specified Business Member must report to a customer by a notice of reconciliation in the category and frequency set forth in each of the following items.

However, this shall not apply to the case where the customer is the one to whom a transaction balance statement is delivered regularly, and the transaction balance statement includes the matters to be set forth on a notice of reconciliation (art. 20, para. 1):

(a) Customers who conduct sale and purchase or other transactions of securities
..... Once a year or more

(b) Customers who conduct specified OTC derivatives transactions or commodity-related market derivatives transactions
..... Twice a year or more

(c) Customers who have a positive balance of securities concerning the business related to specified OTC derivatives transactions, etc. or commodity-related market derivatives transactions brokerage, etc. (excluding customers who conduct the transactions set forth in item (a) and item (b) above)
..... Once a year or more

(d) Customers who have a positive balance of money or securities concerning the specified business and who have not conducted deliveries or transactions set forth in item (a) or (b) above for more than a year
..... From time to time

The matters to be stated on the notice of reconciliation are the balances of the following monies or securities relating to the specified business (art. 20, para. 2):

i) Latest balance of advance money or deposited money;

ii) Latest balance of cash collateral or collateral securities for specified OTC derivatives transactions (limited to the ones relating only to the relevant transactions);

iii) Latest balance of margin and collateral securities for commodity-related market derivatives transactions; and

iv) Latest balance of outstanding account relating to specified OTC derivatives transactions or commodity-related market derivatives transactions.

If a customer is professional investor and a Specified Business Member has established a system which enables a prompt reply to the said customer, the Specified Business Member is allowed to omit a report. Furthermore, among the matters to be included in a notice of reconciliation, matters stated in a document to be delivered upon conclusion of a contract relating to the specified business (limited to such document delivered to a customer) or in a written contract in which terms concerning the specified OTC derivatives transactions, etc. or

commodity-related market derivatives transactions out of the specified business are stated (limited to a written contract executed by and between the person engaged in the business relating to the specified OTC derivatives transactions, etc. or commodity-related market derivatives transactions brokerage, etc. and its customer) may also be omitted in the notice of reconciliation (art. 20, para. 3 and para. 4).

Furthermore, even if there is no current balance of money or securities in the customer's account but there was an outstanding balance at the time of or within less than a year after the most recent report, a Specified Business Member must make a report to the said customer by the notice of reconciliation to the effect that there is no balance at present (art. 10 applied *mutatis mutandis* pursuant to art. 19).

(ii) Preparation and Delivery of the Notice of Reconciliation

The notice of reconciliation shall be prepared in a Specified Business Member's inspection, audit or administration department (art. 11, para. 1 applied *mutatis mutandis* pursuant to art. 19).

A Specified Business Member must conspicuously indicate the matters set forth in the following items concerning the notice of reconciliation (art. 11, para. 2 applied *mutatis mutandis* pursuant to art. 19):

(a) A customer shall, upon receipt of the notice of reconciliation, confirm the contents of the descriptions therein;
(b) In the case where there is a mistake in or a doubt about the descriptions of the notice of reconciliation, an inquiry shall be made directly to the responsible person in the Specified Business Member's inspection, audit or administration department without delay; and
(c) Contact information relating to item (b) above.

In addition, in the case where a Specified Business Member delivers the notice of reconciliation to a customer, the Specified Business Member must mail it to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such notice is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Specified Business Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 11, para. 3 and para. 4 applied *mutatis mutandis* pursuant to art. 19).

Further, in the case where a Specified Business Member has received an inquiry from a customer about the balance of money or securities listed in (i) i) through iv) above, the Specified Business Member's inspection, audit or administration department must accept such inquiry and make a reply without delay to the said customer concerning the balance (art. 12 applied *mutatis mutandis* pursuant to art. 19).

(iii) Delivery of the Document to Be Delivered upon Conclusion of Contract

Just as in the case of the notice of reconciliation mentioned above, in order to ensure direct contact with the customer, when a Specified Business Member delivers a document to be delivered upon conclusion of a contract to a customer, the Specified Business Member, in general, must mail that document to the address or the location of the office of the said customer, or the place designated by the said customer. However, this does not apply in cases where such document is ready for immediate delivery to a customer and is delivered directly to the said customer over the counter or where the said customer makes a particular request on the delivery method and the Specified Business Member makes the arrangement under the provisions of the rules prescribed by the JSDA (art. 13, para.1 applied *mutatis mutandis* pursuant to art. 19).

Also, in the case where a customer is a juridical person or an organization equivalent thereto, if the chief

manager or an employee authorized by the chief manager of a Specified Business Member has brought a document to be delivered upon conclusion of contract to the office of the said customer and delivered it directly to the said customer, the document concerned shall be deemed to have been delivered by mail (art. 13, para. 2 applied *mutatis mutandis* pursuant to art. 19).

The provisions mentioned in (7) (i) through (iii) above do not apply to Special Commodity Futures Members until the day on which they deliver the transaction balance statement prescribed in Article 98, Paragraph 1, Item 3 (a) of the FIBCOO to the customer for the first time.

4 Rules Concerning Internal Administrators, Etc. of Association Members

The purpose of these Rules is to prescribe the posting, qualifications, duties, etc. of officers and employees who engage in management in Association Members of the compliance with the FIEA and other laws and regulations, thereby strengthening the internal administration systems of Association Members and contributing to the performance of proper sales activities (art.1).

(1) Registration of Internal Administration Supervisor

An Association Member must appoint one person as Internal Administration Supervisor and have the person registered in the register of Internal Administration Supervisors kept at the JSDA (art. 2, para. 1). Further, when a change in the contents of the registration occurs, an Association Member must register such change (art. 2, para. 2).

(2) Qualifications for Internal Administration Supervisor

The Regular Member's Internal Administration Supervisor must, in general, be a representative director or a representative executive officer registered who takes charge of internal administration (as for a Regular Member that is a foreign juridical person, the Internal Administration Supervisor shall be a person having the authority corresponding to that of the representative concerned in Japan who is engaged in daily business operations at the said branch office) (art. 3, para. 1).

An Internal Administration Supervisor of the Specified Business Member must, in principle, be an officer who is responsible for the internal administration of all the operations conducted by the Specified Business Member in the Specified Business (art. 3, para. 2).

> The Internal Administration Supervisor must be a person who can give advice to the chief executive officer (the president and representative director in general) from the viewpoint of compliance with the FIEA and other laws, regulations and rules, and accordingly, it is desirable for a person who ranks high in the corporate organization to assume the office of the chief executive officer of the internal administration division.

An Association Member must not appoint as the Internal Administration Supervisor a person who is treated as a Class-1 perpetrator of an inappropriate act by the JSDA (art. 3, para. 4), and must not appoint any of the following persons as the Internal Administration Supervisor during the period specified herein: (a) a person who is treated as a Class-2 perpetrator of an inappropriate act by the JSDA or a person who has been subject to a disciplinary action to revoke his/her Sales Representative registration, during a period of five years from the day the JSDA took such disciplinary action, etc.; or (b) a person who has been subject to the decision to prohibit appointing him/her as a Sales Manager or an Internal Administrator (hereinafter referred to as an "action prohibiting appointment as Sales

Manager, etc."), a person who has been subject to the decision to prohibit assigning him/her to duties of a Sales Representative, or a person who has been subject to the disciplinary action to suspend his/her duties of a Sales Representative, during the effective period of such prohibition or disciplinary action (art. 3, para. 5, para. 6 and para. 7).

(3) Duties of Internal Administration Supervisor

The Internal Administration Supervisor must comply with the FIEA and other relevant laws, regulations and various rules, and endeavor to establish the internal administration system by directing officers or employees to keep a business attitude toward complying with the FIEA and other laws, regulations, and various rules so that sales activities including solicitation for investments, etc. and management of customers may be properly carried out (art. 4, para. 1).

(4) Instructions to Internal Administration Supervisor

The President & Director, etc. must ensure that the Internal Administration Supervisor is able to perform his/her duties properly, and when receiving a report from the Internal Administration Supervisor in accordance with the provisions of Paragraph 4 of the preceding Article, give proper instructions to him/her (art. 5).

(5) Sharing of Duties

The Internal Administration Supervisor may, at his/her own responsibility, delegate a part of the duties to an Internal Administration Assistant Supervisor who meets certain requirements in order to perform his/her duties (art. 6, para. 1).

(6) Recommendation of Replacement of Internal Administration Supervisor and Internal Administration Assistant Supervisor

When the Internal Administration Supervisor or Internal Administration Assistant Supervisor has not properly performed his or her duties (each Paragraph of art. 4; art. 6, para. 6) such as breaching law and regulations, having concealed or having taken no action against breach of laws and regulations, etc., or such breach having occurred due to the instruction by him or her, the JSDA may recommend the Association Member to replace its Internal Administration Supervisor or Internal Administration Assistant Supervisor (art. 9, para. 1 and para. 2).

(7) Allocation of Sales Manager and Internal Administrator

An Association Member shall define the headquarters and other business office or administration office (including departments/sections of the headquarters and other business office or administration office) that conduct sales activities such as investment solicitation, etc. and customer management of the Association Member, as a sales unit, and appoint and allocate the chief of such sales unit as the Sales Manager (art. 10, para. 1).

An Association Members must appoint and allocate a manager etc. of internal administration business as the Internal Administrator of such sales unit (art. 13, para. 1).

(8) Qualifications of Sales Manager and Internal Administrator

A Regular Member must not appoint any person as Sales Manager unless he/she has passed the Qualification Examination for Regular Member's Internal Administrator (including the Qualification Examination for Regular Member's Sales Manager pursuant to the "Rules on Qualification Examination for Sales Representative, etc." prior

to the revision in April 1, 2006) (art. 11, para. 2). A Regular Member must not appoint any person as Internal Administrator unless such person has passed the Qualification Examination for Regular Member's Internal Administrator (art. 14, para. 2).

An Association Member engaging only in the business related to commodity-related market derivatives transactions brokerage, etc. may assign, as a Sales Manager and an Internal Administrator, a person who has completed the internal administrator qualification training program provided by the Commodity Futures Association of Japan and has also completed the accreditation training program prescribed in Article 4, Item 7 (b) of the "Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members" as applied through the replacement of terms under Article 5, Paragraph 1 of the "Rules Concerning Application of Self-Regulatory Rules for Commodity-Related Market Derivatives Transactions, Etc.," by the day specified by JSDA.

An Association Member must not appoint as the Sales Manager or the Internal Administrator a person who is treated as a Class-1 perpetrator of an inappropriate act by the JSDA (art. 11, para. 6, art. 14, para. 6), and must not appoint any of the following persons as the Sales Manager or the Internal Administrator during the period specified herein: (a) a person who is treated as a Class-2 perpetrator of an inappropriate act by the JSDA or a person who has been subject to the disciplinary action to revoke his/her Sales Representative registration, during a period of five years from the day the JSDA took such a disciplinary action, etc.; or (b) a person who has been subject to the decision of an action prohibiting appointment as Sales Manager, etc., a person who has been subject to the decision to prohibit assigning him/ her to duties of a Sales Representative, or a person who has been subject to the disciplinary action to suspend his/her duties of a Sales Representative, during the effective period of such prohibition or disciplinary action (art. 11, para. 7 and para. 8, and art. 14, para. 7 and para. 8).

(9) Duties of Sales Manager and Internal Administrator

The Sales Manager must comply with the FIEA and other laws, regulations, and various rules; and guide and supervise officers or employees belonging to each sales unit for which the Sales Manager is appointed as the Sales Manager to keep a business attitude toward complying with the FIEA and other laws, regulations, and various rules so that sales activities including a solicitation for investments and management of customers may be properly carried out (art. 12, para. 1).

Internal Administrator must comply with the FIEA and other laws, regulations, and various rules; and perform proper internal administration by such means as constantly supervising to see if sales activities at the sales unit for which the Internal Administrator is appointed as the Internal Administrator are properly carried out in accordance with the FIEA and other laws and regulations (art. 15, para. 1).

Sales Manager and Internal Administrator must, when there has occurred a serious case concerning sales activities including solicitation for investments and management of customers at the sales unit for which he or she is appointed as the Sales Manager or Internal Administrator, promptly report to the Internal Administration Supervisor and receive his/her instructions (art. 12, para. 2; art. 15, para. 2).

(10) Action Prohibiting Appointment as Sales Manager, Etc.

(i) Action

In cases where the Sales Manager or Internal Administrator personally breaches laws or regulations, or any of the officers or employees who belong to the Sales Manager's or Internal Administrator's sales unit breaches laws or regulations, and it is judged that the Sales Manager or Internal Administrator has not sufficiently performed his or her duties (art. 12 and art. 15), such as the Sales Manager or Internal Administrator having

concealed or having taken no action against such breach of laws and regulations, etc., or such breach having been caused by the instruction by the Sales Manager or Internal Administrator, the JSDA may make a decision to take action to prohibit the Association Member to which the said Sales Manager or Internal Administrator belonged at the time of such breach from appointing or allocating him/her as a Sales Manager or Internal Administrator for a period not exceeding five years (art. 17, para. 1 and art. 18, para. 1)(Note).

(Note) When the JSDA treats the Sales Manager or Internal Administrator in question as a perpetrator of an inappropriate act, it does not make a decision to take an action prohibiting appointment as Sales Manager, etc. because the qualification of the Sales Manager or Internal Administrator is to be revoked.

(ii) Procedures for Taking Action

In cases where the JSDA intends to take an action prohibiting appointment as Sales Manager, etc., it shall implement the procedures for explanation in accordance with the "Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members," and send a notice of the action decided to the Association Member concerned. In principle, the notices regarding the procedure for explanation and the decision of the action shall also be sent to the employee, etc. concerned in order to provide the employee, etc. with the opportunity to state his/her opinion (Rules Concerning Procedures for Disciplinary Action on Sales Representative, etc. of Association Members, art. 8, 27, and 28).

(iii) Filing of Complaints

An Association Member which is an addressee of a decision to take an action prohibiting appointment as Sales Manager, etc. and its employee, etc. who is subject to that decision may file a complaint on the decision with the JSDA if they have any such complaint (Rules Concerning Filing of Complaints on Disciplinary Action under Self-Regulatory Rules Imposed on Employee, Etc. of Association Member, art. 4).

The Sales Manager and the Internal Administrator are positions responsible for properly conducting control over the employees, etc. who belong to their sales unit. Therefore, the JSDA requires that Association Members appoint appropriate persons to be a Sales Manager and Internal Administrator by taking such action prohibiting appointment as Sales Manager, etc. regarding persons inappropriate for these positions.

5 Rules Concerning Application for Confirmation, Examination, Confirmation, Etc. of Incidents

Financial instruments business operators, etc. are prohibited from compensating losses with respect to securities trading transactions, etc. unless (i) the compensation was due to the incidents of the financial instruments business operator, etc. or its officers or employees and the financial instruments business operator, etc. has obtained in advance the confirmation of the Prime Minister (Competent Director-General of the Local Finance Bureau, etc.), or (ii) it falls under the cases in which confirmation of incidents is not required as prescribed in the FIBCOO (FIEA, art. 39, para. 1 and para. 3; FIBCOO, art. 119, para. 1).

The cases in which confirmation of incidents is not required as prescribed by the FIBCOO include cases where the final judgment of the court has been awarded or cases such as "examination and confirmation by the committee established within the financial instruments firms association has been conducted."

Among the cases in which confirmation of incidents is not required as prescribed by the FIBCOO, cases determined by the financial instruments business operator, etc. or determined by the committee established within the financial instruments firms association must be reported to the Competent Director-General of the Local Finance Bureau, etc. (FIBCOO, art. 119, para. 3).

These Rules prescribe necessary procedures, etc. in order to report to the Competent Director-General of the Local Finance Bureau, etc. in connection with obtaining a confirmation from the Prime Minister (Competent Director-General of the Local Finance Bureau, etc.) as set forth in item (i) of the previous paragraph, and an examination and confirmation by the committee established with the JSDA, which are among the description made in 1. above.

In these Rules, "incidents" refer to incidents concerning the sales and purchase and other transactions, etc. specified in Article 3, Item 8 of the JSDA's Articles of Association from among the incidents set forth in Article 39, Paragraph 3 of the FIEA, and "compensatory conduct" refers to the conducts set forth in Article 39, Paragraph 1, Items 2 and 3 of the FIEA (art. 2, items 1 and 2).

(1) Application for Examination and Confirmation by the Committee

(i) Application for Examination and Confirmation by the Committee

If an Association Member shall take compensatory conduct due to the incidents of the Association Member or its employees, etc. (limited to cases where the amount to be paid to the customer with respect to losses due to incidents are fixed between the Association Member and the customer, and the amount to be paid by the Association Member to the customer does not exceed JPY10 million; hereinafter the same in (1)), it must obtain the examination and confirmation of the committee in advance that the payment to the customer will be made to compensate losses due to incidents except for cases where an application for confirmation will be made or in cases prescribed by the FIBCOO (cases provided for in FIBCOO, art. 119, para. 1, items 1 through 8, item 10 or item 11) (art. 8, para. 1).

An Association Member applying for such examination and confirmation must submit an application for examination and confirmation of incidents (hereinafter referred to as "Application for Examination and Confirmation") to the incident confirmation committee (art. 8, para. 2).

(ii) Examination and Confirmation by the Committee

Upon receiving the Application for Examination and Confirmation from an Association Member pursuant to (i) above, the incident confirmation committee shall conduct an examination and confirm whether the payment to the customer as stated in the Application for Examination and Confirmation will be made to compensate losses due to incidents (art. 9, para. 1).

(iii) Response to the Association Member

After the incident confirmation committee has conducted the examination and confirmation in (ii) above, it shall promptly respond the contents thereof to the Association Member that made the application (art. 10). In response to the results of responses, the Association Member shall provide economic benefits (*e.g.*, payment of money) to the customer.

(2) Reporting of Incidents

If an Association Member has taken compensatory conduct upon examination and confirmation by the incident confirmation committee or taken compensatory conduct of JPY1,000,000 or less, etc. based on its own determination pursuant to the relevant laws and regulations, it must report to the Director-General of the Local

Finance Bureau (art. 12, para. 1).

This report must be made via the JSDA by submitting a report to the JSDA by the 20th of the month following the month in which the compensatory conduct was taken (art. 12, para. 2).

(3) Application for Confirmation

If an Association Member shall take compensatory conduct due to the incidents of the Association Member or its employees, etc. it must receive the confirmation of the competent Director-General of the Local Finance Bureau, etc. in advance that losses concerning the compensatory conduct was due to incidents except for cases where confirmation by the competent Director-General of the Local Finance Bureau, etc. is not required (art. 4, para. 1).

An Association Member applying for such confirmation must submit an application for confirmation of incidents (hereinafter referred to as "Application for Confirmation") to the competent Director-General of the Local Finance Bureau, etc. via the JSDA (art. 4, para. 2 and para. 4).

The JSDA will examine whether the losses concerning the compensation as stated in the Application for Confirmation is due to incidents (art. 5, para. 1), and submit the Application for Confirmation to the competent Director-General of the Local Finance Bureau, etc. (art. 6).

The result of the confirmation by the competent Director-General of the Local Finance Bureau, etc. is notified to the Association Member via the JSDA (art. 7), and if the confirmation of the competent Director-General of the Local Finance Bureau, etc. is obtained, the Association Member shall provide financial benefit (payment of money, etc.) to the customer.

6 Rules Concerning Financial Instruments Intermediary Service Providers

The purpose of these Rules is, in connection with the entrustment of business relating to the financial instruments intermediary service of Association Members, to define matters, etc. that Association Members should ensure that financial instruments intermediary service providers comply with, and to ensure proper business management by the said financial instruments intermediary service providers through the instruction and supervision by Association Members, thereby contributing to the protection of investors (art. 1).

As used here, "financial instruments intermediary service provider" refers to those persons who carry out the financial instruments intermediary service set forth in the FIEA, Article 2, Paragraph 11 (limited to such service relating to the acts set forth in Items 1 through 3 of the said Paragraph (with respect to the acts related to electronically recorded transferable rights (meaning the electronically recorded transferable rights prescribed in Paragraph 3 of the said Article) or the rights prescribed in Article 1-12, Item 12 of the FIEAEO, and the acts set forth in Article 2, Paragraph 11, Item 2 of the FIEA, excluding those pertaining to the transactions set forth in the FIEAEO, Article 16-4, Paragraph 2, Item 1, (a) through (d) and Item 2 of the same Paragraph)) among financial instruments intermediary service providers as set forth in Paragraph 12 of the said Article, whose entrusting financial instruments business operator, etc. (meaning the entrusting financial instruments business operators, etc., as set forth in FIEA, Article 66-2, Paragraph 1, Item 4) is an Association Member (art. 2, item 3; Articles of Association, art.3, item 9).

(1) Thorough Compliance with Laws, Etc. by Financial Instruments Intermediary Service Provider

An Association Member must ensure that a financial instruments intermediary service provider thoroughly understands and complies with the FIEA and other applicable laws and regulations, the Articles of Association, and other rules of the JSDA (hereinafter referred to as "laws, etc." in these Rules) (art. 3, para.1). In case where an

Association Member becomes aware that a financial instruments intermediary service provider has taken an action that breaches the laws, etc., the Association Member must request the financial instruments intermediary service provider to correct such breach (art. 3, para. 2).

If it is found that a person who belongs to a financial instruments intermediary service provider and who seeks to be registered as a sales representative, or a financial instruments intermediary service provider who is an individual (hereinafter referred to as an "individual financial instruments intermediary service provider" in these Rules), has been subject to the decision of treatment as a Class-2 perpetrator of an inappropriate act under Article 12, Paragraph 1 of the Rules Concerning Employees of Association Members, the Association Member concerned shall have the financial instruments intermediary service provider provide training courses, etc. to such person or have the individual financial instruments intermediary service provider attend the training courses, etc. it provides regarding the prevention of violation of laws and regulations and the protection of investors (art.3-2).

(2) Conclusion of a Business Delegation Agreement for Financial Instruments Intermediary Business

In the case where the Association Member concludes a business entrustment agreement on the financial instruments intermediary service, it must provide for the following matters in the business entrustment agreement (art. 4):

i) A financial instruments intermediary service provider or its officers or employees must comply with the FIEA and other applicable laws and regulations;
ii) An Association Member shall instruct and supervise a financial instruments intermediary service provider to comply with the Articles of Association and other rules of the JSDA, and the financial instruments intermediary service provider must comply with the instructions from the Association Member;
iii) In case where the JSDA either took a disciplinary action against an Association Member with respect to an individual financial instruments intermediary service provider or a sales representative of a financial instruments intermediary service provider, or an action prohibiting business of sales representative prescribed in Article 29, Paragraph 1, such individual financial instruments intermediary service provider or sales representative must obey such disciplinary action or action of prohibition;
iv) In the case where the JSDA requests a financial instruments intermediary service provider to participate in an interview or submit materials, the financial instruments intermediary service provider must comply with such request; and
v) An Association Member may inspect a financial instruments intermediary service provider, and the financial instruments intermediary service provider must undergo such inspection.

(3) Prohibition of Dual Registration as Sales Representative of Association Member

An Association Member must not entrust the business relating to the financial instruments intermediary service to an entity to which its own sales representative or sales representative of other Association Members belongs (art. 5, para. 1). In the case where the Association Member entrusts the business relating to the financial instruments intermediary service provider to the entity to which its sales representative or a sales representative of another Association Member belongs, the Association Member must clearly provide in the relevant agreement that the

registration of such sales representative must be cancelled before the completion of registration as a financial instruments intermediary service provider, and that the business entrustment cannot commence until the registration of such sales representative is cancelled (art. 5, para. 2).

An Association Member must not make an officer or employee of a financial instruments intermediary service provider registered as its own sales representative (art. 5, para. 3).

(4) Compliance with Various Rules Concerning Investment Solicitation

An Association Member must thoroughly disseminate matters including the principle of suitability, explanation of important matters and principle of self-responsibility of investors to financial instruments intermediary service providers and ensure their compliance with these matters (art. 6, para. 1). An Association Member must establish a system that enables a financial instruments intermediary service provider to conduct proper investment solicitation by using a "customer card" to be prepared by the Association Member pursuant to Article 5 of the "Rules Concerning Solicitation for Investments and Management of Customers, etc. by Association Members" and as prescribed in Article 5-2 and Article 5-3 of the same rules (art. 6, para. 2).

An Association Member must have a financial instruments intermediary service provider avoid recommending to its customers the securities of specific issues in a uniformed and intensive manner, which represents a provision of subjective and arbitrary information. (art. 8, para.1).

(5) Thorough Implementation of Internal Administration, Etc. Towards Financial Instruments Intermediary Service Provider

An Association Member must thoroughly instruct a financial instruments intermediary service provider to establish, maintain, and comply with internal rules and grasp the status of business operations of the financial instruments intermediary service provider for the purpose of ensuring proper conduct of transactions with customers through the financial instruments intermediary service provider and customer management, and ensure that its internal administrator appropriately controls and audits that a financial instruments intermediary service provider conducts the business properly and complies with the laws and regulations (art. 7).

Any prospective advertising, etc. and offers of premiums to be made by a financial instruments intermediary service provider for its service must be examined by the Association Member (art. 13).

(6) Reference to the JSDA

An Association Member shall refer to the JSDA using a designated method in order to confirm whether a person (limited to individuals) with whom the Association Member intends to execute a business entrustment agreement relating to the financial instruments intermediary service or who belongs to the financial instruments intermediary service provider and intends to be registered as a sales representative (hereinafter "person subject to reference" in these Rules) has been treated as Class-1 perpetrator of an inappropriate act pursuant to the Rules Concerning Employees of Association Member, Article 12, Paragraph 1 or whether such person has been subject to decision concerning treatment and/or action, and /or disciplinary action set forth in (i) through (iv) below in the last five years (art. 15, para. 1 and para. 2).

The JSDA shall, upon receiving a request for reference, reply to the Association Member making the request in the prescribed method as to whether the person subject to reference has been subject to the decision of treatment as a Class-1 perpetrator of an inappropriate act or the decision of treatment and disciplinary action by the JSDA as set forth in (i) through (iv) below within the five years preceding the date of the reply, and the summary thereof,

without delay (art. 15, para. 3 and para. 4):

(i) Disciplinary action to revoke the registration as a sales representative or to order the suspension of duties;
(ii) Action prohibiting assignment to duties of a sales representative;
(iii) Treatment as a class 2 perpetrator of an inappropriate act; or
(iv) Action prohibiting appointment as a sales manager or internal administrator.

(7) Sales Representative Qualifications and Training Courses

Association Members must not permit an individual working as an individual financial instruments intermediary service provider or an employee or officer of a financial instruments intermediary service provider who has not obtained the necessary qualifications as a sales representative to engage in sales representative activity, nor must Association Members permit such parties to engage in sales representative work that are outside the scope of their qualifications (art. 16).

Association Members must ensure that individual financial instruments intermediary service providers and the sales representatives of financial instruments intermediary service providers attend training courses conducted by the JSDA to renew their qualifications (within 180 days from the date of registration as sales representative and every five years from such date of registration) (art. 19).

(Note) Sales representatives who have passed the Sales Representatives Qualification Examination within two years from the first day of the obligatory training period (including those qualified as Special Commodity Futures Sales Representatives or as Special Commodity Futures Sales Representatives (limited to dealing); for details, see this Chapter, 4.2 3 (1) (v) Special Commodity Futures Sales Representatives (limited to dealing)) are deemed to have taken and completed the qualification renewal training.

(8) Prohibited Acts of Sales Representatives

Association Members shall ensure that individual financial instruments intermediary service providers or the Sales Representatives of financial instruments intermediary service providers do not engage in prohibited acts such as compensating customers for losses or conducting sales and purchases without the consent of customers, or improper acts (art. 24 and art. 25).

7 Rules Concerning the Sale of Securities through Financial Service Intermediaries

(1) Purpose

The purpose of these Rules is to provide for matters that an Association Member must comply with when selling securities through a financial service intermediary, and to ensure the proper transactions conducted through a financial service intermediary, thereby contributing to the protection of investors (art. 1).

The rules are summarized below.

(Note) Upon being registered under the Act on the Provision of and the Development of Environment for

Using Financial Services, instead of FIEA, a financial service intermediary is authorized to act as an intermediary for providing one-stop services in business sectors such as securities, banking, insurance and money lending. A financial service intermediary is subject to the Act on the Provision of and the Development of Environment for Using Financial Services, and is in principle also subject to the self-regulatory organization's self-regulatory rules under that Act.
Unlike a financial instruments intermediary service provider, a financial service intermediary is not required to belong to any particular financial institution and is on an equal footing with an Association Member.
In light of the fact that even when conducting transactions with customers through a financial service intermediary that has the characteristics mentioned above, an Association Member is responsible for acting as a "gatekeeper" and complying with laws, regulations and rules on transactions and sale, the Rules Concerning the Sale of Securities through Financial Service Intermediaries provide for matters to be included in a contract with a financial service intermediary and the exchange of information that is deemed necessary for both parties.

(2) Definitions

The term "financial service intermediary" as used in these Rules refers to a "financial service intermediary" as defined in Article 11, Paragraph 6 of the Act on the Provision of and the Development of Environment for Using Financial Services (hereinafter referred to as "APFS") (art. 2, item 1).

The term "securities, etc. intermediary business operations" as used in these Rules refers to "securities, etc. intermediary business operations" as defined in Article 11, Paragraph 4 of the APFS (excluding the business operations pertaining to the act prescribed in Item 4 of that paragraph) (art. 2, item 2).

(3) Checking of a Financial Service Intermediary's Internal Administration System, Etc.

When concluding a contract on securities, etc. intermediary business operations with a financial service intermediary, an Association Member must check whether the financial service intermediary has developed an internal administration system for proper compliance with the APFS and other laws, regulations, and rules, in order to contribute to ensuring proper sale of securities through a financial service intermediary (art. 3, para. 1).

An Association Member must endeavor to establish a cooperative relationship with a financial service intermediary with which the Association Member has concluded a contract on securities, etc. intermediary business operations, in order to share necessary information with the financial service intermediary in a proper and timely manner (art. 3, para. 2).

(4) Conclusion of a Contract on Securities, Etc. Intermediary Business Operations, Etc.

When concluding a contract on securities, etc. intermediary business operations with a financial service intermediary, an Association Member must provide for the following matters in the contract from the perspective of fulfilling its responsibility to a securities market and responsibility for compliance with FIEA and other laws, regulations, and rules (art. 4, main clause):

(i) Matters concerning the division of roles in and the responsibilities for delivering documents and providing an explanation to the customer;

(ii) Matters concerning the provision and management of customer information;
(iii) Matters concerning the response to breach of laws and regulations and other incidents;
(iv) Matters concerning the division of roles and cooperation in preventing unfair transactions;
(v) Matters concerning the response to a dispute with the customer;
(vi) Matters concerning the prevention of transfer of criminal proceeds;
(vii) Matters concerning advertising;
(viii) Matters concerning the revision and renewal of the contract;
(ix) Matters concerning checking of the status of performance of entrusted operations; and
(x) Other matters that the Association Member deems necessary.

(Note) Before concluding a contract, the Association Member and the financial service intermediary are supposed to clarify the roles that they should respectively play and the scope of their respective responsibilities and agree on these matters in the contract.

However, this does not apply to matters whose inclusion in a contract is considered to be unnecessary in light of the content or characteristics of the products or services handled by the financial intermediary service (art. 4, *proviso*).

An Association Member shall perform the obligations of delivering documents and providing an explanation to the customer and preventing unfair transactions based on the customer information it retains, according to the division of roles determined in the contract under Article 4 (art. 6).

(5) Appropriate Use of Customer Cards

When entrusting a financial service intermediary to solicit a customer, an Association Member must provide the financial service intermediary with information that is considered to be necessary for the financial service intermediary to properly conduct solicitation for investment and customer management out of the information contained in a customer card (meaning the "customer card" prescribed in Article 5 of the "Rules Concerning Solicitation for Investments and Management of Customers, etc. by Association Members"; the same applies hereinafter) and an insider registration card (meaning the "insider registration card" prescribed in Article 15 of the same Rules; the same applies hereinafter) (art. 5, para. 1).

(Note) When an Association Member entrusts a financial service intermediary to solicit a customer, if the information contained in the Association Members' customer card, etc. is not properly reflected in the information retained by the financial service intermediary, it would be difficult to ensure that the financial service intermediary solicits a customer properly in accordance with the customer attributes, etc.; therefore, the Association Member should provide the necessary information to the financial service intermediary in advance, and if a change occurs to any of the information contained in the customer card, etc., it should provide the updated information promptly.

If an Association Member receives customer information from a financial service intermediary under a contract prescribed in Article 4, it must update its own customer card and insider registration card as necessary (art. 5, para. 2).

(6) Checking of the Status of Performance of Entrusted Operations

An Association Member must check a financial service intermediary's internal administration system and the status of performance for the operations entrusted to the financial service intermediary on an as-needed basis or periodically (art. 7).

(7) Prohibited Acts

An Association Member must not request a financial service intermediary to carry out acts similar to securities, etc. intermediary business operations or any other acts for soliciting a customer with regard to the types of securities that a financial service intermediary may not handle pursuant to the provisions of APFS (art. 8).

(8) Reporting

An Association Member must report the details to the JSDA by a designated method without delay in the following cases: (i) the Association Member concludes a contract on securities, etc. intermediary business operations with a financial service intermediary; (ii) the Association Member terminates a contact on securities, etc. intermediary business operations with a financial service intermediary; (iii) the trade name or any other name of a financial service intermediary, with which the Association Member has concluded a contract on securities, etc. intermediary business operations, is changed; (iv) or any other case that the JSDA deems necessary (art. 9).

(9) Concept of the Rules

Beyond the matters provided for in these Rules, the JSDA prescribes matters related to the operation, etc. of these Rules by Association Members in the "Guideline for 'Rules Concerning the Sale of Securities through Financial Service Intermediaries'" (art. 10).

8 Rules Concerning Elimination of Relationships with Antisocial Forces

The purpose of these Rules is to provide necessary matters for the elimination of any relationship with any antisocial force, ensure the sound operations of businesses by Regular Members and preclude any antisocial force from financial instruments transactions and financial instruments markets, thereby contributing to the sound development of capital markets and the protection of investors (art. 1).

In these Rules, "antisocial forces" mean organized crime groups (*bōryokudan*), organized crime group members, associate member of organized crime group, associate corporation of organized crime group, corporate racketeer (*sōkaiya*, etc.), blackguard claiming itself a social activist, etc., special intellectual crime group, etc. and other person similar to thereto (art. 2; Rules Concerning the Enforcement of the Articles of Association, art. 15).

(1) Basic Stance

A Regular Member must not effect any sale and purchase or other transactions of securities, etc. with any person knowingly being an antisocial force (art. 3, para. 1).

Furthermore, a Regular Member must not provide any funds or other benefits to any person knowingly being an antisocial force (art. 3, para. 2).

(2) Development and Announcement of Basic Policies

A Regular Member must develop basic policies to shut off any relationships with any antisocial forces and disseminate such basic policies internally and publish the basic policies or their outline (art. 4).

(3) Undertaking That a Customer Is Not an Antisocial Force

A Regular Member must in advance obtain the undertaking that the customer is not a member of an antisocial force before it attempts to open an account for any sale and purchase or other transactions of securities for the customer for the first time (art. 5).

(4) Conclusion of Contract to Preclude Antisocial Forces

A Regular Member must prescribe the matters mentioned in (i) through (iii) below into a contract or trading agreement when it accepts any order for sale and purchase or other transactions of securities, etc. from the customer (art. 6):

(i) The statement that if the undertaking that the customer is not an antisocial force proves to be false, the contract or agreement shall be terminated by notification from the Regular Member;
(ii) The statement that if the customer proves to meet any category of antisocial forces, the contract shall be terminated by notification from the Regular Member; and
(iii) The statement that in the case where a customer makes a demand with nature of violence and makes an unduly demand beyond the responsibility set forth by laws and the Regular Member acknowledges that it will be difficult to maintain the contract, the contract shall be terminated by notification from the Regular Member.

(5) Implementation of Examination

A Regular Member must endeavor to examine whether a customer who wishes to open an account for sale and purchase or other transactions of securities, etc. for the first time meets any category of antisocial forces in advance (art. 7, para. 1).

A Regular Member must examine a customer, who wishes to open an account for sale and purchase or other transactions of securities, etc. for the first time, by a method that has been determined between the JSDA and the Regular Member in advance (art. 7, para. 2), and when conducting the examination, a Regular Member must comply with matters that have been agreed upon in advance between the JSDA and the Regular Member (art. 7, para. 3).

In addition, a Regular Member must endeavor to regularly examine whether there is any person or entity who meets any category of antisocial forces in the customers for whom the Regular Member has opened an account for sale and purchase or other transactions of securities, etc. (art. 7, para. 4).

Furthermore, a Regular Member must examine whether a customer meets any category of antisocial forces whenever a suspicion arises (art. 7, para. 5).

(6) Prohibition of Conclusion of Contract and Dissolution of Relationship

In the case where, as a result of the examination prescribed in Article 7, Paragraph 1 or Paragraph 2 against the customer who wishes to open an account for the first time, a person or entity proves to meet any category of antisocial forces, the Regular Member must never be permitted to enter into any contract with the person or entity; provided, however, that this shall not apply to cases when the contract is entered into to preclude the antisocial forces from the financial instruments transactions and financial instruments markets (art. 8, para. 1).

In addition, in the case where, as a result of the regular examination prescribed in Article 7, Paragraph 4 for the customer who has an account or the examination prescribed in Article 7, Paragraph 5 when a suspicion arises, a person or entity proves to meet any category of antisocial forces, the Regular Member must endeavor to dissolve the relationship with the person or entity as soon as possible (art. 8, para. 2).

(7) Gathering of Information

A Regular Member must endeavor to gather information about antisocial forces (art. 9).

(8) Provision of Trainings, Etc.

In regards to the procedures for the responses to any antisocial force and the control of information on antisocial forces, a Regular Member must endeavor to enlighten officers and employees by providing internal educations and training, etc. (art. 10).

(9) Establishment and Improvement of Internal Administration System

A Regular Member must establish internal rules to implement the basic policies and oblige all the officers and employees to comply with them and endeavor to develop and improve the administration system to shut off the relationship with any antisocial force pursuant to the internal rules prescribed in the preceding Paragraph (art. 11).

(10) Enhancement of Management System

A Regular Member must regularly review the management system to eliminate any relationship with antisocial forces (art. 12).

(11) Collaboration and Cooperation with JSDA and Police, Etc.

A Regular Member must endeavor to have a close collaboration and cooperation with the JSDA and police, etc. with a view to eliminating any relationship with antisocial forces, and whenever any dispute or trouble takes place between a Regular Member and antisocial forces, the Regular Member must endeavor to prevent any occurrence of damages caused by antisocial forces by immediately referring the incident to and consulting with lawyers, the JSDA, police and other relevant organizations, etc. (art. 13).

(12) Application *Mutatis Mutandis* to Specified Business Members

The provisions of these Rules, except for Article 7, Paragraphs 2, 3, and 6, shall apply *mutatis mutandis* to Specified Business Members engaging in the business related to specified OTC derivatives, etc. and Specified Business Members engaging in the business related to commodity-related market derivatives transactions brokerage, etc. (art. 14).

4 2 Employees, Sales Representatives

1 Rules Concerning Employees of Association Members

The purpose of these Rules is, in view of the public nature and importance of the social mission of the financial instruments business, to contribute to the investor protection by prescribing the service standards, etc. for the

employees of the Association Members as well as defining the responsibilities of the Association Members to supervise their employees (art. 1).

Under the rules, the term "employee" means, in the case of a Regular Member, its employees (including seconded persons) that work at the principal office or branch office located in Japan (art. 2, item 6 (a)). In the case of a Specified Business Member, this term refers to its employees engaged in the Specified Business (which means the business set forth in Article 5, Item 2 (a), (b) or (c) of the Articles of Association; hereinafter the same applies in these Rules) or the business incidental to the Specified Business (limited to the business set forth in Article 5, Item 2, (c) of the Articles of Association) in its head office, other business office or office located in Japan (art. 2, item 6 (b)); and in the case of a Special Member, the same term refers to its employees (including seconded persons) engaged in the registered financial institution business (including persons engaged in the specified financial instruments business provided for in FIEA, art. 33-8, para. 2) at the principal office or other business offices or outlets in Japan (art. 2, item 6 (c)). Among dispatched workers under the Act for Securing the Proper Operation of Worker Dispatching Undertakings and Protection of Dispatched Workers, those who are registered as the sales representative prescribed in the provision of FIEA, Article 64, Paragraph1, are the employees under these Rules (art. 2, item 6 (d)).

These Rules also apply *mutatis mutandis* to officers of the Association Member, except for certain portions of the rules, such as Article 4, Paragraph 1 (prohibition on employing the employees of another Association Member) and Article 6 (basic service standards), etc. (art. 17).

The remainder of this section shall briefly describe these Rules.

(1) Hiring of Employees

(i) Treatment of Employees Who Have Violated Laws and Regulations, Etc.

If it is found in the examination for hiring that a person whom an Association Member seeks to hire has been subject to, inter alia, the decision of treatment as a Class-2 perpetrator of an inappropriate act under Article 12, Paragraph 1 of the Rules Concerning Employees of Association Members, the Association Member concerned shall provide training courses, etc. to such person regarding the prevention of breaches of laws and regulations and the protection of investors (art.3-2).

(ii) Prohibition of Hiring

In order to clarify the locus of oversight responsibility for an employee, Association Members are prohibited from hiring any persons who are the employees of another Association Member as their own employees. However, cases where such persons are hired under a secondment, etc. are excluded from this prohibition (art. 4, para. 1).

Also, an Association Member must not hire any person who has been treated as a Class-1 perpetrator of an inappropriate act under the system of perpetrators of inappropriate acts as an employee of an Association Member for an indefinite term. An Association Member must not hire any person who has been treated as Class-2 perpetrator of an inappropriate act within five years from the date when the said person was determined to be a Class-2 perpetrator of an inappropriate act (art. 4, para.2 and para. 3).

(iii) Reference to the JSDA

The JSDA has prescribed a reference system prior to the hiring of an employee with the intent to take all possible measures to exclude persons deemed unqualified to serve as employees, especially those who have been treated as a perpetrator of an inappropriate act (art. 5).

When an Association Member hires a new employee who is currently or was an employee of another

Association Member or a financial instruments intermediary service provider or its sales representative, the Association Member must refer to the JSDA in the prescribed manner as to whether or not the applicant has been treated as a Class-1 perpetrator of an inappropriate act. When an Association Member intends to hire a new employee who is currently or was in the past five years an employee of another Association member, a financial instruments intermediary service provider or its sales representative, or a financial service intermediary sales representative (meaning the sales representative prescribed in Article 75, Paragraph 1 of the APFS; the same applies hereinafter), the Association Member must refer to the JSDA in the prescribed manner as to whether or not the applicant has been subject to decision concerning treatment and/or action, and or disciplinary action set forth in (a) through (d) below (art. 5, para. 1 and para. 2).

The JSDA shall, upon receiving a request for reference, reply to the Association Member making the request in the prescribed manner whether the referred person has been subject to the decision of treatment as a Class-1 perpetrator of an inappropriate act or the decision of treatment and disciplinary action by the JSDA as set forth in (a) through (d) below within the five years preceding the date of the reply, and the summary thereof (art. 5, para. 4 and para. 5):

(a) Treatment as a Class-2 perpetrator of an inappropriate act;
(b) Disciplinary action to revoke the registration of a sales representative or suspend its duties;
(c) Action prohibiting assignment to duties of a sales representative; or
(d) Action prohibiting appointment as a sales manager or internal administrator.

(2) Prohibited Acts

A list of the prohibited acts of officers and employees of financial instruments business operators appears in Article 38 of the FIEA, as well as in Article 117 of the FIBCOO. This series of provisions is included to promote investor protection, secure transactional fairness, and at the same time maintain confidence in the financial instruments business operators and capital market.

In addition to containing a list of the prohibited acts of the officers and employees of an Association Member under these laws and regulations, provisions describing the prohibited acts of employees are also included in these Rules with a view to preventing occurrence of incidents relating to financial instrument trading.

These provisions of prohibited acts literally provide the prohibited acts of Association Members themselves and clarify the Association Members' oversight responsibility for their employees, and the JSDA does not directly bind the Association Members' employees. However, if the behavior of an employee is found to conform to the description of prohibited acts, or if an employee has behaved in such a way as to violate laws or regulations which the employee is required to observe, or has engaged in improper acts prescribed in Article 8 of these Rules (with the exception of negligence), the JSDA imposes on an Association Member the obligation to handle the problem in an appropriate manner in light of the nature of the particular behavior and to submit a report to the JSDA outlining all the related facts (art. 10, para. 1).

This is because, in light of its organization, the scope to which the rules of the JSDA apply directly is limited to the Association Members of the JSDA. It is, therefore, assumed that the basis of these Rules is founded on the expectation that all employees are sufficiently aware of their obligation to follow the spirit of these Rules and to guard against the occurrence of any behavior which might be in violation of the rules as

stipulated here in during the day-to-day execution of their work duties. Moreover, an appropriate attitude toward investment solicitation as well as a generally progressive attitude are also expected.

In addition, the provisions governing the prohibited acts apply *mutatis mutandis* to officers.

Below, the major acts prohibited by the rules are enumerated and explained:

(i) Prohibition Against Margin and Securities-Related Derivatives Transactions, Etc.

An Association Member must ensure that its employees, regardless of whatever name they may use, will not conduct margin transactions, securities-related derivative transactions, specified OTC derivative transactions or commodity-related market derivatives transactions on their own account (art. 7, item 4).

This rule, since the margin transactions, securities-related derivative transactions, specified OTC derivative transactions and commodity-related market derivatives transactions have a speculative nature, has been provided in order to avoid the circumstances where an employee himself/herself runs into excessive speculative trading and as a result leads the customer and the company to suffering losses.

This shall not apply, however, if the trade carried out by the Association Member's employee concerns share or share options for which it has been decided that they will be granted from the Association Member as a part of the employee's remuneration and the trade is carried out during the time periods set out below, and it is a trade conducted in order to reduce risk that may arise due to fluctuation in price pertaining to its retention as listed in FIEA, Article 2, Paragraph 21, Item 3; Paragraph 22, Item 3; and from among those listed in Paragraph 23, those trades analogous to Paragraph 21, Item 3, and has been approved by the Association Member as not being for the purpose of pursuing solely speculative profits:

A. Share: From the day that the grant was decided until the day of the actual grant; or

B. Share options: From the day that the grant was decided until the day that it becomes possible to exercise rights.

(ii) Prohibition Against "Acceptance of So-Called Transactions Under Fictitious Name"

In accepting orders from customers regarding sales and purchase or other transactions of securities, etc., employees must not accept an order knowingly that it is a transaction under fictitious name (art. 7, item 9).

This rule and Article 13 of "Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members" prohibit the acceptance of transactions under fictitious name from the point of view of preventing unfair trades, as well as from the perspective of appropriate customer management, and tax system fairness.

"Transaction under fictitious name" means a transaction in which the person having title to the account and the person to whom the benefits of the trade revert are not one and the same. For example, it is a transaction in which a customer uses a fictitious name or the name of another person and tries to obtain the legal benefit of the transaction.

Because this rule and Article 13 of the "Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members" prohibit the acceptance of the said transactions under fictitious name, it does not impose restraints on acceptance of the account holder's orders from the representative of the account holder or a person (the so-called "messenger") who no more than transmits the intent of the account holder himself.

Provided, even in that case, from the standpoint of preventing acceptance of transactions under fictitious name, it is necessary to devise an internal system for prevention of acceptance of transactions under fictitious name such as by use of a manual that sets out acceptance procedures.

Further, where an order is placed by a relative having a close relationship to the account holder such as a spouse or blood relative within the second degree of consanguinity, it can be said that there is a high probability that it is not a transaction under fictitious name that is prohibited in this provision. Thus, in such case, if it has been confirmed that it is the spouse or blood relative within the second degree of consanguinity of the account holder, so long as there has been no declaration that it is a transaction under fictitious name, it is thought that the possibility is low that acceptance of such order would be in violation of this provision.

In addition to the above, Article 7 also stipulates the examples of prohibited acts for Association Member employees given below, each prescribed in order to protect the interests of investors while foremost maintaining confidence in financial instruments business operators and the capital markets. This includes the establishment of basic guidelines necessary for the development of a healthy attitude toward the solicitation of investments as well as a means of preventing securities incidents.

(iii) To make an offer or promise, or cause a third party to offer or promise to a customer (including the trustor in cases where a trust company, etc. conducts trades of securities, securities-related derivatives transactions, specified OTC derivative transactions or commodity-related market derivatives transactions (hereinafter "securities, etc." in these Rules) pursuant to the trust contract for the account of the trustor; hereinafter the same in (iii), (iv), and (v)) or a person designated by the customer to the effect that, with respect to a sale and purchase or other transaction involving securities, etc. (excluding transactions effected on condition of repurchase at a predetermined repurchase price or other transactions prescribed by FIEAEO, Article 16-5; hereinafter the same in (iv) and (v) below), the Association Member or a third party will provide property benefit to the customer or third party in order to compensate in whole or in part a loss arising from such transaction if the customer incurs a loss on the securities, etc. or make an addition to profit arising from such transaction if the customer does not realize a predetermined amount of profit on the securities, etc. (art. 7, item 1).

(iv) To make an offer or promise, or cause a third party to make an offer or promise to the customer or a person designated by the customer to the effect that, with respect to a sale and purchase or other transaction of securities, etc., the Association Member or a third party will provide property benefit to the customer or third party in order to compensate in whole or in part for losses incurred by the customer on the securities, etc., or to make an

addition to profit realized by the customer on the securities, etc. (art.7, item 2).

(v) To provide, or cause a third party to provide, property benefit to a customer or a third party with respect to a sale and purchase or other transaction of securities, etc., in order to compensate in whole or in part for the losses incurred by the customer on the securities, etc., or to make an addition to profit realized by the customer on the securities, etc. (art. 7, item 3).

(vi) To solicit a customer for a sale and purchase or other transaction of securities, etc. with an excessive volume in light of the amount of funds for investments or other information of which the employee has come to know through the customer card, etc. (art. 7, item 5) (see 4.1 1 "Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members" of this Chapter for details).

(vii) To solicit a customer for sales and purchase or other transactions in securities, etc., or execute such transactions by promising to share with the said customer the profits or losses resulting from the transaction (art. 7, item 6).

(viii) When receiving an order for a sale and purchase or other transaction in securities, etc. to execute the sale and purchase or other transaction of securities, etc. by acting as a counterparty to the transaction (art. 7, item 7).

(ix) To allow a customer to use the employee's own name, the name of his/her relative or of a person who has a special relationship with him/her for a sale and purchase or other transaction in securities, securities related derivatives transactions, specified OTC derivatives transactions or commodity-related market derivatives transactions or a change in the name of the registered holder of securities (art. 7, item 8).

(x) To use the name or address of a customer for its own sale and purchase or other transaction in securities, securities related derivatives transactions, specified OTC derivatives transactions or commodity-related market derivatives transactions (art. 7, item 10).

(xi) To process changes in the name of the registered holder, etc., or other procedures requested by the customer without going through the Association Member for which the employee works (art. 7, item 11).

(xii) To fail to deliver the money or securities which a customer has instructed an employee to deliver to the Association Member for which he/she works, or to fail to deliver without delay the money and securities (in the case of a Specified Business Member, limited to the money and securities pertaining to the specified business.; in the case of a Special Member, limited to the money and securities pertaining to registered financial institution business), which the Association Member for which he/she works has instructed him/her to deliver to the customer (art.7, item 12).

(xiii) To fail to deliver without delay to a customer documents concerning functions which the Association Member for which an employee works has instructed him/her to deliver to the said customer (in the case of a Specified Business Member, limited to documents concerning the specified business; in the case of a Special Member, limited to documents concerning registered financial institution business) (art. 7, item 13).

(xiv) To lend to or to borrow from a customer money or securities concerning a sale and purchase or transaction in securities, etc. (including advance payment of the customer's

debt) (art. 7, item 14).

(xv) To perform any of the following acts regarding information about a customer (including information about prospective customers and customers of underwriting and investment banks, and excluding publicly known information; the same shall apply in (xv)):

(a) when an employee retires from an Association Member (meaning end of assignment of a person accepted as a seconded worker pursuant to Article 2, Item 6-(a) or end of a dispatch labor service contract for the Association Member for a dispatched worker as specified in Article 2, Item 6-(d)), to not return information about the customer to the Association Member or delete such information;

(b) to wrongfully acquire information about a customer of another Association Member or information about a customer of the financial instruments intermediary service of a financial instruments intermediary service provider;

(c) to use information about a customer retained as per (a) above or acquired as per (b) above, or information about a customer retained as per (a) or acquired as per (b) of Article 24, Item 15 of the Rules Concerning Financial Instruments Intermediary Service Providers (hereinafter referred to as the "Financial Instruments Intermediary Service Provider Rules"), in the course of duties;

(d) to use information about a customer retained as per (a) above or acquired as per (b) above by another person, or information about a customer retained as per (a) or acquired as per (b) of Article 24, Item 15 of the Financial Instruments Intermediary Service Provider Rules by another person, or information about a customer divulged or leaked by another Association Member or financial instruments intermediary service provider, in the course of duties with the knowledge that the information has been retained or acquired through such means; or

(e) to divulge or leak information about the customer.

(xvi) To conduct the preferential allotment (*oyabike*) prescribed in Article 2, Paragraph 2 of the Rules Concerning Distribution, Etc. to Customers Related to Underwriting, Etc. of Public Offering, Etc. of Share Certificates, Etc. (excluding the case that falls under the proviso to that paragraph) (art. 7, item 16);

(xvii) To conduct advertising, etc. or offer a premium at the employee's own discretion, without receiving the examination by the advertising examining manager (meaning the "advertising examining manager" set forth in Article 5 of the "Rules Concerning Representation of Advertising, Etc. and Offer of Premium") (art. 7, item 17).

(xviii) To accept an order for the sale of securities from a customer that is conducted on a financial instruments exchange market without confirming whether the subject sale is classified as a short sale. However, this does not apply to those transactions described in Article 11 of the Cabinet Office Ordinance on Restrictions on Securities Transactions (hereinafter the "Securities Transaction Ordinance"). The provisions of the main clause and proviso of this item shall apply *mutatis mutandis* to the sale of securities in the proprietary trading system (the same applies in (xix)) (art. 7, item 21).

(xix) When conducting a short sale of securities entrusted by a customer on a financial instruments exchange market, to execute the short sale at a price equal to or less than the

last quoted price (meaning the last quoted price prescribed in FIEAEO, Article 26-4, Paragraph 1; hereinafter the "Last Quoted Price"; the same applies in (xx)) if the case falls under any of the items of the said Paragraph. However, this does not apply to those transactions described in Article 15 of the Securities Transaction Ordinance and when the short sale is executed at the Last Quoted Price in cases where the Last Quoted Price is greater than the last different price from the Last Quoted Price announced before the announcement of the said Last Quoted Price (the same applies in (xx)) (art. 7, item 22).

(xx) In entrusting another Regular Member to carry out a short sale order received from a customer, to give instruction that the short sale is to be executed at a price that is less than the Last Quoted Price (art. 7, item 23).

(xxi) Upon soliciting switching (meaning the acquisition, purchaser or the entrustment, etc. thereof of trust beneficiary certificates, etc. (meaning the beneficiary certificates of an investment trust or foreign investment trust (other than those enumerated in the FIBCOO, Article 65, Item 2(a) through Item 2(c) and securities possessing characteristics similar thereto), investment certificates or foreign investment certificates classified as investment certificates, but excluding those listed on a financial instruments market of an exchange) in association with the partial cancellation, or redemption of investment units of an investment trust contract or sale of investment trust beneficiary certificates, etc., or the entrustment thereof, with respect to investment trust certificates, etc. that are currently being held) for investment trust beneficiary certificates, etc., to fail to explain the material matters concerning the said switching to the customer (other than professional investors prescribed in FIEA, Article 2, Paragraph 31; the same applies in (xxii) and (xxiii)) (art. 7, item 24).

(xxii) To solicit the execution of a CFD transaction contract (referring to the CFD transaction contract prescribed in Article 3, Item 3 of the "Rules Concerning CFD Transactions" (excluding OTC CFD Transaction Contracts prescribed in Item 4 of the said Article); hereinafter the same shall apply in these Rules) to a customer, without confirming whether or not the customer intends to receive such solicitation prior to solicitation (art. 7, item 25).

(xxiii) To continue the solicitation of the execution of a CFD transaction contract even though the customer being solicited manifested his or her intent not to conclude the CFD transaction contract (including the intent to not receive such solicitation in the future) (art. 7, item 26).

(xxiv) To conclude a contract in sales and purchase or other transactions, etc. in securities regarding while a Regular Member or Specified Business Member knowing that a customer is an antisocial force; provided, however, excluding cases where antisocial forces shall be eliminated from financial instruments trading and the financial instruments market (art. 7, item 27; only applicable to Regular Members and Specified Business Members).

(xxv) To conduct or solicit a transaction relating to the registered financial institution business with a customer with a promise to provide the customer with special consideration concerning financing, guarantees, etc. (art. 7, item 18; only applicable to Special Members).

(xxvi) To extend credit clearly intended to be used as initial or additional margin money for a transaction relating to the registered financial institution business (art. 7, item 19; only applicable to Special Members).

(xxvii) For transactions relating to the registered financial institution's financial instruments intermediary service, to conduct registered financial institution's financial instruments intermediary service with providing or promising to automatically extend credit to the customer in cases where the account of a customer opened with a Regular Member shows a deficit balance (art. 7, item 20; only applicable to Special Members).

(3) Improper Acts

Association Members must give guidance to or supervise their employees in order not to engage in any act enumerated in the following items (hereinafter "improper acts" in these Rules) (art. 8):

(i) To execute a customer order without confirming the issue name, price, volume, classification as a limit order or market order, etc. in sale and purchase or other transactions of securities, etc. (in the case of a Specified Business Member, limited to customer orders concerning the specified business; in the case of a Special Member, limited to customer orders concerning registered financial institution business; the same in (iv));
(ii) To solicit a customer in a way that will mislead him/her with respect to the nature of securities, etc. or terms of the transaction;
(iii) To solicit a customer in a way that will mislead him/her with respect to rise or fall of the price of a security or the value of an option in the transactions set forth in Article 8, Item 3; and
(iv) To make a mistake in administration process by negligence with respect to the execution of a customer order pertaining to sale and purchase or other transactions of securities, etc.

(4) Reporting of Incidents

(i) Incident Notification

In cases where it becomes clear that any person who is currently or had been in the employment of an Association Member (hereinafter "employee, etc." in these Rules) has committed any of the prohibited acts described in (2) above and an act provided for in Article 5 of the "Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members" or an act in violation of any law or regulation, etc. which the employee is required to observe, or any improper act under (3) above (hereinafter an "incident" in these Rules), the Association Member must immediately submit to the JSDA a notification of securities incident using the prescribed form, except where the improper act mentioned in (3) above was committed by negligence (art. 9, para. 1).

(ii) Report of Development and Results of the Incidents

When the particulars of the incident (excluding the case where the improper act mentioned in (3) above was committed by negligence) are found out, the Association Member must take a disciplinary action against the offending employee according to the nature of the incident and must submit to the JSDA without delay a report of development and results of the incidents stating the particulars of the case using the prescribed form (art. 10, para. 1).

An Association Member must, when it finds that the content of the incident is of a nature that causes an egregious loss of confidence in the financial instruments business, include a statement to such effect on the report

of development and results of the incidents (art. 10, para. 2).

(5) System of Perpetrators of Inappropriate Acts

(i) Treatment of Perpetrator of an Inappropriate Act

In cases where the JSDA receives a report of development and results of the incidents, it must examine the contents thereof, and may, when deemed necessary in connection with the examination, ask the Association Member to give an explanation of the contents of the report submitted or provide other documentary evidence, etc. (art. 11, para. 1 and para. 2).

The JSDA may also conduct the examination prescribed in Article 11, Paragraph 1 based on any material it considers to be appropriate, in addition to the report of development and results of the incidents (art. 11, para. 4).

In cases where the JSDA finds, as a result of the examination mentioned above, that the employee concerned has resigned or has been internally disciplined by the Association Member concerned in a manner that is equivalent to discharge, or is an employee of an Association Member whose registration under Article 29 or Article 33-2 of the FIEA has been revoked, and that his/her act is deemed to have caused a significant loss of public confidence in the financial instruments business, it shall determine to treat the person as a perpetrator of an inappropriate act and revoke his/her sales representative qualification, sales manager qualification and internal administrator qualification. Among perpetrators of inappropriate acts, a person admitted to have conducted an act which has a material effect on the credibility of the financial instruments trading business is treated as a Class-1 perpetrator of an inappropriate act. Other persons are treated as Class-2 perpetrator of an inappropriate act (art. 12).

Upon deciding to treat an employee, etc. of an Association Member as a perpetrator of an inappropriate act, the JSDA publishes relevant information, including the name of the Association Member involved in the violation of laws and regulations subject to publication (excluding cases otherwise specified), the outline of the violation, the date of the decision of the treatment as a perpetrator of an inappropriate act, and the details of such treatment (“Rules Concerning Procedures for Disciplinary Action on Sales Representative, Etc. of Association Members” (hereinafter referred to as the “Disciplinary Action Rules”); art. 29).

(ii) Procedures for Taking Action

When the JSDA intends to treat an employee, etc. as a perpetrator of an inappropriate act, it shall implement the procedures for explanation in accordance with the Disciplinary Action Rules, and send a notice of the treatment decided to the Association Member concerned. In principle, the notices regarding the procedure for explanation and the decision of the treatment shall also be sent to the employee, etc. concerned in order to provide the employee, etc. with the opportunity to state his/her opinion (Disciplinary Action Rules, art. 8 and art. 23).

(iii) Filling of Complaints

An Association Member which is an addressee of a decision to treat its employee, etc. as a perpetrator of an inappropriate act and the employee, etc. who is subject to that decision may file a complaint on the decision with the JSDA if they have any such complaint (Rules Concerning Filing of Complaints on Disciplinary Action under Self-Regulatory Rules Imposed on Employee, Etc. of Association Member, art. 4).

(iv) Application for Release

Where an Association Member finds it appropriate to release a person who had been regarded as a perpetrator of an inappropriate act by the JSDA from such treatment because the person has shown clear signs of remorse, or a new fact is found regarding the incident that caused him/her to be regarded as a perpetrator of an

inappropriate act, or if there is any other special reason, it may file with the JSDA an application for the release of such treatment (art. 14, para. 1). In addition, when a person who is regarded as a perpetrator of an inappropriate act by the JSDA finds a new fact regarding the incident that caused him/her to be regarded as a perpetrator of an inappropriate act, or if there is any other special reason, the person may file with the JSDA an application for the release of treatment of a perpetrator of an inappropriate act (Rules Concerning Employees of Association Members, art. 14, para. 2).

(v) Release and Notification

The JSDA shall, when receiving an application for release of treatment of a perpetrator of an inappropriate act, examine it and may determine to release the person related to the application from the treatment of a perpetrator of an inappropriate act, when it finds it appropriate to do so (art. 15, para. 1). The JSDA shall notify the employee, etc. related to the application, the Association Member that submitted the report of development and results of the incidents, and the Association Member that filed the application, of the results of the examination of the application for release (art. 15, para. 2).

2 Rules Concerning Sale and Purchase, Etc. of Specified Securities, Etc. of Listed Companies, Etc. by Employees of Association Members

The purpose of these Rules is to prevent unfair transaction in the sale and purchase, etc. of specified securities of listed companies, etc. by employees of Association Members, by providing an establishment of internal rules and others necessary measures, thereby ensuring confidence in the capital market (art.1).

In these Rules, “employee” means an employee under the Rules Concerning Employees of Association Members (art. 2). This definition applies *mutatis mutandis* to officers (art. 7).

In addition, “sale and purchase relating to the specified securities, etc. of listed companies, etc.” refer to trades, etc. concerning specified securities, etc. of listed companies, etc. provided for in Article 166 of the FIEA, which means the sale and purchase, etc. of securities that are subject to the so-called insider trading regulations (art. 2, item 2).

(1) Basic Stance

In the sale and purchase, etc. of the specified securities, etc. of listed companies, etc. by employees, considering that such investment should be conducted for the purpose of healthy wealth accumulation by such employee itself, the Association Member must make efforts to have such employee comply with laws and various rules and regulations and not to be suspected of conducting insider trading, transaction pursuing speculative profits, and other unfair transactions (art. 3).

> This provides the purport that employees of financial instruments business operators, etc. as the leaders of the capital market must be trusted by investors at all times.

(2) Establishment of Internal Rules

The Association Member must establish internal rules on the sale and purchase, etc. relating to the specified securities, etc. of listed companies, etc. by employees that include the matters set forth in each of the following items (art. 4):

(i) Matters relating to the scope of the employees;
(ii) Matters relating to procedures for sale and purchase, etc. (including matters concerning orders placed with other Association Members);
(iii) Matters relating to the prohibited actions under laws and various rules and regulations such as insider trading, transactions based on special information that is obtained during the course of business, and transactions exclusively aiming at speculative profits; and
(iv) Other matters the Association Member deems necessary.

Employees of Association Members are prohibited from conducting insider trading and speculative trading under laws, regulations and rules. In order to further comply with these prohibited acts, the JSDA requires Association Members to formulate internal rules.

(3) Self-Restriction of Sale and Purchase, Etc. by Employees Belonging to Corporate Business-Related Divisions

The Association Member must provide in its internal rules that, in principle, the employees who belong to corporate business-related divisions should not conduct for themselves the sale and purchase relating to the specified securities, etc. of listed companies, etc. of which they are in charge in the business (art. 5).

This provision prohibits sale and purchase relating to specified securities, etc. of listed companies, etc. by an employee handling the same from the viewpoint of preventing unfair transactions by employees belonging to a division with a high possibility of obtaining confidential corporate information in the course of business (Note) in particular among the divisions of the Association Member.

(Note) "Divisions with a high possibility of obtaining confidential corporate information" include divisions handling corporate activities, underwriting activities and trading management activities, and divisions involved in the merger, acquisition, tender offer, public offering of new shares, etc. of an issuer company, etc.

(4) Enhancement of Management Systems

The Association Member must conduct an inspection on a regular basis to check whether the sale and purchase relating to the specified securities, etc. of listed companies, etc. by the employees are conducted properly pursuant to the internal rules (art. 6).

3 Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members

These Rules were enacted for the purpose of contributing to investor protection by promoting improvements in the quality of sales representatives of Association Members, and the proper and smooth operation of the sales

representatives registration system (art. 1).

The outline of these Rules is as follows:

(1) Sales Representatives

For purposes of these Rules, "Sales Representatives" mean those officers and employees of an Association Member that engage in the business of sales representatives on behalf of the Association Member to which they belong(Note)(art. 2).

(Note) The business of sales representatives refers to the acts listed in the items of Article 64, Paragraph 1 of the FIEA, which pertain to the business operations of Regular Members, Specified Business Members or Special Members. Among deemed securities, rights provided for in the Items of Article 2, Paragraph 2 of the FIEA that are deemed as securities pursuant to the provisions of the said Paragraph are not included in the scope of business of sales representatives.

Sales Representatives of Regular Members are divided into five categories:

(i) Class-1 Sales Representative

These are persons that can perform all of the sales representative work. However, in order to conduct sales representative work pertaining to specified OTC derivatives transactions, etc., one must take and pass the Class-1 Sales Representative examination conducted in April 2009 and thereafter(Note 1). In order to perform the sales representative work related to commodity-related market derivatives transactions, etc., it is necessary to pass the Class-1 Sales Representative examination conducted in July 2020 and thereafter(Note 2).

(Note 1) Persons fulfilling the qualification requirements of a Class-1 Sales Representative pursuant to examinations, etc. implemented on or prior to March 31, 2009, may conduct sales representative work pertaining to specified OTC derivatives transactions, etc. upon taking the internal training seminars designated by the JSDA the results of which are reported to the JSDA (art. 4-2, para. 2).

(Note 2) Persons fulfilling the requirements of the Class-1 Sales Representative as a result of the examinations, etc. implemented on or prior to June 30, 2020, may perform the sales representative work related to commodity-related market derivatives transactions, etc. upon taking and completing the internal training seminars provided by their affiliated Association Members by the method designated by JSDA or the qualification renewal training courses implemented by JSDA on or after July 1, 2020 (art. 4-3, item 2).

(ii) Margin Transaction Sales Representative

These are persons that can perform Class-2 Sales Representatives work and the sales representative work pertaining to margin transactions and when-issued transactions (Note).

(Note) Upon taking the internal training seminars designated by the JSDA the results of which are reported to the JSDA, the sales representative may conduct the work concerning specified OTC derivative transactions, etc. at the Association Member implementing the report (art. 4-2, para. 2).

(iii) Class-2 Sales Representative

These are persons that can perform sales representative work pertaining to securities (excluding the rights set forth in the items of FIEA, Article 2, Paragraph 2, that are regarded as securities pursuant to the provisions of the same Paragraph) and sales representative work pertaining to brokerage for clearing of securities, etc.(Note)

(Note) If sales representatives, who satisfy the requirements for Class-2 Sales Representatives by taking the examination, etc. implemented on or before March 31, 2009, have completed the internal training courses designated by the JSDA, and the results of their training have been reported to the JSDA, they may conduct the business of sales representatives concerning specified OTC derivative transactions, etc. as sales representatives of the Association Member which has reported the said results to the JSDA (art. 4-2, para. 2).

However, they may not perform the business of sales representative pertaining to the following (art. 2, item 4):

a. Securities-related derivatives transactions, etc.;
b. Transactions in bonds with options;
c. Margin transactions and when-issued transactions (provided, however, they can be performed in the case that orders are received when accompanied by a Class-1 Sales Representative or a Margin Transaction Sales Representative of the Association Member to which the Class-2 Sales Representative belongs (including the case where a Class-1 Sales Representative or a Margin Transaction Sales Representative has checked the sales activities of the Class-2 Sales Representative in the sales office or business office));
d. Share option certificates (including those that have the character of share option certificates that are issued abroad or by foreign persons);
e. Investment equity subscription right certificates;
f. Covered warrants;
g. DRs pertaining to those listed in d. and f. (meaning certificates or instruments that are to be issued in a country other than the country of issue of certificates or instruments, by a person with whom the said certificates or instruments have been placed on deposit, and which represent rights in connection with the certificates or instruments that have been placed on deposit);
h. Complex structured bonds similar to OTC derivatives transactions;
i. Complex investment trust similar to OTC derivatives transactions; and
j. Leveraged investment trust.

(iv) Special Commodity Futures Sales Representatives

These are persons who can perform sales representative work pertaining to commodity-related market derivatives transactions, etc. (Note)

(Note) In order to perform work of a "Special Commodity Futures Sales Representatives," it is necessary for an Association Member to apply to the JSDA and obtain accreditation of the qualification as the

relevant type of sales representative for persons that satisfy the requirements prescribed in the rules (Article 4, Item 7 of the Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members as applied through the deemed replacement of terms under Article 5, Paragraph 1 of the Rules Concerning the Application of Self-Regulatory Rules for Commodity-Related Market Transactions of Derivatives, Etc.).

(v) Special Commodity Futures Sales Representatives (limited to dealing)

These are persons who can perform sales representative work pertaining to commodity-related market derivatives transactions conducted in the Association Member's account.(Note)

(Note) In order to perform work of a "Special Commodity Futures Sales Representatives (limited to dealing)," it is necessary for an Association Member to apply to the JSDA and obtain accreditation of the qualification as the relevant type of sales representative for persons that satisfy the requirements prescribed in the rules (Article 4, Item 8 of the Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members as applied through the deemed replacement of terms under Article 5, Paragraph 1 of the Rules Concerning the Application of Self-Regulatory Rules for Commodity-Related Market Transactions of Derivatives, Etc.).

(2) Sales Representatives Qualification

In view of the importance that sales representatives perform their business on behalf of Association Members whether or not they work in or outside of a business office or office, and the effect thereof attributes directly to the Association Member, the Association Member must not allow its officers or employees to conduct the business of a sales representative unless that officer or employee has a certain qualification in accordance with the classification of sales representatives and is registered as a sales representative (such as in the case of a Class-1 Sales Representative, a person having the Class-1 Sales Representative qualification examination) (art. 4 and art. 5).

(3) Registration of Sales Representatives

When an Association Member allows its officers or employees to perform the business of sales representative, it must register their names, dates of birth and other matters in the original registry of sales representatives kept by the JSDA (art. 3). The sales representative registration system provides for the disqualification requirements for eliminating persons who are unsuitable for serving as sales representatives, with the aim of protecting investors.

Additionally, when a registered sales representative changes his/her name or other information, falls under disqualification criteria set forth in the FIEA, or will no longer conduct sales activities due to retirement or other reasons, the Association Member must file a notice with the JSDA without delay (art.10).

(4) Disciplinary Actions, Etc. Against Sales Representatives

(i) Disciplinary Actions Regarding the Registration of Sales Representatives (Administrative Actions)

(a) Disciplinary Action

When a registered sales representative becomes subject to any of the disqualification criteria set forth in the FIEA, is found to have been subject to any of the disqualification criteria at the time of registration,

violates the law and regulations concerning the business of sales representative or its related businesses among the financial instruments trading business, or is found to have engaged in any other extremely inappropriate conduct concerning the business of sales representative, the JSDA will revoke the registration of that sales representative or suspend him/her from the duties of a sales representative for a period of up to two years (art. 11).

Upon taking disciplinary action to revoke a sales representative's registration or impose a suspension from the duties of a sales representative (the action of imposing a suspension from the duties of a sales representative is limited to the action taken as recommended by the Securities and Exchange Surveillance Commission), the JSDA publishes relevant information including the name of the Association Member or the financial instruments intermediary service provider involved in the violation of laws and regulations subject to publication (excluding cases otherwise specified), the outline of the violation, the date of the decision of the administrative action, and the details of the administrative action (Disciplinary Action Rules; art. 29).

(b) Procedures for Taking Administrative Disciplinary Action

When the JSDA intends to impose the administrative disciplinary action, it shall hold a hearing as prescribed in the Administrative Procedure Act and send a notice of the administrative disciplinary action decided to the Association Member concerned. In principle, the notices regarding the procedure for hearing and the decision of the administrative disciplinary action shall also be sent to the Sales Representative concerned in order to provide the Sales Representative with the opportunity to state his/her opinion (Disciplinary Action Rules, art. 3 and 5).

(c) Filing of Complaint, Etc.

An Association Member that is dissatisfied with the administrative disciplinary action may file a request for review with the FSA Commissioner under the Administrative Complaint Review Act (FIEA, art. 64-9). If an Association Member seeks to revoke the administrative disciplinary action in litigation, it may file an action for revocation under the Administrative Case Litigation Act.

(ii) Action Prohibiting Business of Sales Representative

(a) Disciplinary Action

When the JSDA finds that a sales representative (including a former sales representative) has violated the laws and regulations concerning the business of sales representative or related businesses or has engaged in any other extremely inappropriate conduct concerning the business of sales representative, it will make a decision to take action to prohibit the Association Member to which the sales representative belonged at the time of such conduct from assigning him/her to the business of sales representative for a period not exceeding five years (Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members, art. 6).

(b) Procedures for Taking Action

When the JSDA intends to take action prohibiting the business of sales representative, it shall implement the procedures for explanation in accordance with the Disciplinary Action Rules, and send a notice of the action decided to the Association Member concerned. In principle, the notices regarding the procedure for explanation and the decision of the action shall also be sent to the employee, etc. concerned in order to provide the employee, etc. with the opportunity to state his/her opinion (Disciplinary Action Rules, art. 8 and 25).

(c) Filing of Complaint

An Association Member which is an addressee of a decision to take action prohibiting business of sales representative and its employee, etc. who is subject to that decision may file a complaint on the decision with

the JSDA if they have any such complaint (Rules Concerning Filing of Complaints on Disciplinary Action under Self-Regulatory Rules Imposed on Employee, Etc. of Association Member, art. 4).

(iii) Training Courses for Persons Subject to Disciplinary Actions, Etc.

An Association Member must immediately make a person who has been subject to the disciplinary action of suspension of the business of sales representatives among the persons set forth in (i) above or a person who has been subject to the prohibition of assignment to duties of a sales representative among the persons set forth in (ii) above take the training courses designated by the JSDA (art. 13).

This training is implemented to have the sales representatives gain thorough knowledge on the prohibited acts, etc. again and to strive to prohibit the occurrence of such acts, by giving trainings to the persons who have conducted acts of violation of laws and regulations, etc.

(5) Training Courses for Renewal of Sales Representative Qualification

Association Members must require the following persons to attend the training courses for renewal of sales representative qualification, offered by the JSDA, during the periods specified respectively (required training periods) (art. 18):

(i) As for registered sales representatives: within one year from the first day of the month in which every fifth anniversary of the date of their sales representative registration falls; and

(ii) As for persons who are newly registered as sales representatives: within 180 days after the sales representative registration date.

* Persons who passed the sales representative qualification examination within two years prior to the first day of the required training period will be deemed to have completed attendance of the sales representative qualification renewal training course.

If a sales representative fails to complete the sales representative qualification renewal training within the required training period, all of his or her sales representative qualification will be suspended and he or she may not perform the business of sales representatives during the period of suspension.

If a sales representative fails to complete the sales representative qualification renewal training within 180 days from the day following the last day of the required training period, all of his or her sales representative qualification will be revoked.

(6) Participation in Internal Training Courses for Improvement of Quality of Sales Representatives

In addition to these sales representative qualification renewal training courses, Association Members must have their registered sales representatives attend internal training courses every year in order to improve the quality of their sales representatives (art. 19).

4 3 Advertisements

○ Rules Concerning Representation of Advertising, Etc. and Offers of Premiums

(1) Purpose

The purpose of these Rules is, with respect to representation of advertising and offer of premiums placed or made by an Association Member, to ensure appropriate representation of advertising and offer of premiums, and thereby contribute to investor protection by prescribing representations, methods, matters to be observed, etc. (art. 1).

The rules are summarized below.

(2) Definitions

These Rules define as advertisements set forth in FIEA, Article 37 and representations carried out pursuant to the acts set forth in FIBCOO, Article 72 concerning details of a financial instruments business (limited to those conducting sale and purchase or other transactions, etc. of securities in the course of trade) as "representation of advertisements, etc." (art. 2, item 2).

(3) Basic Principles of Advertising, Etc. and Offers of Premiums

The rules contain the following basic principles regarding advertising, etc. made and premiums offered by Association Members with the intent of promoting the further adequacy thereof:

(i) Whenever making representations of advertising, etc., an Association Member must observe fair and equitable principles of transactions and maintain dignity, as well as endeavor to provide accurate information and correct and clear representations in the spirit of the protection of investors (art. 3, para. 1); and

(ii) Whenever offering premiums, an Association Member must observe fair and equitable principles of transactions, maintain dignity and endeavor to offer premiums in an appropriate manner (art. 3, para. 2).

(4) Prohibited Acts

An Association Member may not place representation of advertising, etc. that falls, or is likely to fall, under any of the items (i) to (viii) below (art. 4, para. 1):

(i) Representation of advertising, etc. which runs counter to fair and equitable principles of transactions;

(ii) Representation of advertising, etc. which impairs the dignity of the Association Member;

(iii) Representation of advertising, etc. which contains representations that violate the FIEA or other laws and regulations;

(iv) Representation of advertising, etc. which suggests unlawful acts;

(v) Representation of advertising, etc. which contains representations that may mislead investment decision of an investor;

(vi) Representation of advertising, etc. which hampers fair competition among Association Members;
(vii) Representation of advertising, etc. which has arbitrary or excessively subjective representations; and
(viii) Representation of advertising, etc. which includes a judgment or evaluation of which the basis is not clearly indicated.

When an Association Member offers premiums to its customers, it must not offer premiums which violate or are likely to violate the Act Against Unjustifiable Premiums and Misleading Representations or other laws (art. 4, para. 2). An Association Member must not, directly or indirectly, make any third party conduct the representation of advertisings, etc. or provide premiums which violate the provisions of Article 4, Paragraph 1 prescribed above (art. 4, para. 3).

(5) Internal Examination, Etc. by Association Members

(i) When an Association Member makes the representation of advertising, etc. or offers premiums, it must appoint an officer in charge of examining the representation of advertising, etc. and the offer of premiums (hereinafter referred to as "advertising examining officer" in these Rules), and make the advertising examining officer examine that there has been no violation of the prohibited acts mentioned in (4) above (art. 5, para. 1, main clause).
However, this provision does not apply to representation of advertising, etc. for professional investors prescribed in Article 2, Paragraph 31 of the FIEA and representation of advertising, etc. made by a Special Member, that are related to the financial instruments intermediary service activity as registered financial institutions and that have already been examined by the advertising examining officer of the entrusting member (a Regular Member that entrusts the financial instruments intermediary service activity as registered financial institution to the Special Member) (art. 5, para. 1, *proviso*).

(ii) Association Members must appoint only the persons set forth in (a) to (f) below to act as the advertising examining manager (art. 5, para. 2 through para. 5):

(a) Internal administration supervisor;
(b) Persons who have passed the qualification examination for Regular Member's sales manager prescribed in the "Rules Concerning Qualification Examination for Sales Representatives, Etc." (enacted before April 1, 2006; the same shall apply hereinafter);
(c) Persons who passed the qualification examination for Regular Member's internal administrators prescribed in the "Rules Concerning Qualification Examination for Sales Representatives, Etc.";
(d) Persons who passed the qualification examination for Special Member's sales manager prescribed in the "Rules Concerning Qualification Examination for Sales Representatives, Etc." (Special Members and Specified Business Members only; however, this does not include Special Members who act as advertising examining managers conducting examinations of representation of advertisements, etc. and offers of premium relating to registered financial institution's financial instruments intermediary service activities);
(e) Persons who passed the qualification examination for Special Member's internal

administrators prescribed in the examination rules (Special Members and Specified Business Members only; however, this does not include Special Members who act as advertising examining officers conducting examinations of representation of advertisements, etc. and offers of premiums relating to registered financial institution's financial instruments intermediary service activities); or

(f) Other persons who are recognized by the JSDA as being appropriate to examine the representation of advertising, etc. and the offer of premiums based on their knowledge, etc. (Regular Members and Special Members only)

Advertising examining officers who conduct examinations of representation of advertising, etc. and offers of premium pertaining to specified OTC derivatives transactions, etc. and advertising examining officers of Specified Business Members shall be limited to those persons who fall under Article 4-2, Paragraph 1, Item 1 of the Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members, those who have participated in the Paragraph 1 internal training prescribed in Paragraph 2, Item 2 of the said Article and have reported their training results to the JSDA or those who fall under Items 2 and Item 3 of the said Paragraph and also fall under any of items (a) to (e) above (art. 5, para. 2, *proviso*, art. 5, para. 3, *proviso*, art. 5, para. 5).

A person set forth in (a) to (c) below may be appointed as the advertising examining manager in charge of examinations of representation of advertising, etc. and offers of premium pertaining to commodity-related market derivatives transactions brokerage, etc.:

(a) Person who has passed the qualification examination for Regular Member's internal administrator or the qualification examination for Special Member's internal administrator conducted on or after July 1, 2020;

(b) Person who has passed the qualification examination for Regular Member's internal administrator or the qualification examination for Special Member's internal administrator conducted on or before June 30, 2020, and has completed the internal training courses or qualification renewal courses prescribed in Article 4-3, Item 2 of the "Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members"; or

(c) Person who has completed the internal administrator qualification training program provided by the Commodity Futures Association of Japan and has also taken the accreditation training program prescribed in Article 4, Item 7 (b) of the "Rules Concerning Qualification and Registration, Etc. of Sales Representatives of Association Members" as applied through the replacement of terms under Article 5, Item 1 of the "Rules Concerning the Application of Self-Regulatory Rules for Commodity-Related Market Derivatives Transactions, Etc.," by the day specified by the JSDA.

(6) Development of Internal Administration System

An Association Member shall develop internal rules on the examination system, examination criteria, and retention system concerning the representation of advertising, etc. and the offer of premiums for the purpose of appropriate and proper representation of advertising, etc. and the offer of premiums, disseminate it to all the officers and employees, and thoroughly make them comply with it (art. 6).

(7) Investigation of Violations

If the JSDA determines that the representation of advertising, etc. and offer of premiums, made by an Association Member or its employee violate or are likely to violate the provisions of the provisions of Article 3 ((3) above) or Article 4 ((4) above), the JSDA may request that such Association Member submit the relevant materials and may obtain an explanation (art. 7, para. 1).

An Association Member must reply to the request for submitting materials or making an explanation as prescribed in Article 7, Paragraph 1 (art. 7, para. 2).

(8) Guidelines Concerning Advertising, Etc.

Matters necessary for representation of advertising, etc. made by Association Members which are not prescribed in these Rules shall be prescribed in the "Guidelines Concerning Advertising, etc." separately prepared by the JSDA (art. 8).

(9) Handling of Analysts Reports

Regardless of the provisions of these Rules, internal investigations, etc. pertaining to analyst reports must be conducted in accordance with the provisions of the "Rules Concerning Handling of Analyst Reports" (art. 9)(Note).

(Note) "Rules Concerning Handling of Analyst Reports"

The purpose of these Rules is to ensure that business pertaining to the preparation and the use, etc. of analyst reports is implemented in an appropriate and fair manner by prescribing matters that an Association Member (as for a Special Member, limited to the Special Member who conducts the acts of financial instruments intermediation; and as for analyst reports of the Special Member, limited to those reports relating to acts of financial instruments intermediation) must comply with in respect of the handling, etc. of analyst reports, thereby contributing to the provision of appropriate and valid information to investors and to the improvement of the quality of analysts.

These Rules require Association Members to coordinate their internal administration systems pertaining to analyst's reports, such as internal examination, keeping, disclosure of any conflicts of interest, etc., and thorough going information management. Proper management is required for material information (art. 8) in particular. However, with regard to information that is found to have a significant influence on investors' investment decisions, even if that information does not fall within the category of material information, Association Members must exercise due care to avoid harming the fairness and impartiality of the market by providing such information to a limited scope of investors in the course of soliciting them for investment.

4 4 Personal Information Related Matters

○ Guideline for Protection of Personal Information

This guideline provides for matters concerning personal information, including specifying the purpose of use and safety control action, and also provides for concrete measures that should be taken by an Association Member

with the purpose of ensuring proper handling of personal information, pseudonymized personal information and anonymized personal information in the course of business related to the sale and purchase or other transactions of securities, etc. and other associated business by Regular Members; specified business by a Specified Business Member; and registered financial institution business by Special Members, based on the Act on the Protection of Personal Information (hereinafter referred to as the "PPIA"), the Cabinet Order to Enforce the Act on the Protection of Personal Information, the Enforcement Rules for the Act on the Protection of Personal Information (hereinafter referred to as the "PPIAER"), the Basic Policy on the Protection of Personal Information, various guidelines for personal information protection, and the Guideline for Personal Information Protection in the Financial Field, and others (art. 1).

The outline of this guideline is as follows.

(1) Definitions

The definitions of the terms used in this guideline are as follows (art. 2):

(i) Personal Information

Information about a living individual which can identify a specific individual (including such information as will allow easy reference to other information and will thereby enable a specific individual to be identified), or information containing an individual identification code.

"Information about an individual" shall mean not only information which allows a specific individual to be identified, such as name, address, gender, date of birth, and face image, but also all information that indicates facts, judgment and evaluation regarding personal attributes such as physical features, property, job type, and title, and shall include evaluation information and information that is publicly available by publications, video and voice, irrespective of whether the information is anonymized by such means as encryption. If such "Information about an Individual" is combined with a name and/or any other descriptions, by which "a specific individual can be identified", such "information about an individual" shall become "Personal Information."

(ii) Individual Identification Code

A combination of any character, letter, number, symbol or other codes specified by laws and regulations as a code which independently allows a specific individual to be identified (*e.g.,* an individual number, driver's license number, etc.).

(iii) Personal Information Database, Etc.

A set of information including Personal Information set forth in the following, except for information that is unlikely to harm an individual's rights and interest in light of its method of use):

(a) Systematically aggregated information arranged in a manner such that the specific Personal Information can be searched by using a computer; and

(b) In addition to the information set forth in (a), systematically aggregated information that is arranged according to a certain set of rules in such a manner that the specific Personal Information can be readily searched, and that is in a state wherein Personal Information can be readily searched by reference to list of contents, indexes, symbols, etc.

(iv) Personal Data

Personal Information constituting a Personal Information Database, etc.

(v) Retained Personal Data

The Personal Data for which an Association Member has the authority to disclose, correct, add, or delete

the content, to suspend its use, to erase, and to suspend its provision to a third party in response to a request from the Person or his/her agent, and excluding Personal Data that are likely to pose a threat to the life, body, or property of the Person or a third party if presence or absence of the data is known and the like.

(vi) Person

A specific individual who can be identified by reference to the Personal Information.

(vii) Special Care-Required Personal Information

Personal Information containing descriptions etc. which requires special care in handling so as not to cause unfair discrimination, prejudice or other disadvantages to the Person.

(viii) Sensitive Information

A type of information used in the financial field, which includes Special Care-Required Personal Information and information on the Person's affiliation to a labor union, family origin, registered domicile, health care record, and sexual life (excluding information on any of these matters that falls within the category of Special Care-Required Personal Information), but excludes: information disclosed by the Person, or by a certain scope of entities such as a State organ, a local public entity, an academic institution or the equivalent (meaning a university or other organization or group associated with academic studies, or a person belonging to it), a broadcasting organization, a newspaper company, a news agency, or any other news media; and information that is obvious from the appearance of the Person and can be acquired by visual inspection or visual recording.

(ix) Pseudonymized Personal Information

Information relating to an individual that can be produced through processing personal information by taking any of the measures prescribed in accordance with the divisions of personal information in a way that makes it not possible to identify a specific individual unless collated with other information.

(x) Anonymized Personal Information

Information relating to an individual that can be produced through processing personal information by taking actions prescribed according to the types of personal information, so that the individual can neither be identified in reference to the personal information nor re-identified by restoring the personal information.

(xi) Information Related to Personal Information

Information relating to a living individual which does not fall under any of the categories of personal information, pseudonymized personal information and anonymized personal information.

(xii) Database of Information Related to Personal Information

A collective body of information consisting of Information Related to Personal Information, as set forth in the following:

(a) A collective body of information that has been systematically organized so that particular Information Related to Personal Information can be searched using a computer; and

(b) Beyond what is set forth in (a), a collective body of information that has been systematically organized so that particular Information Related to Personal Information can be searched by arranging Information Related to Personal Information according to certain rules, and that has been made easily searchable by means of a table of contents, an index, a code or anything similar.

(2) Specification of Purpose of Use

When handling Personal Information, an Association Member shall specify, to the extent possible, for what business and for what purpose the Personal Information is used that enables the Person to reasonably assume such

business and purpose (art. 3, para. 1). In addition, when specifying the purpose of use set forth in Article 3, Paragraph 1, as an abstract answer such as "using the Personal Information in a purpose required by our company" shall not be considered sufficient in terms of "specify to the extent possible," an Association Member must present the financial instruments and services it intends to provide and endeavor to specify the purpose (art. 3, para. 2).

(3) Consent of Person

In the case where an Association Member acquires Personal Information of a Person contained in a document directly from the Person during the course of conducting the credit business, such as a margin transaction, a when-issued transaction, or making a loan based on securities under custody as collateral (limited to lending based on securities under custody as collateral by a Regular Member), the member shall endeavor to acquire the consent of the Person by setting a confirmation column in a document that clearly indicates the purpose of use. In such case, the purpose of use under an agreement, etc. shall be clearly described separately from other provisions in the agreement, etc. (art. 4, para. 1).

In addition, unless based on laws and regulations (including local ordinances; the same applies in this guideline), an Association Member must not handle the Personal Information beyond the scope necessary for the achievement of the purpose of use specified by the Association Member without obtaining the prior consent of the Person (art. 6).

Further, when obtaining the consent of the Person, an Association Member shall, in principle, obtain it in writing (including a record made by an electronic means, magnetic means, or any other means that cannot be recognized by human senses) (art. 5). For example, the Person's consent can be obtained by: (i) stating the purpose of use and words of consent on the document from which the Personal Information is obtained directly from the Person, or on a different document, and having the Person sign (and seal) the document, or (ii) using the internet to have the Person indicate consent on the screen (by clicking a consent button, etc.) or by receiving, etc. from the Person an email or SNS message stating words of consent.

(4) Sensitive Information

An Association Member must not acquire, use, or provide to a third party Sensitive Information except for the cases prescribed by laws and regulations, etc. The provision of Article 27, Paragraph 2 of the PPIA (opt-out procedure) does not apply when an Association Member provides Sensitive Information to a third party (art. 7).

(5) Prohibition of Inappropriate Use

An Association Member must not utilize Personal Information in a way that there is a possibility of fomenting or inducing unlawful or unjust act (art. 7-2).

(6) Proper Acquisition of Personal Information

An Association Member must not acquire Personal Information by a fraudulent or other type of dishonest means. When acquiring Personal Information from a third party, an Association Member must not unreasonably infringe the interest of the Person, and must confirm the provider's status of compliance and that the provider has acquired the said Personal Information lawfully (art. 8).

(7) Notification, Publication and Expression, Etc. of the Purpose of Utilization at the Time of Acquiring the Personal Information

When an Association Member acquires the Personal Information, it must immediately notify the Person of the purpose of use or publicize it unless the Association Member publicizes it in advance. In such case, the "notice" must be made in writing in principle, and the "publication" must be made in a proper way; *e.g.*, by announcing the purpose of use on its website, etc., or displaying or placing a document at a counter of its sales office, or, depending on the nature of its business, such as a method of marketing financial instruments (art. 9, para. 1).

Notwithstanding the provisions of Article 9, Paragraph 1, when acquiring the Personal Information that is described in an agreement or other documents at the time of executing the agreement with the Person, an Association Member must expressly indicate the purpose of use to the Person in advance. However, this shall not apply to the case where the acquiring of the Personal Information is necessary to protect the life, body, or property of a person (art. 9, para. 2).

Further, except for certain cases, when an Association Member changes the purpose of use, the member must notify the Person of the changed purpose of use or publicize it (art. 9, para. 3).

(8) Maintenance of the Accuracy of Data, Etc.

An Association Member must endeavor to maintain Personal Data in an accurate and up-to-date manner within the scope that is necessary to achieve the purpose of use, by taking such measures as developing the procedures for verifying and confirming personal information when inputting it into the Personal Database, developing the procedure for correcting errors in the stored data, updating the records, and setting the retention period.

In addition, an Association Member must delete the retained Personal Data without delay when it is no longer necessary to use the data, such as when the purpose of use has been achieved and the rational reason for retaining the data no longer exists in relation to that purpose. However, this shall not apply if a retention period, etc. is prescribed under laws and regulations (art. 10).

(9) Security Control Measures

An Association Member must take necessary and appropriate measures such as the establishment of basic policy on security control, handling rules, and a system pertaining to security control measures for the purpose of preventing leakage, loss, or damage (hereinafter referred to as "leakage, etc." in these Rules) of the Personal Data handled and taking other measures for security control of the Personal Data. The necessary and appropriate measures must include "institutional security control measures," "personnel security control measures," "physical security control measures," "technological security control measures" and "understanding of the outside environment," which are laid out according to the respective levels of acquisition, use, and retention of the Personal Data (art. 11, para. 1).

(i) Institutional security control measures

The establishment of systems and implementation of measures by an Association Member such as defining the responsibilities and authorization of officers and employees for the security control measures of the Personal Data, preparing and operating the rules on security control, and checking and inspecting the implementation status.

(ii) Personnel security control measures

To execute a non-disclosure agreement on the Personal Data with officers and employees, to give education and training for officers and employees, and to supervise officers and employees for ensuring the

security control of the Personal Data.

(iii) Physical security control measures

Physical measures to ensure security and control of Personal Data, such as controlling the areas where Personal Data is handled, preventing theft of equipment, electronic media, etc., preventing leakage, etc. in the case of carrying electronic media, etc., and disposing of equipment, electronic media, etc.

(iv) Technological security control measures

Technical measures for security control of the Personal Data such as access control to an information system that handles the Personal Data, and monitoring of information systems.

(v) Understanding of the outside environment

Understanding systems concerning protection of personal information in a foreign country when handling Personal Data in the foreign country.

(10) Restriction of Provision to a Third Party in Japan or in a Foreign Country

An Association Member must not provide the Personal Data to a third party without obtaining the prior consent of the Person except for the cases prescribed by laws and regulations, etc. When obtaining the consent, the member must clearly indicate to the Person a reasonable and appropriate scope of content of the Personal Data as may be necessary to enable the Person to decide whether or not to give consent. If the member intends in advance to provide the Personal Information to a third party, it must include this as part of the purpose of use (art. 14, para. 1).

However, regarding the Personal Data that is to be provided to a third party, an Association Member may provide the Personal Data to a third party in the case where the provision of the Personal Data to a third party that can identify the Person is to be suspended upon request of the Person and the Association Member notifies the Person of the necessary matters, including the fact that the provision to a third party is included in the purpose of use, or puts these matters in a state where the Person can easily know them, and notifies the Personal Information Protection Commission of these matters while publicizing the content of the notification by a proper method. It is prohibited to provide Sensitive Information or Personal Data acquired by deception or any other wrongful means to a third party under the opt-out procedure, or acquire Personal Data under the opt-out procedure and then provide it under the opt-out procedure (art. 14, para. 2).

When an Association Member provides Personal Data to a third party in a foreign country, it must obtain the Person's consent to the provision of the data to a third party in a foreign country, except in cases where it is based on laws and regulations (art. 14-2, para. 1). In order to obtain the Person's consent, it is necessary to provide the Person with the prescribed information (art. 14-2, para. 2 and para. 3).

(11) Obligations to Confirm and Record Matters Related to Third-Party Provision, Etc.

If an Association Member provides Personal Data to a third party, it must prepare a record of matters specified by the PPIAER, such as the date on which the Personal Data was provided to the third party, and the name of the third party, and preserve such record, except in cases where the provision of the data is based on laws and regulations (art. 14-3 and art. 14-6).

If an Association Member receives Personal Data provided by a third party, it must confirm the name of the third party and the circumstances where the third party acquired the data, and must also prepare a record of the confirmed matters as well as matters specified by the PPIAER, such as the date on which the Personal Data was received from the third party, and the name of the third party, and preserve such record, except in cases where the

recipe of the data is based on laws and regulations (art. 14-4 and art. 14-6).

(12) Restriction on Third-Party Provision of Information Related to Personal Information

An Association Member must not provide Information Related to Personal information that constitutes a Database of Information Related to Personal Information to a third party without confirming in advance the matters specified by laws and regulations except for cases based on laws and regulations, if it is anticipated that the third party acquires the relevant Information Related to Personal Information as Personal Data. In addition, when an Association Member intends to obtain the Person's consent for acquiring Information Related to Personal information as Personal Data from the business operator handling Information Related to Personal Information, it must provide the Person with the prescribed information (art. 14-5).

(13) Disclosure, Etc.

When an Association Member is requested by the Person to disclose the Retained Personal Data that can identify the Person (including the record of provision to a third party), the member must disclose such Retained Personal Data (including the nonexistence of the Retained Personal Data if it does not exist) without delay by a method requested by the Person among the methods of providing electronic or magnetic records, delivering a document and any other methods specified by the Association Member. However, if the disclosure may cause a threat to the life, body, property or other rights or benefits of the Person or a third party, the Member may avoid disclosing the whole or party of such data (art. 16, para. 1 and para. 3).

Further, when an Association Member is requested by the Person to correct, add, or delete (hereinafter referred to as the "correction, etc." in these Rules) the Retained Personal Data for the reason that the Retained Personal Data that can identify the Person is incorrect due to errors contained therein, the member must conduct a necessary investigation such as confirming the fact without delay within the scope necessary for the achievement of the purpose of use, and make the correction, etc. to such Retained Personal Data based on the result of the investigation, in principle. When an Association Member makes the correction etc. on the whole or part of the Retained Personal Data upon request or decides not to make the correction, etc., the Association Member must notify the Person of such handling (including what has been changed if any correction, etc. is made) without delay (art. 17, para. 1 and para. 2).

When requested by the Person to notify him/her of the purpose of use or to disclose the retained personal data, an Association Member may charge a fee for the conduct of such measures (art. 21, para. 1).

(14) Response to Leakage, Etc.

An Association Member must endeavor to address a complaint regarding the handling of the Personal Information properly and promptly, and strive to establish a system necessary for this purpose (art. 22, para. 1 and para. 2).

When an Association Member becomes aware of any of the situations specified in the items of Article 7 of the PPIAER ([i] the situation where the leakage, etc. of Personal Data containing Special-Care Required Personal Information has occurred or is likely to have occurred; [ii] the situation where the leakage, etc. of Personal Data that is likely to cause property damage if used unlawfully has occurred or is likely to have occurred; [iii] the leakage, etc. of Personal Data (including personal information that the Association Member has acquired or seeks to acquire and that is intended to be treated as personal data) by an act against the Association Member committed for unlawful purposes has occurred or is likely to have occurred; or [iv] the situation where the leakage, etc. of Personal

Data that involves more than 1,000 Persons has occurred or is likely to have occurred), the Association Member must report it to the Personal Information Protection Committee (or to the Commissioner of the Financial Services Agency, etc. if the Commissioner of the Financial Services Agency, etc. is authorized to receive reports under Article 150 of the PPIA; or to the head of a local government, etc. if the head of a local government, etc. carries out affairs under the authority to receive reports under Article 170 of the PPIA) and to the JSDA. In the case of an incident of leakage of Specific Personal Information specified by laws and regulations, a report must also be made to the Personal Information Protection Committee. When an Association Member becomes aware of any of the situations specified in the items of Article 7 of the PPIAER, it must notify the Person (art. 23, para. 1 and para. 3). If an Association Member becomes aware of the situation where the leakage, etc. of Personal Information that it handles has occurred or is likely to have occurred, or the situation where the leakage, etc. of deleted information relevant to the Pseudonymized Personal Information it handles or information on the processing method of Anonymized Personal Information has occurred or is likely to have occurred, the Association Member must report it to the Financial Services Agency and the JSDA (art. 23, para. 2). If any of these situations is detected, the Association Member must take necessary measures such as preventing the spread of damage (art. 23, para. 4).

Further, given the importance to explain in advance a policy on Personal Information handling in an easy-to-understand manner, an Association Member shall prepare and publicize the statement of its concept and policy on the Personal Information protection (a so-called privacy policy or privacy statement, etc.) (art. 24, para. 1).

4 5 Shares Related Matters

1 Rules Concerning Over-the-Counter Securities

These Rules prescribe matters concerning over-the-counter transactions in over-the-counter securities conducted by Regular Members and the solicitation of investment in over-the-counter securities conducted by Association Members, etc.

(1) Breakdown of Over-the-Counter Securities

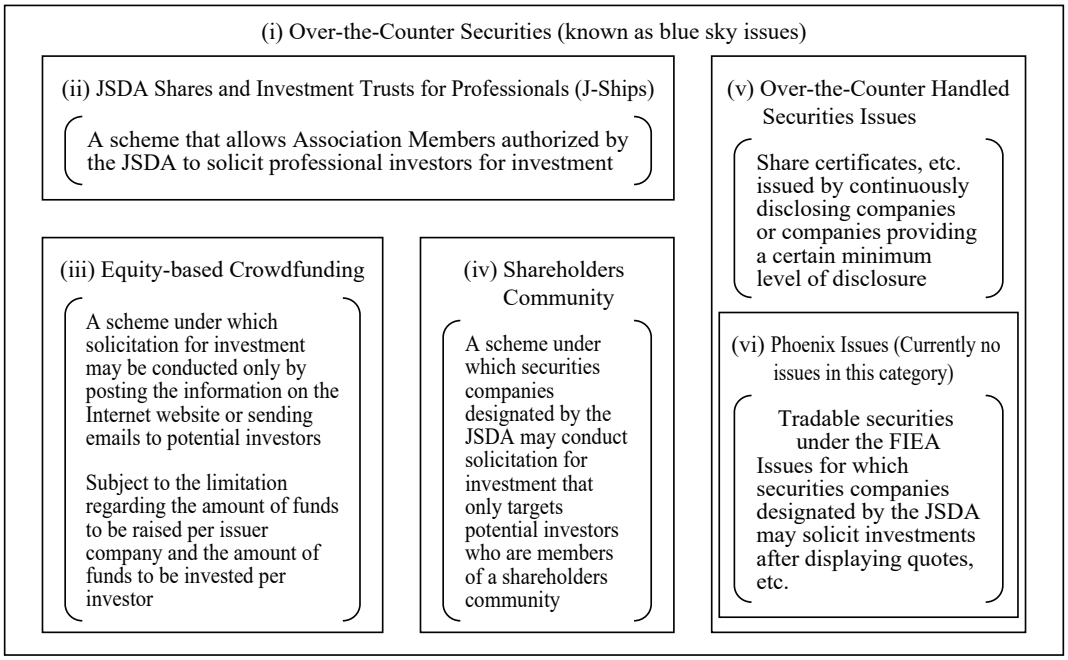
Over-the-counter securities (see Chart, (i)) consist of share certificates, share options and bonds with share option certificates that a domestic juridical person issues in Japan and are not listed on a financial instruments exchange market.

As for the JSDA Shares and Investment Trusts for Professionals (J-Ships) (Chart, (ii)), equity-based crowdfunding (Chart,(iii)) and shareholders community (Chart, (iv)), please see the description below (see 4.5 2 Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc., 3 "(1) What Is Equity-based Crowdfunding Business?" and 4 "(1) Composition of a Shareholders Community" in this Chapter for details).

Over-the-counter handled securities (see Chart, (v)) consist of share certificates, share option certificates and bonds with share options that are over-the-counter securities for which the issuing company is a company that is required to submit an annual securities report pursuant to the provisions of FIEA, Article 24, Paragraph 1, or a company that prepares a "explanatory note on business conditions" (Note).

As for Phoenix Issues (Chart, (vi)), please see the description below (see 4.5 5 "(1) What Is a Phoenix Issue?" in this Chapter for details).

Chart **Conceptual Diagram of Over-the-Counter Securities**



(Note) An "explanatory note on business conditions" is an explanatory document used by a Regular Member, or a Special Member or a financial instruments intermediary service provider commissioned by the said Regular Member to carry out financial instruments intermediary service when conducting investment solicitation for over-the-counter handled securities (art. 2, item 3), and it is prepared by the issuing company. It makes the statements in accordance with the categories for stating "confidential corporate information" out of an annual securities report as set forth in the Cabinet Office Ordinance on Disclosure of Corporate Affairs. The financial statements and consolidated financial statements must also be stated in accordance with the FIEA. Moreover, an audit similar to that under the FIEA must be conducted by a certified public accountant, etc., or an audit by a certified public accountant under the Companies Act or a similar audit must be conducted, and an auditor's report with an unqualified general opinion must be attached. In this case, the handling of the auditor's report is the same as a company filing annual securities reports (art. 5).

(2) Prohibition of Solicitation for Investment in Over-the-Counter Securities

Association Members are prohibited from soliciting customers to invest in over-the-counter securities, except in the event of soliciting investment for transactions intended to transfer a controlling interest, etc., soliciting qualified institutional investors for investment, soliciting professional investors(Note) capable of making corporate valuation for investment, handling public offering, secondary distribution, private placements or private secondary distribution (meaning any offer to sell, etc. falling under (a) through (c) of the FIEA, Article 2, Paragraph 4, Item 2) of, or engaging in the secondary distribution or private secondary distribution of over-the-counter handled securities issued by unlisted companies (hereinafter referred to as "handling, etc. of public offering, etc." in these Rules), soliciting investments in accordance with the "Rules Concerning Shareholders Community," "Rules Concerning Equity-Based Crowdfunding Business" or "Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc.," or soliciting investments in over-the-counter handled securities issued

by companies issuing listed securities (art. 3).

Solicitation of investment for transactions intended to transfer a controlling interest, etc. means solicitation of investment for transactions or intermediation of transactions in over-the-counter securities which are conducted in order to enable the customer, who is a prospective buyer, to acquire a majority of the voting rights of all shareholders or a majority of all issued shares of the issuing company, on the condition that the customer is given the opportunity to conduct due diligence on the issuing company (art. 3-2).

When soliciting a qualified institutional investor for investment, restrictions against the transfer of these securities to persons other than qualified institutional investors must be imposed in principle (art. 4, para. 1 and para. 2).

When soliciting customers who are professional investors capable of making corporate valuation for investment, an Association Member must obtain the customers' assurance that they will evaluate details of the issuing company on their own responsibility and make investments based on their corporate valuation; and must provide the customers with information on the issuing company, such as the corporate outline, business description, and financial data (except when the Association Member has confirmed that the customers do not request the provision of such information) (art. 4-2, para. 2 and para. 3).

(Note 1) "Professional investors" under Article 4-2 of the OTC Securities Rules do not include persons who are deemed to be customers other than professional investors pursuant to the provisions of Article 34-2, Paragraph 5 of the FIEA (including as applied mutatis mutandis pursuant to Article 34-4, Paragraph 6 of the FIEA), but include persons who are deemed to be professional investors pursuant to the provisions of Article 34-3, Paragraph 4.

(Note 2) As of November 12, 2024, the OTC Securities Rules were partially amended to include professional investors who are individuals in the scope of professional investors under Article 4-2 of these Rules. The amendment of these Rules came into effect as of the same day.

(3) Solicitation for Investment in Over-the-Counter Handled Securities

An Association Member may solicit investment related to the handling, etc. of offering, etc. of over-the-counter handled securities (excluding among over-the-counter handled securities, share certificates and bonds with share options delisted by a financial instruments exchange, which are issued by the company whose financial statements for the immediately preceding business year contained in an annual securities report, securities registration statement or company information memorandum are accompanied by an audit report(Note) with an unqualified general opinion) (art. 6, para. 1).

(Notes) The handling of auditors reports differs in accordance with the following categorization:

1. Auditors reports attached to the annual securities report or the securities registration statement prepared by the issuing company of an issue listed on a financial instruments exchange market: an unqualified general opinion for the financial statements and consolidated financial statements for the immediately preceding business year.
2. Auditors reports attached to the annual securities report, the securities registration statement or the explanatory note on business conditions prepared by the issuing company other than 1 above: an unqualified general opinion for all financial statements and consolidated financial statements or

other financial information included in the annual securities report, the securities registration statement or the explanatory note on business conditions.

An Association Member, when it carries out handing of the public offering or secondary distribution, or secondary distribution of over-the-counter handled securities for which a prospectus must be prepared and delivered pursuant to Article 13 and Article 15, Paragraph 2 of the FIEA, must give a customer a full explanation with respect to the details of the over-the-counter handled securities and their issuing companies after delivering such prospectus (art. 6, para. 2).

An Association Member, when it carries out dealing, etc. of public offering of over-the-counter handled securities (excluding those issued by an issuing company of listed securities and not listed on Financial Instruments Exchange Markets) for which preparation and delivery of a prospectus pursuant to Article 13 and Article 15, Paragraph 2 of the FIEA are not required, must give a customer a full explanation with respect to the details of the over-the-counter handled securities and their issuing companies, using an annual securities report or explanatory note on business conditions (art. 6, para. 3).

Moreover, an Association Member, when it carries out dealing, etc. of public offering of over-the-counter handled securities (limited to non-listed on Financial Instruments Exchange Markets which are issued by an issuing company of listed securities) for which preparation and delivery of a prospectus pursuant to Article 13 and Article 15, Paragraph 2, of the FIEA are not required, must give a customer a full explanation with respect to the details of the over-the-counter handled securities using explanatory note on business conditions (art. 6, item 4).

In any of these cases, each time an Association Member accepts an order from its customer for a transaction of over-the-counter handled securities, it must clearly specify that such securities are over-the-counter handled securities (art. 6, para. 6) and an Association Member, when it carries out dealing, etc. of offering of over-the-counter handled securities, must maintain a registration statement, prospectus, or explanatory note on business conditions in its handling departments and branches and make it available to customers (art. 6, para. 7).

(4) Trading, Etc. of Over-the-Counter Securities

Transactions in over-the-counter securities that employ fictitious, wash trades, etc., or other improper trading methods, over-the-counter transactions viewed as excessive, margin transactions and over-the-counter transactions in unissued over-the-counter securities, as well as over the counter transactions for the purpose of distribution among Regular Members (excluding the cases set forth in art. 3-2, art. 4, art. 4-2, art. 6, and art. 7, solicitation for investment under the provisions of the "Rules Concerning Solicitation of Professional Investors for Investment in Over-The-Counter Securities, Etc." and transactions in authorized unlisted PTS issues prescribed in Article 2, Item 5 of the "Rules Concerning Transactions, Etc. of Unlisted Securities Over Proprietary Trading Systems (PTS)") or registered PTS issues prescribed in Article 2, Item 14 of the same Rules are prohibited (art. 10, art. 11, art. 13, and art. 14).

(Note) As of November 20, 2024, the OTC Securities Rules were partially amended to develop self-regulatory rules in response to the 2024 amendment to the FIEA, which introduced a regime wherein financial instruments business operators that register type-I financial instruments businesses are allowed to conduct part of the proprietary trading system (PTS) operation services without obtaining authorization (registered PTS). The amendment of these Rules came into effect as of November 21, 2024.

2 Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc.

The system named "JSDA Shares and Investment Trusts for Professionals (J-Ships)" is a system for professional investors (Note 1) for trading over-the-counter securities and investment trusts, etc.(Note 2) (hereinafter referred to as "over-the-counter securities, etc.").

These Rules provide for matters necessary in the case of conducting a private placement of over-the-counter securities, etc. (limited to the case set forth in Article 2, Paragraph 3, Item 2 (b) of the FIEA; hereinafter the same applies in these Rules) for professional investors or an exclusive offer to sell, etc. to professional investors regarding these securities, etc. or handling of these securities, etc., or conducting solicitation for an investment related to PTS transactions in securities for professional investors(Note 3) (meaning the sale and purchase of securities prescribed in Article 1-7-3, Item 3 of the FIEAEO (limited to those set forth in (b) of that item)), for the purpose of promoting the supply of growth funds by professional investors and creating the opportunities to invest in diverse products including unlisted shares, etc.

(Note 1) "Professional investors" do not include persons who are deemed to be customers other than professional investors under Article 34-2, Paragraph 5 of the FIEA but include persons who are deemed to be professional investors under Article 34-3, Paragraph 4 of the FIEA (including as applies mutatis mutandis pursuant to Article 34-4, Paragraph 6 of the FIEA).

(Note 2) "Over-the-counter securities" refers to over-the-counter securities prescribed in Article 2, Item 1 of the OTC Securities Rules (for details, see 4.5 1 "(1) Breakdown of Over-the-Counter Securities" in this Chapter), and "investment trusts, etc." refers to beneficiary certificates of an investment trust prescribed in Article 2, Paragraph 1, Item 10 of the FIEA or investment securities or investment equity subscription right certificates prescribed in Article 2, Paragraph 1, Item 11 of the FIEA, which are not listed on a financial instruments exchange market.

(Note 3) As of November 20, 2024, the Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc. were partially amended to enable Handling Association Members to engage in solicitation for investment regarding PTS transactions in securities for professional investors and to specify requirements for the solicitation for investment. The amendment of these Rules came into effect as of November 21, 2024.

(1) Verification and Examination

A Handling Association Member must understand the details of the characteristics and risks of over-the-counter securities, etc. for which it intends to solicited new customers(Note) for investment and verify whether it is appropriate to solicit these customers for investment in these securities, etc. and the scope of customers to be targeted for investment solicitation (art. 3, para. 1).

When conducting verification of over-the-counter securities, etc., a Handling Association Member must examine certain matters according to the category of securities pursuant to the internal rules formulated by the Handling Association Member, and preserve the results of the verification and examination for five years (art. 3, para. 2 and para. 3).

(Note) "Customers" mentioned herein are limited to professional investors (hereinafter the same applies in

these Rules, except in Article 9, Article 10, and the main clause of Article 11).

(2) Measures Taken to Eliminate Antisocial Forces

A Handling Association Member must provide for necessary matters in an agreement with the issuer of over-the-counter securities, etc., such as the issuer pledging that it is not an antisocial force (art. 4).

If it is found that the issuer of over-the-counter securities, etc. falls within the category of antisocial forces or it is revealed that the issuer is related to an antisocial force, a Handling Association Member must not solicit investment in the relevant over-the-counter securities, etc. (art. 5).

(3) Specified Information on Securities and Information on the Issuer

A Handling Association Member may solicit investment in over-the-counter securities, etc. only if specified information on securities (Article 27-31, Paragraph 1 of the FIEA) regarding the relevant over-the-counter securities, etc. is provided or disclosed to the party to be solicited for investment by a method specified in these Rules (art. 6, para. 1). The Handling Association Member must provide or disclose information on the issuer (Article 27-32, Paragraph 1 of the FIEA) regarding the over-the-counter securities, etc. to the customer who has acquired the relevant over-the-counter securities, etc. through its investment solicitation, or confirm that the issuer provides or discloses such information to that customer (art. 7, para. 1).

Specified information on securities consists of securities information in Section 1, corporate information in Section 2 (or fund information in the case of investment trust, etc.), and the overview of the settlor company, etc. (only in the case of beneficiary certificates of an investment trust). Information on the issuer consists of corporate information (or fund information in the case of beneficiary certificates of an investment trust) and the overview of the settlor company (only in the case of beneficiary certificates of an investment trust), which are equivalent to Sections 2 and 3 among the contents of specified information on securities.

With regard to the contents of specified information on securities and information on the issuer, these Rules specify the formats and instructions for describing these items of information (art. 6, para. 3 and art. 7, para. 3).

(4) Explanation to Customers, Etc.

If, as a result of investment solicitation under Article 8 conducted by a Handling Association Member, a customer(Note) intends to purchase any of the over-the-counter securities and investment trusts, etc. for the first time, the Handling Association Member must deliver a document specifying the risks according to the category of securities and explain such risks to the customer. The Handling Association Member must also collect a confirmation document from the customer to the effect that the customer understands the matters specified in the written explanation and conducts transactions according to the customer's own judgment and responsibility (art. 10).

When soliciting a customer for an investment related to a purchase under Article 8, a Handling Association Member must deliver a written explanation specifying certain matters concerning individual issues to the customer(Note 1) who is the party to be solicited for investment and provide sufficient explanation on these matters (art. 11, para. 1).

However, if a Handling Member conducts PTS transactions in securities for professional investors and provides a customer with information necessary for viewing the website of an Authorized Unlisted PTS Operating Member (meaning the Authorized Unlisted PTS Operating Member prescribed in Article 2, Item 9 of the "Rules

Concerning Transactions, Etc. of Unlisted Securities Over Proprietary Trading Systems (PTS)", and limited to one that establishes a proprietary trading system for conducting the sale and purchase of the relevant securities), the website of a Registered PTS Operating Member (meaning the Registered PTS Operating Member prescribed in Article 2, Item 17 of the Rules Concerning Transactions, Etc. of Unlisted Securities Over Proprietary Trading Systems (PTS), and limited to one that establishes a proprietary trading system for conducting the sale and purchase of the relevant securities), or the website of the Handling Member, the Handling Member is not required to provide the information for matters indicated in the written explanation (art. 11, para. 2).

(Note 1) The "customer" in Articled 10 and the main clause of Article 11 is limited to a person that is deemed to be a professional investor pursuant to the provisions of Article 34-3, Paragraph 4 of the FIEA as applied mutatis mutandis pursuant to Article 34-4, Paragraph 6 of the FIEA.

(Note 2) As of November 20, 2024, the Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc. were partially amended to develop self-regulatory rules in response to the 2024 amendment to the FIEA, which introduced a regime wherein financial instruments business operators that register type-I financial instruments businesses are allowed to conduct a part of the proprietary trading system (PTS) operation services without obtaining authorization (registered PTS). The amendment of these Rules came into effect as of November 21, 2024.

(5) Designation as Handling Association Member

Solicitation under these Rules may be conducted only by Association Members designated by the JSDA as "Handling Association Members." A Handling Association Member must prepare internal rules concerning the details of the matters prescribed in these Rules and develop a system to ensure compliance with these internal rules (art. 12, para. 1).

In addition, a Handling Association Member must prepare operational guidelines based on the provisions of the internal rules and submit these guidelines to the JSDA and disclose them. The Handling Association Member must also take these measures when it has changed the content of the operational guidelines (art. 12, para. 2 and para. 3).

However, an Association Member that only conducts PTS transactions in securities for professional investors is not required to be designated as a "Handling Member" (art. 18, para. 2).

(6) Reporting of Status of Transactions

A Handling Association Member must report the status of transactions subject to investment solicitation under these Rules to the JSDA by the 15th day of the following month (if that day falls upon a non-business day, by the following business day) (art. 15).

(7) Application Mutatis Mutandis to Foreign Securities

While these Rules apply to domestic securities, the Foreign Securities Rules contain provisions under which these Rules apply mutatis mutandis to foreign share certificates, foreign share option certificates, foreign bonds with share options, beneficiary certificates of foreign investment trusts, foreign investment securities, and foreign investment equity subscription rights certificates. Thus, the same rules as those applicable to domestic securities are

in place with regard to foreign securities (Foreign Securities Rules, art. 49 to art. 52).

(8) Exclusion of PTS Transactions from Application

The provisions of Articles 3 to 7 and Article 12 do not apply to the case of conducting investment solicitation for PTS transactions in securities for professional investors. However, Article 7 applies if the solicitation for investment is related to the registered PTS operation service dedicated to the registered PTS Operating Member's Customers prescribed in Article 2, Item 20 of the "Rules Concerning Transactions, Etc. of Unlisted Securities Over Proprietary Trading Systems (PTS)" (art. 18).

(Note) As of November 20, 2024, the Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc. were partially amended to develop self-regulatory rules in response to the 2024 amendment to the FIEA, which introduced a regime wherein financial instruments business operators that register type-I financial instruments businesses are allowed to conduct a part of the proprietary trading system (PTS) operation services without obtaining authorization (registered PTS). The amendment of these Rules came into effect as of November 21, 2024.

(9) Handling of Cases Where Handling Association Members Entrust Solicitation for Investment to Others

A Handling Association Member must provide instructions to and conduct supervision of the financial instruments intermediary service provider to which it entrusts solicitation for investment to ensure that the financial instruments intermediary service provider complies with the provisions of Articles 5, 6, 8, 9, 10, and 11 (art. 19).

If a Special Member engages in solicitation for investment under the Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc. based on an entrustment from a Handling Association Member, and either the Special Member or the Handling Association Member has performed any of the acts prescribed in Articles 3, 4, 6, 7, 10, and 11, the other Member is not required to perform the act under the relevant Article (art. 20).

(Note) As of November 12, 2024, the Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc. were partially amended to introduce additional provisions concerning instructions to and supervision of financial instruments intermediary service providers and to take measures to reduce the duplication of the acts by a Handling Association Member and a Special Member in the case where the Handling Association Member entrusts the Special Member with the solicitation for investment. The amendment of these Rules came into effect as of the same day.

3 Rules Concerning Equity-Based Crowdfunding Business

The purpose of these Rules is to provide for the necessary matters for the equity-based crowdfunding business conducted by Regular Members and by Specified Business Members engaged only in the type I small amount electronic offering handling business (meaning the type I small amount electronic offering handling business prescribed in Article 29-4-2, Paragraph 9(*) of the FIEA) in the scope of type I financial instruments business (for

details, see 1.1 "(2) Specified Business Members" in this Chapter) (collectively referred to as "Regular Members, etc."; hereinafter the same shall apply in these Rules) in connection with over-the-counter securities, and to ensure proper management of business and protection of investors so that equity-based crowdfunding will be used based on a proper understanding of the risks inherent therein and will contribute to facilitating the supply of risk money to emerging and growth companies.

For the definition of over-the-counter securities, etc., please refer to the abovementioned description (for details, see 4.5 1 "(1) Breakdown of Over-the-Counter Securities" of this Chapter).

* The parts marked with (*) in this section correspond to the provisions of laws and regulations effective as of November 1, 2024.

(1) What Is Equity-based Crowdfunding Business?

Crowdfunding is generally understood as a scheme that connects emerging and growth companies in need of funds with prospective fund suppliers by collecting a small amount of funds from a number of fund suppliers.

The equity-based crowdfunding business refers to type I small amount electronic offering handling business conducted by Regular Members, etc. in connection with share certificates or share option certificates among over-the-counter securities (art. 2, item 2).

The type I small amount electronic offering handling business is defined as: (i) electronic offering handling business,(Note) which is the handling of public offering or handling of private placement of share certificates or share option certificates not listed on a financial instrument exchange (excluding those specified by Cabinet Order) and which satisfies the small amount requirement (see (2) and (7) below) in connection with the total issue value of these securities and the amount to be paid in by the person who acquires the securities; or (ii) receiving of a deposit of money from customers in relation to electronic offering handling business (FIEA, art. 29-4-2, para. 9(*)).

(Note) "Electronic offering handling business" is defined as performing, on a regular basis, the handling of a public offering or secondary distribution of securities, or the handling of a private placement of securities or exclusive offer to sell, etc. to professional investors, by means of an electronic data processing system or by any other means of information and communications technology specified by Cabinet Office Ordinance ((i) using the Internet website and (ii) using email on the basis of the use of the Internet) (FIEA, art. 29-2, para. 1, item 6).

(2) Examination of the Issuer

In order to launch an equity-based crowdfunding business, a Regular Member, etc. must conduct strict examination of over-the-counter securities to be handled in the business in advance in terms of matters including (i) the existence of the issuer and its business, (ii) the issuer's financial condition, (iii) the validity of the issuer's business plan, and (iv) the issuer's social acceptability including its compliance with law, in accordance with the internal rules established based on these Rules (art. 4, para. 1).

A Regular Member, etc. must also pay attention to whether the issuer will be capable of meeting investors' expectations, whether the intended business is appropriate as a financing scheme to be carried out in the form of equity-based crowdfunding business, and whether the issuer has prepared its confidential corporate information under laws and regulations. A Regular Member, etc. must not conduct the intended business if it is not deemed to be appropriate to conduct the said business as an equity-based crowdfunding business based on the examination

result (art. 4, para. 2).

A Regular Member, etc. must not conduct the equity-based crowdfunding business unless the public offering or secondary distribution of the securities involved in the equity-based crowdfunding business meets the small amount requirement(Note) (art. 4, para. 3).

A Regular Member, etc. must prepare records of matters such as the details of the examination, the grounds for reaching a decision as to the examination result, and problems identified during the examination process, and preserve such records for ten years from the day of completion of examination (art. 4, para. 4).

(Note) The sum of the amount of funds to be raised by the public offering or secondary distribution and the amount of funds raised through the issuance of the same class of securities by the same issuer by equity-based crowdfunding within the last one year must be less than JPY100 million (FIEAEO, art. 15-10-3, item 1; FIBCOO, art. 16-2, para. 1(*)). Under the FIEA, this small amount requirement applies only to the type I small amount electronic offering handling business (equity-based crowdfunding business) conducted by type I small amount electronic offering handling business operators, but it is also applicable under the JSDA's self-regulatory rules to the said business conducted by Regular Members.

(3) Measures Toward the Elimination of Antisocial Forces

A Regular Member, etc. must provide for the necessary matters in a contract to be concluded with the issuer in relation to the equity-based crowdfunding business, such as the issuer's assurance to not be an antisocial force (art. 5).

If, before a Regular Member, etc. commences the equity-based crowdfunding business, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Regular Member, etc. must not conduct the equity-based crowdfunding business in relation to the over-the-counter securities to be issued by the issuer (art. 6, para. 1).

If, after a Regular Member, etc. commences the equity-based crowdfunding business, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Regular Member, etc. must suspend the equity-based crowdfunding business immediately (art. 6, para. 2).

(4) Prohibition of Engagement in the Equity-based Crowdfunding Business due to Violation of Laws and Regulations

If a Regular Member, etc. is requested to improve its operational control system on the grounds of violation of laws and regulations or the JSDA Rules, it must not engage in the equity-based crowdfunding business until it completes improvement (art. 7).

If, after a Regular Member, etc. commences the equity-based crowdfunding business, the situation examined as referred to in (2) is found to differ from the actual situation or to have changed subsequently and as a result it is necessary or it is likely to be necessary to change the previous decision, the Regular Member, etc. must conduct the equity-based crowdfunding business carefully (art. 8).

(5) Provision of Information via the Website

While a Regular Member, etc. conducts the equity-based crowdfunding business, it must post on its website

the information on the issuer and fund raising relating to the business as well as the information on risks, etc. involved in the acquisition of over-the-counter securities handled in the business (including the fact that the issuer is not required to make the same level of disclosure as the disclosure required under the FIEA or the timely disclosure required at an exchange) and make such information available for inspection by investors (art. 9; FIEA, art. 43-5).

(6) Prohibition of Combined Use of Solicitation Methods

When conducting the equity-based crowdfunding business, a Regular Member, etc. must use the methods prescribed in the items of Article 6-2 of the FIBCOO ((i) using the Internet website and (ii) using email on the basis of the use of the Internet), and it must not solicit customers to invest through the business by making phone calls or paying visits to them (art. 12).

(7) Verification of the Paid-in Amount Meeting the Small Amount Requirement

A Regular Member, etc. must verify that the amount paid in by customers (excluding professional investors (for details, see the note in 4.5 2 "Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc." in this Chapter)) whom it invites to acquire over-the-counter securities though the equity-based crowdfunding business meets the small amount requirement (Note) (art. 13).

(Note) The sum of the amount paid in by a customer (excluding professional investors) through the equity-based crowdfunding business and the amount paid in by that customer for the issuance of the same class of securities by the same issuer within the last one year must be less than JPY500,000 (FIEAEO, art. 15-10-3, item 2; FIBCOO, art. 16-2, para. 2(*)). Under the FIEA, this small amount requirement applies only to the type I small amount electronic offering handling business (equity-based crowdfunding business) conducted by type I small amount electronic offering handling business operators (Specified Business Members), but it is also applicable under the JSDA's self-regulatory rules to the said business conducted by Regular Members.

(8) Fair Distribution

When conducting the equity-based crowdfunding business, a Regular Member, etc. must endeavor to ensure that over-the-counter securities handled in the equity-based crowdfunding business are distributed among investors in a fair manner and are not excessively skewed to specific investors without reasonable grounds, while fully taking into consideration the trends of investment demand (art. 15).

(9) Periodical Provision of Information by the Issuer

A Regular Member, etc. must enter into a contract with the issuer of the over-the-counter securities handled in the equity-based crowdfunding business, to the effect that after customers pay in the amount of subscription through the equity-based crowdfunding business, the issuer will provide appropriate information concerning the status of its business periodically to the customers who have acquired the over-the-counter securities. A Regular Member, etc. must also verify that the issuer provides information as required under the contract (art. 16, para. 1 and para. 2).

(10) Explanation to Customers

In order to confirm with customers, who are to acquire over-the-counter securities through the equity-based

crowdfunding business for the first time (excluding professional investors), that they understand the risks, fees and other matters concerning the act of financial instruments transaction as stated in the documents to be delivered prior to conclusion of contract and that they intend to acquire the securities at their own discretion and responsibility, a Regular Member, etc. must in advance prepare a document containing the matters stated in the documents to be delivered prior to conclusion of contract and deliver it to the customers, and then collect a confirmation letter from them regarding the acquisition of over-the-counter securities through the equity-based crowdfunding business (art. 11).

The delivery and collection of these documents may be performed by electromagnetic means (art. 28).

When conducting the equity-based crowdfunding business, a Regular Member, etc. must include, in the documents to be delivered prior to conclusion of contract, at least the information that needs to be made public on its website as referred to in (5), and deliver such documents to customers (excluding professional investors) (art. 10).

(11) Report and Disclosure of the Status of Transaction

A Regular Member, etc. must report to the JSDA the status of the equity-based crowdfunding business through which the public offering is ongoing or closed, by the tenth day of the month following the month in which the equity-based crowdfunding business pertaining to the relevant over-the-counter securities is commenced or closed (if the said tenth day falls upon a holiday, the next business day). The JSDA must disclose the content of such report (art. 26, para. 1 and para. 2).

(12) Establishment of the Operational Control System

A Regular Member, etc. must establish internal rules to specify matters necessary for performing the equity-based crowdfunding business in compliance with the FIEA and these Rules, and must also establish systems for carrying out the matters as provided in the internal rules appropriately (art. 17, para. 1).

A Regular Member, etc. must also prepare operational guidelines based on the provisions of the internal rules, and submit these guidelines to the JSDA and make them available for inspection by investors by the same method as that for providing information to investors via the website described in (5) above. A Regular Member, etc. must also take these measures when it has changed the content of the operational guidelines (art. 17, para. 2 through para. 4).

In addition, a Regular Member, etc. must establish a system necessary for making appropriate responses to inquiries from investors in relation to the equity-based crowdfunding business (art. 18).

Furthermore, when a Regular Member, etc. receives deposits of money from customers whom it invites to acquire over-the-counter securities through the equity-based crowdfunding business, it must perform separate management of such money appropriately pursuant to the FIEA (art. 14).

4 Rules Concerning Shareholders Community

The shareholders community system is an unlisted stock trading system which allows only investors who are members of a "shareholders community" to be the target of solicitation for investment.

The purpose of the Rules Concerning Shareholders Community is to provide for the necessary matters for transactions of shareholders community issues that have limited liquidity and to secure appropriateness in the operation, so that the shareholders community system will be used based on a proper understanding of the risks inherent therein and will thereby ensure the fair and smooth transactions of shareholders community issues and

contribute to the protection of investors.

For the definition of over-the-counter securities, etc., please refer to the abovementioned description (for details, see 4.5 1 "(1) Breakdown of Over-the-Counter Securities" of this Chapter).

(1) Composition of a Shareholders Community

A shareholders community is a group of investors who intend to invest in a single issue of over-the-counter securities. A shareholders community issue is an issue of over-the-counter securities for which a single Operating Member operates a shareholders community and solicits customers for investment (art. 2, items 3 and 5).

In order to set up a shareholders community, a Regular Member must be designated as an Operating Member by the JSDA (art. 2, item 4, and art. 4, para.1).

An Operating Member must set up a shareholders community for each issue (art. 4, para. 2).

(2) Examination of the Issuer

An Operating Member must conduct strict examination of over-the-counter securities for which it is to set up a shareholders community, in terms of matters including (i) the existence of the issuer and its business, (ii) the issuer's financial condition, and (iii) the issuer's social acceptability including its compliance with law, in accordance with the internal rules established based on these Rules, and if the relevant securities are not found to be suitable to be a shareholders community issue, the Operating Member must not set up a shareholders community for the said securities (art. 5, para. 1).

In addition, when handling the public offering or secondary distribution of a shareholders community issue, an Operating Member must also strictly examine the issuer in terms of matters such as the validity of the issuer's business plan (art. 8, para. 1).

An Operating Member must prepare records of matters such as the details of the examination, the grounds for reaching a decision as to the examination result, and problems identified during the examination process, and preserve such records for five years from whichever is the later of the day of completion of examination or the day of dissolution of the shareholders community (art. 5, para. 2, and art. 8, para. 2).

(3) Measures Toward the Elimination of Antisocial Forces

In order to set up a shareholders community, an Operating Member must provide for the necessary matters in a contract to be concluded with the issuer, such as the issuer's assurance to not be an antisocial force (art. 6).

If, before an Operating Member sets up a shareholders community, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Operating Member must not set up a shareholders community in relation to the over-the-counter securities to be issued by the issuer (art. 7, para. 1).

If, after an Operating Member sets up a shareholders community, the issuer is found to fall within the category of antisocial forces or it is revealed that the issuer is related to any antisocial force, the Operating Member must dissolve the shareholders community immediately (art. 7, para. 2).

(4) Prohibition of Unauthorized Inclusion and Solicitation for Participation in a Shareholders Community

An Operating Member must not perform the procedure to include an investor in a shareholders community, and must not solicit investors to participate in a shareholders community, unless the investor so requests; provided, however, that if an Operating Member can confirm that the investor whom the Operating Member solicits falls

under any of the following, the Operating Member may solicit the investor to participate in the shareholders community (art. 9, para. 1 and para. 2):

(i) Holder of the shareholders community issue;
(ii) Officer or employee of the issuer of the shareholders community issue;
(iii) Officer or employee of the controlled company, etc. (meaning the controlled company, etc. prescribed in Article 6, Paragraph 3 of the Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act (hereinafter referred to as the "Definition Ordinance") or associated company (meaning the associated company prescribed in Article 7, Paragraph 2 of the Definition Ordinance) of the issuer of the shareholders community issue;
(iv) Officer or employee of a party concerned with the transaction of the issuer (meaning a person in a transactional relationship with the issuer who is specified by the issuer) of the shareholders community Issue;
(v) Person who used to be in the position of any of (i) to (iv);
(vi) Spouse or a relative within the second degree of kinship of the person who falls under (ii), or who used to be in the position of, (ii); or
(vii) Professional investor (for details, see the note in 4.5 2 "Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc." in this Chapter)

If the shareholder community issue falls within the category of over-the-counter handled securities (for details, see 4.5 1 "(1) Breakdown of Over-the-Counter Securities" in this Chapter), an Operating Member may solicit participation in the shareholder community relevant to the shareholder community issue. In this case, the Operating Member, through consultation with the issuer, in advance, shall determine the attributes of a customer who is to be the party to be solicited for participation in line with the purpose of forming the shareholder community, and solicit only customers who have such attributes (art. 9, para. 3).

(Note) As of November 12, 2024, the Rules Concerning Shareholders Community were partially amended to enhance the scope of investors who may be solicited to participate in a shareholders community. The amendment of these Rules came into effect as of the same day.

(5) Prohibition of Solicitation of Investment in the Shareholder Community Issue

Furthermore, an Operating Member must not solicit investors other than those who are members of the shareholders community it operates to invest in the shareholders community issue pertaining to the shareholders community (art. 16).

However, an Operating Member may conduct the handling of private placement of the shareholders community issue for a small number of investors targeting persons other than the participants in the shareholders community (limited to those set forth in the items of Article 9, Paragraph 2) only if the participation in the shareholders community is required as a condition for acquisition of the shareholders community issue (art. 16-3, para. 1, item 1).

An Operating Member may solicit customers who fall under any of (4)(i) through (vi) above for investment only if participation in the shareholder community is required as a condition for the acquisition of the shareholder community issue (art. 16-3, para. 1, item 2).

In addition, an Operating Member may solicit customers who fall under (4)(i) above to invest by selling the shareholders community issue they hold. In this case, the customer who is the party to be solicited for investment may conduct over-the-counter transactions for the sale with a participant of the shareholder community or the Operating Member without participating in the shareholder community (art. 16-3, para. 2 and para. 3).

(6) Provision of Information to Investors

An Operating Member provides investors with information, as described below.

To whom and how information is provided	Content of information to be provided
Disclosing information to all investors (including those who are not participants in the shareholders community) (art. 12, para. 1)	(i) Issue name (ii) URL of the website where the issuer information is available (or in the case of the issuer who does not have its own website, its main phone number) (iii) Special benefits offered to the shareholders (iv) If the service of handling public offering or secondary distribution or the service of conducting secondary distribution is available, a statement to that effect and the period for application for such service (v) If participation is solicited with regard to over-the-counter handled securities, the attributes of the customer who is the party to be solicited for participation
Disclosure to all investors (including those who are not participants in the shareholders community) is possible. Also disclosing the date of confirmation of the information and the party with whom the information is confirmed (art. 12, para. 2)	(i) Type of business of the issuer (ii) Location of the head office of the issuer (iii) Business outline of the issuer (iv) Whether the issuer has the obligation to submit annual securities reports prescribed in Article 24, Paragraph 1 of the FIEA
Providing information to investors who have applied for participation in the shareholders community (art. 9, para. 3)	(i) Basic information on the issuer, such as the business year, the time of holding an annual shareholders meeting, and the record date regarding voting rights to be exercised at an annual shareholders meeting (ii) Information on the method of receiving or inspecting the issuer information
Providing information concerning the shareholders community issue to an investor other than the participants in the shareholders community at the request of such investor (art. 12, para. 3)	(i) Information officially announced or made available to the public by the issuer of the shareholders community issue or information posted on a web page for viewing by many and unspecified persons (ii) Information for which the issuer of the shareholders community issue has consented to provide to persons other than participants of the shareholders community of the shareholders community issue (iii) Information concerning the contract of the shareholders community issue

To whom and how information is provided	Content of information to be provided
Providing information concerning the shareholders community issue only to participants in the shareholders community or making such information available for inspection only by the participants (art. 14)	(i) Registration statements, annual reports, semiannual reports or extraordinary reports under the FIEA (ii) In the absence of the information mentioned in (i) above, the following information: (a) Financial statements and business reports under the Companies Act (or documents equivalent thereto a public company under the Companies Act is required to prepare) (b) Information compiled in terms of matters that would have been included in "business risks" and "overview of administrative tasks pertaining to shares of the filing company" in the "confidential corporate information" section of an annual report (c) Information compiled in terms of matters that would have been included in the "securities information" section of the securities registration statement (iii) Other information deemed necessary by the Operating Member
Providing information to participants whom the Operating Member solicits for investment when conducting the handling, etc. of private placement of the shareholders community issue (art. 16-2, para. 1)(Note)	Information compiled in terms of matters that would have been included in the "securities information" section of the securities registration statement
Providing information to participants in the shareholders community or making information available for inspection by the participants without delay after conducting the handling, etc. of private placement, etc. of the shareholders community issue (art. 16-2, para. 3)	Information of the fact that the handling etc. of the private placement, etc. is conducted

(Note) Handling of private placement or private secondary distribution, or private secondary distribution

(7) Explanation to Customers

In order to confirm with customers, who are to participate for the first time in a shareholders community operated by an Operating Member (excluding professional investors), that they understand the risks, fees and other matters concerning the act of financial instruments transaction as stated in the documents to be delivered prior to conclusion of contract and that they intend to conduct over-the-counter transactions of the shareholders community issue at their own discretion and responsibility, the Operating Members must prepare in advance a document containing the matters stated in the documents to be delivered prior to conclusion of contract and deliver it to the customers, and then collect a confirmation letter from them regarding the over-the-counter transactions of the shareholders community issue (art. 10).

The delivery and collection of these documents may be performed by electromagnetic means (art. 31).

An Operating Member must also include, in documents to be delivered prior to conclusion of contract to members of a shareholders community who conduct over-the-counter transactions of the shareholders community issue (excluding professional investors), at least the information on risks, etc. involved in the shareholders community issue (including the fact that the issuer is not required to make the same level of disclosure as the disclosure required under the FIEA or the timely disclosure required at an exchange) and deliver such documents to

them while providing them with sufficient explanation on these matters (art. 15, para. 1).

When an Operating Member solicits members of a shareholders community who conduct over-the-counter transactions of the shareholders community issue to invest in the said issue, the Operating Member must notify these members that they may seek an explanation of the details of the information to be provided under Article 14 of these Rules as referred to in (5) above (art. 15, para. 2).

When an Operating Member, while conducting the handling, etc. of private placement, etc. of the shareholders community issue, receives an order for over-the-counter transactions in the shareholders community issue from a participant who is not solicited for investment related to the handling, etc. of private replacement, etc., the Operating Member must explain to the participant that the handling, etc. of private placement, etc. of the shareholders community issue is conducted for other investors (art. 16-2, para. 2).

(8) Withdrawal from a Shareholders Community

An Operating Member shall perform the procedure for a member of a shareholders community to withdraw from the shareholders community upon the member's request for withdraw or on any grounds prescribed in the operational guidelines (art. 11).

(9) Prohibition of Unfair Trading Practices, Etc.

Over-the-counter transactions of a shareholders community issue must be conducted between members of the shareholders community operated by an Operating Member or between such members and the Operating Member (art. 17).

When an Operating Member conducts over-the-counter transactions of the shareholders community issue, it must confirm that these over-the-counter transactions do not violate any provisions of the FIEA or other related laws and regulations, or these Rules (art. 18).

(10) Report and Disclosure of the Status of Transaction

An Operating Member must report to the JSDA the status of over-the-counter transactions of the shareholders community issue that it handles and the handling of public offering, etc. thereof every Monday (or on Monday of the week immediately following the week in which the expiration date of the period for any handling, etc. of offerings falls, with regard to the status of handling, etc. of offerings; if Monday is a holiday, the next business day). The JSDA must disclose the content of such report (art. 29, para. 1 and para. 2).

(11) Establishment of the Operational Control System

An Operating Member must establish internal rules to specify matters provided in these Rules, including matters concerning the examination of the issuer, the requirements and procedures for participation in, withdrawal from and dissolution of a shareholders community, and provision of information to members of a shareholders community, and must also establish systems for carrying out the matters as provided in their internal rules appropriately (art.25, para. 1).

An Operating Member must also prepare operational guidelines based on the provisions of the internal rules, and submit these guidelines to the JSDA and disclose them. An Operating Member must also take these measures when it has changed the content of the operational guidelines (art. 25, para. 2 through para. 4).

(12) Designation as an Operating Member

A Regular Member that seeks to be an Operating Member must file an application with the JSDA 15 business days prior to the day on which it intends to set up a shareholders community, while submitting the operational guidelines, a written oath as an Operating Member, and other necessary documents (art. 26, para. 1 and para. 2).

If the JSDA finds the documents submitted by the Regular Member which has filed the application to be free of defects, it designates the Regular Member as an Operating Member and publicizes this designation. However, the JSDA may refuse to designate the Regular Member as an Operating Member when it is deemed necessary on grounds such as the Regular Member's violation of laws and regulations or the JSDA Rules (art. 26, para. 3 and para. 4).

(13) Revocation of Designation as an Operating Member

An Operating Member that seeks revocation of its designation as an Operating Member must notify the JSDA to that effect five business days prior to the day on which it wishes its designation to be revoked (art. 27, para. 1).

When the JSDA deems it especially necessary on grounds such as an Operating Member's violation of laws and regulations or the JSDA Rules, the JSDA may revoke the designation of the Operating Member or suspend the designation for a certain period without relying on this notification (art. 27, para. 2).

When an Operating Member has its designation as an Operating Member revoked by the JSDA, it must dissolve all shareholders communities it operates immediately (art. 28).

(14) Special Provisions for Delisted Issues

A Regular Member, other than an Operating Member that operates a shareholders community regarding a share certificate or bond with share option that has been delisted by a financial instruments exchange, may conduct solicitation for investment involving the sale by customers on the condition that the Regular Member obtains approval from the Operating Member related to the shareholders community issue to handle the shareholders community issue and conducts the sale and purchase or the intermediary, brokerage or agency service for the sale and purchase (hereinafter referred to as the "brokerage, etc.") on behalf of the Operating Member (art. 32).

In this case, the Operating Member that has given approval must provide the Regular Member undertaking the brokerage, etc. (hereinafter referred to as "Regular Member undertaking brokerage, etc.") with information stated in the document to be delivered prior to conclusion of contract and information stated in the confirmation document concerning over-the-counter transactions in the shareholders community issue (art. 33, para. 1).

A Regular Member undertaking the brokerage, etc. must deliver to the customer who is to sell the shareholders community issue a document to be delivered prior to conclusion of contract that contains information obtained from the Operating Member, provide the customer with information provided by the Operating Member as information required to be provided to investors, and explain such document and information sufficiently to the customer (art. 33, para. 3).

5 Rules Concerning Phoenix Issues

These Rules are prescribed with respect to the "tradable securities" as set forth in FIEA, Article 67-18, Item 4. This section mainly discusses the handling, etc.

For the definition of over-the-counter securities, etc., please refer to the abovementioned description (for details, see 4.5 1 "(1) Breakdown of Over-the-Counter Securities" of this Chapter).

(1) What Is a Phoenix Issue?

Among Over-the-Counter Handled Securities (limited to those issued by an issuing company that meets the qualification prescribed in Article 2, Item 4 (b) or (d) of the Rules Concerning Over-the-Counter Securities), those which were determined by a Regular Member who intended to be a Handling Member to give distribution opportunities to the holders when these were listed on the financial instruments exchange, and designated by the JSDA as securities that an Association Member and a financial instruments intermediary service provider can handle in conducting its solicitation of investments (art.2, item 5). At present, the "tradable securities" prescribed in Article 67-18, Item 4 of the FIEA are limited to Phoenix Issues (art. 1).

Investment solicitations must not be conducted by an Association Member other than a Handling Member and Association Handling Member (hereinafter referred to as a "Handling Member, etc.") except the solicitation of selling Phoenix Issues for the account of the customer (art. 20, para. 1).

(2) Handling Member and Associate Handling Member

A "Handling Member" shall mean a Regular Member designated by the JSDA, after such Regular Member notifies the JSDA that Over-the-Counter Handled Securities shall be Phoenix Issues and the JSDA designates the Over-the-Counter Handled Securities as Phoenix Issues, as a member that is allowed to conduct solicitation for investment in the Phoenix Issues with a Special Member and a financial instruments intermediary service provider entrusted by such Regular Member to carry out financial instruments intermediary service, and that bears obligation as prescribed in the rules of the JSDA (art. 2, item 6).

An "Associate Handling Member" shall mean a Regular Member designated by the JSDA as a member that is allowed to conduct solicitation for investment in Phoenix Issues with a Special Member and a financial instruments intermediary service provider commissioned by such Regular Member to carry out a financial instruments intermediary service, and that bears obligation as prescribed in the rules of the JSDA (art. 2, item 7).

(3) Conditions for Designation as Phoenix Issues

Securities to be designated as Phoenix Issues and their issuer must satisfy all of the following conditions (art. 6, para. 1).

(i) The issuer of the securities has entrusted a shareholder register administrator with clerical work regarding the securities (including the case where the issuer has obtained informal consent from a shareholder register administrator for undertaking such clerical work).

(ii) The issuer of the securities has not imposed any transfer restriction on the securities by the date of designation.

(iii) The issuer of the securities is not an antisocial force and does not have any relationship with any antisocial forces, and it has in place a structure for eliminating antisocial forces.

(iv) The issue of the securities was delisted because the financial instruments exchange considered the delisting to be appropriate due to insufficiency in the issuer's disclosure system or for public interest or investor protection, but such insufficiency in the disclosure system, etc. has been improved, corrected or resolved.

(v) The issue of the securities was delisted by the financial instruments exchange due to the issuer falling into the situation where it needed to go through bankruptcy proceedings, rehabilitation proceedings, or reorganization proceedings, and the relevant proceedings have been completed.

(vi) The issuer of the securities has given consent to a designated book-entry transfer institution to handle its

issue as prescribed in Article 13, Paragraph 1 of the Act on Book-Entry Transfer of Corporate Bonds and Shares or agreed to the matters specified by the designated book-entry transfer institution, or is expected to express such agreement by the time the JSDA designates the issue as a Phoenix Issue.

(4) Consent for Timely Disclosure

Upon designation as a Phoenix Issue, a letter of consent must also be submitted along with the notification of designation as a Phoenix Issue by the issuing company, stating among other things that it will actively cooperate in, *inter alia*, timely and appropriate disclosure of confidential corporate information, as well as an interview conducted by the JSDA (art. 8, para. 1). Furthermore, it must be confirmed by a prescribed document that the issuer is not an antisocial force and has no relationship with antisocial forces, and the copy thereof must be submitted to the JSDA (art. 8, para. 2).

When an issuing company conducts allotment of shares or share options for subscription through third-party allotment, a Handling Member must obtain a confirmation in a prescribed document from the issuing company that the party who is to receive such allotment of shares or share options is not an antisocial force or does not have a relationship with an antisocial force, and must submit its copy to the JSDA (art. 18-2).

(5) Notification and Designation

A notification of a Phoenix Issue must be submitted by a Regular Member who intends to be a Handling Member of such issue, together with an explanatory note on business conditions, etc. and other necessary documents, at least five business days prior to the date when the offering of quotations for the said issue begins (art. 9, para. 1 and para. 3).

If the JSDA confirms that there are no flaws in the documents submitted thereto, it will designate the issue as a Phoenix Issue. At the same time, the JSDA will designate the Regular Member that filed the notification as a Handling Member (art. 9, para. 4).

In the event of a notification of a Phoenix Issue as Associate Handling Member, the Regular Member who intends to be the Associate Handling Member of the issue must file the notification with the JSDA at least five business days prior to the date when the offering of quotations for the said issue begins (art. 11).

(6) Disclosure of Company Information

The Handling Member must submit an explanatory note on business conditions or an annual securities report, which is prepared by the company issuing Phoenix Issues for each accounting term, to the JSDA within three months in principle after the last day of the accounting term of the issuing company. In addition, the matters to be reported as separately prescribed by the JSDA must be reported to the JSDA and disclosed using TDnet (meaning the timely disclosure information communication system that is operated and managed by the JSDA and domestic financial instruments exchanges). The Handling Member, etc. and the JSDA must make these documents available for public inspection for a certain period of time (art. 15 and art. 16).

Furthermore, the Handling Member is responsible for providing guidance to the issuing company of the Phoenix Issue regarding preparation of documents such as the explanatory note on business conditions and other disclosure of company information (art. 14).

(7) Explanation to Customers

Association Members must deliver to customers (excluding professional investors (for details, see the note in

4.5 2 "Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc." in this Chapter)) who engage in transactions of Phoenix Issues a document to be delivered prior to conclusion of contract that describes the characteristics and risks, etc. of investing in Phoenix Issues in simple language, and fully explain the same. Additionally, these parties must collect a "written confirmation concerning a transaction of Phoenix Issue" from customers who engage in such transactions for the first time (excluding customers selling Phoenix Issues) (art. 19).

Furthermore, delivery and collection of these documents may be done through electronic means (art. 40).

When soliciting investments in a Phoenix Issue, an Association Member must give a full explanation regarding the said issue and the issuing company to the customer (excluding qualified institutional investors) using the most recent explanatory note on business conditions and document stating matters to be reported as separately prescribed by the JSDA. Furthermore, in a public offering, etc., where it is necessary to prepare and deliver a prospectus pursuant to the provisions of the FIEA, a full explanation must be given to the customer after delivering the prospectus (art. 20 and art. 21).

Each time an Association Member receives an order from a customer (excluding professional investors) for a Phoenix Issue, the Association Member must divulge that the issue is a Phoenix Issue (art. 22).

(8) Prohibition, Etc. of Unfair Trading Practices

When a Handling Member, etc. or a Special Member that is entrusted by such Handling Member, etc. to carry out financial instruments intermediary service, conducts Over-the-Counter Transactions in Phoenix Issues, the Handling Member, etc. or Special Member must confirm that such Over-the-Counter Transactions do not violate any provisions of the FIEA, other related laws and regulations, and the rules, and must establish internal rules and trading management systems necessary for such purpose (art. 32, para. 1 and para. 2).

(9) Report, Etc. of Quotations and Sale and Purchase

When making notification of designation as a Phoenix Issue, a Handling Member, etc. must choose whether it will update quotations and make reports of sale and purchase daily or weekly, and then must continually display quotes at the trading desks, etc. of its transacting branches each business day for issues that it chooses to announce daily, or at least once each week for issues it elects to announce weekly (art. 35, para. 1).

Additionally, the last quotation and details of over-the-counter transactions must be reported to the JSDA by 5:00 PM each business day for daily announced issues, or by 5:00 PM each Monday (or the following business day if Monday is a holiday) for weekly announced issues (art. 35, para. 3 and para. 5). The JSDA must make public the contents of the quotes and sale and purchase reported by Regular Members (art. 35, para. 7).

(10) Guidance Regarding a Structure for Eliminating Antisocial Forces

Handling Members must provide appropriate guidance to the issuer of a Phoenix Issue with respect to the structure for eliminating antisocial forces prescribed by the said issuer (art. 43).

(11) Revocation of Designation as a Handling Member, Etc.

Handling Members, etc. that desire revocation of their designation as a handling member, etc. must file notice to that effect with the JSDA by the "day preceding the corresponding date of the preceding month" of the date they desire the revocation (art. 36, para. 3).

When a Handling Member falls under matters prescribed by the JSDA (art. 36, para. 5), the JSDA may revoke

the designation as a Handling Member for all applicable issues without the filing of a notice by that Handling Member, and in addition, when the JSDA deems it especially necessary on grounds such as a legal or regulatory violation or violation of JSDA rules, etc., the JSDA may revoke the designation of the Handling Member or suspend the designation for a certain period without relying on this notice (art. 36, para. 6).

When all Handling Members for a Phoenix Issue no longer exist, the designation as a Phoenix Issue will be revoked (art. 37, para. 1).

6 Rules Concerning Sale and Purchase, Etc. of the Listed Share Certificates, Etc. Conducted Outside of a Financial Instruments Exchange Market

The purpose of these Rules is to ensure fair and smooth sale and purchase, and its intermediary services, etc. of the listed share certificates, etc. conducted outside of financial instruments exchange markets by Association Members (for Special Members, limited to those who conduct the financial instruments intermediary service; the same shall apply in these Rules) and fair and smooth sale and purchase of the listed share certificates, etc. for which the intermediary service, etc. is conducted by Association Members outside of financial instruments exchange market, and thereby to contribute to the protection of investors.

(1) Exceptions

These Rules do not apply to: (i) an off-exchange sale and purchase conducted by the Regular Member with a volume of less than one sale-and-purchase unit prescribed by the financial instruments exchange; (ii) a purchase made in the conduct of a certain type of tender offer or sale made in response to such tender offer; (iii) an off-exchange sale and purchase that is conducted in the OTC transactions of derivatives; and (iv) an off-exchange sale and purchase conducted, with the customer's consent, between the customer's account and the account for dealing with the incident in order to cancel the sales and purchase resulting from the incident or perform the obligation in compliance with the purpose of the customer's order (art. 4, para. 1 through para. 4).

(2) Confirmation of Sale and Purchase Price, Etc., and Record Keeping

When an Association Member conducts the off-exchange sale and purchase, it must confirm that the price or the amount of money of the sale and purchase is appropriate and must keep the records of such confirmation (art. 5).

(3) Suspension of Sale and Purchase, Etc.

When an Association Member learns that the financial instruments exchange is suspending or planning for a suspension of the sale and purchase of the said listed share certificates, etc. due to a case where information related to the said Listed Share Certificates, etc. or the issuer, etc. thereof that is deemed to be likely to materially affect the investors' investment judgement is disclosed, if the content of such information is unclear or if the Financial Instruments Exchange deemed it necessary to disseminate the content of such information, the Association Member must not conclude an off-exchange sale and purchase of the relevant listed share certificates, etc. until the financial instruments exchange resumes the sale and purchase (art. 6).

An Association Member must establish the following systems when it intends to conduct an off-exchange sale and purchase of listed share certificates, etc. (excluding an off-exchange sale and purchase conducted under the Approved Business (Note) of an Approved Member(Note)), or intermediary service, etc. thereof (excluding intermediary services, etc. of an off-exchange sale and purchase conducted under the Approved Business of an Approved

Member and intermediary service, etc. by a Participation Member for an Approved Member regarding an order to be executed through the Approved Business of the Approved Member) (art. 6-2).

(Note) "Approved Member" refers to a Regular Member who obtains approval of proprietary trading system operation business (for details, see Volume 1, Chapter 2, 2.2 (1), "(x) Proprietary Trading System (PTS) Operations"). The proprietary trading system operation business conducted by such Approved Member is referred to as the "Approved Business."

(i) System for confirming whether there is the following information:
- **(a) Information concerning the suspension by the financial instruments exchange of the sale and purchase of listed share certificates, etc.;**
- **(b) Information that is found to be likely to materially influence investors' investment decisions; and**
- **(c) Information concerning the suspension by an Approved Member of the sale and purchase of listed share certificates, etc.; and**

(ii) System for suspending an off-exchange sale and purchase of listed share certificates, etc. upon becoming aware of the information referred to in (i)(b) above after trading hours, until the starting time of trading on the financial instruments exchange.

An Approved Member must also have in place a system for confirming the existence of the information referred to in (i)(a) during the hours for handling the Approved Business, and a system for suspending an off-exchange sale and purchase under the Approved Business immediately if there is any information that is found to be likely to materially influence investors' investment decisions and the content of such information is unclear (art. 6-4, para. 1 and para. 2). If an Approved Member suspends an off-exchange sale and purchase of listed share certificates, etc. under the Approved Business, it must immediately publicize the relevant particulars, such as the issue subject to the suspension of sale and purchase and the period of suspension, by such method as making them freely accessible from the outside (art. 6-4, para. 3).

The JSDA may suspend an off-exchange sale and purchase to be conducted by a Regular Member and an off-exchange sale and purchase for which an Association Member conducts intermediary service, etc. if it deems necessary and appropriate to do so for public interest or protection of investors (art. 6-5).

(4) Establishment, Etc. of Administration System for Short Sale in the Proprietary Trading System

When an Approved Member conducts a short sale in the proprietary trading system (FIEAEO, Article 26-2-2, Paragraph 7), it must fully establish a method and system to eliminate sale and purchase, etc. that may harm the fairness of a short sale, and describe such method and system in the business operation procedure document (FIEA, Article 30-3, Paragraph 2) (art. 6-6, para. 1).

A short sale conducted in the proprietary trading system is subject to the short selling restrictions under laws and regulations (for details, see Chapter 3, 3.1 (4) "(ii) Short Selling Restrictions"). When an Approved Member conducts a short sale in the proprietary trading system and receives an order for short sale from its customer (excluding a Participation Member; the same shall apply in these Rules), it shall be subject to the same level of restrictions as short sale restrictions applicable to members of a financial instrument exchange, such as obligation to

take settlement measures and to make clear statement and confirmation of conducting a short sale (art. 6-6, para. 2).

(5) Handling of PTS Margin Transactions by Approved Members

When an Approved Member handles PTS Margin Transactions, it must establish and publish Operational Rules for PTS Margin Transactions which provide for the scope of Participating Members who may handle PTS Margin Transactions, the hours when PTS Margin Transactions are available, and the criteria for selection of issues for PTS Standardized Margin Transactions and issues for Loans for PTS Margin Transactions, and have its Participating Members comply with such rules. As the details and criteria for implementing regulatory measures for PTS Margin Transactions, an Approved Member must provide in these rules that measures to restrict or prohibit PTS Margin Transactions shall be taken with regard to issues for which Tokyo Stock Exchange, Inc. has taken measures to restrict or prohibit margin transactions, and issues for which a securities finance company designated by the Approved Member has taken action such as giving a warning notice concerning the use of lending shares, etc. (art. 6-7).

When a Regular Member that is not a Participating Member conducts PTS Margin Transactions, the Participating Member must notify such Regular Member of the Operational Rules for PTS Margin Transactions established by the Approved Member for whom the Participating Member conducts brokerage for the transaction order and ensure that the Regular Member complies with the Operational Rules for PTS Margin Transactions (art. 6-8).

Furthermore, when a Regular Member's customer intends to open an account for PTS Margin Transactions, the Regular Member receives an "Agreement on PTS Margin Transactions" from the customer, in addition to an "Agreement for Establishment of a Margin Transaction Account" designated by Tokyo Stock Exchange, Inc. (art. 6-9).

(6) Reporting and Publication

(i) In the case where a Regular Member (excluding an Approved Member; hereinafter the same applies in (6)) makes, outside of a financial instruments exchange market, an application for sale or purchase of the listed share certificates, etc. to a large number of persons simultaneously, it must report the name of the issues and the highest prices if the application pertains to purchase or the lowest price if the application pertains to sale, together with the volume and other matters pertaining to the application through the report and publication system to the JSDA (art. 7, para. 1). If an Approved Member makes such application through the Approved Business, it must report the name of issues and the highest prices as of the date of application if the application pertains to purchase or the lowest price as of the date of application if the application pertains to sale, together with the volume and other matters pertaining to the application through the report and publication system to the JSDA (art. 10, para. 1).

(ii) In cases where an off-exchange sale and purchase has been concluded, a Regular Member must report name of issues, sale and purchase price, sale and purchase volume, etc., to the JSDA through the report and publication system (art. 7, para. 2). The same applies when an Approved Member executes sale and purchase through the Approved Business (art. 11, para. 1).

(iii) A Regular Member must report as mentioned in (i) and (ii) above, at the time specified as follows for each type of transaction: (a) with respect to the sale and purchase applied and concluded from 8:10 a.m. to 4:59 p.m.: within five minutes from the time when the application is made or the sale and purchase is concluded; (b) with respect to the sale and purchase concluded from 5:00 p.m. to 11:59 p.m. or the sale

and purchase concluded on a non-business day: from 8:10 a.m. to 8:29 a.m. of the next business day; and (c) with respect to sale and purchase concluded from 0:00 a.m. to 8:09 a.m.: from 8:30 a.m. to 9:00 a.m. of the next business day (art. 7, para. 3). An Approved Member must make a report mentioned in (i) by 8:30 a.m. of the business day following the date of application and a report mentioned in (ii) by 8:30 a.m. of the business day following the date of conclusion of the sale and purchase (art. 10, para. 2, art. 11, para. 3).

(iv) When the JSDA receives a report as prescribed in (i) or (ii) from a Regular Member, the JSDA will notify other Regular Members and publicize the contents thereof at the prescribed timing (art. 9, para. 1 and para. 2).

(v) When the JSDA receives a report as prescribed in (i) or (ii) from an Approved Member, the JSDA will notify other Approved Members without delay (art. 14, para. 1 and para. 2).

(vi) The JSDA sums up the information obtained by way of the reports mentioned in (i) and (ii) which it considers necessary and publicizes such information on a daily basis (art. 9, para. 3 and para. 4, and art. 14, para. 3 and para. 4).

(7) Availability of the Price, Etc. of Off-Exchange Sale and Purchase Through Approved Business

If an Approved Member makes an application for or concludes sale and purchase through the Approved Business, it must make the designated information available for inspection within five minutes from the application or from the conclusion of sale and purchase, by a designated method (art. 17-2 and art. 17-3):

(8) Explanation to Customers

In cases where an Association Member receives an order concerning the off-exchange sale and purchase from a customer, it must explain in advance to the customer the matters prescribed in (i) and (ii) below, depending on the category set forth in (i) and (ii) below (art. 18):

(i) In cases where the Association Member receives a short sale order that is to be conducted in the proprietary trading system:
- **(a) Conditions of delivery and settlement;**
- **(b) Handling of short sale transactions (matters concerning the settlement measures and clear confirmation by the Approved Member regarding a short sale, as described in (4) above); and**
- **(c) Other matters deemed necessary by the Association Member;**

(ii) In cases other than (i) above:
- **(a) Conditions of delivery and settlement; and**
- **(b) Other matters deemed necessary by the Association Member.**

7 Rules Concerning Underwriting, Etc. of Securities

Underwriting means, at the time of public offering, secondary distribution or private placement or exclusive offer to sell, etc. for professional investors of securities, either concluding a contract for acquiring all or part of the securities for the purpose of having other persons acquire them (firm commitment), or, with regard to all or part of securities, promising to acquire all of the remaining securities which are not acquired by another person (standby

commitment), or concluding a contract for acquiring the share option certificates whose share options are yet to be exercised and exercising such share options by itself or a third party, where the relevant securities are share option certificates and the person who has acquired the share option certificates does not exercise the share options for all or part of such certificates (commitment of a commitment-type rights offering), and is one category of the financial instruments business (FIEA, art. 2, para. 6, and para. 8, item 6).

The purpose of these Rules is to ensure proper business operations and protection of investors and to contribute to sound development of the capital market with respect to the underwriting of public offerings or secondary distributions of share certificates, etc. and company bonds, etc. in Japan by Regular Members, and handling of public offerings or secondary distributions of share certificates, etc. in Japan by Association Members.

A summary of these Rules is set forth below:

(1) Conduct of Appropriate Underwriting

When a Regular Member Underwriter conducts the underwriting, it must secure a necessary and sufficient period of time to implement the underwriting examination and make an underwriting judgment with a comprehensive judgment and responsibility based on the result of the underwriting examination implemented pursuant to the rules (art. 3).

(2) Development of Underwriting System

(i) Ensuring the Independency of Underwriting Examination

A Regular Member Underwriter must have the personnel structure that enables him or her to implement a proper underwriting examination and in principle must also have an organization system that satisfies the following requirements in order to form examination opinions that are independent from the underwriting promotion section and the underwriting examination section (art. 5):

(a) Establishing an underwriting examination section;
(b) Persons who conduct the underwriting examination in the underwriting examination section shall not be involved in the underwriting promotion business or the underwriting business; and
(c) Officers in charge of the underwriting examination section shall not be responsible for the underwriting promotion section or underwriting section.

(ii) Development of Internal Rules and Internal Manual for the Underwriting Examination, Etc.

A Regular Member Underwriter must develop internal rules in which items to be examined at the time of underwriting examination (hereinafter referred to as "Underwriting Examination Items") and matters that are necessary to properly examine these items are defined, and establish an internal manual that describes procedures for examining the Underwriting Examination Items (art. 6).

(iii) Preparation and Retention of Internal Records

Regular Member Underwriters must preserve for five years the materials, etc. collected in the underwriting examination, the contents of the analysis and evaluation of the said materials, etc. as well as the record created pertaining to the process of forming the underwriting judgment, etc. (art. 7).

(iv) Implementation of Inspection or Audit

A Regular Member Underwriter must implement an inspection or audit on the following Items on a regular

basis (art. 8):

(a) Compliance with the internal rules concerning underwriting examination; and
(b) Proper compliance with the internal manual concerning underwriting examination.

(3) Implementation of Proper Underwriting Examination

(i) Proper Underwriting Examination

When a Regular Member Underwriter conducts Underwriting, its underwriting examination section must conduct a strict underwriting examination on the Underwriting Examination Items prescribed in these Rules. When carrying out the underwriting examination, in principle, the Regular Member Underwriter must receive underwriting examination materials with a sufficient period prior to conducting underwriting examination, and must also receive a comfort letter (an examination report concerning the issuer of the share certificates or corporate bonds prepared by the auditor, which has stated matters and contents, etc. that are prepared in conformance with the Outline of "Letter to an Administrative Underwriting Manager Securities Company from an Audit Corporation" (The Japanese Institute of Certified Public Accountants, Japan Securities Dealers Association) from the auditor in order to carry out examinations, etc. pertaining to the accuracy of the financial information stated in the securities registration statement, etc., and later fluctuations in the said financial information (art. 12, para. 1, para. 2 and para. 5; Detailed Rules Relating to the Rules Concerning Underwriting, Etc. of Securities (hereinafter referred to as the "Detailed Underwriting Rules", art. 6 and art. 7).

(ii) Cooperation between the Lead Managing Regular Member Underwriter and Other Regular Member Underwriter

The Lead Managing Regular Member Underwriter must provide, etc. the materials and information necessary for the underwriting examination to other Regular Member Underwriters sufficiently ahead of time and must to the extent possible cooperate with the said other Regular Member Underwriters' underwriting examinations (art. 13, para. 1; Detailed Underwriting Rules art. 8).

(iii) In case of Replacement, etc. of the Lead Managing Regular Member Underwriter

Upon carrying out the underwriting examination, if the Lead Managing Regular Member Underwriter has come to know that there is a replacement of the previously planned Lead Managing Regular Member Underwriter for such project subject to underwriting examination, a replacement of the auditor, or a change in the financial instruments exchange market for which it was planned to apply for listing, along with confirming the reason for this with the issuer, the lead managing member must sufficiently consider the reasonableness of the details of the said confirmation (art. 14).

(iv) Actions after the Completion of Underwriting Examination

Where the issuer makes public disclosure of a material fact immediately after an initial public offering, the Lead Managing Regular Member Underwriter, etc. must confirm with the said issuer whether or not the said fact occurred prior to the initial public offering and whether or not there was any falsehood in the explanation from the said issuer during the course of the underwriting examination, and must verify whether the disclosures in the securities registration statement, etc. at the time of the initial public offering were appropriate (art. 15, para. 1).

Where as a result of this verification it becomes clear that there was a material difference between disclosures in the securities registration statement, etc. and the business circumstances, etc. of the issuer at the time of the underwriting examination, the Lead Managing Regular Member Underwriter must request the issuer

to make a sufficient explanation of that reason to investors (art. 15, para. 2).

(4) Measures Toward the Elimination of Antisocial Forces

A Regular Member Underwriter must prescribe matters necessary in the wholesale underwriting contract executed between the issuer and the seller (hereinafter "issuer, etc." in these Rules) such as the undertaking that the issuer, etc. is not an antisocial force, etc. (art. 8-2).

In addition, a Regular Member Underwriter must confirm in the underwriting examination whether or not the issuer, etc. is an antisocial force or related to an antisocial force, and if as a result of the confirmation the issuer, etc. is found to be an antisocial force or related to an antisocial force, it must not enter into the wholesale underwriting contract (art. 8-3, para. 1 and para. 2).

If a Regular Member Underwriter finds that the issuer, etc. is an antisocial force after the execution of the wholesale underwriting contract, it must not underwrite securities pursuant to the said contract (art. 8-3, para. 3)

(5) Determination of Fair Terms and Conditions

(i) Determination of Proper Terms and Conditions

A Regular Member Underwriter must, upon underwriting securities, determine proper terms and conditions concerning the public offering or secondary distribution in terms of the market conditions by means such as investigating investment demands as necessary, and refrain from underwriting securities with significantly improper volumes, prices or other terms and conditions (art. 24).

(ii) Determination of Prices, Etc. by Book Building

In cases where the book building method is used (meaning the researching of the status of demand by investors) upon underwriting share certificates, etc. or corporate bonds, etc., the Regular Member Underwriter must determine a policy for ascertaining indications of interest and conduct its research based on this policy. In conducting their research, Regular Member Underwriters must be aware that statements clearly falling under those not based on investors demand, excessive statements made in order to garner more share of the offering or multiple statements based on the demand from a single investor will not be counted for this purpose. Additionally, if a Regular Member Underwriter discovers an overlap in the statements received from other Regular Member Underwriter, it shall deliberate with the other Regular Member Underwriter to resolve the overlap (art. 25; Detailed Underwriting Rules, art. 14).

In the process of determining the IPO price by book building at the time of the initial public offering, when a Regular Member Underwriter determines an IPO price that exceeds the upper limit price or falls below the lower limit price under the tentative terms and conditions (hereinafter referred to as the "IPO price beyond the range of tentative terms and conditions") and changes the number of shares concurrently with determining the IPO price, the Regular Member Underwriter is not required to conduct book building again if the IPO price and the number of shares are within a certain range (Note) separately specified by the JSDA (Detailed Underwriting Rules, art. 15, para. 1).

(Note) The "certain range separately specified by the JSDA" means the range that satisfies all of the following:
(i) The IPO price is determined within the range between 80% or more of the lower limit price and not more than 120% of the upper limit price under the tentative terms and conditions;
(ii) The number of shares for secondary distribution to be determined is between 80% and 120%

of the "number of shares for secondary distribution at the time of setting tentative terms and conditions"; and

(iii) The size of the offering to be determined (the number of shares (number of shares for public offering + number of shares for secondary distribution) × IPO price) is within the range between 80% or more of "the lower limit price under the tentative terms and conditions × the number of shares at the time of setting the tentative terms and conditions" and not more than 120% of "the upper limit price under the tentative terms and conditions × the number of shares at the time of setting the tentative terms and conditions."

If a Regular Member Underwriter determines the IPO price beyond the range under the tentative terms and conditions or changes the number of shares, the Regular Member Underwriter must confirm that the following information is contained in the securities registration statement and prospectus (Detailed Underwriting Rules, art. 15, para. 2):

(i) The possibility that an IPO price beyond the range under the tentative terms and conditions may be determined without conducting book building again, and the range of the IPO price; and

(ii) The possibility that the number of shares may be changed without conducting book building again, and the range of the number of shares.

If a Regular Member Underwriter determines the IPO price beyond the range under the tentative terms and conditions or changes the number of shares, the Regular Member Underwriter must explain the following matters to the investors before the IPO price is determined (Detailed Underwriting Rules, art. 15, para. 3):

(i) The possibility that an IPO price beyond the range under the tentative terms and conditions may be determined without conducting book building again within the range specified in the securities registration statement and prospectus, the range of the IPO price that may be determined, and the method by which the investors can confirm the determined IPO price; and

(ii) The possibility that the number of shares may be changed concurrently with determining the IPO price without conducting book building again within the range specified in the securities registration statement and prospectus, the range of the number of shares that may be changed, and the method by which the investors can confirm the determined number of shares.

(iii) Consulting about the Underwriting Ratio and Confirmation of Adequacy of Prices, Etc. at the Time of Initial Public Offering

A Lead Managing Regular Member Underwriter must consult with the issuer, etc. when determining the underwriting ratio of the Lead Managing Regular Member Underwriter upon underwriting of shares certificates, etc. in a public offering or secondary distribution concerning initial public offerings (such underwriting ratio means the ratio of the volume of share certificates, etc. to be underwritten by the Lead Managing Regular Member Underwriter to the volume of share certificates, etc. subject to the public offering or secondary

distribution) (art. 26, para. 1).

In addition, when determining the assumed price (if the assumed price is not specified in the securities registration statement, the appraised amount of corporate value applies; the same applies in hereinafter), temporary conditions or initial offering price upon underwriting of shares certificates, etc. in a public offering or secondary distribution concerning initial public offerings, a Lead Managing Regular Member Underwriter must confirm the appropriateness of such price or the price range, etc. at a division or a committee that does not have a close business relationship with the issuer, etc. or the investor, and explain the basis for these prices or price range to the issuer, etc. (art. 26, para. 2).

(iv) Development of Internal Rules and Internal Manual for the Determination of IPO Price, Etc.

The Regular Member Underwriter must prescribe the following matters in its internal regulations upon underwriting share certificates, etc. in a public offering or secondary distribution concerning initial public offering of share certificates, etc. However, this shall not apply to the following matters which the procedures concerning the said matter will not be performed (art. 27):

(i) Matters necessary for adequately determining the assumed price;
(ii) Matters necessary for adequately determining the temporary conditions;
(iii) Matters necessary for adequately using the book-building method;
(iv) Matters necessary for adequately implementing competitive bids;
(v) Matters necessary for adequately determining the initial offering price; and
(vi) Other necessary matters.

(6) Over-Allotment

"Over-allotment" means, in connection with a public offering or secondary distribution for share certificates, etc., the Regular Member Underwriter's selling additional shares at the same terms and conditions in addition to the scheduled volume of such public offering or secondary distribution; provided, however, in the case of public offering or secondary distribution of foreign share trust beneficiary certificates or foreign infrastructure fund beneficiary certificates, over-allotment refers to the Regular Member Underwriter's selling additional units at the same terms and conditions in addition to the scheduled volume of such public offering or secondary distribution (art. 2, item 20).

If the Regular Member Underwriter has temporarily borrowed shares from the issuing company or large shareholders, etc. in order to procure share certificates, etc. for an additional secondary distribution by the over-allotment, it should return these borrowed shares through the exercise of the green shoe option or by those share certificates, etc., acquired in the syndicate cover transactions.

The total over-allotment volume (in cases where a public offering or secondary distribution is conducted in Japan and in a foreign country simultaneously, including the volume of the public offering or secondary distribution conducted in the foreign country that is similar to over-allotment) must be limited to 15% of the volume of the public offering or secondary distribution (in cases where a public offering and secondary distribution are conducted simultaneously, the sum of the volume of the public offering and volume of secondary distribution; in cases where a public offering or secondary distribution is conducted in Japan and in a foreign country simultaneously, the sum of the volumes of the public offering or secondary distribution in Japan and in the foreign country) (art. 29, para. 1).

A "green shoe option" is the option granted to a Regular Member Underwriter upon the execution of a

wholesale underwriting contract that allows the Regular Member Underwriter to purchase share certificates, etc. of the same issue as the share certificates, etc. pertaining to a public offering or secondary distribution from the issuer or holder (in the case of a public offering or secondary distribution of foreign share trust beneficiary certificates, the holder of foreign share certificates that are the entrusted securities provided for in FIEAEO, Article 2-3, Item 3; in the case of a public offering or secondary distribution of foreign infrastructure trust beneficiary certificates, the holder of the foreign infrastructure funds that are the entrusted securities provided for in the said item) (art. 2, item 21).

A "syndicate cover transaction" is the buying back of the shares subject to the public offering or secondary distribution by a Regular Member Underwriter in its own account who exercised the over-allotment, which is conducted after the public offering or secondary distribution period in order to reduce the short position resulting from the over-allotment (art. 2, item 22).

(7) Commitment-Type Rights Offering

"Commitment-type rights offering" means, among the method of capital increase in which a listed issuer makes allotment of share options without contribution pursuant to the provisions of Article 277 of the Companies Act or allotment of investment equity subscription rights without contribution pursuant to the provisions of Article 88-13 of the Act on Investment Trusts and Investment Corporations, the exercise of share options or investment equity subscription rights yet to be exercised by a Regular Member Underwriter or a third party that acquires the relevant share options or investment equity subscription rights from the Regular Member Underwriter, based on the contract provided for in Article 2, Paragraph 6, Item 3 of the FIEA (art. 2, item 25).

Where a Regular Member Underwriter acquires new share option certificates or investment equity subscription right certificates from a listed issuer or another Regular Member Underwriter in the course of the business of underwriting commitment-type rights offering, the relevant Regular Member Underwriter must, immediately after the acquisition, disclose the state of acquisition of share option certificates or investment equity subscription right certificates by a prescribed method (art. 30, para. 1). A Regular Member Underwriter must not exercise the voting rights of share certificates acquired by exercising the share options of the relevant share option certificates or the investment securities acquired by exercising investment equity subscription rights of the relevant investment equity subscription right certificates at the shareholders meeting or the investors meeting for which a record date (meaning the record date as prescribed in Article 124, Paragraph 1 of the Companies Act or the record date as prescribed in Article 77-3, Paragraph 2 of the Act on Investment Trusts and Investment Corporations) has been established during the period until 60 days pass from the day of acquisition (art. 31).

A Lead Managing Regular Member Underwriter must request the listed issuer to publicize the volume of share option certificates or investment equity subscription right certificates transferred to each Regular Member Underwriter in press release materials (art. 30, para. 2).

In cases where underwriting a commitment-type rights offering for which the exercise of share options or investment equity subscription rights by shareholders or investors residing in a specific foreign country is restricted, the Regular Member Underwriter must carry out underwriting examination from the perspective of finding whether or not there are any factors that hinder the liquidity of the share option certificates or investment equity subscription right certificates in a financial instruments exchange market (art. 32).

(8) Handling of Transactions by Officers of Listed Issuer

The Lead Managing Regular Member Underwriter must not underwrite the public offering or secondary

distribution of share certificates, etc. (in the case of real estate investment trust securities, limited to those that fall within the category of investment securities; in the case of infrastructure funds, limited to those that fall within investment securities or foreign investment securities; and in the case of foreign infrastructure fund beneficiary certificates, limited to those for which the entrusted securities are foreign investment securities) if it is found that an officer of a listed issuer has traded the share certificates, etc. issued by such listed issuer while knowing that a public offering or secondary distribution of share certificates, etc. issued by the said listed issuer before the information concerning the public offering or secondary distribution is publicly disclosed (art. 34, para. 1).

The Lead Managing Regular Member Underwriter must, if it is found that an officer of a listed issuer has conducted transactions in share certificates, etc. issued by the said listed issuer during the preparation time of the public offering or secondary distribution of share certificates, etc., confirm for each instance by a document from the listed issuer that such transaction was not conducted by the officer while knowing that a public offering or secondary distribution of share certificates, etc. that has not been announced will be conducted (art. 34, para. 2).

In addition, when the Lead Managing Regular Member Underwriter is to underwrite a primary offering or a secondary distribution of share certificates, etc. by a listed issuer, if it is found that the Lead Managing Regular Member Underwriter that the listed issuer planned to designate was changed, the Lead Managing Regular Member Underwriter shall confirm with the listed issuer in writing that the plan to make a public offering or a secondary distribution of share certificates, etc. by the listed issuer was not cancelled pursuant to the provisions of Article 34, Paragraph 1 of these Rules during the 6 months prior to the date (limited to a date that will be announced) determined by the organ determining the execution of business of the listed issuer concerning the public offering or secondary distribution (art. 34, para. 3).

If the Lead Managing Regular Member Underwriter cancels an underwriting pursuant to the provisions of Article 34, Paragraph 1 of these Rules, it must not underwrite the public offering or a secondary distribution of share certificates, etc. issued by such listed issuer until 6 months have elapsed (with respect to a secondary distribution, until the period determined as appropriate by the Lead Managing Regular Member Underwriter in light of the individual case has elapsed) from the date of the transaction conducted by the officer of such listed issuer to the date (limited to a date that will be announced) determined by the organ determining the execution of business of the listed issues concerning the public offering or secondary distribution of share certificates, etc. to be newly made by the listed issuer (art. 34, para. 4).

(9) Handling in Case of Information Leakage, Etc.

When the Regular Member Underwriter intends to underwrite a public offering or secondary distribution of share certificates, etc. issued by a listed issuer and it is found that the confidential corporate information related to such public offering or secondary distribution was leaked by an officer or employee of the Regular Member Underwriter (excluding the cases where such leakage is necessary for its business operations and the necessary procedures have been performed) before the information on such public offering or secondary distribution is publicly disclosed, the Regular Member Underwriter must not underwrite such public offering or secondary distribution. However, this does not apply if the Regular Member Underwriter reports such leakage to the listed issuer, and the listed issuer requests the Regular Member Underwriter to conduct the underwriting. In such case, the Regular Member Underwriter must report the leakage and the request to the Lead Managing Regular Member Underwriter (art. 34-2, para. 1).

When the Lead Managing Regular Member Underwriter underwrites the share certificates, etc. issued by a listed issuer, it must discuss the date of public offering or secondary distribution with the listed issuer if any of the

following situations arises before the information on such public offering or secondary distribution is publicly disclosed:

(i) it is found that a transaction of the share certificates, etc. issued by the listed issuer was conducted by a person who knows an undisclosed plan of public offering or secondary distribution (excluding the case that falls under Article 34, Paragraph 1 or Article 34-2, Paragraph 1 of these Rules); or

(ii) the share price of the listed issuer or the price of real estate investment trust securities (limited to those that fall within the category of investment securities), infrastructure funds (limited to those that fall within investment securities or foreign investment securities), venture funds or foreign infrastructure fund beneficiary certificates (limited to those for which the entrusted securities are foreign investment securities) sharply declines (art. 34-2, para. 2).

(10) Underwriting Terms

The Lead Managing Regular Member Underwriter shall, upon underwriting share certificates, etc., with respect to share certificates, etc., confirm the investment activities of the allottees of the capital increase through the third party allotment conducted immediately preceding (limited to those conducted within 5 years prior to the day on which payment for the public offering was made), subsequent to the allotment concerning the share certificates, etc., and if it is discovered that the matters disclosed with respect to the holding policy upon the immediately preceding capital increase through third party allotment and the investment activities of the allottees thereafter are different, it must not underwrite the share certificates, etc. until the details thereof have been announced (art. 35).

(11) Underwriting Not Pursuant to These Rules, Etc.

Upon underwriting a secondary distribution which does not require the preparation of a prospectus, measures the Regular Member Underwriter deems necessary shall be taken by paying regard to the rules (art. 36, para. 1).

8 Rules Concerning Distribution, Etc. to Customers Related to Underwriting, Etc. of Public Offering, Etc. of Share Certificates, Etc.

These Rules have been provided with the purpose of achieving the smooth selling of share certificates, etc., fair distribution to customers, and proper management of business with attention paid to the actual market conditions, by specifying necessary matters concerning the distribution to customers and the provision of information to issuers, etc. conducted by Association Members when performing the underwriting, etc. of public offerings, etc. of share certificates, etc. (art. 1).

The outline of the rules is as follows:

(1) Fair Distribution

In conducting an underwriting, etc. of public offerings, etc., an Association Member must endeavor to make the distribution of share certificates in relation to the underwriting, etc. of public offerings, etc. fair and not to make it excessively skewed to specific investors without reasonable grounds, by sufficiently taking into consideration the actual conditions of the market and trends in the investment demands, etc. (art. 2, para. 1).

(2) Sales to Purchasers That Are Designated by the Issuing Company ("*Oyabike*")

In conducting an underwriting of public offering or secondary distribution of share certificates, etc., a Regular Member Underwriter shall not conduct sales to purchasers that are designated by the issuing company ("*oyabike*",

meaning the sales to purchasers designated by the issuer specified in Article 1-2, Item 14 of these Rules, and including substantially similar acts such as suggesting candidates for purchasers; hereinafter the same shall apply in these Rules) unless it satisfies all of the following requirements (art. 2, para. 2).

(i) The Regular Member Underwriter has judged that the distribution would not be made in violation of (1) above, even if the said *oyabike* was conducted;
(ii) The issuer makes an appropriate publication of necessary matters regarding the relevant *oyabike*; and
(iii) The Lead Managing Regular Member Underwriter obtains from the planned purchaser of the *oyabike* a commitment that it will continuously hold the relevant share certificates until the day on which 180 days has passed from the due date of payment or last day of payment period for public offering or the due date for delivery for secondary distribution (lock-up).

(3) Concurrent Allocation to Third Parties

"Concurrent allocation to third parties" means the allocation to third parties the share certificates, etc. which are issued by the issuer thereof, that is made concurrently with the public offering or secondary distribution of share certificates underwritten by the Regular Member Underwriter.

In cases where a concurrent allocation to third parties is to be made, a Regular Member Underwriter must require the issuer to conduct the concurrent allocation to third parties by paying regard to the purpose mentioned in (2) above (excluding (ii)) (art. 2, para. 3).

(4) Partial Distribution by Drawing at the Initial Public Offering

When an Association Member distributes share certificates or beneficiary certificates of foreign share trusts to retail customers at the time of initial public offering, in principle, it shall determine the distributees by drawing for 10% or more of the quantity that is to be distributed by the Association Member to retail customers. However, where the demand for book building is not sufficiently accumulating or where the number of retail customers' applications received by an Association Member does not reach the quantity that is planned for distribution to retail customers by the Association Member, the Association Member may either decrease the ratio for drawing, or may choose not to adopt the distribution by drawing or cancel the distribution by drawing (art. 3).

(5) Prohibition of Centralized Distribution and Unfair Distribution at the Initial Public Offering

In cases where an Association Member distributes share certificates or beneficiary certificates of foreign share trusts to retail customers at the initial public offering under a method other than drawing, it must not excessively centralize the distribution or conduct an unfair distribution to a specific customer. The Association Member must pay attention that the distribution to each customer by means other than drawing should not be excessive compared with the average quantity distributed by drawing to each customer, and must not repeatedly distribute to the same customer (art. 4).

(6) Provision of Information on Demand and Share-Distributed Entity Information

The Joint Lead Managing Regular Member Underwriter and other Regular Member Underwriters must provide without delay to the Representative Lead Managing Regular Member Underwriter with demand and share-

distributed entity information (information set forth in (i) to (iii) below) concerning the customers (a bank, insurance company or non-resident, etc. (excluding individuals)) (art. 5, para. 1 and para. 2).

(i) The names of the customers to whom the roadshow (a series of opinion hearings) was conducted, the assumed share price of the share certificates, etc. as part of the customers' opinions, information on their intention to participate in the public offering or secondary distribution, and other information that is deemed helpful by the Regular Member Underwriter in determining the tentative terms and conditions;

(ii) The names of the customers to whom the book building was conducted, and information on the demand price and volume of share certificates, etc. reported by the customers; and

(iii) The names of the customers to whom the underwritten share certificates, etc. are distributed (excluding the case of distribution by *oyabike*) and information on the volume of the share certificates, etc. distributed to the customers.

When acquiring demand and share-distributed entity information, the Regular Member Underwriter shall inform the customers in advance that the relevant information will be provided to the issuer, etc. (meaning the issuer (Note) and the secondary distributor designated by the issuer through consultation with the Representative Lead Managing Regular Member Underwriter; the same applies hereinafter) (art. 5, para. 3).

(Note) The "issuer" includes the asset management company of the investment corporation which is the issuer of real estate investment trust certificates, the asset management company of the investment corporation which is the issuer of infrastructure funds, and the asset management company of the investment corporation which is the issuer of venture funds.

A Regular Member Underwriter shall inform the customers in advance that they can make a request to refuse the provision of their names as part of the information mentioned in (i) above, and if such request is made, the Regular Member Underwriter shall provide the name of the requesting customer under anonymity (art. 5, para. 4).

The Representative Lead Managing Regular Member Underwriter must provide the issuer, etc. of the share certificates, etc. without delay with the demand and share-distributed entity information concerning the customer that it has acquired as well as the demand and share-distributed entity information that it has received from the Joint Lead Managing Regular Member Underwriter and other Regular Member Underwriters (art. 6).

In cases where the issuer, etc. receives the demand and share-distributed entity information, the Representative Lead Managing Regular Member Underwriter must receive a commitment in writing from the issuer, etc. to the effect that the issuer, etc. would properly manage the demand and share-distributed entity information without any leakage (art. 8).

(7) Basic Policy of Distribution

In conducting an underwriting, etc. of public offering, etc., an Association Members must prepare a basic policy on distributing share certificates, etc. to investors, in advance, and disseminate the detailed contents of such basic policy to the investors by appropriate means such as the displaying it on its branch offices/sales counters or uploading it on its website (art. 9, para. 1 and para. 3).

The basic policy must be prescribed concretely and in an easy-to-understand manner for investors, the ratio of

quantity under drawing, handling of drawing, possibility of decreasing the ratio for drawing or not adopting or canceling the distribution by drawing, if any, and the handling of distribution by means other than drawing (art. 9, para. 2).

An Association Member must submit the basic policy to the JSDA if it so requires (art. 9, para. 4).

(8) Internal Rules Concerning Distribution, Etc.

An Association Member must establish internal rules concerning the distribution, etc. of share certificates, etc. subject to the underwriting, etc. of public offering, etc. and comply with them (art. 10, para. 1).

The internal rules must prescribe in detail and concretely the customers, etc. that are not allowed to apply for the distribution, handling of distribution related to hot issues, handling of distribution when the equity market environment deteriorates, and internal inspection procedures in addition to the contents of the basic policy prescribed in (7) above (art. 10, para. 2).

An Association Member must submit the internal rules to the JSDA if it so requires (art. 10, para. 3).

(9) Enhancement of Internal Administration System

An Association Member must regularly inspect whether the distribution, etc. of share certificates, etc. under the underwriting, etc. of public offering, etc. was properly conducted pursuant to its internal rules under the responsibility of the internal administration supervisor (art. 11).

(10) Retention, Etc. of Record

An Association Member must retain the record concerning distribution of individual issues, record concerning quantity under drawing (including the reason for decreasing the ratio of quantity under drawing, not adopting the drawing or cancelling the drawing, if any), and record concerning results of inspection set forth in (9) above, for five years so that an external audit and inspection, etc. are conducted properly (art. 12).

(11) Announcement of Distribution Condition

A Regular Member must collect the information on distribution of share certificates, etc. underwritten by it on a quarterly basis, analyze the information and report the result of the analysis to the JSDA (art. 13, para. 1).

An Association Member must summarize the distribution condition of share certificates, etc. of foreign share trust beneficiary certificates to retail customers at the initial public offering on a monthly basis, analyze it, and report it to the JSDA by the month after the next month in which the payment due date falls (art. 13, para. 2).

The JSDA shall regularly announce to the general public the distribution condition reported (art. 13, para. 3).

9 Rules Concerning Handling of Allotment of New Shares to Third Party, Etc.

The purpose of these Rules is to prescribe matters that should be complied with when purchasing share certificates, etc. relating to the allotment of new shares to third party, etc., and to ensure that secondary market transactions concerning MSCBs, etc., and the exercise of share options, etc. are conducted in a fair and smooth manner, thereby contributing to the sound development of capital markets. (art. 1).

The “allotment of new shares to third party, etc.” means public offering or secondary distribution of share certificates, share option certificates and bonds with share options by way of allocation to a third party (art. 2, item 1).

The “purchase” upon the allotment of new shares to third party, etc. means acquisition of all or part of share

certificates, etc. relating to the allotment of new shares to third party, etc., without intending to have the third party acquire such share certificates, etc. (art. 2, item 3).

"MSCBs, etc." means securities enumerated below that are issued by a listed issuer (meaning the issuer of securities listed in a domestic financial instruments exchange market; hereinafter the same shall apply in these Rules) by way of allocation of new share certificates to a third-party, etc., containing an issuing term to the effect that the price payable per share (hereinafter referred to as the "Exercise Price" in these Rules) when exercising the share options or put options granted or represented thereon (hereinafter referred to as the "Share Options, etc." in these Rules) may be adjusted, at a frequency greater than once every six-months, based on the price of the share certificates on the financial instruments exchange market or in the PTS, etc. (including an average price, volume weighted average price, or other price calculated using the said price; hereinafter the same shall apply in these Rules) delivered from the exercise of such Share Options, etc. (art. 2, items 2 and 7):

(i) Convertible-type bonds with share options (among bonds with share options, those bonds wherein the objective of the investment when exercising the share options is the bonds that are connected with such bonds with share options; the same shall apply in the following (ii));
(ii) Bonds with share options (bonds with share options (excluding convertible-type bonds with share options) and simultaneously offered and simultaneously allotted bonds and share options certificates issued to be traded as a single unit);
(iii) Share options certificates; and
(iv) Share certificates with put options (refers to those where the consideration delivered for exercise of put options is the listed share certificates issued by the listed issuer of such share certificates with put options).

(1) Matters to Be Verified When Purchasing Share Certificates, Etc.

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc., a Regular Member must verify at least matters listed in the following items, and must make such purchase based on its comprehensive judgment and at its own responsibility (art. 3).

In addition, upon purchasing MSCBs, etc., the Regular Member must at least confirm the matters in parenthesis among the matters below (art. 9):

(i) Financial condition and business performance (adequacy of financial condition and cash flow situation, earnings record and earnings forecast, analysis of reasons for changes in financial condition and business performance, and earnings forecast and progress review already made public);
(ii) Intended use of funds raised (rationality of intended use of funds raised and review of appropriation of funds raised in the past);
(iii) Share price trend (share prices over time and trading volume over time);
(iv) Effect on the market and existing shareholders (rationality of the Exercise Price (including the revised provisions of the Exercise Price), exercise period, and other terms for Share Options, etc., and rationality of the MSCB, etc. issue amount and dilution accompanying such issuance in view of the liquidity and market capitalization of the underlying share certificates, etc.);

(v) Proper disclosure of company information etc. (proper disclosure of circumstances since the end of the latest business year); and
(vi) Other matters deemed necessary by the Regular Member.

(2) Explanation to the Listed Issuer

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer, and at the same time, structuring securities whose underlying assets are such share certificates, etc. (including a similar act), a Regular Member must explain that it plans to structure the securities to the listed issuer (art. 4, para. 1).

In addition, when structuring the securities, or purchasing share certificates, etc. relating to allotment of new shares to third party, etc. whose terms are determined based on the terms of a derivatives transaction) or other transactions, a Regular Member must explain the above matters to the listed issuer (art. 4, para. 2).

When proposing to a listed issuer the issuance of MSCBs, etc., a Regular Member must provide a product description to such listed issuer that is sufficient for such listed issuer to fully understand the characteristics of MSCBs, etc. as well as the advantages and disadvantages of issuing such MSCBs, etc. and to choose to issue MSCBs, etc. after fully considering the effects, etc. on existing shareholders (art. 8).

(3) Request to the Listed Issuer

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc., a Regular Member must request to the listed issuer that the listed issuer determine the amount paid for new share certificates, etc. pursuant to the "Guidance Concerning Handling of Allotment of New Shares to Third Party, Etc." that is separately prescribed by the JSDA (art. 5, para. 1).

In addition, Regular Members must, upon purchasing share certificates, etc. relating to allotment of new shares to third party, etc., request the listed issuer to sufficiently disclose the following matters (art. 5, para. 2):

(i) Intended use of funds raised;
(ii) Reason(s) for choosing the allotment of new shares to third party, etc.;
(iii) Reason(s) for selecting the allottees for the allotment of new shares to third party, etc.;
(iv) Rationality of the issuing terms of the allotment of new shares to third party, etc.;
(v) Schedule for share certificate, etc. lending transactions with the listed issuer's officers and major shareholders;
(vi) Status of exercise of share options, etc. after the conduct of the allotment of new shares to third party, etc.; and
(vii) Other matters deemed necessary by the Regular Member.

(4) Purchase Conditions

When purchasing share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer, a Regular Member shall verify the manner in which share certificates, etc. relating to the immediately preceding allotment of new shares to third party, etc. by the same listed issuer (limited to those conducted within five years prior to such purchase) were subsequently invested by the allottees. If it is found that information

contained in the disclosure on the holding policy for immediately preceding allotment of new shares to third party, etc. by the listed issuer and the subsequent investment activities by the allottees are inconsistent, the Regular Member must not purchase such share certificates, etc. before the details on such inconsistency are publicly announced (art. 6).

(5) Handling of Cancellation of Purchase

When confirming that an officer of a listed issuer has conducted a transaction of share certificates, etc. issued by such listed issuer with knowing that such listed issuer plans to offer share certificates, etc. and that such information is not disclosed, a Regular Member must not purchase share certificates, etc. relating to allotment of new shares to third party, etc. by such listed issuer (art. 7, para. 1).

When a Regular Member purchases share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer and becomes aware that an officer of the listed issuer has conducted a transaction of share certificates, etc. issued by such listed issuer during the period of preparing for the offering of share certificates, etc., the Regular Member shall verify with the listed issuer in writing that in conducting the transaction the officer did not know the undisclosed information that the offering of such share certificates, etc. was planned (art. 7, para. 2).

In addition, when a Regular Member purchases share certificates, etc. relating to allotment of new shares to third party, etc. by a listed issuer and becomes aware that a purchaser whom the listed issuer plans to appoint as an allottee has been changed, the Regular Member shall verify with the listed issuer in writing that a plan for conducting allotment of new shares to third party, etc. has not been cancelled pursuant to the provision of Paragraph 1 during six months preceding the date of determining the allotment of new shares to third party, etc. by an organization which determines the business execution of the listed issuers (limited to those to be disclosed) (art. 7, para. 3).

After cancelling the purchase pursuant to the provision of the rules, Article 7, Paragraph 1, a Regular Member must not purchase share certificates, etc. relating to allotment of new shares to third party, etc. by such listed issuers until at least the period of six months has passed from the date of transaction of share certificates, etc. issued by the listed issuers that was conducted by an officer of the listed issuer to the date of determining new allotment of new shares to third party, etc. by an organization which determines the business execution of the listed issuers relating to the new allotment of new shares to third party, etc. (limited to those to be disclosed) (art. 7, para. 4).

(6) Elimination of Antisocial Forces

Regular Members shall provide in the agreement concerning the purchase of and mediation for purchase of share certificates, etc. relating to the allotment of new share certificates to a third party, etc. executed with the issuer (regardless of whether it is a listed company or a private company) prescribed matters such as the undertaking by the issuer that it is not an antisocial force, and must take measures to eliminate antisocial forces upon purchase such as confirming whether or not the issuer is an antisocial force (art. 7-2 and art. 7-3).

(7) Handling of MSCBs, Etc.

Regular Members must note the following matters upon purchasing MSCBs, etc. issued by a listed issuer or upon holding MSCBs, etc. after the purchase:

(i) Short Sale and Market Sales During the Observation Period

A Regular Member holding MSCBs, etc. must not conduct a short sale for hedging MSCBs, etc. it holds during the observation period of the MSCBs, etc. at a price below the most recent price published by the financial

instruments exchange if, on the market where the short sale is to be conducted, price control is enforced under certain conditions such as where the price of the share certificates, etc. subject to the short sale is 10% lower than the standard price calculated on the basis of the last closing price on the market. However, this shall not apply if the price published by the financial instruments exchange is in an upward phase and the short sale is conducted at the most recent published price.

A Regular Member holding MSCBs, etc. must not, if the Exercise Price of the MSCBs, etc. uses the closing price as reference, place general orders concerning the market sale of the underlying share certificates, etc. relating to the MSCBs for its own account during the 15 minutes prior to the close of the trading session at the financial instruments exchange market or in the proprietary trading system on each business day during the observation period of the MSCBs, etc.

A Regular Member holding MSCBs, etc. must not, if the Exercise Price of the MSCBs, etc. uses the volume weighted average price (VWAP) of the day as reference, conduct, in general, market sales of the underlying share certificates, etc. relating to the MSCBs for its own account in excess of 25% of the average trading volume (if such quantity is less than 1 trading unit, 1 trading unit) of the underlying share certificates, etc. in the financial instruments exchange market or in the proprietary trading system during the 10 business days prior to each business day during the observation period of the MSCBs, etc.

There are exemptions to the provisions above (art. 10 through art. 12).

(ii) Restrictions on Exercise of Share Options

In general, a Regular Member must, upon purchasing MSCBs, etc., provide in the purchase agreement prescribed matters that if the quantity of the exercised Share Options, etc. will exceed 10% of the number of listed shares at the time of payment of the issuance of MSCBs during the calendar month which includes the day of exercise, etc., the exercise of the portion in excess of the 10%-limit (hereinafter "exercise in excess of the limit" in these Rules) shall not be allowed, and the Regular Member must comply with this provision.

With respect to an exercise exceeding the limit, the purchase agreement may provide that the exercise can be made in certain cases such as from the time of announcement of a merger, etc. which will cause the underlying share certificates, etc. relating to the MSCBs be delisted until the time of the merger, etc. or the announcement that no such merger, etc. will be conducted, and the share options, etc. must not be exercised in other cases while knowing that the exercise falls under an exercise exceeding the limit (art. 13).

(iii) Acceptance of Proper Short Sale

When a Regular Member accepts a short sale by an affiliate of the Regular Member while knowing that the affiliate is holding MSCBs, etc., it shall handle the same in the same manner as those required by a Regular Member holding MSCBs, etc. above (art. 14).

(iv) Developing Internal Systems

A Regular Member purchasing MSCBs, etc. shall establish necessary internal systems including the establishment of internal rules, etc. in order to confirm the matters that should be confirmed upon purchase, without influence from businesses promoting the purchase of MSCBs, etc.

In addition, a Regular Member holding MSCBs, etc. shall monitor the status of compliance with rules with respect to the short sale price and market sale during the observation period (art .15).

(8) Response to the Case Where a Person Other Than the Regular Member Purchases

If a Regular Member shall mediate the purchase of share certificates, etc. (excluding the purchase of MSCBs, etc.) relating to allotment of new share certificates to a third party, etc. that is a person other than the Regular

Member by a listed issuer, it shall request such person to comply with these Rules or respect the gist of the provisions of these Rules, depending on the attribute of the counterparty to the mediation (art. 16).

In addition, if a Regular Member shall mediate the purchase of MSCBs, etc. by a person other than the Regular Member, it must request such person to comply with these Rules or respect the gist of the provisions of these Rules, depending on the attribute of the counterparty to the mediation (art. 17).

(9) Application to Deemed MSCBs, Etc.

In a case a Regular Member purchases or intermediates the purchase of share certificates, etc. relating to allotment of new shares to third party, etc. (excluding the purchase of MSCB, etc.) by a listed issuer, if a derivatives transaction or other transaction has a close and inseparable relationship with the share certificates, etc. relating to allotment of new shares to third party, etc., and such share certificates, etc. and such derivatives transaction or other transaction uniformly have an effect that is equivalent to MSCBs, etc., they shall be deemed as MSCBs, etc., and shall be treated in accordance with these Rules (art. 18).

(10) Exemption of Application

These Rules shall not apply to share certificates, etc. issued in accordance with the decision pursuant to the Act on Special Measures for Enforcement of Financial Functions, etc. which are considered appropriate by the JSDA (art. 19).

4 6 Bonds Related Matters

1 Rules Concerning Transactions, Etc. of Unlisted Securities Over Proprietary Trading Systems (PTS)

[Points to Note]

- As of November 20, 2024, these Rules were partially amended to develop self-regulatory rules in response to the 2024 amendment to the FIEA, which introduced a regime wherein financial instruments business operators that register type-I financial instruments businesses are allowed to conduct a part of the PTS operation services without obtaining authorization (registered PTS). The amendment of these Rules came into effect as of November 21, 2024.
- The explanation on these Rules provided below is based on the contents of the foregoing amended provisions.

The purpose of these Rules is to achieve fair and smooth transactions of unlisted securities on proprietary trading systems by providing necessary matters concerning transactions of unlisted securities on proprietary trading systems, thereby contributing to the protection of investors and the sound development of secondary markets of unlisted securities (art. 1).

The term “authorized unlisted PTS” means a proprietary trading system that is operated under authorization for conducting the acts under Article 2, Paragraph 8, Item 10 of the FIEA for unlisted securities as business pursuant to the main clause of Article 30, Paragraph 1 of the FIEA (art. 2, item 3).

The term “registered PTS” means a proprietary trading system operated that is operated, without authorization

upon conducting acts specified under Article 2, Paragraph 8, Item 10 of the FIEA as business, as provided for in *proviso* to Article 30, Paragraph 1 of the FIEA (art. 2, item 11).

The term "authorized unlisted PTS issues" means unlisted securities which fall within the category of tokenized securities or over-the-counter securities, etc. that are securities for professional investors, which are traded on an authorized unlisted PTS established by a Regular Member (art. 2, item 4).

The term "registered PTS issues" means unlisted securities that are any of the securities defined in the items of Article 30, Paragraph 1 of the FIEA and that are traded on a registered PTS established by a Regular Member (art. 2, item 12).

The term "publicly offered registered PTS issues" means registered PTS issues those that fall under the cases where disclosure specified in the items of Article 4, Paragraph 7 of the FIEA is made (art. 2, item 13).

The term "authorized unlisted PTS operation services" means operations of a Regular Member conducting transactions of authorized unlisted PTS issues or intermediary services, etc., therefor on an authorized unlisted PTS established by the Regular Member (art. 2, item 7).

The term "registered PTS operation services" means operations of a Regular Member conducting transactions of registered PTS issues or intermediary services, etc., therefor on a registered PTS established by the Regular Member (art. 2, item 15).

The term "brokerage-type registered PTS operation services" means the registered PTS operation services, those that are conducted targeting customers of Registered PTS Trading Association Members, or both customers of Registered PTS Trading Association Members and customers of Registered PTS Operating Members (art. 2, item 19).

The term "registered PTS operation services for member's customers" means the registered PTS operation services, those that are conducted targeting only customers of Registered PTS Operating Members (art. 2, item 20).

The term "authorized unlisted PTS trading services" means operations of an Association Member conducting transactions of authorized unlisted PTS issues or intermediary services, etc., therefor on an authorized unlisted PTS established by another Regular Member, or the operations of brokerage for the entrustment of such intermediary services, etc. (art. 2, item 8).

The term "registered PTS trading services" means operations of an Association Member conducting transactions of registered PTS issues or intermediary services, etc., therefor on a registered PTS established by another Regular Member, or the operations of brokerage for the entrustment of such intermediary services, etc. (art. 2, item 16).

(1) Establishment, Etc. of Internal Rules

An Authorized Unlisted PTS Operating Member shall prepare internal rules setting forth the matters listed below when conducting authorized unlisted PTS operation services (art. 4, para. 1):

(i) Matters concerning examination on appropriateness of authorized unlisted PTS issues;
(ii) Matters concerning standards for abolishing to handle authorized unlisted PTS issues;
(iii) Matters concerning contracts with the issuing entity;
(iv) Matters concerning timely provision of information;
(v) Matters concerning implementation of trade examination;
(vi) Matters concerning public disclosure, etc. of price information;
(vii) Matters concerning measures against the issuing entity and measures, etc. to suspend

trading of an authorized unlisted PTS issue;
(viii) Matters concerning delivery settlement;
(ix) Matters concerning measures to prevent confusion with securities listed on a financial instruments exchange market in Japan (hereinafter referred to as "listed securities"); and
(x) Matters to be observed by Authorized Unlisted PTS Trading Association Members.

In conducting the authorized unlisted PTS trading services, an Authorized Unlisted PTS Trading Association Member shall observe the matters provided for in the internal rules established by the Authorized Unlisted PTS Operating Member pursuant to (x) above (art. 4, para. 2).

A Registered PTS Operating Member performing brokerage-type registered PTS operation services shall prepare internal rules setting forth the matters listed below when conducting brokerage-type registered PTS operation services (art. 4-2, para. 1, item 1):

(i) Matters concerning examination on appropriateness of registered PTS issues;
(ii) Matters concerning standards for abolishing to handle registered PTS issues;
(iii) Matters concerning contracts with the issuing entity;
(iv) Matters concerning timely provision of information;
(v) Matters concerning implementation of trade examination;
(vi) Matters concerning public disclosure, etc. of price information;
(vii) Matters concerning measures against the issuing entity and measures, etc. to suspend trading of a registered PTS issue;
(viii) Matters concerning delivery settlement;
(ix) Matters concerning measures to prevent misidentification with listed securities and authorized unlisted PTS issues; and
(x) Matters to be observed by Registered PTS Trading Association Members.

In conducting the registered PTS trading services, Registered PTS Trading Association Members shall observe the matters provided for in the internal rules established by the Registered PTS Operating Member pursuant to (x) above (art. 4-2, para. 2).

A Registered PTS Operating Member performing registered PTS operation services for member's customers shall prepare internal rules setting forth the matters listed below when conducting registered PTS operation services for member's customers; however, the matters set forth in (iii), (iv) and (vii) will be excluded if publicly offered registered PTS issues will be handled (art. 4-2, para. 1, item 2):

(i) Matters concerning examination on appropriateness of registered PTS issues;
(ii) Matters concerning standards for abolishing to handle registered PTS issues;
(iii) Matters concerning contracts with the issuing entity;
(iv) Matters concerning timely provision of information;
(v) Matters concerning implementation of trade examination;
(vi) Matters concerning public disclosure, etc. of price information;
(vii) Matters concerning measures against the issuing entity;
(viii) Matters concerning measures to suspend trading of a registered PTS issue;

(ix) Matters concerning delivery settlement; and
(x) Matters concerning measures to prevent misidentification with listed securities and authorized unlisted PTS issues..

(2) Publication of Details of Operations

An Authorized Unlisted PTS Operating Member or a Registered PTS Operating Member must publicize the details of its authorized unlisted PTS operation services or its registered PTS operation services, respectively, by posting them on its website or by other means using the Internet. However, this shall not apply to cases where a Registered PTS Operating Member performing registered PTS operation services for member's customers provides explanations on the details of its registered PTS operation services for member's customers to a customer engaging in the trading of registered PTS issues (art. 5).

(3) Examination on Appropriateness

When adding unlisted securities as an authorized unlisted PTS issue, an Authorized Unlisted PTS Operating Member must examine the appropriateness of the unlisted securities in advance according to the categories set forth in (i) and (ii) in terms of the matters set forth in (i) and (ii) (art. 6):

(i) Corporate Finance Instruments:
  (a) The issuing entity is required to submit an annual securities report or provide or publicize information on the issuer;
  (b) The existence of the issuing entity's operations and the system for business continuity;
  (c) The corporate governance and internal control system of the issuing entity;
  (d) The financial status of the issuing entity;
  (e) The status of development of the system for the submission of an annual securities report, or publication of the information on the issuer, and timely provision of information on the issuer by the issuing entity in an appropriate manner;
  (f) That the issuing entity has no relationship with antisocial forces;
  (g) The matters related to the transfer of rights, etc. of the unlisted securities (limited to tokenized securities); and
  (h) Other matters that the Authorized Unlisted PTS Operating Member finds necessary from the perspective of protecting investors;
(ii) Asset Finance Instruments:
  (a) The issuing entity is required to submit an annual securities report or provide or publicize information on the issuer;
  (b) The rationality and appropriateness of the asset securitization scheme;
  (c) The corporate governance and internal control system of the issuing entity and the management company, etc.;
  (d) The status of conflict of interest between the beneficiaries, etc., and the issuing entity and management company, etc.;
  (e) The financial conditions of the issuing entity and the management company, etc.;
  (f) The status of development of the system for the submission of an annual securities

report, or publication of the information on the issuer, and timely provision of information on the issuer by the issuing entity and management company, etc., in an appropriate manner;

(g) That the issuing entity and management company, etc. have no relationship with antisocial forces;

(h) The matters related to the transfer of rights, etc. of the unlisted securities (limited to tokenized securities); and

(i) Other matters that the Authorized Unlisted PTS Operating Member finds necessary from the perspective of protecting investors.

When adding unlisted securities as a registered PTS issue, a Registered PTS Operating Member must examine the appropriateness of the unlisted securities in advance according to the categories set forth in (i) and (ii) in terms of the matters set forth in (i) and (ii) (art. 6-2):

(i) Corporate Financial Instruments:

(a) The existence of the issuing entity's operations and the system for business continuity;

(b) The corporate governance and internal control system of the issuing entity;

(c) The financial status of the issuing entity;

(d) The status of development of the system for the submission of an annual securities report, or publication, etc. of the information on the issuer by the issuing entity in an appropriate manner;

(e) The status of development of the system for the timely provision of information by the issuing entity in an appropriate manner (excluding cases where a Registered PTS Operating Member performing registered PTS operation services for member's customers adds unlisted securities as a publicly offered registered PTS issue);

(f) That the issuing entity has no relationship with antisocial forces;

(g) The matters related to the transfer of rights, etc. of the unlisted securities (limited to tokenized securities); and

(h) Other matters that the Registered PTS Operating Member finds necessary from the perspective of protecting investors;

(ii) Asset Financial Instruments:

(a) The rationality and appropriateness of the asset securitization scheme;

(b) The status of corporate governance and internal control system of the issuing entity and the management company, etc.;

(c) The status of conflict of interest between the beneficiaries, etc., and the issuing entity and management company, etc.;

(d) The financial conditions of the issuing entity and management company, etc.;

(e) The status of development of the system for the submission of an annual securities report, or publication, etc. of the information on the issuer by the issuing entity and management company, etc. in an appropriate manner;

(f) The status of development of the system for the timely provision of information by the issuing entity and management company, etc. in an appropriate manner (excluding cases

where a Registered PTS Operating Member performing registered PTS operation services for member's customers adds Unlisted securities as a publicly offered registered PTS issue);

(g) That the issuing entity and management company, etc. have no relationship with antisocial forces;

(h) The matters related to the transfer of rights, etc. of the unlisted securities (limited to tokenized securities); and

(i) Other matters that the Registered PTS Operating Member finds necessary from the perspective of protecting investors.

(4) Conclusion of a Contract with an Issuing Entity

When adding unlisted securities as an authorized unlisted PTS issue, an Authorized Unlisted PTS Operating Member must enter into a contract in advance with the issuing entity of the unlisted securities regarding the following matters (art. 7, para. 1):

(i) Matters concerning the timely provision of information by the issuing entity to the Authorized Unlisted PTS Operating Member;

(ii) Matters concerning the publication of information that is subject to the timely provision on the website, etc. of the issuing entity or the management company, etc.;

(iii) Matters concerning measures to be taken when the issuing entity does not provide timely information to the Authorized Unlisted PTS Operating Member or when the content of the information provided is inappropriate;

(iv) A statement to the effect that if the management company, etc. possesses the information necessary for the issuing entity to provide timely information to the Authorized Unlisted PTS Operating Member, the issuing entity will gain the cooperation of the management company, etc.; and

(v) In addition to the matters set forth above, a statement to the effect that the issuing entity will comply with the rules established by the Authorized Unlisted PTS Operating Member.

When adding unlisted securities as a registered PTS issues (excluding cases where a Registered PTS Operating Member performing registered PTS operation services for member's customers adds unlisted securities to publicly offered registered PTS issues), the Registered PTS Operating Member must enter into a contract in advance with the issuing entity for the unlisted securities regarding the following matters (art. 7, para. 2):

(i) Matters concerning the timely provision of information by the issuing entity to the Registered PTS Operating Member;

(ii) Matters concerning the publication of information that is subject to the timely provision on the website, etc. of the issuing entity or the management company, etc.;

(iii) Matters concerning measures to be taken when the issuing entity does not provide timely information to the Registered PTS Operating Member or when the content of the information provided is inappropriate;

(iv) A statement to the effect that if the management company, etc. possesses the information necessary for the issuing entity to provide timely information to the Registered PTS Operating Member, the issuing entity will gain cooperation from the management company, etc.; and
(v) In addition to the matters set forth above, a statement to the effect that the issuing entity will comply with the rules established by the Registered PTS Operating Member.

(5) Timely Provision of Information by the Issuing Entity

An Authorized Unlisted PTS Operating Member must stipulate the following matters in a contract with the issuing entity mentioned in (4) above with respect to the timely provision of information to the Authorized Unlisted PTS Operating Member by the Issuing Entity (art. 8, para. 1):

(i) The following matters for cases where timely provision of information is required from the issuing entity to the Authorized Unlisted PTS Operating Member:
  (a) For tokenized securities, cases where an extraordinary report must be submitted;
  (b) For securities for professional investors, cases where the publicized specified information on securities or information on the issuer (hereinafter referred to as "specified information on securities, etc." in these Rules) contains any matters that must be corrected;
  (c) Cases where a fact that has a material influence on investors' investment decisions has been determined or has occurred (excluding the cases specified in (a) and (b)); and
  (d) In addition to the cases specified in (a) through (c), cases where the Authorized Unlisted PTS Operating Member deemed necessary;
(ii) The following matters require timely provision of information from the issuing entity to the Authorized Unlisted PTS Operating Member:
  (a) For cases set forth in (i)(a) above, the matters to be included in the extraordinary report to be submitted;
  (b) For cases set forth in (i)(b) above, the details of the information to be corrected;
  (c) For cases set forth in (i)(c) above, the details of the facts that have a material influence on investors' investment decisions; and
  (d) For cases set forth in (i)(d) above, matters deemed necessary by the Authorized Unlisted PTS Operating Member;
(iii) Time limit for provision of information to the Authorized Unlisted PTS Operating Member from the issuing entity.

A Registered PTS Operating Member performing brokerage-type registered PTS operation services must stipulate the following matters in a contract with the issuing entity mentioned in (4) above with respect to the timely provision of information to the Registered PTS Operating Member by the issuing entity (art. 8-2, para. 1):

(i) The following matters for cases where timely provision of information is required from the issuing entity to the Registered PTS Operating Member:
  (a) For registered PTS issues, cases where an extraordinary report must be submitted;

(b) For registered PTS issues, cases where the publicized specified information on securities, etc. contains any matters that must be corrected;
(c) Cases where a fact that has a material influence on investors' investment decisions has been determined or has occurred (excluding the cases specified in (a) and (b)); and
(d) In addition to the cases specified in (a) through (c), cases where the Registered PTS Operating Member deemed necessary;

(ii) The following matters require timely provision of information from the issuing entity to the Registered PTS Operating Member:
(a) For cases set forth in (i)(a) above, the matters to be included in the extraordinary report to be submitted;
(b) Fo cases set forth in (i)(b) above, the details of the information to be corrected;
(c) For cases set forth in (i)(c) above, the details of the facts that have a material influence on investors' investment decisions; and
(d) For cases set forth in (i)(d) above, matters deemed necessary by the Registered PTS Operating Member;

(iii) Time limit for provision of information to the Registered PTS Operating Member from the issuing entity.

A Registered PTS Operating Member performing registered PTS operation services for member's customers must stipulate the following matters in a contract with the issuing entity mentioned in (4) above with respect to the timely provision of information to the Registered PTS Operating Member by the issuing entity (art. 8-2, para. 2):

(i) The following matters for cases where timely provision of information is required from the issuing entity to the Registered PTS Operating Member:
(a) For registered PTS issues, cases where the publicized, or otherwise disclosed, specified information on securities, etc. contains any matters that must be corrected;
(b) Cases where financial statements or business reports based on the Companies Act have been prepared;
(c) Case where a material doubt has arisen on the going concern assumption; and
(d) In addition to the cases specified in (a) through (c), cases where the Registered PTS Operating Member deemed necessary;

(ii) The following matters require timely provision of information from the issuing entity to the Registered PTS Operating Member:
(a) For cases set forth in (i)(a) above, the details of the information to be corrected;
(b) For cases set forth in (i)(b) above, the details of the financial statements or business reports prepared;
(c) For cases set forth in (i)(c) above, the details of the material doubt; and
(d) For cases set forth in (i)(d) above, matters deemed necessary by the Registered PTS Operating Member;

(iii) Time limit for provision of information to the Registered PTS Operating Member from the issuing entity.

An Authorized Unlisted PTS Operating Member and a Registered PTS Operating Member must make the details of the timely information they have received from the issuing entity available for public inspection by methods such as posting these details on their websites (art. 8, para. 2 and art. 8-2, para. 3). However, in cases where the Registered PTS Operating Member performing registered PTS operation services for member's customers has provided the information to a customer, it is not required to make the information available for public inspection (art. 8-2, para. 3). An Authorized Unlisted PTS Operating Member and a Registered PTS Operating Member must endeavor to ensure the appropriateness of the details of the relevant information (art. 8, para. 3 and art. 8-2, para. 4).

(6) Publication, Etc. of Price Information

An Authorized Unlisted PTS Operating Member must publicize the contract price, final quotations, and trading volume of the authorized unlisted PTS issues on its website or by other means every business day, and develop a system to promptly present the latest contract price, etc. of an authorized unlisted PTS issue when requested by an Authorized Unlisted PTS Trading Association Member to provide the contract price, etc. (art. 9, para. 1 and para. 2).

An Authorized Unlisted PTS Trading Association Member must develop a system to promptly present the latest contract price, etc. of the authorized unlisted PTS issues when requested by a customer to provide the contract price, etc. (art. 9, para. 3).

A Registered PTS Operating Member performing brokerage-type registered PTS operation services must publicize the contract price, final quotations, and trading volume of registered PTS issues on its website or by other means every business day, and develop a system to promptly present the latest contract price, etc. of a registered PTS issue when requested by a Registered PTS Trading Association Member to provide the contract price, etc. (art. 9-2, para. 1 and para. 2).

A Registered PTS Operating Member performing registered PTS Operation services for member's customers and a Registered PTS Trading Association Member must develop a system to promptly present the latest contract price, etc. of a registered PTS issue when requested by a customer to provide the contract price, etc. (art. 9-2, para. 3).

(7) Prevention of Unfair Transactions, Etc.

An Authorized Unlisted PTS Trading Association Member or a Registered PTS Trading Association Member shall develop and maintain a system that prevents the following transactions when conducting the authorized unlisted PTS Trading services or registered PTS trading services, respectively (art. 10, para. 1):

(i) Transactions conducted by unlawful means such as fictitious trading or wash trading;
(ii) Transactions such as purchase of authorized unlisted PTS issues or registered PTS issues by sequentially raising quotations or purchase prices, or sales of such issues by sequentially lowering quotations or sales prices, with the objective of misleading others, artificially disguising a boom or exerting an unfair impact on the market, or creating fictitious quotations that do not reflect actual market conditions; and
(iii) Transactions such as purchase or sale without the intention to contract, which are conducted with the objective to induce other investors to enter into purchase and sale transactions by misleading them into believing that a market price has been formed naturally.

In addition to the unfair transactions listed above, an Authorized Unlisted PTS Trading Association Member and a Registered PTS Trading Association Member must develop and maintain a system that prevents transactions that are deemed to be excessive compared to the transaction conditions of authorized unlisted PTS issues or registered PTS issues, respectively (art. 10, para. 2).

(8) Implementation of Trade Examination

An Authorized Unlisted PTS Operating Member and a Registered PTS Operating Member must appropriately conduct trade examination for transactions of authorized unlisted PTS issues or registered PTS issues pursuant to the internal rules (art. 11, para. 1).

In cases such as when an Authorized Unlisted PTS Operating Member or a Registered PTS Operating Member performing brokerage-type registered PTS operation services recognizes, as a result of conducting a trade examination, that a transaction falls under an unfair transaction, etc., it must take measures that include alerting the Authorized Unlisted PTS Trading Association Member or the Registered PTS Trading Association Member that has conducted intermediary services, etc. for the transaction (art. 11, para. 2).

In cases such as when a Registered PTS Operating Member performing registered PTS operation services for member's customers recognizes, as a result of conducting a trade examination, that a transaction falls under an unfair transaction, etc., it must take appropriate measures based on the internal rules (art. 11, para. 3).

(9) Measures to Suspend Trading

An Authorized Unlisted PTS Operating Member or a Registered PTS Operating Member must appropriately take measures to suspend trading pursuant to the internal rules (art. 12).

(10) Measures to Prevent Confusion with Listed Securities, Etc.

An Authorized Unlisted PTS Operating Member must make it clear on its website that authorized unlisted PTS issues are not listed securities (art. 13, para. 1).

An Authorized Unlisted PTS Trading Association Member must explain to customers that authorized unlisted PTS issues are not listed securities (art. 13, para. 2).

A Registered PTS Operating Member must make it clear on its website that registered PTS issues are not listed securities or authorized unlisted PTS issues. However, this shall not apply to cases where a Registered PTS Operating Member performing registered PTS operation services for member's customers provides explanations to a customer (art. 13, para. 3).

A Registered PTS Trading Association Member must explain to customers that registered PTS issues are not listed securities or authorized unlisted PTS issues (art. 13, para. 4).

(11) Ensuring Fairness in Transactions

When trading in an authorized unlisted PTS issue or a registered PTS issue with a customer, an Authorized Unlisted PTS Operating Member and a Registered PTS Operating Member must trade with a fair price, using a market price calculated using a reasonable method as a benchmark, in order to ensure the fairness of that transaction (art. 14).

(12) Special Provisions, etc. on Securities for Professional Investors

Authorized Unlisted PTS Trading Association Members or Registered PTS Trading Association Members

must not accept a request for the purchase of securities for professional investors through a proprietary trading system from any customer who is not a professional investor (art. 15, para. 1).

In the case where the Authorized Unlisted PTS Operating Member or the Registered PTS Operating Member adds an investment trust, etc., which is Securities for Professional Investors, to the Authorized Unlisted PTS Issues or Registered PTS Issues, it must examine the appropriateness of the investment trust, etc., according to the categories set forth respectively in (i) and (ii) in terms of the matters specified in (i) and (ii) below, in advance (art. 15, para. 2):

(i) Investment Trust Beneficiary Certificates:
- **(a) The status of development of the system for the submission of an annual securities report, or publication, etc. of the information on the issuer by the issuing entity in an appropriate manner**
- **(b) The status of development of the system for the timely provision of information by the issuing entity in an appropriate manner;**
- **(c) The matters related to the transfer of rights , etc. of the investment trust beneficiary certificates (limited to tokenized securities); and**
- **(d) Other matters that the Authorized Unlisted PTS Operating Member or the Registered PTS Operating Member finds necessary from the perspective of protecting investors;**

(ii) Investment Securities, Etc.:
- **(a) The corporate governance and internal control system of the issuing entity and the management company, etc.;**
- **(b) The status of conflict of interest between the beneficiaries, etc., and the issuing entity and management company, etc.;**
- **(c) The status of development of the system for the submission of an annual securities report, or publication, etc. of the information on the issuer by the issuing entity and management company, etc. in an appropriate manner**
- **(d) The status of development of the system for the timely provision of information by the issuing entity and the management company, etc. in an appropriate manner;**
- **(e) That the issuing entity and management company, etc. have no relationship with antisocial forces;**
- **(f) The matters related to the transfer of rights , etc. of the investment securities, etc. (limited to tokenized securities); and**
- **(g) Other matters that the Authorized Unlisted PTS Operating Member or the Registered PTS Operating Member finds necessary from the perspective of protecting investors.**

When adding securities for professional investors to authorized unlisted PTS issues or registered PTS issues, the Authorized Unlisted PTS Operating Member or the Registered PTS Operating Member must enter into a contract in advance with the issuing entity for the securities for professional investors regarding the matters including the publication of information on the issuer (art. 15, para. 3).

2 Rules Concerning Provision of Demand Information and Purchaser Information for Public Offering of Corporate Bond Certificates, Etc.

The purpose of these Rules is to provide for matters necessary for Regular Members upon underwriting the public offering of corporate bonds, etc. with regard to the provision of demand information and purchaser information concerning corporate bond certificates, etc. and ensure the proper management of business operations that respects the market conditions, thereby contributing to the sound development of capital markets (art. 1).

The term "subject corporate bond certificates, etc." refers to corporate bond certificates issued under the lead manager system (municipal bonds, FLIP agency bonds, specified corporate bonds, corporate bonds, investment corporation bonds, Samurai bonds, and sovereign bonds issued in Japan), except for corporate bond certificates underwritten by the Representative Lead Managing Regular Member Underwriter mainly for the purpose of having them acquired by individuals (generally referred to as retail bonds) (art. 2, item 1).

The term "lead manager system" refers to the system wherein the Regular Member Underwriter designated by the issuer as the Lead Managing Regular Member Underwriter is involved in deciding the issuing terms upon the public offering of securities (art. 2, item 2).

(1) Provision of Demand Information to the Issuer, Etc.

The term "demand information" refers to: (i) with regard to customers whose real names must be included in information to be provided, the names of customers for each set of issuing terms of the subject corporate bond certificates, etc. and the amount of demand of each customer; and (ii) with regard to other customers, the number of customers by business type for each set of issuing terms of the subject corporate bond certificates, etc. and the amount of demand of each customer. The term excludes information on individuals (art. 2, item 8, art. 5, para. 1).

The Representative Lead Managing Regular Member Underwriter must provide the issuer with demand information obtained through pre-marketing (meaning a procedure wherein the Regular Member Underwriter, upon underwriting the subject corporate bond certificates, etc., receives opinions from investors regarding the level of the issuing terms), every business day or by the business day preceding the date of decision of the issuing terms (or before the issuing terms are decided on the date of decision of the issuing terms if there are unavoidable circumstances) (art. 3, para. 1).

If there is any Joint Lead Managing Regular Member Underwriter or Other Regular Member Underwriter (limited to Other Regular Member Underwriters in the case where the total estimated amount to be underwritten by all Other Regular Member Underwriters exceeds 10% of the estimated amount of issue), the Representative Lead Managing Regular Member Underwriter must obtain the demand information that has been obtained by the Joint Lead Managing Regular Member Underwriter or Other Regular Member Underwriter through pre-marketing, and include such information in the demand information to be provided to the issuer. The Joint Lead Managing Regular Member Underwriter and Other Regular Member Underwriter shall provide the Representative Lead Managing Regular Member Underwriter with the demand information they have obtained, by the deadline agreed with the Representative Lead Managing Regular Member Underwriter (art. 3, para. 2 and para. 3).

The Representative Lead Managing Regular Member Underwriter may, with the issuer's consent, have the Joint Lead Managing Regular Member Underwriter and Other Regular Member Underwriter directly provide the issuer with demand information (art. 3, para. 4).

The Lead Managing Regular Member Underwriters shall share among themselves; the demand information within the scope agreed upon in advance among themselves and the issuer (art. 3, para. 5).

(2) Provision of Purchaser Information to the Issuer, Etc.

The term "purchaser information" refers to: (i) with regard to customers whose real names must be included in information to be provided, the names of customers who are purchasers of the subject corporate bond certificates, etc. and the amount of purchases by each customer; and (ii) with regard to other customers, the number of customers by business type for each set of issuing terms of the subject corporate bond certificates, etc. and the amount of purchases by each customer. The term excludes information on individuals (art. 2, item 9, art. 5, para. 1).

The Representative Lead Managing Regular Member Underwriter must provide the issuer with purchase information without delay (art. 4, para. 1).

If there is any Joint Lead Managing Regular Member Underwriter or Other Regular Member Underwriter, the Representative Lead Managing Regular Member Underwriter must obtain the purchaser information from the Joint Lead Managing Regular Member Underwriter or Other Regular Member Underwriter, and include such information in the purchaser information to be provided to the issuer. The Joint Lead Managing Regular Member Underwriter and Other Regular Member Underwriter shall provide the Representative Lead Managing Regular Member Underwriter with the purchaser information without delay after the sale (art. 4, para. 2 and para. 3).

The Representative Lead Managing Regular Member Underwriter may, with the issuer's consent, have the Joint Lead Managing Regular Member Underwriter and Other Regular Member Underwriter directly provide the issuer with purchaser information (art. 4, para. 4).

The Lead Managing Regular Member Underwriters shall share among themselves; the purchaser information within the scope agreed upon in advance among themselves and the issuer (art. 4, para. 5).

(3) Scope of Customers Whose Real Names Must Be Included in Information to Be Provided

With regard to major investors and investors for whom the amount of demand or amount of sale is JPY1 billion or more, the Regular Member Underwriter must provide the issuer, etc. with information of the amount of demand or amount of sale with the real names of these investors for each set of issuing terms (art. 5, para. 1).

The Regular Member Underwriter shall make it known in advance to customers whose real names must be included in demand information and purchaser information, that the demand information and purchaser information will be provided to the issuer and the Lead Managing Regular Member Underwriter, except when the customers notify the Regular Member Underwriter of their intention to refuse to provide their names as part of such information (art. 5, para. 2).

If the Regular Member Underwriter receives such notification from the customer of their intention to refuse to provide their names, the Regular Member Underwriter shall provide the issuer and the Lead Managing Regular Member Underwriter with the demand information and purchase information using anonymous names instead of their real names (art. 5, para. 3).

If the Regular Member Underwriter itself has demand for the subject corporate bonds, etc., it must clarify the amount of demand in its real name for each set of issuing terms, and if it itself purchases the subject corporate bonds, etc., it must clarify the amount of sale in its real name (art. 5, para. 4).

(4) Appropriate Management of Provided Information by the Issuer

When the issuer receives demand information and purchase information, the Regular Member Underwriter must obtain the issuer's assurance that the issuer will appropriately manage the information so as not to cause its leakage (art. 6).

(5) Establishment of Internal Rules

In order to underwrite the subject corporate bond certificates, etc., the Regular Member Underwriter must establish internal rules which provide for the following matters concerning the provision of demand information and purchaser information relevant to the subject corporate bond certificates, etc., and comply with these rules (art. 7, para. 1 and para. 2):

(i) Methods of obtaining and providing demand information;
(ii) Methods of obtaining and providing purchaser information;
(iii) Methods of retaining and preserving materials used as the basis for preparing demand information and purchase information;
(iv) Proper information provision to the media;
(v) Internal inspection procedure; and
(vi) Other matters deemed necessary by the Regular Member.

(6) Enhancement of Internal Management System

The Regular Member Underwriter must periodically inspect whether the issuance procedure of the subject corporate bond certificates, etc. has been conducted properly, through such measures as the comparison of demand information and purchase information relevant to the subject corporate bond certificates, etc. (art. 8).

(7) Preparation and Preservation of Records

The Regular Member Underwriter must prepare the following records concerning the subject corporate bond certificates, etc. and preserve them for five years from the date of issuance of the subject corporate bond certificates, etc. in order to ensure that external audits and inspections can be conducted appropriately (art. 9):

(i) Records concerning demand information;
(ii) Records concerning purchaser information;
(iii) If the customer is anonymized, the record of the name of the customer and the fact that the customer refused to provide its name;
(iv) Records concerning inspection results; and
(v) Other records deemed necessary by the Regular Member.

(8) Reporting to the JSDA

The JSDA may request the Regular Member Underwriter to submit reports or materials with regard to these Rules, and the Regular Member Underwriter must do so as requested (art. 10, para. 1 and para. 2).

3 Rules Concerning Publication of Over-the-Counter Trading Reference Prices, Etc. and Trading Prices of Bonds

The secondary markets for bonds consist of the financial instruments exchange market and the over-the-counter market. In practice, the bond trading takes place chiefly in over-the-counter markets. As such, the JSDA, in addition to publishing the Reference Statistical Prices [Yields] for OTC Bond Transactions (hereinafter referred to

as the "Reference Statistical Prices [Yields] for Transaction") between Association Members and their customers (including other Association Members), establishes the necessary matters for over-the-counter trading.

These Rules consist of five major components: (1) publication of the Reference Statistical Prices [Yields] for Transaction; (2) publication of monthly trading volume; (3) publication of information on corporate bond transactions; (4) ensuring fairness of transaction; (5) prohibition of extraordinary transactions; and (6) administration of the execution process. By prescribing necessary matters with respect to these components, the rules have as their purpose to occasion the fair and efficient over-the-counter sale and purchase or other transactions in bonds, thereby contributing to investor protection (art. 1).

Publication of information on corporate bond transactions is a new system introduced in November 2015 with the aim of revitalizing the bond market by improving the transparency and securing the reliability of the bond price information.

(1) Publication of Reference Statistical Prices [Yields] for Transaction

The JSDA publishes the Reference Statistical Prices [Yields] for Transaction each business day in order to contribute to Association Members' and customers' reference for the over-the-counter transactions of bonds conducted between Association Members and customers, based on the reports from the Association Members designated by the JSDA (art. 3).

(2) Publication of Monthly Trading Volume, Etc.

Each month the JSDA publishes the monthly Trading Volume of Over-the-Counter (OTC) Bonds (the *gensaki* trading amount shall be indicated separately), and the month-end balance of *gensaki* trading, based on reports from Association Members (art. 10).

(3) Publication of Information on Corporate Bond Transactions

The JSDA publishes information on corporate bond transactions based on reports from Regular Members every business day (art. 11-3).

The following corporate bonds are covered by publication (Detailed Rules Relating to the Rules Concerning Publication of Over-the-Counter Trading Reference Prices, etc. and Trading Prices of Bonds, art. 7).

(i) Corporate bonds to be published

Corporate bonds to be published shall be those that fall under either of the following, except for those subject to a measure to suspend publication as separately provided by the JSDA:

(a) Credit rating for the bonds is "AA or equivalent" or higher; or

(b) Credit rating for the bonds is "A or equivalent" (excluding "A-") and the amount of issuance is not less than JPY50 billion (excluding subordinated corporate bonds and corporate bonds with remaining maturity of 20 years or more)

(ii) Transactions to be published

Transactions to be published are those traded at a volume of not less than JPY100 million at face value.

(iii) Matters to be published

Matters to be published are as set forth below:

(a) Execution date;
(b) Issue code;
(c) Issue name;
(d) Maturity date;
(e) Yield;
(f) Trading volume (recognized based on the face value);
(g) Execution price per unit;
(h) Whether the transaction is sale or purchase; and
(i) Other matters separately specified by the JSDA.

(4) Ensuring Fairness of Transactions

Association Members, in executing Over-the-Counter transactions of public and corporate bonds with customers, must ensure the fairness of the transaction by acting at a proper price based on the current market price computed in reasonable manners (hereinafter referred to as "Internal Current Market Price") (with respect to pre-auction government bond transactions among pre-issued government bond transactions, the proper compound interest rate calculated in accordance with the method used for the Internal Current Market Price). (Rules Concerning Publication of Over-the-Counter Trading Reference Prices, Etc. and Trading Prices of Bonds, art. 12, para. 1).

Furthermore, Internal Current Market Price shall be made in consideration of maintenance of method of acquisition and computation (art. 12, para. 2).

Additionally, in Over-the-Counter trades with customers who initiate bond transactions worth less than JPY10 million face value (excluding qualified institutional investors set forth in Article 2, Paragraph 3, Item 1 of the FIEA, or certain business entities, etc.; hereinafter referred to as "small investors" in these Rules), Association Members must make special efforts to disclose price information and provide education and raise awareness regarding Over-the-Counter transactions of bonds to further increase the fairness of transactions in these securities. An Association Member also has the duty to explain the differences between transactions on a financial instruments exchange market and Over-the-Counter trades, etc. to small investors who trades in listed bond certificates for the first time (art. 14 and art. 15).

In addition to the above, Association Members must provide customers who are entering into a pre-issued government bond transaction with a prior explanation of the fact that such trades are subject to a condition precedent and of the treatment in the event that the condition precedent is not satisfied (art. 13).

(5) Prohibition of Extraordinary Transactions

Association Members must not effect the acts set forth in each of the following items and any other acts with the aim of compensating for the customer's loss or adding to his/her profit (hereinafter referred to as "Extraordinary Transactions" in these Rules) (art. 16, para. 1):

(i) Over-the-Counter transactions in same-bond issues in which sales and purchases are effected simultaneously at prices favorable to customers or the third parties, but unfavorable to the Association Members (the price differential that corresponds to a proper interest based on a difference in the delivery date and the price differential which corresponds to the differential

in delivery terms between the cash bonds and registered bonds are excluded);

(ii) The act of repurchasing or selling at prices favorable to customers performed in purchasing bonds from or selling bonds to customers, or transactions effected on the basis of prior promises that contracts will be cancelled (*Gensaki* Transactions are excluded); and

(iii) A transaction to be conducted in collusion with a third party promising in advance on the occasion of selling a bond to a customer or purchasing it from a customer that the customer will be sure to gain profits by selling the bond to, or purchasing it from, the third party.

Furthermore, an Association Member must, when a short-term transaction conducted with a customer has produced a substantial amount of profits for the customer, be mindful of the possibility that such a transaction may fall under the Extraordinary Transaction, and must endeavor to further strengthen internal control of matters concerning the contract with the customer, confirmation of such a contract, and keeping of records, etc. (art. 16, para. 2).

(6) Administration of the Execution Process, Etc.

When conducting Over-the-Counter transactions in bonds, an Association Member must promptly prepare, file and keep an order slip, etc. pertaining to the said order stating the time, etc. of the contract, and manage these in an appropriate manner. Furthermore, Association Members must establish internal rules concerning the administration of the execution process in order to control the work of processing contracts properly (art. 17 and art. 18).

4 7 Foreign Instruments and Transactions Related Matters

○ Rules Concerning Foreign Securities Transactions

These are rules that Association Members must observe for the purpose of protecting investors with respect to transactions of foreign securities conducted between an Association Member and its customer or another Association Member or in underwriting, etc., a public offering of foreign shares, etc., in Japan.

However, derivatives transactions and transactions on domestic financial instruments exchange markets are not subject to these Rules (art. 1).

(1) Conclusion of Contract and Processing Under the Agreement

When an Association Member receives an order for a foreign securities transaction from a customer or another Association Member (including handling of public offering or secondary distribution or the handling of private placements), the Association Member must enter into a contract with the customer or other Association Member for the foreign securities transaction. When an Association Member purports to enter into such contract with a customer (excluding professional investors in the case where the sale of foreign securities is made by handling of a private placement), it must deliver the agreement on foreign securities trading account (hereinafter "Agreement" in these Rules) to the customer (in cases where the Association Member has already delivered the Agreement and the customer has not applied for the delivery of the Agreement again, it is unnecessary to deliver the Agreement) and receive an application form describing that they apply for the establishment of a trading account pursuant to the Agreement submitted by the customer.

When an Association Member receives the application, it must establish a system to confirm that it has received the application from the customer by the method of accepting the application form describing that the customers apply for the establishment of a trading account pursuant to the Agreement or by other methods it prescribed. Moreover, when an Association Member approves the application, it must open the account and notify the customer to such effect (art. 3).

The Agreement controls the execution of trades in foreign securities based on the customer's order, the settlement of trade monies, the custody of securities, and the treatment of rights such as for dividends and share options. Transactions in foreign securities with customers take place according to the Agreement except for brokering sales in response to a tender offer (meaning offering to purchase of foreign share certificates, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds or soliciting of offers to sell them to many and unspecified persons, and then effecting the purchase of foreign share certificates, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds outside of a foreign financial instruments exchange market; hereinafter the same applies in these Rules) (art. 4).

(2) Compliance Matters

In the case of foreign securities, except in the case of public offering and secondary distribution, no disclosure of confidential corporate information, etc. under the FIEA is made, which limits the information that investors can obtain. Therefore, in view of the fact that the member's responsibility as a broker is immense, an Association Member shall, in soliciting a customer for an investment in foreign securities, take due care so that the investment may be made in a manner suitable to the intention, investment experience, and financial resources, etc. of the customer (art. 5).

(3) Offering of Materials, Etc.

When receiving an order for a transaction in foreign securities for which domestic disclosure is not conducted from a customer, the Association Member must explain to the customer to that effect in principle (art. 6, para. 4).

In addition, the Association Member must keep the notices and other information materials provided by the issuer of the foreign securities which the Association Member is entrusted with the custody of, and allow the customer to access these, and must deliver notices and materials, etc. delivered by the issuer at the customer's request (art. 6, para. 1 and para. 3).

Furthermore, the Association Member must endeavor to make important materials that have been made public by the issuer of the foreign securities which contribute to the relevant customer's investment decision available to the customer (art. 6, para. 2).

(4) Solicitation, Etc. of Already-Issued Foreign Securities

(i) Eligible Securities

From the standpoint of investor protection, concerning foreign share, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds that already have been issued, those for which an Association Member is permitted to solicit orders from customers (except for institutional investors and certain business entities, etc.; hereinafter the same shall apply in (4)(i) and (ii)) are limited to the following foreign securities; provided, however, that foreign securities involved in "foreign securities distribution " and "private secondary distribution" provided for in the FIEA, and foreign securities to be delivered in connection with the settlement of foreign securities futures transactions, etc. are excluded (art. 7, para. 1):

(a) Foreign share, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds that are traded in a Qualified Foreign Financial Instruments Market (foreign financial instruments exchange markets and over-the-counter markets that Association Members determine adequately protect investors and satisfy the regulatory requirements contained in these Rules; hereinafter the same shall apply in these Rules), foreign share, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds (limited to those meeting both of the following requirements) that are expected to be traded in a Qualified Foreign Financial Instruments Market and the foreign bonds issued by the issuer of these securities:

i) that the transaction is scheduled on such Qualified Foreign Financial Instruments Market is publicly disclosed or approved by such Qualified Foreign Financial Instruments Market or a competent authority or a similar organization that supervises such Qualified Foreign Instruments Market; and

ii) that the price in the public offering or the secondary distribution of such securities has already been determined, or the price that is a basis for the transaction of such securities is publicly disclosed by such Qualified Foreign Financial Instruments Market.

(b) Those foreign government bonds, etc. and those bonds which were issued by an international organization of which Japan is a member;

(c) Those foreign bonds and foreign preferred subscription securities (limited to those prescribed in FSA Notification No. 19 dated on March 27, 2006 and similar ones) of which disclosure is conducted pursuant to the FIEA;

(d) Those foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds traded at a financial instruments exchange market in Japan;

(e) Those foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds that are issued by the issuer of securities that are listed on the markets described in (d) above;

In addition, concerning foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds that have already been issued, those for which Association Members are permitted to solicit orders from customers by a "private secondary distribution" (excluding an exclusive offer to sell, etc. to professional investors) are limited to the following foreign securities (art. 7, para. 2 and para. 3);

(f) Foreign shares, etc., foreign share option certificates and foreign investment equity subscription right certificates falling under (a) above; and

(g) Foreign bonds falling under (a), (b) or (e) above and those issued pursuant to the laws and regulations of the country or territory meeting the requirements under each Item of Article 7, paragraph 3 of these Rules.

(ii) Case of Selling Without Solicitation

An Association Member must, when selling (including the case of entrustment) or conducting an intermediary service of a sell order (including intermediary service of entrusted sell order) in connection with foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds other than the eligible securities prescribed in (i) above without soliciting a customer, properly manage it by preparing a document stating that the order is based on the customer's intention, and keeping and maintaining the document except for the cases prescribed in the rules (art. 8).

(iii) Transaction Forms

The transaction forms for already-issued foreign securities are generally classified into transactions on a financial instruments exchange market in Japan (hereinafter "domestic entrustment transactions" in these Rules), foreign transactions, and domestic OTC transactions, but because domestic entrustment transactions are regulated by the various exchange regulations, they are not subject to these Rules.

(a) Foreign Transaction

Foreign transaction means a transaction that is a sale and purchase order for foreign securities (excluding foreign investment trust securities) executed by method of intermediating, brokering, or acting as agent on a foreign financial instruments market (including OTC markets) as well as the brokering of sales for tender offers of foreign securities (art. 2, para. 1, item 18).

(b) Domestic OTC Transaction

Domestic OTC transaction means a domestic OTC transaction for a foreign security (excluding foreign investment trust securities) (art. 2, para. 1, item 19).

(5) Domestic Over-the-Counter Transactions

(i) Settlement

Settlement of securities in domestic over-the-counter transactions is processed by an account transfer (art. 10).

(ii) Ensuring Fairness in Transactions

In order for an Association Member to carry out a domestic over-the-counter trade with a customer for foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds, the trade must take place at an appropriate price based on the "Internal Market Price (market price computed in a reasonable manner)" (art. 11, para. 1).

The duty of best execution as prescribed in the FIEA will apply if an Association Member enters into a domestic over-the-counter transaction with a customer for foreign shares, etc. that are listed on a domestic financial instruments exchange market.

In addition, the Internal Market Price must be fixed taking into account the continuity of the methods used for acquisition and computation. If the Internal Market Price is difficult to obtain or if the Internal Market Price of an issue was not calculated on an ongoing basis, then the Internal Market Price shall be calculated in accordance with a reasonable and appropriate price (art. 11, para. 2 and para. 3).

Furthermore, at the customer's request, an Association Member must explain to the customer a summary of the computation method, etc. from which the trading price was derived, either verbally or in writing (art. 11, para. 4).

(iii) Ensuring Fairness in Transactions with Small Investors

If an Association Member will conduct a domestic over-the-counter trade with a customer (other than a qualified institutional investor prescribed in Article 2, Paragraph 3, Item 1 of the FIEA and certain business entities, etc.), *i.e.,* small investors, who will engage in a transaction in foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds under a contract of less than JPY10 million when converted into Japanese yen, the Association Member must give sufficient heed to the following items in addition to those mentioned in (ii) above in order to provide greater fairness in trading (art. 12):

(a) Notification of price information

In general, it is difficult for small investors to obtain price information as compared to qualified institutional investors. Therefore, when price information is requested by small investors, an Association Member must notify these investors of the trading prices at its offices in a prompt manner, as well as present other reference information such as the closing price of foreign securities on the foreign financial instruments exchange market to the small investors when requested (art. 12, item 1).

(b) Raising awareness of domestic over-the-counter transaction

An Association Member shall endeavor to raise awareness among small investors with respect to domestic Over-the-Counter transactions in foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds, by keeping at a counter leaf lets, etc. (art. 12, item 2).

(iv) Prohibition of Extraordinary Transactions

(a) With respect to domestic Over-the-Counter transaction in foreign bonds to be conducted by an Association Member with a customer or another Association Member, the Association Member must not effect the transactions set forth in these Rules and any other acts of providing financial returns to customers or the third parties with the aim of compensating for the customer's loss or adding to the profit (art. 13, para. 1).

(b) An Association Member must, when a short-term transaction conducted with a customer has produced a substantial amount of profits for the customer, be mindful of the possibility that such a transaction may fall under an "Extraordinary Transaction," and must endeavor to strengthen further internal control of matters concerning the contract with the customer, confirmation of such a contract, keeping of records, etc. (art. 13, para. 2).

The phrase "short-term" refers to trades where the buy and sell occur within two business days based on the contract date or the delivery date. "Substantial amount of profit" means one percent or more per face value (art. 13, para. 3 and para. 4).

(v) Preparing and Keeping of Transaction Records

When an Association Member has effected domestic Over-the-Counter transaction of foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates and foreign bonds, it must properly manage by immediately preparing an order slip and other related documents that state such matters as the contracting time, and must keep and maintain those documents in a proper manner. (art. 14, para. 1).

In addition, an Association Member must keep and maintain Internal Market Price on a daily basis; provided, however, that, if Internal Market Price is calculated in accordance with a certain rule, it is enough for them to keep and maintain the basis for such rule (art. 14, para. 2).

Where obtaining the Internal Market Price is difficult, or where a transactions is conducted in an issue for which calculations are not made on a continuing bases, such Association Member must retain (i) the quotations of foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds related to such transaction which are acquired through a market information service, (ii) the price or quotations of such foreign shares, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds at their principal trading markets, and/or other information which was referred to in conducting the transaction. (art. 14, para. 3).

(6) Sale, Etc. of Foreign Investment Trust Securities

Some kinds of foreign investment trust securities (meaning the beneficiary certificates of an open-end type

foreign investment trust (excluding foreign ETFs) and open-end type investment securities (excluding foreign ETFs); hereinafter the same in these Rules) are not seen in Japan, and there are countless different types of such investment trust securities. Therefore, provisions are included concerning the selection criteria, disclosure of materials, marketing methods, etc. for those foreign investment trust securities sold in Japan, geared particularly towards the protection of investors:

(i) Eligible Securities

The foreign investment trust securities for which an Association Member may solicit (excluding "foreign securities distribution") and sell to customers (excluding qualified institutional investors) must be the ones confirmed by the Association Member to meet all of the criteria set forth in each of the following and not to have any problem in view of investor protection (art. 15):

(a) those foreign investment trust securities established in accordance with the laws and regulations of the countries or regions that satisfy certain requirements; and
(b) in case of falling under a public offering or a secondary distribution, those meet the "selection criteria" separately prescribed for foreign investment trust beneficiary certificates (limited to open-end; excluding foreign ETFs) or foreign investment securities (limited to open-end foreign investment securities; excluding foreign ETFs) .

(ii) Selection Criteria

In these Rules, the selection criteria for foreign investment trust securities differ depending on whether the securities are foreign investment trust beneficiary securities or foreign investment securities (art. 16 and art. 17).

(iii) Notification, Etc. of Commencement of Sale

Upon the handling of a public offering or secondary distribution (excluding "foreign securities distribution" provided for in the FIEA; hereinafter the same in these Rules) of foreign investment trust securities, an Agent Association Member must be appointed. An Agent Association Member is an Association Member that is the designated firm with respect to the said foreign investment trust securities and engages in delivery of informational material pertaining to the said foreign investment trust securities and publication of the net asset value, etc., on behalf of the issuer under a contract it enters into with the issuer or local underwriter.

The Agent Association Member must submit a "Statement of Notification of Handling of Foreign Investment Trust Securities", a "Confirmation Letter" that relates to the conformity to the selection criteria, a copy of the contract related to the Agent Association Member and other documents prescribed by the JSDA upon commencing sales of the foreign investment trust securities (art. 18, para. 1).

Also, when an Agent Association Member intends to discontinue such agent functions, it must notify the JSDA to that effect (art. 18, para. 2).

(iv) Obligation to Repurchase

An Association Member must, even when the foreign investment trust securities have become unable to meet the selection criteria, accept an order from a customer for brokerage for the repurchase or cancellation of the securities (art. 19).

(v) Disclosure of Materials

An Association Member must send to the customer to whom the Association Member sold foreign investment trust securities the financial statement and all other documents (hereinafter referred to as the "financial statement, etc." in these Rules) with respect to the foreign investment trust securities.

However, this shall not apply in the case where the issuer sends the financial statement, etc. to the customer, or where an Agent Association Member or another Association Member (who sold the relevant foreign investment trust securities to the customer) has provided the particulars that are required to be stated in the financial statement, etc. to the customer by means of an electronic data processing system or by any other means of information and communications technology.

Furthermore, if the foreign investment trust securities the Association Member itself sold to a customer no longer comply with the selection criteria, that Association Member must notify the customer of that effect without delay (art. 22).

(7) Underwriting, Etc. of Public Offering of Foreign Shares , Etc. in Japan

(i) Eligible Securities

The foreign share certificates, etc. (excluding the foreign preferred subscription securities provided for in the FSA Notification No.19 dated on March 27, 2006, and similar instruments) that an Association Member can conduct underwriting, etc. of Public Offering in Japan (meaning the underwriting (limited to that carried out in a public offering), secondary distribution, or the handling of public offering or a secondary distribution, exclusive offer to sell, etc. to professional investors or the handling of exclusive offer to sell, etc. to professional investors of foreign share certificates, etc. by an Association Member; hereinafter the same in these Rules) are limited to the following certificates (art. 24):

(a) Securities traded or scheduled to be traded on the Qualified Foreign Financial Instruments Market; and

(b) Securities traded or scheduled to be traded on a Financial Instruments Exchange Market in Japan.

(ii) Smooth Conclusion, Etc. of Sale and Purchase

An Association Member who conducts Underwriting, etc. of Public Offering in Japan of foreign shares, etc. which are not listed on a financial instruments exchange market in Japan shall endeavor to smoothly execute sell or purchase orders of customers through foreign transactions or domestic Over-the-Counter transactions (art. 26).

(iii) Notification of Underwriting, Etc. of Domestic Public Offering

When underwriting, etc. a domestic public offering of foreign share certificates, etc. that are not listed on a domestic financial instruments market of an exchange, an Association Member must submit in advance to the JSDA "Statement of Notification of Underwriting, etc. of Public Offering in Japan of Foreign Shares, etc." and other materials deemed necessary by the JSDA (art. 27, para. 1).

(iv) Submission, Etc. of Materials, Etc.

An Association Member must promptly receive or collect materials helpful to investors' investment decisions that are published by the issuer and materials or information deemed especially necessary by the JSDA received from such issuer (including the Japanese agent thereof), and is obligated to submit these to customers and make them available to the public in accordance with this rule. However, this shall not apply to cases where the materials, etc. published by the issuer can be easily and continuously acquired in Japan by using the Internet or by any other means (art. 28, para. 1).

When an Association Member receives or collects materials, etc. from issuers, it must secure the reliability in the delivery of information by entering into a contract, etc., with the issuer and submit in advance to the JSDA

copies of documents related to the said contract, etc., and a document that states the operating procedure for collecting information, etc. (business rules for information collection) (art. 28, para. 2).

(v) Publication of the Name, Etc. of the Issuer

The JSDA shall publicize the name of the issuer and the name, etc. of the main qualified foreign financial instruments market among the matters notified by an Association Member pursuant to (iii) and (iv) above (art. 29).

(vi) How to Respond in Case Materials, Etc. Cannot Be Received or Collected from the Issuer

In cases where a problem occurs that prevents an Association Member from receiving or collecting materials, etc. immediately from an issuer, the Association Member must promptly collect materials, etc. in connection with the issuer that has publicly disclosed to the main qualified foreign financial instruments market, the authority that supervises such qualified foreign financial instruments market, or a self-regulatory organization equivalent in status to the JSDA, and furnish these to customers and make them available to the public in accordance with these Rules.

When a situation arises where it is difficult to promptly receive or collect the materials, etc. from the issuer, or when such situation is resolved, the Association Member shall immediately notify to that effect to the JSDA and announce such facts publicly (art. 28, para. 3).

(8) Investment Solicitation, Etc. for Professional Investors (Application Mutatis Mutandis, etc. of JSDA Shares and Investment Trusts for Professionals (J-Ships))

If an Association Member makes an exclusive offer to sell, etc. to professional investors or a private placement (limited to the case set forth in Article 2, Paragraph 3, Item 2 (b) of the FIEA) or handles an exclusive offer to sell, etc. to professional investors regarding foreign shares, etc., foreign share option certificates, foreign bonds with share options, foreign investment trust beneficiary certificates, foreign investment securities, or foreign investment equity subscription right certificates that have not been listed on a financial instruments exchange market in Japan, the Association Member must follow these Rules and part of the "Rules Concerning Solicitation of Professional Investors for Investment in Over-The-Counter Securities, Etc." (art. 49 to art. 52).

(9) Foreign Stocks Margin Transaction System

Foreign stocks margin transactions are margin transactions defined in Article 156-24, Paragraph 1 of FIEA for which a Regular Member conducts the intermediary, brokerage or agency service for the sale and purchase of securities on a foreign financial instruments exchange by granting credit to a customer in Japan, and the Regular Member or the customer does not receive credit from the local securities dealer (art. 2, para. 1, item 23).

(i) Scope of eligible foreign share certificates, etc.

Foreign share certificates, etc. to be handled by a Regular Member in foreign stocks margin transactions are limited to those listed on a qualified foreign financial instruments exchange located in the United States, and other securities are not eligible for foreign stocks margin transactions. A Regular Member shall formulate and publish criterial for selection, etc. of issues it handles from among issues that meet the following criteria under the "Guidelines for Selection of Issues, etc." established by the JSDA and shall provide customers with information on the selected issues (art. 31).

(a) Issues that are component issues of any of the stock indices a. to c. below (in case of securities similar to investment securities issued by a foreign investment corporation,

limited to those for which notification has been made to the Financial Services Agency pursuant to the provisions of Article 220 of the Act on Investment Trusts and Investment Corporations (including securities for which notification is not required pursuant to the provisions in parentheses in Paragraph 1 of Article 220)):

a. Dow Jones Industrial Average;
b. Standard & Poor's 500 Stock Index; and
c. NASDAQ 100 Index;

(b) Issues that do not meet the criterion mentioned in (a) but meet all of the criteria in a. to g. below:

a. an issue for which the average market capitalization of the previous month is USD 5 billion or more;
b. an issue for which the average trading value per day on a US market for the previous six-month period is USD 50 million or more; and
c. an issue that is listed on any of the following:
i) The New York Stock Exchange;
ii) Nasdaq Global Market;
iii) Nasdaq Global Select Market;
iv) NYSE Arca (limited to ETFs); or
v) Cboe BZX Exchange (limited to Tier I);
d. an issue which has been listed for 30 days from the date of listing (except for ETFs);
e. an issue for which the average stock price in the previous month is USD 10 or more;
f. an issue for which a fact or event that would lead to delisting is not published or scheduled; and
g. in the case of an ETF, an issue which meets the criteria mentioned in (b), a. to f., and also meets the following criteria:
i) the ETF is not a leveraged ETF or inverse ETF;
ii) the ETF is not an issue that invests in derivatives transactions, except for any of the following purposes:
[i] the purpose of realizing profits and losses similar to as in the case of holding the assets in which an investment is to be made;
[ii] the purpose of reducing risks that may arise from price fluctuations and interest rate fluctuations; or
[iii] the purpose of reducing risks that may arise from exchange rate fluctuations; and
iii) the ETF is an issue for which notification has been made to the Financial Services Agency pursuant to Article 58 of the Act on Investment Trusts and Investment Corporations (including issues for which notification is not required pursuant to the provisions in parentheses in Paragraph 1 of Article 58).

(ii) Written Agreement for Establishment of a Foreign Stocks Margin Transaction Account, Etc.

When conducting foreign stocks margin transactions with a customer, a Regular Member must receive from the customer a "Written Agreement for Establishment of a Foreign Stocks Margin Transaction Account" in

which the necessary information is stated and establish a "foreign stocks margin transaction account" (art. 32).

(iii) Receipt of Security Deposit in Foreign Stocks Margin Transactions

When a sale or purchase in foreign stocks margin transactions (excluding reversing trade conducted for the settlement of foreign stocks margin transactions) is executed, a Regular Member shall receive money in an amount equivalent to or more than either of the following amounts as a security deposit from a customer by the date and time designated by the Regular Member on the third business day counting from the contract date (art. 33):

(a) If, at the time of receipt, there is no deposit that has been received for the customer's foreign stocks margin transactions:

The amount obtained by multiplying the contract value by 50 percent (hereinafter referred to as the "normal minimum amount"); however, if the amount thus obtained falls below the amount in US dollars designated by the Regular Member as an amount equivalent to JPY300,000 or more (hereinafter referred to as the "designated minimum amount"), the designated minimum amount shall apply; or

(b) If, at the time of receipt, there is a deposit that has been received for the customer's foreign stocks margin transactions:

a. If the sum of the normal minimum amount for the foreign stocks margin transactions and the total amount of security deposit that has been received from the customer for foreign stocks margin transactions is equivalent to or more of the designated minimum amount: the normal minimum amount for the foreign stocks margin transactions; or

b. If the sum of the normal minimum amount for the foreign stocks margin transactions and the total amount of security deposit that has been received from the customer for foreign stocks margin transactions is less than the designated minimum amount: the normal minimum amount for the foreign stocks margin transactions plus the difference.

(iv) Type of Money Received as Security Deposit, Etc.

Money that a Regular Member may receive as a security deposit from a customer is denominated in Japanese yen or US dollars, and if such money is received in Japanese yen, the amount thereof shall be an amount obtained by multiplying the amount converted into US dollars based on the foreign exchange rate designated by the Regular Member by 95 percent (art. 34).

(v) Use of Securities as a Substitute for Security Deposit in Margin Transactions

A Regular Member may have a security deposit for foreign stocks margin transactions substituted by securities. The types of securities in lieu of a security deposit (margin securities) are as set forth in the following, and the substitute price at the time of receipt does not exceed an amount obtained by multiplying the market price on the previous day (if the market price on the date of receipt is available, such market price may be applied) by the substitution ratio (in the case of yen-denominated securities, it does not exceed an amount converted into US dollars based on the foreign exchange rate designated by the Regular Member) (art. 35, para. 1 and para. 2).

<Substitution ratio for margin securities>

(a) Share certificates listed on a domestic financial instruments exchange market: 70/100;
(b) Japanese Government Bonds: 85/100;
(c) Local Government Bonds: 75/100;
(d) Bonds issued by corporations under a special law:
  a. Bonds for which the government guarantees redemption of principal and payment of interest: 80/100;
  b. Other bonds: 75/100;
(e) Corporate bonds listed on a domestic financial instruments exchange market: 75/100;
(f) Corporate bonds with share options listed on a domestic financial instruments exchange market or corporate bonds with share options issued by a company whose share certificates are listed on a domestic financial instruments exchange market and which are issued by a company other than a foreign corporation: 70/100;
(g) Exchangeable corporate bonds listed on a domestic financial instruments exchange market: 70/100;
(h) Foreign government bonds listed on a domestic financial instruments exchange market: 75/100;
(i) Foreign municipal bonds listed on a domestic financial instruments exchange market: 75/10;
(j) Yen-denominated bonds of International Bank for Reconstruction and Development: 80/100;
(k) Yen-denominated bonds of Asian Development Bank: 80/100;
(l) Yen-denominated foreign bonds issued by a foreign corporation other than issuers of the bonds referred to in (h) to (k): 75/100;
(m) Investment trust beneficiary certificates and investment securities:
  a. Beneficiary certificates of a public and corporate bond investment trust: 75/100;
  b. Others: 70/100;
(n) Foreign share certificates, etc., beneficiary certificates of foreign beneficiary certificate-issuing trusts and ETNs listed on a qualified foreign financial instruments market located in the United States: 60/100 (or 70/100 if the most recent market value applies).

(vi) Lending of Securities or Money in Foreign Stocks Margin Transactions and Deadline for Return

A Regular Member shall lend the securities sold or the purchase price on the delivery date for the sale or purchase in foreign stocks margin transactions, by taking the sales proceeds or the securities purchased and security deposit as collateral. The deadline for return or repayment shall be the business day following the day of lending, and if the customer has not notified the Regular Member of the intention to return or repay by the day that is three business days prior to the deadline, the deadline shall be extended to the following business day sequentially. A Regular Member may designate the maximum number of times of such extension (art. 36).

(vii) Withdrawal of Security Deposit, Etc.

Regarding money or securities which have been received from a customer as security deposits for foreign

stocks margin transactions, a Regular Member may allow the customer to withdraw money up to the amount calculated by subtracting the amount obtained by multiplying the contract value for all securities pertaining to the customer's foreign stocks margin transactions (excluding securities pertaining to reversing trade or securities for which delivery of money or securities necessary for settlement by other methods than reversing trade was received) by 50 percent (if the amount thus obtained is less than the designated minimum amount (except in the case where it is zero), subtracting the designated minimum amount) from the total amount of security deposit received for the customer's foreign stocks margin transactions (art. 37, para. 1).

(viii) Calculation Method of Security Deposit in Foreign Stocks Margin Transactions

The total amount of security deposit received shall be calculated by deducting each of the following amounts; provided, however, that in the calculation of the total amount of security deposit received in the case of settling part of the unsettled account, the amount referred to in (a) below for the unsettled account to be settled shall not be deducted (art. 38, para. 1):

(a) The amount equivalent to the total amount to be borne by the customer for the customer's foreign stocks margin transactions, including the amount corresponding to implicit losses calculated by deducting profits from losses arising from fluctuations of the prices of the securities pertaining to the customer's foreign stocks margin transactions, the loss due to reversing trade and brokerage commissions, interest on loans, and the premium charge pertaining to borrowed securities (excluding the amount to be borne by the customer in accompaniment of ex-rights occurring on securities sold in foreign stocks margin transactions, when calculating the total amount of security deposit from the customer);

(b) In cases where the customer is granted credit in addition to the credit granted that is equivalent to the contract value of securities pertaining to the customer's foreign stocks margin transactions, the amount equivalent to such additionally granted credit; and

(c) In cases where the customer has remaining obligations to the Regular Member even after the settlement of the customer's unsettled account (including loans and other obligations related to new claims and obligations with the Regular Member), the amount equivalent to such remaining amount.

In the calculation of the total amount of security deposit received, substitute securities and securities pertaining to foreign stocks margin transactions shall be appraised on the basis of the market price on the previous day (if the market price on the precious day is not available, the most recent market price shall be applied; if the market price on the date of calculation is available, such market price may be applied) (art. 38, para. 2 and para. 3).

In addition, if a Regular Member intends to allow a customer to conduct foreign stocks margin transactions on a non-business day in Japan, the Regular Member shall calculate the amount of security deposit received on the non-business day as well (art. 38, para. 7).

(ix) Receipt of Additional Security Deposit in Foreign Stocks Margin Transactions

If any implicit loss arises in a customer's foreign stocks margin transactions due to fluctuations of the prices of the securities pertaining to the customer's foreign stocks margin transactions, a Regular Member may receive from the customer an amount equivalent to the amount of such loss as an additional security deposit (art. 40).

(x) Maintenance of Security Deposit in Foreign Stocks Margin Transactions

On each business day, a Regular Member shall calculate the total amount of security deposit received for a customer's foreign stocks margin transactions and the amount obtained by multiplying the contract value for all securities pertaining to the customer's foreign stocks margin transactions by 30 percent. If the total amount of security deposit received for a customer's foreign stocks margin transactions falls below the amount obtained by multiplying the contract value for all securities pertaining to the customer's foreign stocks margin transactions by 30 percent, a Regular Member must receive from the customer an additional security deposit in an amount necessary to maintain that total amount, by the date and time designated by the Regular Member on the third business day counting from the day on which the implicit loss is calculated. However, this shall not apply if a customer files a request for settlement of an unsettled account subject to the calculation of the implicit loss (in the case of settlement by a method other than reversing trade, limited to cases where delivery of money or securities necessary for settlement by other methods than reversing trade was received) (art. 41.)

(xi) Receipt of Order for Foreign Stocks Margin Transactions, Etc.

When an order for foreign stocks margin transactions is received from a customer, a Regular Member must receive an instruction from the customer to execute the order by foreign stocks margin transactions, and when acting as a broker to send a customer's order for foreign stocks margin transactions to a local securities dealer, a Regular Member shall employ a method whereby a distinction can be made between foreign stocks margin transactions and other transactions (art. 42).

(xii) Treatment of Amount of Adjustment for Ex-Dividend Stock, Etc.

If dividends of surplus or any other money is delivered with regard to an issue for which foreign stocks margin transactions are conducted, a Regular Member shall collect from the customer selling the issue on margin, an amount calculated according to the "Guidelines for Treatment of Rights" established by the JSDA and pay such amount to the customer purchasing the issue on margin (art. 43, para. 1).

In addition, if a right to receive shares or any other rights are granted as a result of a share split, etc. regarding the issue for which foreign stocks margin transaction are conducted, a Regular Member shall treat such rights according to the "Guidelines for Treatment of Rights" established by the JSDA (art. 43, para. 2).

(xiii) Prevention of Excessive Solicitation, Etc.

A Regular Member shall refrain from soliciting customers to conduct foreign stocks margin transactions (excluding reversing trade conducted for the settlement of foreign stocks margin transactions) in issues for which a qualified foreign financial securities market located in the United States, the supervisory authorities that supervise the qualified foreign financial securities market or a self-regulatory organization similar to the JSDA gives warnings or imposes restrictions on transactions individually, and if a Regular Member accepts orders for foreign stocks margin transactions in such issues from a customer, the Regular Member must explain to the customer the fact that such warnings are given or restrictions are imposed, and the details thereof (art. 44, para. 1 and para. 2).

In addition, a Regular Member shall not accept orders for foreign stocks margin transactions (excluding reversing trade conducted for the settlement of foreign stocks margin transactions) in issues for which delisting has been decided by a qualified foreign financial instruments market located in the United States.

A Regular Member must provide in advance guidance on how to treat orders yet to be executed for foreign stocks margin transactions when a qualified foreign financial instruments market located in the United States suspends trading (including cases where a circuit breaker is triggered), and explain this to a customer (art. 44, para. 3 and para. 4).

(xiv) Notice of Transaction Balance

A Regular Member shall notify a customer of his or her unsettled account pertaining to foreign stocks margin transactions by sending a written notice every month (art. 46).

4 8 Other Rules

(1) Uniform Practice Rules

The Uniform Practice Rules have been established to unify the practice concerning sale and purchase or other transactions, etc. of securities by Association Members and actions related thereto, improving the efficiency of the processing of transactions and eliminating disputes arising from the ambiguity or disunity thereof.

(2) Rules for Handling Disputes

The Rules for Handling Disputes have been established to contribute to the resolution of complaints from customers regarding the business operations conducted by Association Members and the mediation for resolution of disputes between customers and Association Members and the prompt and fair resolution of disputes between Association Members concerning the sale and purchase or other transactions, etc. of securities.

As of February 2010, the mediation services for processing complaints from customers of Association Members and resolving disputes between customers and Association Members have been entrusted from the JSDA to the Financial Instruments Mediation Assistance Center (FINMAC).

[Reference] Flows of Procedures for Dispute Resolution at FINMAC

The Financial Instruments Mediation Assistance Center (FINMAC) is a financial ADR (alternative dispute resolution) organization certified by the FSA and the Ministry of Justice to accept requests for consultation, complaints and motions for mediation from users with regard to transactions in financial instruments, in order to resolve complaints or disputes from a fair and neutral standpoint.

Association Members are required to cooperate with FINMAC for promoting resolution of complaints or disputes involving their customers.

The main services of FINMAC include responding to “requests for consultation” and “complaints” brought thereto by users, and conducting the “mediation procedure” (dispute resolution),

1. Acceptance of requests for consultation

FINMAC staff provides consultation and advice to users in response to their requests and questions regarding transactions in financial instruments.

2. Procedure for dispute resolution

FINMAC notifies Association Members of the details of the complaints it has confirmed with users, aiming to resolve the disputes between the users and the Association Members.

<Procedural flow>

(1) Confirm the details of the complaint

FINMAC accepts a complaint from a user (a user’s manifestation to an Association Member of their dissatisfaction with the services provided by the Association Member; the same shall apply hereinafter).

(2) Notify the Association Member of the complaint

FINMAC notifies the Association Member of the complaint filed against it by the user and requests investigation.

(3) Report the investigation results to the user

The Association Member and FINMAC report the investigation results to the complaining user.

3. Mediation procedure (initiated if the dispute is unable to be resolved by the procedure in 2)

A mediator, who is a lawyer, positions him/herself between the disputing user and Association Member, aiming to resolve their dispute.

<Procedural flow>

(1) Accept a motion for mediation

If a user seeks dispute resolution by the mediation procedure, FINMAC receives a motion for mediation from the user and accepts it after confirming its content.

(2) Receive the mediation motion fee

The user is required to pay a mediation motion fee (the amount of the fee depends on the amount of damages claimed) within 10 days from the day on which the notice of acceptance of the motion for mediation arrives at the user.

(3) Conduct the mediation procedure

The mediator, who is a lawyer, hears the circumstances of the dispute from both the user and the Association Member, and indicates a settlement proposal to solve the dispute.

If both the user and the Association Member are satisfied with the settlement proposal, they sign a settlement agreement.

The mediation procedure may be called off if both the user and the Association Member are dissatisfied with the settlement proposal, or the mediator judges that a settlement cannot be reached. In this case, the parties to the dispute may go to court to solve their dispute in civil action if they wish to do so.

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Introduction

A financial instruments exchange is a juridical person (either a financial instruments membership corporation or stock company) that establishes and operates a marketplace on which sale and purchase in securities or market derivatives transactions (hereinafter "securities trading, etc.") take place ("financial instruments market") (Financial Instruments and Exchange Act, hereinafter "FIEA," art. 2, para. 16).

Because establishing a financial instrument market is imbued with a strong public character, license by the Prime Minister is required (FIEA, art. 80, para. 1). The application for a license is examined to ensure, inter alia, that: (i) the articles of incorporation, business regulations and brokerage agreement standards—which are the important regulations of the financial instruments exchanges—conform to the law and regulations and are sufficient for achieving the fair and smoothly functioning securities trading, etc. on the financial instruments markets operated by financial instruments exchanges (hereinafter referred to as "financial instruments exchange markets"), and for protecting investors; and (ii) the license applicant has a sufficient personnel structure to run a financial instruments exchange market in an appropriate manner (FIEA, art. 82, para. 1). If thereafter a change occurs, the approval of the Prime Minister (the Commissioner of the Financial Services Agency) must be received with respect to each such change (FIEA, art. 149, para. 1, art. 194-7, para. 1).

The major regulations of the financial instruments exchanges are the articles of incorporation, which provide for fundamental matters of the organization and operation of the financial instruments exchange; the business regulations, which prescribe the methods, etc. for transactions conducted on the market at the financial instruments exchange; the trading participant regulations, which prescribe matters concerning trading participants; the clearing and settlement regulations, which prescribe matters concerning the clearing and settlement of transactions conducted on the financial instruments exchange market; the listing regulations, which prescribe for the listing, de-listing, and timely disclosure, etc. of securities; and the brokerage agreement standards, which prescribe the terms and conditions concerning the agreement between the customer and the financial instruments business operator, etc. which is trading participant.

An outline of the major items among the various regulations of the Tokyo Stock Exchange Incorporated (hereinafter referred as the "TSE") and Osaka Exchange Incorporated (hereinafter referred to as the "OSE"; the TSE and the OSE are hereinafter collectively referred to as the "Exchange") is described below.

Foundation of Japan Exchange Group, Inc.

Tokyo Stock Exchange Group, Inc. and Osaka Securities Exchange, Inc. effected a merger as of January 1, 2013, and Japan Exchange Group, Inc. (hereinafter referred to as "JPX") was founded as an organization that owns Tokyo Stock Exchange, Inc. (hereinafter referred to as the "TSE"), Osaka Securities Exchange, Inc. (renamed Osaka Exchange, Inc. in March 2014; hereinafter referred to as the "OSE") and others as its affiliates.

Following this, the OSE's spot markets were integrated into the TSE's spot markets as of July 16, 2013, and the TSE's derivatives markets were integrated into the OSE's derivatives markets as of March 24, 2014. Thus, the markets previously operated by the respective exchanges were integrated according to the characteristics of the products traded on the markets. In addition, in order to realize a comprehensive exchange enabling one-stop transactions for a broad range of products from financial instruments to commodities, JPX made Tokyo Commodity Exchange, Inc. (hereinafter referred to as "TOCOM") its subsidiary on October 1, 2019, and transferred part of the products listed on TOCOM's commodity futures markets to OSE's markets as

of July 27, 2020.

With regard to clearing after transactions, OSE's clearing function for market derivatives transactions was integrated into the Japan Securities Clearing Corporation as of July 16, 2013. As in the case of TSE's clearing function, this company further merged with Japan Commodity Clearing House Co., Ltd., which was TOCOM's subsidiary, as of July 27, 2020.

Self-Regulation Organization

The Exchange must perform self-regulation related services in an appropriate manner in order to ensure the fair purchase and sale of securities on the financial instruments exchange market, as well as to protect investors (FIEA, art. 84, para. 1).

The "self-regulation related services" are the following services conducted in respect of a financial instruments exchange: (i) services related to the listing and delisting of financial instruments, etc.; (ii) the investigation of whether the members or trading participants (hereinafter referred to as the "members, etc.") comply with laws and regulations, dispositions by government agencies which are based on laws and regulations, with the articles of incorporation and other rules, and with the equitable principle of trade; and (iii) services related to an examination of the contents of purchase and sale of securities which are conducted by the members, etc. on a financial instruments exchange market (FIEA, art. 84, para. 2; Cabinet Office Ordinance on Financial Instruments Exchanges, art. 7).

With the authorization of the Prime Minister (the Commissioner of the Financial Services Agency), the Exchange may entrust the whole or part of these self-regulation services to a self-regulation organization (FIEA, art. 85, para. 1, art. 194-7, para. 1).

It is not permissible for a person other than the Exchange, etc. to incorporate a self-regulation organization (FIEA, art. 102-3). A self-regulation organization must obtain the authorization of the Prime Minister (the Commissioner of the Financial Services Agency) if it seeks to perform self-regulation services. In order to obtain the authorization, the applicant for authorization must undergo an examination regarding whether the application conforms to the criteria including: (i) the provisions of the articles of incorporation and the operational rules of the self-regulation organization conform to laws and regulations, and are sufficient to allow the proper operation of self-regulation services; and (ii) the applicant has a sufficient personnel structure to operate self-regulation services in an appropriate manner (FIEA, art. 102-16, art. 194-7, para. 1).

In order to perform self-regulation services properly, a self-regulation organization needs to have in place an organizational structure which allows it to maintain a high-level of autonomy and manage and operate its services from a neutral stance, and also needs to be well-versed in the functions and characteristics of financial markets.

Within the framework under the FIEA as described above, in October 2007, the Tokyo Stock Exchange Group established a self-regulation organization, Tokyo Stock Exchange Regulation, as its group member organization which was independent from the TSE, a market operating organization.

In November 2007, Tokyo Stock Exchange Regulation began operation as an organization specialized in performing self-regulation services upon entrustment by the TSE.

Following the inauguration of the JPX in January 2013, the self-regulation functions of the OSE were transferred to Tokyo Stock Exchange Regulation in July 2013, and then Tokyo Stock Exchange Regulation was renamed Japan Exchange Regulation in April 2014.

Based on the self-regulation structure developed in this manner, Japan Exchange Regulation performs

self-regulation services effectively for financial instruments exchange markets, in a position that is neutral and independent from TSE and OSE, while exerting a high level of expertise in close coordination with both exchanges.

1 Articles of Incorporation

The articles of incorporation contain the fundamental rules governing a juridical person.

The Exchange is a stock company under the Companies Act, and the articles of incorporation of the Exchange contain provisions concerning its trade name, purposes, location of principal office, manner of public notices, matters concerning shares, matters concerning the shareholders meeting, matters concerning directors and the board of directors, matters concerning auditors and the board of auditors, matters concerning accounting auditors, and matters concerning accounting, similar to an ordinary stock company.

In addition, since the Exchange operates a financial instruments market as a financial instruments exchange, in addition to the above matters, the articles of incorporation provide for the following matters.

1 1 Matters Concerning the Financial Instruments Exchange Market

The articles of incorporation provide that the types of transactions conducted on the financial instruments exchange market (hereinafter the "exchange market") are sale and purchase in securities on the TSE or market derivatives transactions on the OSE (TSE Articles of Incorporation, art. 2, para. 1, item 1, art. 42; OSE Articles of Incorporation, art. 2, para. 1, item 1, art. 42).

Moreover, in view of the importance and the public nature of the exchange for the national economy, the articles of incorporation include a statement that the exchange market shall conduct its operations, placing the highest value on making securities trading, etc. executed in a fair and smooth manner in order to contribute to the public interest and the protection of investors (TSE Articles of Incorporation, art. 2, para. 2; OSE Articles of Incorporation, art. 2, para. 2).

1 2 Matters Concerning Rule-Making

The articles of incorporation of the Exchange provide that: (i) matters necessary for securities trading, etc. on the exchange market shall be provided by the business regulations; (ii) any agreement pertaining to the acceptance of brokerage by a trading participant for securities trading, etc. on the exchange market shall be provided by the brokerage agreement standards; and (iii) in addition to above, the Exchange may establish other rules as necessary in the operations of the exchange market (TSE Articles of Incorporation, art. 44; OSE Articles of Incorporation, art. 44).

Furthermore, among necessary matters concerning securities trading, etc., the business regulations have delegated regulations on matters concerning trading participants, clearance and settlement, and listed securities to the trading participant regulations, clearance and settlement regulations, listing regulations, and other relevant regulations, respectively (TSE Business Regulations. rule 1-3; OSE Business Regulations, rule 2).

1 3 Matters Concerning Compliance with the Laws/Regulations and Various Rules by Trading Participants, Examinations, and Disciplinary Actions

When securities trading, etc. proceeds in a fair and smooth manner, exchange markets can play an important and public role in the national economy. To this end, trading participants must be persons who are sufficiently trustworthy to become market players.

As such, in order to regulate these trading participants, the articles of incorporation provide that trading participants must comply with laws and regulations, the regulations of the exchanges and the just and equitable principles of trade, etc. (TSE Articles of Incorporation, art. 45; OSE Articles of Incorporation, art. 45). Moreover, to realize this goal and to duly perform its role as market operator, the Exchange may conduct any necessary investigations in order to examine the status of the compliance of trading participants with laws and regulations, the regulations of the exchanges or the just and equitable principles of trade, etc., or any other cases prescribed by the business regulations. In addition, when a trading participant violates laws and regulations, or the rules and regulations of the Exchange, takes any action in violation of the just and equitable principles of trade, or falls under any other causes for a disciplinary action set forth in the business regulations, the Exchange may take disciplinary actions against the trading participant such as imposition of fines, suspension from or restriction on securities trading, etc. by the offending trading participant on the exchange market, revocation of the trading qualifications, or any other dispositions (TSE Articles of Incorporation, art. 46 and art. 47; OSE Articles of Incorporation, art. 46 and art. 47).

1 4 Matters Concerning Advisory Committees

Since it is important that the Exchange, which plays an important and public role in the national economy, is managed properly, the Exchange provides for the establishment of advisory committees to deliberate on important matters concerning the operations of its markets (TSE Articles of Incorporation, art. 41; OSE Articles of Incorporation, art. 41).

Currently, there is the market management committee as an advisory committee.

2 Trading Participant Regulations

2 1 General Provisions

The TSE Trading Participant Regulations and the OSE Trading Participant Regulations provide for necessary matters concerning the trading participants of the TSE and the OSE, pursuant to Rule 1-3, Paragraph 1 of the TSE Business Regulations and Rule 2, Paragraph 1 of the OSE Business Regulations, respectively.

There is only one type of trading participants on the TSE: general trading participants who are qualified to conduct the sale and purchase of securities (TSE Trading Participant Regulations, rule 2, para. 1 and para. 2).

The training participants on the OSE are categorized into four types: (i) futures, etc. trading participants who are qualified to conduct government bond futures transactions, interest rate futures transactions, index futures transactions, commodity futures transactions, securities options transactions, government bond futures options transactions, index options transactions, and commodity futures options transactions; (ii) government bond futures, etc. trading participants who are qualified to conduct government bond futures transactions, interest rate futures transactions, and government bond futures options transactions; (iii) commodity futures, etc. trading participants who are qualified to conduct commodity index futures transactions, commodity futures transactions and commodity futures options transactions; and (iv) foreign exchange margin trading participants (FX trading participants)* who are qualified to conduct exchange foreign exchange (FX) margin transactions (OSE Trading Participant Regulations, rule 2, para. 1 through para. 5).

Commodity futures, etc. trading participants are classified into two categories depending on the type of transactions they conduct: commodity brokerage trading participants who are qualified to conduct commodity index futures transactions, commodity futures transactions and commodity futures options transactions on OSE's markets; and commodity market trading participants who are qualified to conduct commodity index futures transactions, commodity futures transactions and commodity futures options transactions on OSE's markets only on their own accounts. By type of commodity, they are also classified into four categories: precious metal division trading participants; rubber division trading participants; agricultural division trading participants; and crude oil division trading participants (OSE Trading Participant Regulations, rules 2-2 and 2-3).

Trading participants are required to endeavor to ensure fair price formation and efficient distribution in the exchange markets, thereby maintaining and enhancing its functions as a financial instruments exchange market. Moreover, they must be persons who conduct securities trading, etc. on the exchange markets as their important business (TSE Trading Participant Regulations, rule 3, para. 1 and para. 2; OSE Trading Participant Regulations, rule 4, para. 1 and para. 2).

* The OSE's exchange FX margin transactions market had seen a constant growth in the trading volume since its opening. However, trading on this market was suspended temporarily in October 2014, partly due to the shift of transactions from exchange markets to over-the-counter markets accompanying the increased transparency, reliability and convenience of over-the-counter FX margin transactions market resulting from the tightened regulations and tax system reforms.

2 2 Acquisition of Trading Qualifications

Persons desiring to acquire trading qualifications must make an application to the Exchange to acquire trading qualifications (TSE Trading Participant Regulations, rule 4, para. 1; OSE Trading Participant Regulations, rule 30, para. 1).

Financial instruments business operators (limited to those registered for the business concerning acts provided for in FIEA, art. 28, para. 1, item 1) or exchange trading authorized firms can become general trading participants and futures, etc. trading participants. Financial instruments business operators (limited to those registered for the business concerning acts provided for in FIEA, art. 28, para. 1, item 1), exchange trading authorized firms or registered financial institutions can become government bond futures, etc. trading participants.

Among commodity futures, etc. trading participants, financial instruments business operators (limited to those registered for the business concerning acts provided for in FIEA, art. 28, para. 1, item 1-2), exchange trading authorized firms or registered financial institutions can become commodity brokerage trading participants. In addition to these types of business operators, persons such as business operators engaging in a business of the sale and purchase, intermediary, brokerage or agency services, production, processing or use of the commodities designated by OSE, or commodity futures brokers (meaning the commodity futures brokers prescribed in Article 2, Paragraph 23 of the Commodity Derivatives Transaction Act), can also become commodity market trading participants. However, individuals and other persons who are disqualified under the FIEA cannot become commodity market trading participants.

Financial instruments business operators (limited to those registered for type II financial instrument business) or registered financial institutions can become FX trading participants (TSE Trading Participant Regulations, rule 4, para. 2; OSE Trading Participant Regulations, rule 32, para. 1).

When the Exchange approves the application, once the applicant takes the necessary procedures to obtain trading qualifications (TSE Trading Participant Regulations, rule 5, para. 1; OSE Trading Participant Regulations, rule 32, para. 2), pays the admission fee (TSE) or trading participation fee (OSE) and enters into a trading participation agreement by the day immediately prior to the date designated by the Exchange (the date of acquisition of trading qualification), takes the necessary procedures to obtain clearing qualifications (where the applicant does not obtain clearing qualifications, it must enter into a clearing entrustment contract and designate a designated clearing participant) under the clearance and settlement regulations (see “Section 5. Clearing and Settlement Regulations” of this Chapter for details), deposits the guarantee fee, and deposits the trading participant guarantee, the applicant will obtain trading qualifications on the date prescribed by the Exchange (TSE Trading Participant Regulations, rule 6, para. 1: OSE Trading Participant Regulations, rule 33).

2 3 Duties, Etc. of the Trading Participant

Trading participants must enter into an agreement with the Exchange whereby they assent to comply with the regulations, etc. of the Exchange (TSE Trading Participant Regulations, rule 7: OSE Trading Participant Regulations, rule 31). Also, trading participants must register one person as its trading participant representative with the Exchange, who is appropriate for representing such trading participant at the Exchange (TSE Trading

Participant Regulations, rule 8, para. 1 OSE Trading Participant Regulations, rule 6, para. 1), and must register one office as a liaison office at which it receives notifications from the Exchange (TSE Trading Participant Regulations, rule 10; OSE Trading Participant Regulations, rule 8).

When the Exchange finds that the cooperative or control relationship of the officers of a trading participant and other person is inappropriate in the light of operation of the Exchange markets, after holding a hearing with such trading participant, the Exchange may demand the alteration thereof by giving the reason therefore (TSE Trading Participant Regulations, rule 9, para. 1; OSE Trading Participant Regulations, rule 5, para. 1).

Trading participants must pay trading participant fees (TSE Trading Participant Regulations, rule 11; OSE Trading Participant Regulations, rule 9) and deposit the participant bond and trading participant security money with the Exchange (TSE Trading Participant Regulations, rule 12, para. 1; rule 13, para. 1; OSE Trading Participant Regulations, rule 11, para. 1, and rule 11-2, para. 1). The participation bond secures the claims of the entrustors of transactions on the financial instruments markets, and the other trading participants, as well as financial instruments exchanges and financial instruments clearing organizations. Entrustors of transactions on financial instruments exchanges are given first priority to be satisfied out of the participation bond prior to the other trading participants (FIEA, art. 114, para. 4 and art. 115). The Exchange sets the required amount of participation bond as JPY3 million (TSE Trading Participant Regulations, a rule. 12, para. 2; OSE Trading Participant Regulations, rule 11, para. 1). Furthermore, securities can be deposited in lieu of cash with respect to participation bond and trading participant security money, in principle (TSE Trading Participant Regulations, rule 12, para. 3, rule 13, para. 2; OSE Trading Participant Regulations, rule 11, para. 2, and rule 11-2, para. 2; FIEA, art. 114, para. 2).

In addition, in light of the operations of the Exchange market, the Exchange ascertains the actual state of management and business of the trading participants by requiring trading participants to obtain a prior approval of the Exchange in cases where they are going to conduct a merger, etc., or to file a prior notice with the Exchange in cases where they are going to change their officers, and also by imposing reporting duties on them with respect to various other matters prescribed by the Exchange (TSE Trading Participant Regulations, rule 16 through rule 18; OSE Trading Participant Regulations, rule 14 through rule 16).

It is needless to say that there are an innumerable number of investors behind the backdrop of securities trading, etc. and the settlement thereof on the exchange market. To protect these investors and maintain order, the Exchange shall conduct investigations of trading participants, and can impose a variety of restrictions on trading participants with respect to the securities trading, etc. they are entrusted from customers.

First, as regards the examination of trading participants, where the Exchange conducts an examination of the trading participant's compliance with laws and regulations, etc., the Exchange can demand the submission of reports and materials to be used as a reference concerning the operations or property of the trading participant, or investigate the status of the trading participant's operations, property or books, documents or other items (TSE Trading Participant Regulations, rule 19; OSE Trading Participant Regulations, rule 17).

In addition, in order to eliminate exaggerated advertisements or prevent obstacles to fair competition, the trading participant must conduct its advertising activities in accordance with the rules prescribed by the Exchange (TSE Trading Participant Regulations, rule 20).

Next, with a view to preventing incidents, etc. when a trading participant accepts the trade, etc. of securities to be conducted on the exchange market, it must carry out prior inquiries as to the address, full name, and other matters concerning the customer (TSE Trading Participant Regulations, rule 21; OSE Trading Participant Regulations, rule 19).

In addition, a trading participant must develop a trading management system designed to prevent unfair trading

(TSE Trading Participant Regulations, rule 22-2; OSE Trading Participant Regulations, rule 21), as well as an order management system designed to prevent accepting and placing erroneous orders (TSE Trading Participant Regulations, rule 22-3; OSE Trading Participant Regulations, rule 21-2). Furthermore, a trading participant must properly develop the system for examining the listing eligibility of companies applying for listing of its securities as the managing trading participant and a risk management system regarding the positions in market derivatives transactions (TSE Trading Participant Regulations, rule 22-4: OSE Trading Participant Regulations, rule 21-3), and it must also develop a corporate information management system that is deemed necessary and appropriate in light of the operations of the exchange markets in order to prevent unfair transactions using corporate information (TSE Trading Participant Regulations, rule 22-5: OSE Trading Participant Regulations, rule 21-4).

In addition to the various operating regulations described above, when the Exchange finds it urgently necessary in the light of operations of the exchange market, the Exchange may implement necessary and proper restrictions concerning the operations of all or part of trading participants (TSE Trading Participant Regulations, rule 24; OSE Trading Participant Regulations, rule 23).

2 4 Loss of Trading Qualification

There are two ways to lose trading qualification: voluntary loss and mandatory loss. In the case of the former, the approval of the Exchange is necessary. In the case of the latter, however, notwithstanding the intent of the trading participant, if it falls within certain legally prescribed circumstances, which are (i) loss of trading qualifications by the trading participant; (ii) dissolution; and (iii) where trading qualification is automatically lost due to the revocation of the trading qualification, then the approval of the Exchange or procedures to apply to renounce trading qualification are unnecessary (FIEA, art. 94 and 95 applied *mutatis mutandis* pursuant to FIEA, art. 113, para. 3).

Upon losing its trading qualification, there is an issue concerning which method shall be in place to process the remaining unsettled sales and purchases, etc. of securities conducted by the trading participant.

In the case of voluntary loss of trading qualification, the Exchange shall suspend securities trading, etc. on the exchange market pertaining to the trading qualification of the trading participant from the day after the date it accepts the application to renounce trading qualification from trading participants (TSE Trading Participant Regulations, rule 26; OSE Trading Participant Regulations, rule 35), and must process the unsettled transactions of the trading participant by having another trading participant succeed to such obligations (TSE Clearing and Settlement Regulations, rule 56; OSE Clearing and Settlement Regulations, rule 34). The Exchange grants its approval with respect to the loss of trading qualification on a certain date in the future (TSE Trading Participant Regulations, rule 28, para. 1; OSE Trading Participant Regulations, rule 37, para. 1).

Furthermore, where the trading participant who made an application to renounce trading qualification loses such qualification simultaneously upon a merger, etc. with another person such as a person possessing a trading qualification similar to the original trading qualification, since the rights and obligations of the applicant will by operation of law be succeeded to by such person, there is no special need to process the unsettled transactions of the applicant by globally suspending its securities trading, etc., and in this case, the securities trading, etc. of the applicant is generally not suspended (TSE Trading Participant Regulations, rule 27; OSE Trading Participant Regulations, rule 36).

On the other hand, in the case of a mandatory loss, the trading participant will lose its trading qualification when the prescribed events occur, and the unsettled securities trading, etc. is carried over after such loss. Moreover, even in the case of a voluntary loss, there could be cases where unsettled securities trading, etc. is carried over. As such, when the person who lost his/her trading qualification has unsettled securities trades, etc. which relate to his/her lost trading qualification, such person or a general successor may trade securities, etc. for the purpose of settlement thereof, and under the management of the Exchange (TSE Trading Participant Regulations, rule 31; OSE Trading Participant Regulations, rule 40).

When the trading participant loses its trading qualification, the Exchange shall immediately give public notice of the fact that the participant has lost its trading qualification. Moreover, when the trading participant conducts acceptance of securities trading, etc., the Exchange shall give public notice regarding the return of the trading participant's participation bond (TSE Trading Participant Regulations, rule 29, para. 1; OSE Trading Participant Regulations, rule 38, para. 1). The trading participant cannot request the return of its participation bond until six months after the date of the aforementioned public notice (TSE Trading Participant Regulations, rule 29, para. 2; OSE Trading Participant Regulations, rule 38, para. 3).

Persons who lost their trading qualification must allot all cash and securities to be returned from the Exchange towards the satisfaction of all claims such persons owe to the Exchange as a trading participant (TSE Trading Participant Regulations, rule 30; OSE Trading Participant Regulations, rule 39).

2 5 Disciplinary Actions and Measures Towards Trading Participants

In order to secure its market management, the Exchange can take disciplinary actions or measures towards trading participants that disturb the maintenance of order on the exchange markets, under strict rules.

First, the cases where the Exchange will take disciplinary actions towards trading participants are broadly classified into the following cases: (i) where such participants are unfit as trading participants; (ii) where a trading participant encounters difficulties in its assets or business such as insolvency or breach of contract; and (iii) where a trading participant violates its duties. After conducting an examination of the trading participant who falls under any of these circumstances, the Exchange can impose a fine, warning, suspension or restriction of securities trading, etc. by the trading participant, suspension or restriction of its clearing brokerage entrustment, or revocation of its trading qualification (TSE Trading Participant Regulations, rule 34; OSE Trading Participant Regulations, rule 42).

When the trading participant has objections to the disciplinary actions, relief measures such as the filing of a protest can be taken (TSE Trading Participant Regulations, rule 9, para. 3 and para. 4 as applied mutatis mutandis pursuant to rule 38; OSE Trading Participant Regulations, rule 5, para. 3 and para. 4 as applied mutatis mutandis pursuant to rule 46).

Next, when the trading participant is subject to sanction under the laws and regulations, the Exchange will implement measures such as suspending or restricting the trading participant's trades, etc. of securities, suspending or restricting the entrustment of clearing brokerage or revoke its trading qualification, depending on the content of such sanction (TSE Trading Participant Regulations, rule 39; OSE Trading Participant Regulations, rule 45).

In addition to these disciplinary action and measures, when the Exchange finds that the officers or control relationship, etc. of the trading participant is improper in view of the market management, in order to urge the improvement thereof, it may suspend or restrict the securities trading, etc. of the trading participant, suspend or

restrict its clearing brokerage entrustment, or implement any other measures deemed necessary and appropriate by the Exchange (TSE Trading Participant Regulations, rule 35, para. 1; OSE Trading Participant Regulations, rule 43, para. 1). Moreover, if the trading participant encounters financial difficulties, the Exchange can suspend or restrict its securities trading, etc. or suspend or restrict entrustment of its clearing (TSE Trading Participant Regulations, rule 35, para. 2; OSE Trading Participant Regulations, rule 43, para. 2); and when the trading participant becomes insolvent or is likely to become insolvent, the Exchange may suspend its securities trading, etc., suspend its clearing brokerage entrustment (TSE Trading Participant Regulations, rule 35, para. 3; OSE Trading Participant Regulations, rule 43, para. 3), and cause it to process any unsettled transactions remaining (TSE Clearing and Settlement Regulations, rule 58; OSE Clearing and Settlement Regulations, rule 36) in an attempt to return the situation to normal.

Finally, the Exchange lists the acts that violate the duty of good faith in transactions (*e.g.,* acceptance of an order for cornering of shares from persons having the purpose of selling such shares to the related persons of the issuer), and take any administrative measures for such cases (TSE Trading Participant Regulations, rule 34, para. 1, item 8, rule 42; OSE Trading Participant Regulations, rule 42, para. 1, item 10, and rule 51).

2 6 Mediation

The Exchange establishes a system to autonomously resolve a dispute between trading participants concerning the trade, etc. of securities, a loan of securities or other transaction (TSE Trading Participant Regulations, rule 44; OSE Trading Participant Regulations, rules 53 through 55).

2 7 Remote Trading Participant System

Against the increase of trades by overseas investors in the recent years, and in response to the needs for direct participation to the exchange market from overseas, the remote trading participant system which allows foreign securities dealers that do not have branch offices, etc. in Japan to directly participate in the exchange market as a trading participant was introduced in February 2009. In principle, regulations similar to “2.1 General Provisions” through “2.6 Mediation” above have been established with respect to remote trading participants.

3 Securities Listing Regulations

Securities for trading in the exchange market are the securities that are listed on that financial instruments exchange. Securities that are not listed cannot be traded on financial instruments exchanges.

Listing on a financial instruments exchange means that a financial instruments exchange admits the securities issued by corporations and others as securities for trading in the market that are operated by that financial instruments exchange.

The securities to be listed are limited to securities as defined under the FIEA. Specifically, these include share certificates, government bonds, municipal bonds, corporate bonds and convertible type bonds with share options.

By listing securities, the issuer or investors of the securities enjoy a variety of benefits. Generally, because listed securities are broadly available to the public and the market price is publicly announced every day through the media, etc., the issuer can benefit from the increase in the power to procure funds, the modernization and streamlining of management, the improvement of social trustworthiness and company awareness. On the other hand, because setting fair prices and the appropriate circulation are secured through transactions on the exchange, investors can benefit from the increased ease of trading (liquidity) as well as the increase in the asset and collateral value of the securities invested.

Thus, the listing of securities serves the important function of connecting issuers of securities and investors through the financial instruments exchange market.

The listing system of securities of the TSE can be divided largely into the listing examination system of securities and the management system of listed securities. The TSE Securities Listing Regulations (hereinafter referred to as the "TSE Listing Regulations") cover the application for listing securities with respect to the former, and timely disclosure of company information of the issuer, ensuring of the effectiveness of listing management, and delisting of listed securities, etc. with regard to the latter, and the system is managed pursuant to respective guidelines.

The TSE decided to reorganize the existing five market segments (1st Section, 2nd Section, Mothers, JASDAQ Standard and JASDAQ Growth) based on clear concepts, with the aim of boosting listed companies' sustainable growth and mid- to long-term corporate value creation, thereby providing attractive stock markets that have the approval of a diverse range of global and domestic investors and further contributing to a more affluent society in general. As of April 4, 2022, the three new market segments, the Standard Market, the Prime Market, and the Growth Market, started operation.

The concepts of respective market segments are as follows.

<Standard Market>

For companies which have appropriate levels of market capitalization (liquidity) to be investment instruments in the open market, keep the basic level of corporate governance expected of listed companies, and commit to sustainable growth and improvement of medium- to long-term corporate value.

<Prime Market>

For companies which have appropriate levels of market capitalization (liquidity) to be investment instruments for many institutional investors, keep a higher quality of corporate governance, and commit to sustainable growth and improvement of medium- to long-term corporate value, putting constructive dialogue with investors at the center.

<Growth Market>

For companies which have a certain level of market value by disclosing business plans for realizing high growth potential and their progress towards these appropriately and in a timely manner, but at the same time pose a relatively high investment risk from the perspective of business track record.

In addition to this, the TSE is operating the TOKYO PRO Market, a market for share certificates, etc., and the TOKYO PRO-BOND Market, a market for bonds, both of which have been established based on the "professional market system" introduced pursuant to the amendments to the FIEA in 2008. While the TOKYO PRO Market is a

market aimed at providing an opportunity to procure funds to Japanese and Asian growing companies which are at the early stage unsupported by general exchange markets, the TOKYO PRO-BOND Market is a market aimed at realizing expeditious and flexible issuance of bonds in response to the market environment by greatly simplifying the documents required to be disclosed upon issuance of bonds without damaging the quality of the information provision service to investors and thereby making the procedures more efficient. Please note that these markets have adopted systems largely different from that of general exchange markets such that in principle, persons other than professional investors (FIEA, art. 2, para. 3, item 2 (b) 2.) cannot purchase the securities listed on such markets (FIEA, art. 117-2, para. 1). The general system for listing securities which are adopted at markets except for professional markets shall be explained below.

3 1 Procedures for New Listing of Shares, Etc.

Except for government bonds, etc., the TSE does not list shares, etc. unless the issuer files a listing application for such shares, etc. (TSE Listing Regulations, rule 201). On the face of the law, as long as the TSE makes a registration with the Prime Minister, it could theoretically list an issue of shares, etc. regardless of the intent of the issuer; however, the intent of this provision is to ensure that listing proceeds based on the actual application made by the issuer.

When an issuer intends to list its shares, etc., it must submit documents including a "Security Initial Listing Application Form" and "Written Oath Concerning Application for Initial Listing" prescribed by the TSE (TSE Listing Regulations, rule 204).

Upon receipt of the application for listing, the TSE shall examine the appropriateness of the listing based on the Listing Requirements (TSE Listing Regulations, rule 205-207, etc.), and shall file the listing notification with the Prime Minister when it decides to list the shares, etc. (FIEA, art. 121; the notification must be submitted to the Local Finance Bureau under the Cabinet Office Ordinance on Financial Instruments Exchanges, art. 70).

When the TSE newly lists an issue of shares, etc., the TSE shall require the issuer to submit the listing agreement specified by the TSE, and shall enter the required items such as the issue name of the subject shares, etc., the volume, etc. in the original register of listed shares, etc. on the effective date of the listing agreement (TSE Listing Regulations, rule 203).

3 2 Listing Requirements of Shares, Etc.

With regard to the listing examination of shares, etc., the examination is conducted with the emphasis on whether the listing of the shares, etc. on the TSE would be necessary and appropriate for setting a fair price and to facilitate the maintenance of adequate circulation, as well as benefit the public and protect investors, as described below. In "3-2 Listing Requirements of Shares, Etc.," the new listing on the Standard Market is explained.

This listing examination is conducted for companies that meet all of the following formal requirements (TSE Listing Regulations, rule 205):

(i) The number of shareholders;
(ii) Shares in circulation;
(iii) The number of continued years of business;
(iv) The amount of net assets;
(v) The amount of profits;
(vi) False statements or adverse opinions, etc.;
(vii) Audit by the registered auditor of listed companies;
(viii) The appointment of a transfer agent;
(ix) The number of shares in a unit;
(x) The types of the share certificate, etc.;
(xi) Restriction on transfer of shares;
(xii) The handling by designated book-entry transfer institutions; and
(xiii) Outlook for conducting mergers, etc.

Applications meeting the formal requirements are examined substantially in terms of the following factors (TSE Listing Regulations, rule 207, para. 1):

(i) Corporate continuity and profitability (operates business continuously, and has a stable revenue base);
(ii) Healthiness of corporate management (performs operations fairly and faithfully);
(iii) Effectiveness of corporate governance and internal management systems (the corporate governance and internal management systems have been prepared appropriately and are functioning);
(iv) Appropriateness of corporate disclosure, etc. (can disclose corporate details appropriately); and
(v) Other matters considered necessary by the TSE from the viewpoint of public interest or investor protection, with respect to the issuer.

The foregoing is the overview of the listing examination for domestic shares. As for the listing examination for foreign shares, etc., the examination is conducted based on the listing examination system for domestic shares, taking into consideration characteristics that are unique to foreign shares, etc.

Specifically, a substantive examination is conducted for companies that can meet the criteria of deposit agreements, etc., in addition to satisfying all of items (i) through (vi) (as for (ii), the requirement regarding the ratio of tradable shares does not apply), and (xiii) for domestic shares (TSE Listing Regulations, rule 206, para. 1, item 4). This substantive examination takes into consideration the laws, business practices, etc. of the issuer's domicile.

Meanwhile, if an issuer of share certificates, etc. that have already been listed on the TSE (hereinafter called the "listed company") newly issues the same type of share certificates, etc., the listing shall, as a rule, be approved (TSE Listing Regulations, rule 302).

Following the series of public stock offerings that resulted in the significant share dilution, rapid progress has been made in the development of systems for increasing capital by allotting share options without contribution (generally referred to as "rights offering"). However, there is an argument that some companies which would have

been unqualified to raise capital by the conventional capital increase methods use the rights offering scheme and issue a large number of shares without going through a third party's review on whether their share issues are reasonable, giving rise to a concern that shareholders may suffer disadvantage from such share issues. Under such circumstances, the TSE revised its listing criteria for share option certificates (meaning the securities set forth in Article 2, Paragraph 1, Item 9 of the FIEA or the securities set forth in Item 17 of the said paragraph that have the nature of share option certificates set forth in Item 9 of the said paragraph) in October 2014.

Specifically, a listing of share option certificates to be allotted through a generally-called non-commitment-type rights offering* must meet (i) the criteria regarding the procedure for assessment of reasonableness of the capital increase and (ii) the criteria regarding the issuing company's business performance and financial conditions, in addition to the existing listing criteria (TSE Listing Regulations, rule 304).

* "Non-commitment-type rights offering" refers to a type of rights offering for which there is no underwriter who commits to exercise share options that remain unexercised.

3 3 Market Restructuring

If the TSE receives an application for alteration of market segment to a different market segment (meaning the Standard Market, the Prime Market or the Growth Market, other than the one on which the relevant share certificates, etc. are currently listed), it shall conduct examinations in the same manner as the application for new listing described above (TSE Listing Regulations, rules 306 through 308).

3 4 Timely Disclosure, Etc. and Other Listing Management

For listed shares, etc. that have been listed after having gone through examinations in accordance with examination requirements, the TSE imposes a continual obligation on the issuers of the shares, etc. to ascertain and report any facts that may have material effects on their management as well as any important decisions that may affect rights concerning shares, etc.

In other words, the TSE imposes obligations such as: (i) disclosure concerning determinations made on material matters for making investment decisions concerning the issuance of shares, capital reductions, mergers, etc. (TSE Listing Regulations, rule 402, item 1); (ii) disclosure where facts arise which are material on making investment decisions, such as occurrence of damages, changes to the major shareholder, dishonoring of bills, etc. (TSE Listing Regulations, rule 402, item 2); (iii) disclosure of facts concerning subsidiaries (TSE Listing Regulations, rule 403); and (iv) disclosure of details of the account settlement (earnings reports or *kessan tanshin*) (TSE Listing Regulations, rule 404). The issuer shall disclose corporate information timely using TDnet (the timely disclosure information transmission system of the TSE) (TSE Listing Regulations, rule 414, para. 1). In addition, the TSE requires the issuer to agree to make documents which have been disclosed via TDnet available for public inspection (TSE Listing Regulations, rule 414, para. 6).

In addition to the above, the TSE sets, as the charter of corporate behavior, "matters to be observed" setting forth matters that listed companies must observe at the minimum, such as matters to be observed concerning third

party allotments (TSE Listing Regulations, rule 432), securing of independent officers (TSE Listing Regulations, rule 436-2), prohibition of insider trading (TSE Listing Regulations, rule 442), and exclusion of antisocial forces (TSE Listing Regulations, rule 443), and "desired matters" setting forth matters for which listed companies are requested to make efforts, such as maintenance of system for eliminating antisocial forces (TSE Listing Regulations, rule 450), etc.

In particular, with respect to third party allotments, the TSE has improved systems concerning third party allotments in 2009 such as (i) improvement of delisting criteria, (ii) new establishment of corporate code of conduct, (iii) establishment of provisions regarding timely disclosure, (iv) submission of a written confirmation stating that the person who receives an allocation does not have relationships with any antisocial forces, in order to ensure an environment in which investors can make investments securely.

In 2015, a new corporate governance system was introduced, requiring listed companies to implement the principles of the "Corporate Governance Code," or, if they do not implement the principles, requiring them to explain the reasons in their corporate governance report (TSE Listing Regulations, rule 436-3). As such, listed companies must respect the objective and spirit of the "Corporate Governance Code" and make efforts to enhance their corporate governance (TSE Listing Regulations, rule 445-3), and also make efforts to retain at least one independent director among the members of the board of directors (TSE Listing Regulations, rule 445-4).

Integration of Quarterly Securities Reports into Quarterly Earnings Reports

In 1999, the TSE started to require the companies listed on the former Mothers market to make a quarterly disclosure, and then, starting in 2003, it applied this requirement to all listed companies in phases. In 2006, the quarterly securities report system was introduced under the FIEA as a system for providing investors with substantial information on the business performance and financial conditions of listed companies on a quarterly basis, while ensuring comparability and reliability of such information.

On the other hand, with non-financial information related to mid to long-term corporate values becoming more important in recent years, it was pointed out that quarterly securities reports required under the FIEA and quarterly earnings reports required under the TSE rules partially overlapped in terms of content and the timings of their disclosure were close, and there was a call for the review of the quarterly disclosure system from the perspective of reducing costs and enhancing efficiency. In light of such situation, the amendment of the FIEA in 2023 abolished quarterly securities reports, which had been required to be submitted in the first and third quarters, in order to integrate them into quarterly earnings reports under the TSE rules from April 1, 2024.

Corporate Governance Code

The "Corporate Governance Code" is a set of principles attached to the TSE Listing Regulations, which was prepared based on the "Corporate Governance Code [Final Proposal]" developed by the "Council of Experts Concerning the Corporate Governance Code" (finalized on March 5, 2015). The "Corporate Governance Code" establishes fundamental principles for effective corporate governance at listed companies in Japan. It is expected that the Code's appropriate implementation will contribute to the development and success of companies, investors and the Japanese economy as a whole through individual companies' self-motivated actions in order to achieve sustainable growth and increase corporate value over the mid- to long-term.

3 5 Ensuring Effectiveness

The TSE takes measures necessary for listing management in accordance with the timely disclosure, etc. of corporate information by the issuer or the charter of corporate behavior to contribute to investor protection.

Specifically, the TSE takes measures including the following: the designation of securities on special alert (TSE Listing Regulations, rule 503) and submission of improvement reports (TSE Listing Regulations, rules 504 through 507) from the viewpoint of promoting improvement as measures to ensure effectiveness upon violation of rules such as the timely disclosure of corporate information, etc. and violation of the "matters to be observed" under the charter of corporate behavior; and public announcement (TSE Listing Regulations, rule 508) and imposition of listing contract penalty (TSE Listing Regulations, rule 509) from the viewpoint of imposing penalty.

In 2014, a new rule has been introduced to allow the TSE to give cautions to investors by publicizing the information on the matters mentioned above more speedily and flexibly (TSE Business Regulations, rule 30).

3 6 Delisting Requirements for Share Certificates, Etc.

A delisting of shares listed on the TSE shall be handled with great care since it may have a significant influence on stakeholders such as trade counterparties, financial institutions, investors, etc., not to mention the listed company itself.

The TSE has prescribed standards for delisting domestic share certificates, and if a listed domestic share certificate falls under any of the following criteria, it will be delisted (TSE Listing Regulations, rule 601):

(i) In conformity to the standards for maintaining listing;
(ii) Suspension of banking transactions;
(iii) Bankruptcy, civil rehabilitation, or corporate reorganization proceedings;
(iv) Suspension of business activities;
(v) Inappropriate mergers, etc.;
(vi) Damaging the soundness of transactions with controlling shareholders;
(vii) Delayed submission of annual securities reports or semiannual securities reports;
(viii) False statements or adverse opinions, etc.;
(ix) Securities on special alert; etc.;
(x) Violations of the listing agreement, etc.;
(xi) Entrustment to a transfer agent;
(xii) Restrictions on stock transfers;
(xiii) The issuer becomes a wholly owned subsidiary company;
(xiv) The handling by designated book-entry transfer institutions;
(xv) Unfair restrictions on the rights of shareholders;
(xvi) The acquisition of all shares by the listed company;
(xvii) The acquisition of shares, etc. in response to demand for a share, etc. cash-out;
(xviii) Consolidation of shares;

(xix) Involvement of antisocial forces; and
(xx) Other criteria.

For the delisting of foreign share certificates, etc., in addition to the above-mentioned criteria (ii) through (x), (xiii) and (xv) through (xx), the following criteria have been established: (i) nonconformity to continued listing criteria regarding foreign share certificates, etc.; (ii) termination of deposit agreements, etc.; and (iii) delisting, etc. on an overseas financial instruments exchange, etc. (TSE Listing Regulations, rule 602).

Furthermore, if a listed share certificate, etc. has a possibility of meeting one of the delisting requirements or if the issuer of the listed share certificates, etc. requests delisting, the TSE may designate such share certificates, etc. as Securities Under Supervision so as to apprise investors of the facts (TSE Listing Regulations, rule 608). Furthermore, if the delisting of a listed share certificate, etc. has been determined, the TSE may designate such share certificates, etc. as Securities To Be Delisted until the day prior to the delisting date so as to apprise investors of the facts (TSE Listing Regulations, rule 609).

3 7 Listing of Non-participating Preferred Share and Tracking Share

While the application for listing non-participating preferred shares (class shares with preferred rights concerning the distribution of surplus which distribution will not be made from the amount available for distribution remaining after payment of preferred distributions) and tracking shares (classes of shares that provide for the payment of dividends based on the performance, or surplus, etc. of a consolidated subsidiary of the issuer; together with the non-participating preferred share, hereinafter "preferred shares") is conducted using procedures very similar to "3.1 Procedures for New Listing of Shares, Etc." above (TSE Listing Regulations, rules 801 to 803), in light of the uniqueness of preferred shares, etc., the listing examination and delisting are conducted in accordance with requirements and standards that are different from those for "3.2 Listing Requirements of Shares, Etc." and "3.6 Delisting Requirements for Share Certificates, Etc."

The listing examination is conducted for issues applying for new listing that can meet formal requirements such as: (i) the issuer shall have listed common share (voting share); (ii) the number of owners of preferred shares; (iii) shares in circulation; (iv) handling by designated book-entry transfer institutions; and (v) restrictions on stock transfers (TSE Listing Regulations, rule 804), by a substantial examination in terms of: (i) outlook for booking profit sufficient for distributing surplus; (ii) situation in which the details of shares, corporate information, etc. may be disclosed properly; and (iii) not being deemed inappropriate in light of public interest or investor protection (TSE Listing Regulations, rule 805).

As regards the issuer of preferred share, etc., in addition to the timely disclosure applicable to the issuer of common share, the issuer is obligated to disclose information regarding the peculiarities of preferred share, etc., such as disclosing the contents of major decisions concerning the management, functions or property made by the business execution-determining organ of the subsidiary covered by the tracking share in the case of the issuer of tracking share (TSE Listing Regulations, rule 806).

Also, with respect to delisting, if the issuer meets either of the following criteria: (i) the issuer commits a material breach of the preferred share listing agreement or ceases to be a party to the preferred share listing agreement, or (ii) the issuer's common share meets the delisting requirements for the common share, all issues of

preferred shares, etc. issued shall be delisted. If the listed preferred share, etc. meets one of the following criteria: (i) the number of owners of preferred shares; (ii) shares in circulation; (iii) the preferred share, etc. term has been completed; (iv) trading volume; (v) exclusion from the scope of securities covered by the book-entry transfer business of designated book entry transfer institutions; (vi) restriction on the transfer of shares; (vii) the issuer acquiring all shares concerning the issue; or (viii) other occasions where the TSE acknowledges delisting to be appropriate to the public interest and to protect investors, the listed issue shall be delisted (TSE Listing Regulations, rule 808).

Meanwhile, the preferred share, etc. shall be the same market category as the common stock issued by that issuer (TSE Listing Regulations, rule 802, para. 4).

3 8 Listing of Bonds

As with shares, etc., listing procedures for bonds are based on applying for listing by the issuer and filing to the Prime Minister.

However, government bonds may be listed without applications for listing from issuers (TSE Listing Regulations, rule 901, para. 4).

Among the listing requirements for bonds, requirements for issuers and requirements for corporate bonds applying for listing are provided. Examinations are conducted for bonds that meet these requirements and then listings are determined (TSE Listing Regulations, rule 904). These requirements are as follows: First of all, the issuer must be a listed company on the TSE (TSE Listing Regulations, rule 904, para. 1, item 1), and the criteria for bonds applying for listing include: (i) the aggregate face amount of outstanding bonds; (ii) the number of the bonds subscribed; (iii) par value; and (iv) that the bond is subject to handling by the book-entry transfer business of a designated custody and book-entry transfer institution (TSE Listing Regulations, rule 904, para. 1, item 2). Also, as for bonds other than corporate bonds, listing shall be determined in light of the above-mentioned requirements for bonds applying for listing (TSE Listing Regulations, rule 905, para. 1).

As with the listing requirements, for the delisting requirements for bonds, requirements for issuers and requirements for listed bonds are provided. As with corporate bonds, if an issuer meets either of the following criteria, all issues of bonds issued by the issuer will be delisted: (i) significant violations concerning the listing agreement for the bonds or the issuer not becoming a party to the listing agreement concerning the bonds (TSE Listing Regulations, rule 912, para. 1, item 1); or (ii) the share, etc. (common share) issued by the issuer falls under (ii) through (x), (xix) or (xx) referred to in “3.6 Delisting Requirements for Share Certificates, Etc.” (TSE Listing Regulations, rule 912, para. 1, item 2 a-(a)); and if the listed corporate bonds meet any of the following criteria: (i) where the total nominal amount of outstanding bonds becomes less than JPY300 million by the day a month before the day on which the final redemption date arrives; (ii) where the final redemption date arrives or where advanced redemption is carried out for the total amount of bonds ; or (iii) acceleration of payment; (iv) cases where the debts pertaining to the listed issue are succeeded by another company in an absorption-type company split or incorporation-type company split; (v) cases where the bonds are no longer subject to the book-entry transfer business of a designated custody and book-entry transfer institutions; or (vi) cases where delisting is deemed appropriate in order to protect the public interest or investors, the listed issue shall be delisted (TSE Listing Regulations, rule 912, para. 2).

3 9 Listing of Convertible Type Bonds with Share Options

As with other bonds, when a listing application is filed for convertible type bonds with share options (referring to those bonds with share options which the object of the contribution made upon the exercise of the share option is the bonds underlying such bonds with share options; same hereinafter), a listing examination is conducted, and a determination will be made in accordance with the listing requirements (TSE Listing Regulations, rule 917).

Listing requirements are comprised of requirements for issuers and requirements for issues applying for listing. The former includes the requirement that the issuer is a listed company on the TSE, and the latter includes criteria regarding the following: (i) the total issue amount; (ii) that the terms for exercise of the share options are not terms that are recognized as being inappropriate; (iii) the share options shall be subject to handling by designated book-entry transfer institutions; and (iv) that the bond is not considered inappropriate in order to protect the public good or investors, etc. (TSE Listing Regulations, rule 920, para. 1).

The delisting requirements also prescribe standards concerning the issuer and standards concerning the listed issue. With respect to the former standards, if the issuer falls under any of the following, all issues of the convertible type bonds with share options issued by the issuer will be delisted: (i) if the issuer has materially violated the convertible type bonds with share options, etc. listing agreement or ceases to be a party to the convertible type bonds with share options, etc. listing agreement; (ii) if the share, etc. issued by the issuer meets one of items of various criteria in Rule 601 and Rule 602 of the TSE Listing regulations; and (iii) cases where the issuer will become a wholly-owned subsidiary of another company through a stock swap or stock transfer, and when such other company, etc. is a listed company or expects to list its shares promptly (TSE Listing Regulations, rule 921, para. 1). Also, with respect to the latter standards, if the listed convertible type bonds with share options meet any of the following criteria, the listed issue will be delisted: (i) where the total listed nominal amount becomes less than JPY300 million by the day a month before the day on which the final redemption date arrives; (ii) where the exercise period for a share option reaches maturity; (including the completion of the exercise period due to execution of the early redemption of the total amount of the convertible type bonds with share options); (iii) acceleration of payment; (iv) cases where the liabilities pertaining to the bonds concerning the listed issue are succeeded by another company pursuant to a merger or a absorption-type company split or incorporation-type company split; (v) when the issue will not be subject to handling by designated book-entry transfer institutions; or (vi) where the TSE finds delisting proper in order to protect the public interest or investors, the listed issue shall be delisted (TSE Listing Regulations, rule 921, para. 2).

Furthermore, the TSE provides separately in Rule 926 through Rule 940 of the TSE Listing Regulations concerning the listing of Exchangeable Bonds (referring to bond certificates that may be exchanged for share certificates of a company other than the issuer of such bond at the request of the bondholder).

3 10 Listing of ETN

ETN (Exchange Traded Note) refers to securities issued in foreign countries which are corporate bonds or those which have the nature of corporate bonds, and whose redemption price is aimed at tracking specific indicators such as share price index and commodity price. The TSE Rules provide for a listing system for ETN trust

beneficiary certificates (referring to securities trust beneficiary certificates whose entrusted securities are ETN). The listing of an ETN trust beneficiary certificate shall be determined based on an application by the issuer of the ETN which is the entrusted security, after examination conducted under the criteria for listing examination (TSE Listing Regulations, rule 941).

The criteria for listing examination provide for the qualification requirements for the issuer (*e.g.,* registered financial institution, financial instruments business operator), and the requirements for soundness of the issuer's financial standing (in terms of the amount of net assets or net worth, capital adequacy ratio, and credit rating). The criteria also specify the following matters concerning the merchantability of the ETN to be issued: (i) the matters to be stated in the issuance agreement; (ii) indicator eligibility; (iii) expectations for efficient distribution; (iv) the period until the final redemption date; (v) the requirement that the sum of the total remaining redemption value and the scheduled issuance value of the ETN to be issued should not exceed a certain proportion of the amount of net assets of the issuer; (vi) the handling of the ETN at the designated book-entry transfer institution; (vii) concurrent listing on a foreign financial instruments exchange of the ETN which is the entrusted security; and (viii) the determination that the listing of the ETN is not deemed inappropriate from the viewpoint of the public interest or the protection of investors (TSE Listing Regulations, rule 945).

The criteria further specify the information to be disclosed, including: information to be disclosed on a timely basis, such as the decisions made by the issuer, etc. and the events that occur concerning the issuer, etc.; and the settlement of accounts and credit status (TSE Listing Regulations, rule 947). In addition, the issuer shall provide investors with the following information by a method that enables public inspection: (i) daily data concerning the total remaining redemption value and redemption value per security of the ETN, which is an entrusted security, and (ii) the tracking of the fluctuation of a specified indicator by redemption value per security (TSE Listing Regulations, rule 947-2).

Similarly, the delisting criteria provide for the benchmarks for delisting in relation to the issuer's status, soundness of the issuer's financial standing, and nature of product of the ETN— (a) The benchmarks relating to the issuer's status include (i) the issuer's loss of status as a registered financial institution, etc.; and (ii) the issuer's suspension of its business activities or dissolution. (b) The benchmarks relating to the soundness of the issuer's financial standing include: (i) the amount of net assets or net worth; (ii) capital adequacy ratio; and (iii) credit rating. (c) The benchmarks relating to nature of product include: (i) the matters stated in the issuance agreement; (ii) the correlation coefficient between the redemption value per security and a specified indicator; (iii) the percentage of the total remaining redemption value of the ETN to the amount of net assets of the issuer; (iv) the arrival of the final redemption date; (v) acceleration of payment; (vi) material breach of the listing agreement; (vii) exclusion from the scope of securities covered by the book-entry transfer business of the designated book-entry transfer institution; (viii) delisting from a foreign financial instruments exchange; (ix) termination of the trust agreement; (x) there ceases to be a specific indicator pertaining to a listed ETN trust beneficiary certificate; (xi) a specific indicator pertaining to a listed ETN trust beneficiary certificate is changed to a new indicator, and the Exchange deems that the indicator after the change does not meet the eligibility requirement, or when the Exchange deems that changes in such indicator have a remarkable effect on characteristics associated with a listed ETN trust beneficiary certificate; and (xii) the determination that the delisting of the ETN is appropriate from the viewpoint of the public interest or the protection of investors. An ETN shall be delisted if it falls under any of the above cases (TSE Listing Regulations, rule 951).

3 11 Listing of ETF

ETF (Exchange Traded Fund) collectively refers to beneficiary certificates of investment trusts, etc. intended for managing investment trust property, etc. for investment mainly in securities, rights involved in derivatives transactions or rights involved in transactions of commodities investment, which are traded on an exchange. Under the TSE regulations, listing systems for ETFs are categorized into seven types in accordance with the country of incorporation of the issuer, the law governing the issuance of ETFs and the management method: domestic indicator-tracking ETFs, foreign ETFs, foreign ETF trust beneficiary certificates, domestic spot commodity ETFs, foreign spot commodity ETFs, foreign spot commodity ETF trust beneficiary certificates, and domestic actively managed ETFs. Hereafter, we will explain the listing system of ETFs with domestic ETFs as an example.

The listing of domestic indicator-tracking ETFs (the beneficiary certificates of the investment trusts enumerated in Article 2, Paragraph 1, Item 10 of the FIEA that are related to investment trusts intended for managing investment trust property for investment mainly in securities, rights involved in derivatives transactions or rights involved in transactions of commodities investment, and that are related to investment trusts, managed to match the fluctuation rate of the amount of net assets of the investment trust property, etc. per unit with the fluctuation rate of a specified index) is determined when the investment trust management company, etc. (hereinafter referred to as "management company") and trust company, etc. (hereinafter referred to as "trustee"), acting as trustee files a listing application and the TSE conducts an examination based on the listing requirements (TSE Listing Regulations, rule 1101).

The listing requirements prescribe that the management company must be a member of the Investment Trust Association, Japan and that it gives an undertaking with respect to timely disclosure, etc., as well as the following as the formal standards pertaining to listed issues: (i) the domestic indicator-tracking ETF falls within the category of beneficiary certificates of securities investment trusts other than bond investment trusts or the category of beneficiary certificates of investment trusts set forth in Article 12, Item 1 or Item 2 of the Enforcement Order for the Act on Investment Trusts and Investment Corporations (hereinafter the "ITAEO"); (ii) matters to be stated in indentures; (iii) eligibility, etc. of the juridical person specified in the securities registration statement regarding the domestic indicator-tracking ETF as a person handling the public offering of the domestic indicator-tracking ETF (hereinafter referred to as the "Designated Participant"); (iv) adequacy of the index; (iv) issues comprising the trust property, etc.; (vi) prospect for smooth circulation, etc.; (vii) false statements or adverse opinions, etc.; (viii) handling by designated book-entry transfer institutions; and (ix) the issues are not deemed inappropriate from the perspective of the public interest or investor protection (TSE Listing Regulations, rule 1104).

With respect to disclosure of information, matters such as facts determined by the management company and the trustee and facts that occurred with respect to the management company and the trustee are specified as information to be disclosed (TSE Listing Regulations, rule 1107). The management company shall provide investors with the following information by a method that enables public inspection of (i) details determined on a daily basis with respect to the securities portfolio necessary for acquiring beneficiary certificates under additional entrustment in the future; (ii) daily data of net asset value and net asset value per unit; and (iii) the tracking of the fluctuation of a specified indicator by the net asset value per unit (TSE Listing Regulations, rule 1107-2).

As delisting requirements concerning the person who entered into the listing agreement, the Listing Regulations provide the following criteria: (i) where the registration of the financial instruments trading business of the management company is invalidated or revoked; (ii) where the authorization, etc. of the trustee is revoked; (iii)

the appropriateness of the management company; and (iv) violation of the listing agreement, etc. The delisting requirements contain the following standards concerning the individual issue: (i) the certificates do not fall within beneficiary certificates of securities investment trusts other than bond investment trusts or the certificates are not those of investment trusts specified in Article 12, Item 1 or Item 2 of the ITAEO; (ii) change of matters to be stated in indentures; (iii) the appropriateness of the Designated Participant, etc.; (iv) the linkage between the net asset value per unit and the index; (v) late submission of the securities reports, etc.; (vi) false statements or adverse opinions, etc.; (vi) expiration of the investment trust indenture; (viii) there ceases to be a specific indicator pertaining to a listed ETF; (ix) a specific indicator pertaining to a listed ETF is changed to a new indicator, and the Exchange deems that the indicator after the change does not meet the eligibility requirement, or when the Exchange deems that changes in such indicator have a remarkable effect on characteristics associated with a listed ETF; (x) the issue does not become subject to handling by designated book-entry transfer institutions; and (xi) cases where delisting is deemed appropriate in order to protect the public interest or investors. The beneficiary certificates of the issuer will be delisted where any of these standards are met (TSE Listing Regulations, rule 1112).

Expansion of the ETF Market

The world's first ETF is said to be "TIPS-35 (Toronto-35 Index Participation Units)" listed on the Toronto Stock Exchange of Canada in 1990. Thereafter, in the 2000s, the ETF market has rapidly grown particularly in Europe and the US supported by a wide variety of investors from individual investors to institutional investors, and currently approximately 6,000 issues of ETFs (including issues of ETN) are listed in more than 40 exchanges around the world.

Meanwhile, in Japan, the "Nikkei 300 Index Fund" was listed as Japan's first ETF in 1995, and other types of ETF aimed at tracking major share price indices such as "Nikkei 225 ETF" and "TOPIX ETF" were listed in 2001. However, both the number of issues and trading volume in ETFs were growing at a sluggish pace.

In response to such circumstances, the government put together the "Better Market Initiative" at the end of 2007 and focused on the diversification of ETF which is a means of investment that enables investors to make easy and effective diversified investments at a low cost. In addition, the TSE declared in its three year mid-term management plan announced in 2008 to target 100 listed ETF issues which was three times more compared to the number as of the end of fiscal year 2007.

Subsequently, the TSE has made various improvements in the system, leading to the diversification of listed ETF issues including those linked with the commodity indexes (*e.g.*, gold, crude oil) and those linked with foreign stock indexes (*e.g.*, Chinese and Brazilian stocks), and in March 2011, the number of listed ETF issues exceeded the target number of 100.

In April 2011, a system for trading ETN (Exchange Traded Note), a type of financial instruments linked with certain indexes as in the case of ETF, was introduced. In June 2023, the market for actively managed ETFs that do not track any specific indicators was developed. The ETN and ETF markets have expanded as a result of the subsequent movements including the integration between the TSE and the OSE in July 2013. As of June 19, 2024, 328 ETF issues and 29 ETN issues, totaling 357 issues, were listed on the TSE.

3 12 Listing of Real Estate Investment Trust Securities

Real estate investment trust securities refer to beneficiary certificates of an investment trust enumerated in Article 2, Paragraph 1, Item 10 of the FIEA, or investment securities enumerated in Item 11 of the same Paragraph, which have as their purpose the management of the investors' funds as investments principally in real estate, etc. The TSE rules provide for listing systems respectively for three categories, namely, investment securities, beneficiary certificates for investment trusts managed under instructions from the settlor, and beneficiary certificates for investment trusts managed without instructions from the settlor. The listing of real estate investment trust securities is determined based upon a listing application filed by the persons specified for the respective categories, *i.e.*, the investment corporation and the asset management company in the case of investment securities, and the settlor company of an investment trust and the trust company in the case of a beneficiary certificate of an investment trust (hereinafter referred to as the "issuer, etc."), after an examination conducted under the listing requirements (TSE Listing Regulations, rule 1201-2).

The listing standards provide that the asset management company, the settlor company of an investment trust or the trust company, etc. must be a member of the Investment Trust Association, Japan, as well as the following requirements pertaining to the product characteristics of the listed issue as formality requirements: (i) ratio of the amount of real estate, etc. among the managed assets, etc.; (ii) setting the ratio of the total amount of real estate, etc., real estate related assets and current assets, etc., among the managed assets, etc.; (iii) number of units listed; (iv) total net asset value; (v) total asset value; (vi) ratio of the number of investment units held by large investors plus the number of investment units held by the issuer or the ratio of the number of investment units of beneficiary interests held by large beneficiaries; (vii) number of investors excluding large investors and the issuer who holds its own investment units and has applied for listing of its issue or number of beneficiaries excluding large beneficiaries; (viii) false statements or adverse opinions, etc.; (ix) matters to be stated in indentures or by-laws; (x) handling by designated book-entry transfer institutions; (xi) an administrator of the investor register (TSE Listing Regulations, rule 1205). For issues meeting the formality requirements, a substantial examination is held from the following viewpoints: (i) to be in a status to appropriately disclose information concerning the real estate investment trust certificates; (ii) to be in a status to manage, etc. the assets in a healthy manner; (iii) to have a prospect for distributing profit or cash continuously after listing; and (iv) the issue is not found inappropriate from the perspective of the public interest or investor protection (TSE Listing Regulations, rule 1206).

The timely disclosure provisions provide the following matters as information to be disclosed in the following broad categories: (i) information concerning the issuer, etc.; (ii) information concerning the managed assets; (iii) information concerning account settlement, including information concerning the price of the assets; and (iv) other information (TSE Listing Regulations, rule 1213).

Regarding delisting, in addition to criteria relating to the issuer, etc. such as the investment corporation becomes subject to dissolution causes or the registration of the financial instruments business of the asset management company expires, etc., the delisting requirements contain the following standards concerning the individual issue: (i) ratio of the total amount of real estate, etc., real estate related assets and current assets, etc., among the managed assets, etc.; (ii) ratio of the amount of real estate, etc., among the managed assets; (iii) distribution of profit or cash; (iv) net asset value; (v) asset scale; (vi) number of units listed; (vii) trading volume; (viii) late submission of the securities reports, etc.; (ix) false statements or adverse opinions, etc.; (x) violation of listing agreements; (xi) matters to be stated in indentures; (xii) handling by designated book-entry transfer

institutions; (xiii) termination of the investment trust agreement where the listed security is a beneficiary certificate of an investment trust; (xiv) involvement of antisocial forces; or (xv) cases where delisting is deemed appropriate in order to protect the public interest or investors (TSE Listing Regulations, rule 1218). Real estate investment trust securities will be delisted where any of these standards are met.

4 Business Regulations

The Business Regulations include detailed provisions governing securities trading in the TSE market. In addition, the TSE has also prescribed the Regulations Regarding Margin Transactions and Loans for Margin Transactions, which have the force equivalent to that of the Business Regulations. The discussion below will describe the broad outline of these regulations.

Government bond futures transactions, interest rate futures transactions, index futures transactions, commodity futures transactions, securities option transactions, government bond futures option transactions index option transactions and commodity futures options transactions on the OSE markets will be mentioned only when necessary. The general issues concerning these transactions will be discussed in "Section 7. Market Derivatives Transactions" below.

4 1 Structure of Securities Trading

(1) Types of Securities Trading

Securities trading conducted on the TSE market can be categorized into securities trading on auction market (meaning a market on which the sale and purchase of securities during a trading session is conducted; the same shall apply hereinafter) and securities trading on markets other than the auction market (ToSTNeT market) (Special Regulations of Business Regulations and Brokerage Agreement Standards Concerning ToSTNeT Market, rule 1). With respect to the securities trading on auction market, there are (i) cash transactions; (ii) regular transactions; (iii) when-issued transactions (TSE Business Regulations. rule 9, para. 1) as transactions during trading session, and as transactions other than those during trading session, there are (i) transactions for the correcting errors, etc. (TSE Business Regulations, rule 41); and (ii) off-auction distribution (TSE Business Regulations, rule 42), etc.

The trading of securities on the ToSTNeT market (ToSTNeT transactions) can be categorized into (i) single issue transactions, (ii) basket transactions; (iii) closing price transactions; and (iv) off-auction own share repurchase transaction (Special Regulations of Business Regulations and Brokerage Agreement Standards Concerning ToSTNeT Market, rule 2 and Chapter 2).

Transactions in bonds (excluding convertible type bonds with share options and exchangeable bonds; hereinafter the same) are categorized into two types: (i) cash transactions; and (ii) regular transactions (TSE Business Regulations, rule 9, para. 1); however, the trading of government bonds is conducted by regular transactions only (TSE Business Regulations, rule 9, para. 4).

(i) Transactions During Trading Session on Auction Market

Cash transactions are transactions that are settled on the day the trading contract is concluded (TSE

Business Regulations, rule 9, para. 2).

Regular transactions are settled on the third day counting from the day that the trading contract was concluded (excluding holidays; the same shall apply hereinafter in counting the number of days) (TSE Business Regulations, rule 9, para. 3). However, the settlement on a regular transaction must be made on the fourth day counting from the day the trading contract was concluded if the transaction was concluded on the date prescribed as the date of amendment of exercise conditions with respect to convertible type bonds with share options and the date prescribed as the date of amendment of exchange conditions with respect to exchangeable bonds, ex-rights date for the right to request early redemption with respect to convertible type bonds with share options and exchangeable bonds, or the day that is three days prior to the interest payment date on interest bearing convertible type bonds with share options (excluding interest bearing convertible type bonds with share options that are not handled by the JASDEC in its book-entry transfer business) and interest bearing exchangeable bonds. The purpose behind extending settlement in these cases is to prevent the double payment of rights, etc. (TSE Business Regulations, rule 9, para. 3, para. 5 and para. 6). In the case of government bonds transactions, settlement shall be made on the second day counting from the day of conclusion of the trading contract (TSE Business Regulations, rule 9, para. 4).

When-issued transactions are transactions that relate to shareholder allotment with consideration of domestic share certificates and preferred equity investor allotment with consideration of preferred equity investment certificates prescribed in the Act on Preferred Equity Investment by Cooperative Structured Financial Institution. As a rule, the transaction is carried out during the period from an ex-rights day to the day two days prior to the new registration date concerning the new share certificates, and all settlements are made on the new registration date concerning the new share certificates (TSE Business Regulations, rule 9, para. 7; TSE Business Regulations Enforcement Rules, rule 5).

The term of a when-issued transaction ranges from one month to three months. For this reason, the financial instruments exchange clearing organization requires the clearing participants to deposit a trade margin from the perspective of ensuring settlement, and receive and pay for the profit and loss account arising from daily fluctuations (this is called the mark-to-market system) (the business method manual issued by Japan Securities Clearing Corporation).

(ii) Transactions Other than Those During Trading Session on Auction Market

Transactions for correcting errors, etc. are expedient trades executed on exchange market, in which a participant becomes its own counterparty under a certain conditions. These are for orders from customers the transaction for which was unable to be conducted on exchange based on a purport of consignment by, due to a mistake.

Such conditions required are: (i) for an error, etc. caused by an inevitable circumstance; (ii) with prior approval of the exchange; and (iii) at a price approved by the exchange as an adequate price (TSE Business Regulations, rule 41, para. 1). These strict conditions are reasonable considering that execution method outside trading session is allowed for the convenience of participants.

Settlement for transactions for correcting errors, etc. will be made on the original settlement day that the transaction would have been executed based on a purport of entrustment (TSE Business Regulations, rule 41, para. 2).

Off auction distribution is made when a sale of a significantly large entrustment is ordered by a customer and is executed after the TSE announces the conditions for distribution for the purpose of securing liquidity of the bulk order by encouraging the participation of many ordinary investors, thereby avoiding

abrupt market fluctuations. Recently, the method has been utilized to distribute a major shareholder's shares to ordinary investors for the purpose of improving share distributions among investors.

A trading participant wishing to execute an off auction distribution (hereinafter called a "handling trading participant") must collect not only the commission pertaining to the distribution but also a commission for accepting of off auction distribution from the customer who placed the bulk order (hereinafter the "distributor") (TSE Brokerage Agreement Standards, rule 51, para. 1). The reason for the commission for accepting off auction distribution arises from the fact that the handling trading participant may need to make considerable efforts for the sale depending on the marketability of the issues offered for sale.

The handling trading participant forwards the commission for handling the off auction distribution to the trading participants who acquired the issues by participating in the off auction distribution (TSE Business Regulations, rule 47, para. 1).

Once notification from the handling trading participant is accepted (notification must be submitted after the trading session is closed), the TSE confirms that the volume of the sale exceeds the volume predetermined and announces the methods used in such distribution and other necessary matters (TSE Business Regulations, rule 42, para. 3); provided, however, that off auction distribution may not be executed in cases deemed inappropriate in light of trade management by the TSE (TSE Business Regulations, rule 42, para. 1).

Off auction distribution must be made at the price designated by the distributor and approved by the TSE, within the range of the closing price on the day the TSE accepts the notification and the price derived by subtracting an amount equivalent to 10% of the closing price (TSE Business Regulations, rule 43).

In an off auction distribution, all purchase applications are submitted between 8:00 a.m. and 8:45 a.m. on the day following the day the TSE accepts the notification (TSE Business Regulations, rule 44, para. 1). Following the period of purchase application, trade contracts are concluded in accordance with a certain set of requirements. Delivery takes place on the third day counting from the date the contract is concluded (if the day falls on the date prescribed as the date of amendment of exercise conditions with respect to convertible type bonds with share options, etc., the fourth day) through the TSE (TSE Business Regulations, rule 42, para. 2).

The volume of shares per purchase application per customer may be limited if the off auction distribution was intended to improve stock ownership distribution (TSE Business Regulations Enforcement Rules, rule 31).

(2) Ex-Dividend Trades and Ex-Rights Trades, Etc.

The TSE provides that in a regular transaction of share certificates (excluding equity contribution securities set forth in Article 2, Paragraph 1, Item 6 of the FIEA), ex-dividend or ex-rights trades commence at the day prior to the record date for shareholders eligible for dividends (including interim dividends) or the record date for share options and other rights (TSE Business Regulations, rule 25; TSE Business Regulations Enforcement Rules, rule 18).

When the consideration for acquisition, or the conditions for exercise of rights or conditions for exchange are revised for convertible preferred shares, convertible type bonds with share options or exchangeable bonds for which it is provided that acquisition may be requested to the issuing company, etc., these are traded under the revised conditions starting the day prior to the last day of application of the former conditions in the case of revision of the consideration for acquisition, or starting two days prior to the last day of application of the former conditions in the case of revision of the conditions for exercise of rights or conditions for exchange (TSE Business Regulations, rule 26, TSE Business Regulations Enforcement Rules, rule 19). Convertible type bonds with share options with a call provision are traded ex-rights starting the day following the last day of the call period in the case of cash

transactions or starting two days prior to the last day of the call period in the case of regular transactions in principle (TSE Business Regulations, rule 26-2, TSE Business Regulations Enforcement Rules, rule 19-2).

(3) Margin Transactions and Loans for Margin Transactions

Trades of share certificates in an exchange transaction are treated as a spot transaction, and cash and share certificates are exchanged on the settlement day. However, implementation of mock supply and demand is necessary to further ensure smooth circulation and the formation of fair market prices. The margin transaction system was implemented to serve such goals.

In this scheme, a customer deposits a security deposit at a certain rate to a financial instruments business operator and borrows the acquisition money or sale securities required for the settlement of the entrusted order from the financial instruments business operator (provision of credit). The financial instruments business operator then settles the transaction in the financial instruments exchange. After the settlement, the lending and borrowing relationship between the customer and the financial instruments business operator remains, thereby in reality deferring the settlement of the trade. Settlement for the borrowing and lending relationship is made by repaying the borrowed money or securities. Such settlement can also be made with the acquired securities or sale money from a reverse transaction.

In that sense, margin transactions are a type of deferred transaction made possible through financial operation. Therefore, a considerable amount of capital is required to support such a scheme. As a result, several securities finance companies were established as specialized securities financing institutions in order to support such capital needs. In Japan, where the stock lending market is rather primitive, these securities finance companies also serve the role of funding institutions.

The relationship between financial instruments business operators and securities finance companies plays an important role in the existence of margin transactions. The lending of capital or share certificates (financing, lending of share certificates) established between a financial instruments business operator and a securities finance company is called **loans for margin transactions**.

The major issues pertaining to margin transactions, which concern the relationship between a trading participant and a customer, are set forth in the Brokerage Agreement Standards. Under the Regulations Regarding Margin Transactions and Loans for Margin Transactions, (i) there are **standardized margin transactions** in which the broker loan rate (when the share lending balance exceeds the loan balance for the relevant share issue in the Japan Securities Finance Co., Ltd., the broker loan fees are collected from the customers borrowing the shares and are paid to the customer borrowing the money at the same fees) and the possible deferral of the repayment term are regulated by the TSE and **negotiable margin transactions** in which the broker loan rate and possible extension of repayment term are negotiable between the participant and a customer (TSE Regulations Regarding Margin Transactions and Loans for Margin Transactions, rule 2 and rule 7); (ii) a participant shall not engage in margin transactions in share options, equity contribution securities, or investment equity subscription right certificates prescribed in Article 2, Paragraph 18 of the Act on Investment Trusts and Investment Corporations, or in issues that have become subject to the criteria for delisting or other issues deemed inappropriate by the TSE (*id*. rule 3); (iii) a participant shall not conduct margin transactions pertaining to transactions of off-auction distribution (*id*. rule 4); (iv) a participant shall not conduct margin transactions for its officers or employees (*id*. rule 5); and (v) a participant shall, in principle, furnish monthly reports providing the matters determined by the TSE to the customers who have outstanding margin transactions yet to be settled (*id*. rule 6).

The selection of issues that can be traded using standardized margin transactions (hereinafter called

"standardized margin issues") is made pursuant to the "Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions" established by the TSE in order to comply with trade management strategy (*id*. rule 7, para. 2).

The lending standards of securities finance companies established the system for loans for margin transactions. The issues that can be loaned are selected by the TSE from standardized margin transaction issues, because issues for loans for margin transactions with small circulation volumes or a small number of shareholders can cause inconvenience. The selection of issues is also made pursuant to the "Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions" (*id*. rule 10).

In addition, the TSE makes various attempts to ensure the sound operation of loans for margin transactions as demonstrated by its close contact and communication with securities finance companies.

4 2 Trading Session

(1) Trading Hours and Holidays

The trading hours are shown in the table below. In November 2024, the TSE reviewed the trading regime for the purpose of strengthening the functions of the cash equity market upon putting the updated trading system into operation, and as part of this review process, it extended trading hours for 30 minutes (TSE Business Regulations, rule 2, para. 1; Special Regulations of Business Regulations and Brokerage Agreement Standards Concerning ToSTNeT Market, art. 10, para. 1 and art. 11, para. 1). Along with the changes in training hours at the TSE, the OES also changed trading hours, except for those applicable to some types of transactions (OSE Business Regulations, art. 18, para, 1; Special Rules for Business Regulations and Brokerage Agreement Standards Related to the J-NET Market, art. 4, para. 1).

The holidays of the Exchange are Sundays, national holidays, the earliest subsequent day that is not a national holiday if a national holiday falls on a Sunday, a day that is in-between two national holidays, Saturdays, the three days at the beginning of a year (January 1 through 3), and December 31 (TSE Business Regulations, rule 3, para. 1; OSE Business Regulations, rule 19, para. 1).

When it deems it necessary, the Exchange can implement a temporary closing for an entire day (TSE Business Regulations, rule 3, para. 2; OSE Business Regulations, rule 19, para. 2), or temporarily close all or part of a trading session. At the same time, the Exchange can open a trading session on a non-business day (TSE Business Regulations, rule 4, etc.; OSE Business Regulations, rule 20, etc.).

Since September 2022, the OSE has been operating a holiday trading system for trading in derivatives. The OSE designates holiday trading days from among non-business days except for Saturdays, Sundays and January 1, while excluding days that the OSE deems necessary for system operations, etc. at Japan Exchange Group, Inc. and its subsidiaries (including the OSE) and days on which the OSE deems appropriate not to conduct trading from the perspective of risk management. Trading sessions (holiday trading) are held on holiday trading days (OSE Business Regulations, rule 19, para. 3, item 2).

(2) Bids and Offers and Trading (Transaction) Unit

Bids and offers for trading, etc. must be provided before a trade can be established in a trading session. The bids and offers for transactions, etc. executed using a trading system are the bids and offers based on the information

entered into the trading participant's terminals that are linked to the trading system (TSE Business Regulations, rule 14, para. 1 and para. 2; OSE Business Regulations, rule 26, para. 1 and para. 2). The units of bids and offers are shown in the table below.

With a view to increasing the convenience for a wide range of investors, the TSE streamlined the units for bids and offers for share certificates with high liquidity (those constituting TOPIX100) in three phases, on January 14 and July 22, 2014, and September 24, 2015.

To reduce the execution costs to be paid by investors in ETFs and certain other products, and thus enhance the convenience of investment in which they are used, the units of bids and offers for ETFs and certain other products were revised on November 29, 2021, to apply the units of bids and offers which are applicable to TOPIX 100 constituents to all issues. On June 5, 2023, the units of bids and offers for medium liquidity stocks (share certificates constituting TOPIX Mid400) were revised to apply the same units of bids and offers to TOPIX 500 constituents and ETFs, etc.

Bids and offers for share certificates must be made on a cum-dividend basis, while bids and offers are made flat quotation for interest-bearing bonds, interest-bearing convertible corporate bonds with share options and interest-bearing exchangeable bonds. Bids and offers for bonds other than interest-bearing bonds, convertible type bonds with share options other than interest-bearing types, and exchangeable bonds other than interest-bearing exchangeable bonds are made cum-interest (TSE Business Regulations, rule 14, para. 4).

The trading (transaction) units are shown in the table below.

<table>
<tr><td></td><td colspan="3">TSE</td></tr>
<tr><td></td><td colspan="3">Share Certificates</td></tr>
<tr><td></td><td>Domestic share certificates</td><td>Equity investment securities, preferred equity investment certificates, investment trust beneficiary certificates, investment securities, investment equity subscription right certificates</td><td>Foreign share certificates</td></tr>
<tr><td>Trading Session Hours</td><td colspan="3">(Auction trading)
・Morning trading session (9:00 – 11:30)
・Afternoon trading session (12:30 – 15:30)
(ToSTNeT)
・Single issue transactions and basket transactions: 8:20 – 18:00 ..... A
・Closing price transactions: 8:20 – 8:45, 11:30 – 12:15, 15:30 – 16:30 .. B
・Off-auction own share repurchase transactions: 8:45 (orders for sale accepted from 8:00 – 8:45)</td></tr>
<tr><td>Unit of Bids and Offers</td><td colspan="2">Share certificates (excluding those listed on the right)

Price per share (lot)
JPY 3,000 or less JPY 1
Over JPY 3,000 – JPY 5,000 or less JPY 5
Over JPY 5,000 – JPY 30,000 or less JPY 10
Over JPY 30,000 – JPY 50,000 or less JPY 50
Over JPY 50,000 – JPY 300,000 or less JPY 100
Over JPY 300,000 – JPY 500,000 or less JPY 500
Over JPY 500,000 – JPY 3 million or less JPY 1,000
Over JPY 3,000,000 – JPY 5 million or less JPY 5,000
Over JPY 5,000,000 – JPY 30 million or less JPY 10,000
Over JPY 30 million – JPY 50 million or less JPY 50,000
Over JPY 50 million JPY 100,000</td><td>Share certificates in TOPIX 500 and ETFs, etc. (limited to those the TSE deems capable of maintaining price per trading unit above the monetary unit of yen to facilitate a smooth settlement)
Price per share, etc. (lot)
JPY 1,000 or less JPY 0.1
Over JPY 1,000 – JPY 3,000 or less JPY 0.5
Over JPY 3,000 – JPY 10,000 or less JPY 1
Over JPY 10,000 – JPY 30,000 or less JPY 5
Over JPY 30,000 – JPY 100,000 or less JPY 10
Over JPY 100,000 – JPY 300,000 or less JPY 50
Over JPY 300,000 – JPY 1 million or less JPY 100
Over JPY 1 million – JPY 3 million or less JPY 500
Over JPY 3 million – JPY 10 million or less JPY 1,000
Over JPY 10 million – JPY 30 million or less JPY 5,000
Over JPY 30 million JPY 10,000</td></tr>
<tr><td>Trading (Transaction) Unit</td><td>Companies that fix the number of shares constituting a unit..... number of shares per unit
Companies that do not fix the number of shares constituting a unit..... one share;
provided, however, for the issues specifically identified by the exchange, the number specified by the exchange</td><td>One unit. Provided, for issues specifically identified by the exchange, the number of units specified in each instance by the exchange</td><td>1,000 shares, 500 shares, 100 shares, 50 shares, 10 shares, or 1 share (depending on the market price)</td></tr>
</table>

	TSE				
	Bonds			Convertible Type Bonds with Share Options	Exchangeable Bonds
	Government bonds	JPY-denominated foreign bonds	Bonds other than government bonds and foreign bonds (municipal bonds, specialized bonds, bank debentures, corporate bonds)	JPY-denominated	
Trading Session Hours	12:30 – 14:00	12:30 – 15:30		(Auction trading) ・Morning trading session (9:00 – 11:30) ・Afternoon trading session (12:30 – 15:30) (ToSTNeT) ・Single issue transactions and basket transactions: (same as A above) ・Closing price transactions: (same as B above)	・Morning trading session (9:00 – 11:30) ・Afternoon trading session (12:30 –15:30)
Unit of Bids and Offers	JPY 0.01 per face value of JPY100			JPY 0.05 per face value of JPY100	
Trading (Transaction) Unit	Face value of JPY50,000	Face value of JPY10 million, face value JPY1 million or face value of JPY100,000		Face value of JPY5 million, JPY4 million, JPY3 million, JPY2 million, JPY1 million, JPY500,000 or JPY100,000	One security

	OSE
	Major Index Futures Transactions, Index Options Transactions, Commodity Futures Transactions, Commodity Futures Options Transactions *TAIEX futures are traded only during the daytime trading session.
Trading Session Hours	(Trading on auction market*1) Daytime trading session: 8:45 – 15:40, 15:45 Evening trading session: 17:00 – 5:55, 6:00 *1 Nikkei 225 VI futures and commodity futures transactions (rubber markets): Daytime trading session (9:00 – 15:40, 15:45) Evening trading session (17:00 – 18:55, 19:00) (J-NET trading*2) 8:20 – 16:30; 16:45 – 6:00 *2 Nikkei 225 VI futures and commodity futures transactions (rubber markets): 8:20 – 16:30; 16:45 – 19:00 Trading with a flexible contract month: 8:20 – 16:30; 16:45 – 6:00
Unit of Bids and Offers	(Index futures transactions) Nikkei 225 Futures (Large): JPY 10 Nikkei 225 Futures (Mini): JPY 5 Nikkei 225 Futures (Micro): JPY 5 TOPIX Futures (Large): 0.5 points TOPIX Futures (Mini): 0.25 points JPX-Nikkei Index 400: 5 points TSE Growth Market 250 Index Futures: 1 points JPX Prime 150 Index Futures: 0.5 points RN Prime Index Futures: 0.5 points TOPIX Core30 Futures: 0.5 points TSE Banks Index Futures: 0.1 points TSE REIT Index Futures: 0.5 points DJIA Futures: 1 points TAIEX Futures: 1 points FTSE China 50 Index Futures: 5 points Nikkei 225 VI Futures: 0.05 points Nikkei 225 Dividend Index Futures: JPY 0.1 S&P/JPX 500 ESG Score Tilted Index Futures: 0.5 points FTSE JPX Net Zero Japan 500 Index Futures: 0.5 points Nikkei 225 Climate Change 1.5℃ Target Index Futures: JPY 10 CME Group Petroleum Index Futures: 0.05 points (Commodity futures transactions) Gold (physically delivered): JPY 1 per gram Gold (cash-settled in the contract month): JPY 0.5 per gram
Trading (Transaction) Unit	(Index futures transactions) The amount derived by multiplying the numerical value of index in an index futures transaction by each of the following amounts Nikkei 225 Futures (Large): JPY 1,000 Nikkei 225 Futures (Mini): JPY 100 Nikkei 225 Futures (Micro): JPY 10 TOPIX Futures (Large): JPY 10,000 TOPIX Futures (Mini): JPY 1,000 JPX-Nikkei Index 400: JPY 100 TSE Growth Market 250 Index Futures: JPY 1,000 JPX Prime 150 Index Futures: JPY 1,000 RN Prime Index Futures: JPY 10,000 TOPIX Core30 Futures: JPY 1,000 TSE Banks Index Futures: JPY 10,000 TSE REIT Index Futures: JPY 1,000 DJIA Futures: JPY 100 TAIEX Futures: JPY 100 FTSE China 50 Index Futures: JPY 100 Nikkei 225 VI Futures: JPY 10,000 Nikkei 225 Dividend Index Futures: JPY 1,000 S&P/JPX 500 ESG Score Tilted Index Futures: JPY 10,000 FTSE JPX Net Zero Japan 500 Index Futures: JPY 10,000 Nikkei 225 Climate Change 1.5℃ Target Index Futures: JPY 1,000 CME Group Petroleum Index Futures: JPY 10,000 (Commodity futures transactions) Gold (physically delivered): 1kg Gold (cash-settled in the contract month): 100g

Gold (cash-settled on the contract day)	JPY 1 per gram
Silver	JPY 0.1 per gram
Platinum (physically delivered)	JPY 1 per gram
Platinum (cash-settled in the contract month)	JPY 0.5 per gram
Platinum (cash-settled on the contract day)	JPY 1 per gram

Gold (cash-settled on the contract day)	100g
Silver	30kg

Palladium	JPY 1 per gram
Rubber	JPY 0.1 per kilogram
Soybean	JPY 10 per 1,000 kg
Red bean	JPY 10 per bag
Corn	JPY 10 per 1,000 kg

Platinum (physically delivered)	500g
Platinum (cash-settled in the contract month)	100g
Platinum (cash-settled on the contract day)	100g
Palladium	3kg
Rubber	5,000kg
Soybean	25,000kg
Red bean	2,400kg
Corn	50,000kg

(Index options transactions)
(Nikkei 225 Large Options, Nikkei 225 mini Options)
Unit of bids and offers

JPY 100 or less	JPY 1
Over JPY 100	JPY 5

(TOPIX Options)

20 points or less	0.1 points
Over 20 points	0.5 points

(1 point = JPY 10,000)
(JPX-Nikkei Index 400 Options)

50 points or less	1 point
Over 50 points	5 points

(1 point = JPY 1,000)

(Index options transactions)
One unit of an index put option or an index call option (one unit of option the exercise of which can execute a contract for receiving an amount of money derived by multiplying the difference between the actual index value and the exercise price by the trading unit*)

*
JPY 100 for Nikkei 225 mini Options
JPY 1,000 for Nikkei 225 Options, JPX-Nikkei Index 400 Options
JPY 10,000 for TOPIX Options

(Commodity futures options)
For all units of bids and offers JPY1

(Commodity futures options)
One unit of a gold futures put option or a gold futures call option (one unit of option the exercise of which can execute a contract for receiving an amount of money derived by multiplying the difference between the actual value and the exercise price by JPY100)

	OSE	
	Government Bond Futures Transactions, Government Bond Futures Options Transactions Interest Rate Futures Transactions	Securities Options Transactions
Trading Session Hours	・Morning trading session (8:45 – 11:00, 11:02) ・Afternoon trading session (12:30 – 15:00, 15:02) ・Evening trading session (15:30 – 5:55, 6:00) (J-NET trading) ・8:20 – 15:15; 15:25 – 6:00	・Morning trading session (9:00 – 11:30, 11:35) ・Afternoon trading session (12:30 – 15:40, 15:45) (J-NET trading*) ・8:20 – 16:30 * Trading with a flexible contract month: ・8:20 – 16:30, 16:45 – 18:00
Unit of Bids and Offers	(JGB Futures Transactions) JPY 0.01 (or JPY 0.005 for cash-settled futures transactions) per face value of JPY 100 JPY 0.01 per face value of JPY 100 of the underlying issue of the government bond futures transaction to be executed by the exercise of the options (Options on JGB Futures) JPY 0.01 per face value of JPY 100 of the underlying issue of the government bond futures transaction to be executed by the exercise of the options (Interest Rate Futures Transactions) 0.0025 points	When the minimum of the bids and offers for a securities option transaction is: Below JPY 50 JPY 0.1 (JPY 1) JPY 50 – Below JPY 1,000 JPY 0.5 (JPY 1) Amount in ( ) is for when the trading unit is an odd number. JPY 1,000 – Below JPY 3,000 JPY 1 JPY 3,000 – Below JPY 30,000 JPY 5 JPY 30,000 – Below JPY 50,000 JPY 25 JPY 50,000 – Below JPY 100,000 JPY 50 JPY 100,000 – Below JPY 1,000,000 JPY 500 Over JPY 1 million JPY 5,000
Trading (Transaction) Unit	(JGB Futures Transactions) Standardized medium-term or long-term government bonds Face value of JPY 100 million Standardized super-long- term government bonds Face value of JPY 10 million (or for cash-settled futures transactions, the amount derived by multiplying the price of the standardized long- term government bonds by JPY 100,000) One unit of a government bond futures put option or government bond futures call option (one unit of option the exercise of which can execute a sale or purchase of government bond futures with a face value of JPY100 million at an exercise price for the underlying government bond futures contract month) (Options on JGB Futures) One unit of a government bond futures put option or government bond futures call option (one unit of option the exercise of which can execute a sale or purchase of government bond futures with a face value of JPY100 million at an exercise price for the underlying government bond futures contract month) (Interest Rate Futures Transactions) 100 minus 3-month compounded TONA × JPY 250,000	One unit of a securities put option or securities call option (one unit of option the exercise of which can execute a sale or purchase of the trading unit of the underlying securities at the exercise price or one unit of option for which the exercise can execute a contract that enables the option holder to receive from the other party an amount of money calculated by multiplying the difference between the actual index value and the exercise price by the number of underlying securities)

* ETFs, etc. include investment trust beneficiary certificates, foreign investment trust beneficiary certificates, foreign investment securities, beneficiary certificates of a beneficiary certificate issuing trust, and beneficiary certificates of a foreign beneficiary certificate issuing trust.
* When the exchange determines that it is necessary to lower the unit of bids and offers and designates such issues, the unit of bids and offers that falls below the bids and offers in question.
* In addition to the index futures indicated above, Nikkei 225 Total Return Index Futures are available only for trading with a flexible contract month.
* In addition to the index options indicated above, TOPIX Banks Index Options and TSE REIT Index Options are available only for trading with a flexible contract month.

(Source) As of November 5, 2024

(3) Conclusion of Trading Contracts

The transactions during trading session of the TSE's market shall be effected by auction where the buying orders and selling orders are concentrated on the market respectively and placed according to the rules of price priority and timing priority (TSE Business Regulations, rule 10, para. 1 and para. 2, etc.).

The rule of price priority is the rule under which a lower offer shall have priority to higher offers and a higher bid shall have priority to lower bids (TSE Business Regulations, rule 10, para. 2, item 1, etc.).

The seller selling the goods at a lower price and the buyer buying the goods at a higher price always receive higher priority in any market, and such practice is the principle of price competition. What happens when two or more quotations for a same price are given? The rule of timing priority applies in such a case.

The rule of timing priority is the rule giving priority to the bids or offers made earlier when two or more bids or offers are made at the same price (TSE Business Regulations, rule 10, para. 2, item 2(a), etc.).

The Enforcement Regulations of the Business Regulations set forth the rules for cases where two or more bids or offers for the same price are made at the same time or for cases where the timing of bids or offers with the same price is not clear. In any case, the basic principle is to prioritize the bids or offers in order of the person with the greater quantity of bids or offers to the smaller quantity of bids or offers (TSE Business Regulations, rule 10, para. 2, item 2(b); TSE Business Regulation Enforcements Rules, rule 6, etc.).

Market orders always have price priority over other orders. When there are more than two market orders, such market orders hold the same priority and all volumes are executed at the same time (TSE Business Regulations, rule 10, para. 2, item 3, etc.). However, when a closing price for an afternoon trading session is determined at a price limit as mentioned below, all remaining market orders shall be deemed to be limit orders to buy or sell at the said price and in this instance, all bids and offers at the said price shall be deemed to have been made simultaneously (TSE Business Regulations, rule 10, para. 4). (See "4.3 (1) Price Limit of Quotations" of this Chapter for details)

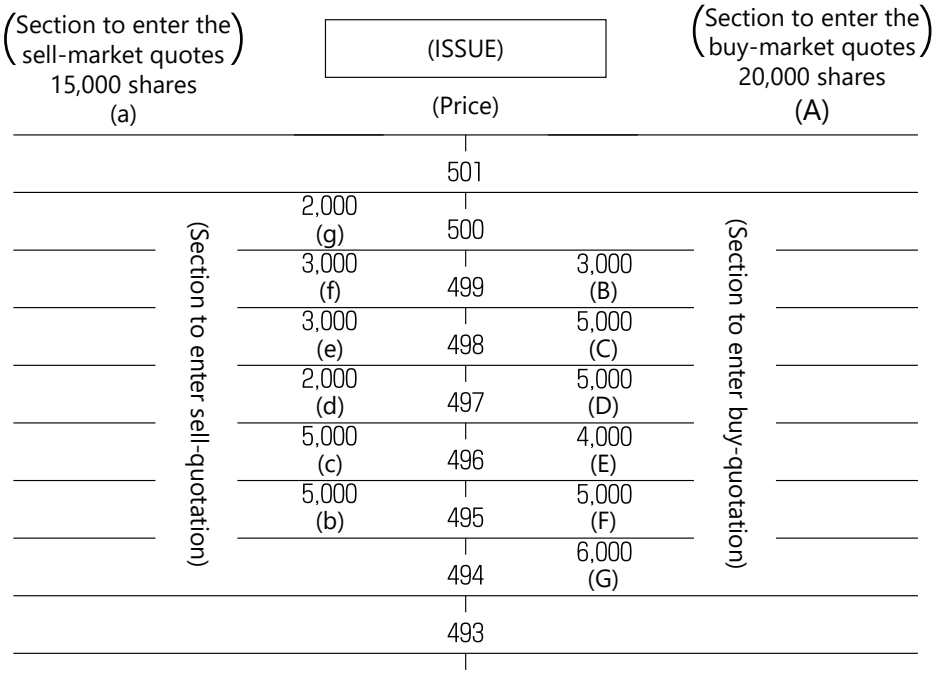
The priorities of trade contract prices are formed through the competition among bids and offers, respectively. How is a contract price determined? The individual auction is the method that determines the contract price (TSE Business Regulations, rule 12, para. 1, etc.).

In the individual auction, price of transaction is established when the lowest sell quote among many quotes and the highest buy quote among many quotes match. Then, transactions shall be effected according to the order of priority described above (TSE Business Regulations, rule 10, para. 2 and rule 12, para. 2, etc.).

Another method of determining a transaction price is the *Itayose*. In this method, if a certain volume (total volume of buy quotes and sell quotes listed in (i) through (iii) — (i) total volume of the market orders; (ii) total volume of sell quotes that does not reach the price in question and the total volume of buy quotes that exceeds the price in question; and (iii) total volume of the either buy quotes or sell quotes (for bonds only, the volume more than the buy and sell unit for opposing orders) of bids and offers at the price in question) of the buy quote and sell quote matches at a certain price, a trade is established by using the price as a contract price between corresponding quotes according to the order of priority (TSE Business Regulations, rule 12, para. 3, etc.). This method is used when (i) determining the opening price for a trading session; (ii) determining the first contract price following the suspension of trading of a certain issue, etc.; (iii) determining the closing price for a trading session; and (iv) in addition to (i) through (iii) above, determining the contract price while the quotations are being posted as prescribed by the TSE.

JGB futures transactions, interest rate futures transactions, index futures transactions, commodity futures transactions, securities options transactions, government bond securities futures option transactions, index options transactions and commodity futures options transactions are traded generally in the same way as securities trades.

Chart 2-1 Status of Orders (Book) Before the Determination of an Opening Price



<Opening price> Opening price = JPY498, volume = 28,000 shares

Price determination process

(Sell)		(Buy)
(a) 15,000 shares at market rate	———	(A) 20,000 shares at market rate
(b) 5,000 shares at JPY495	———	(A) 5,000 shares at market rate
(c) 5,000 shares at JPY496	———	(B) 3,000 shares at JPY499
(c) 2,000 shares at JPY496	———	(C) 5,000 shares at JPY498
(d) 2,000 shares at JPY497	———	(C) 3,000 shares at JPY498
(e) 3,000 shares at JPY498	———	(C) 1,000 shares at JPY498

(i) *Itayose* (see Chart 2-1)

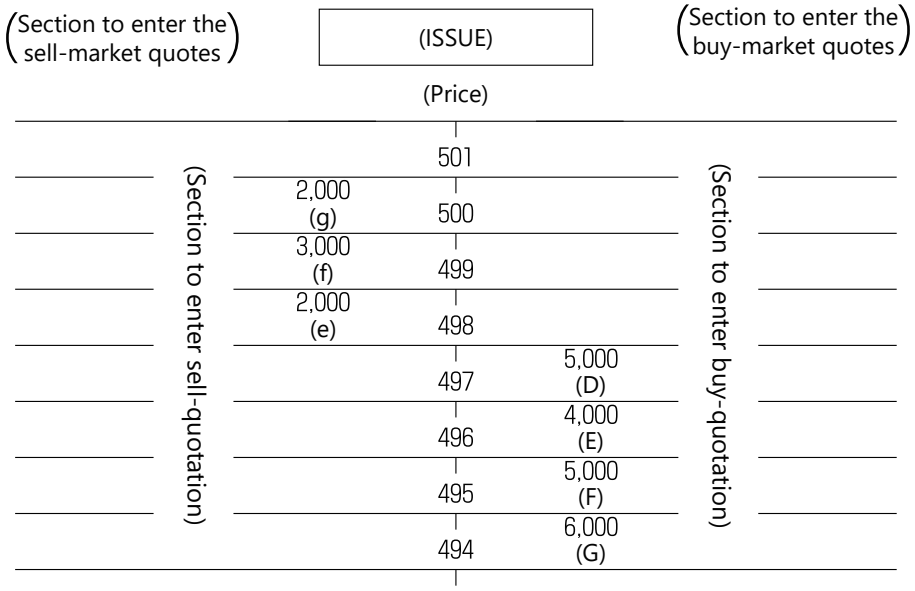
a. A sell quote for market order/15,000 shares (a) and a buy quote for market order/20,000 shares (A) are matched. A buy quote for market order/5,000 shares remains as a result.

b. The remaining 5,000 shares of the buy quote are matched with the lowest sell quote of JPY495/5,000 shares (b). At this point, the entire volume of buy quote (A) is executed. However, the buy orders at rates of (B), (C), (D), and (E), which are higher than JPY495, are not executed.

c. Among the remaining quotes, the highest buy quote of JPY499/3,000 shares (B) is matched with the lowest sell quote of JPY496/5,000 shares (c). The remaining 2,000 shares of order (c) are then matched with the buy quote of JPY498/5,000 shares (C). The remaining 3,000 shares of (C) are matched with the sell quote of JPY497/2,000 shares (d).

d. At this point, 1,000 shares of the buy quote of JPY498/5,000 shares (C) remain. This is then matched with the sell quote of JPY498/3,000 shares (e). Then the conditions for determining a contract price through *itayose* method are established at the matching buy and sell at JPY498. As a result, the opening price is determined at JPY498 and all quotes matched in the matching process are traded at the uniform price of JPY498.

Chart 2-2 **Conditions of the Orders (Board) by Broker Members After the Determination of an Opening Price**



(ii) *Zaraba* (see Chart 2-2)

a. A sell order of JPY497/3,000 shares (h) is placed after the opening price was determined.
The 3,000 shares are matched with a highest buy quote of JPY497/5,000 shares (D). 3,000 shares are matched at JPY497 and 2,000 shares remain.

b. Next, a buy quote of JPY498/5,000 shares (H) is placed.
The 5,000 shares are matched with the lowest sell quote of JPY498/2,000 shares (e). 2,000 shares are matched at JPY498 and 3,000 shares remain.

c. Next, a sell order of 6,000 shares (i) by the market order is placed.
First, 6,000 shares are matched with the highest buy quote of JPY498/3,000 shares (H). Then the remaining shares are matched with the next highest buy quote of JPY497/2,000 shares (D). Finally, the remaining 1,000 shares are matched with a buy quote of JPY496/4,000 shares (E). The contract price for each order is JPY498, JPY497 and JPY496, respectively.

4 3 Measures for the Rationalization of Securities Trading, Etc.

The core functions of the Exchange lie in its management of trades conducted in the market. The management of trades conducted in the market can be categorized into two main aspects:(i) daily management of the market to ensure the systematic and methodical execution and operation of trades and (ii) the management of rationalization measures that have been established to eliminate unfair trading and to prevent the occurrence of abnormal situations.

The most notable rules among the securities trade rationalization measures that have been established by the Exchange are described below:

(1) Price Limit of Quotations

Volatile fluctuations in securities prices lead to unexpected losses for investors. In order to prevent this, the TSE limits the daily price fluctuation to a certain proportion of the previous day's closing price (TSE Business Regulations, rule 14, para. 5). The price limits for trading share certificates are categorized into 34 levels according to the price of the securities (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 2) (see Chart 2-3).

In addition, the price limit of a convertible bond-type bond with share option is computed by multiplying the price limit for the listed share certificates of the issuer underlying the convertible bond by the Conversion Ratio (Issuance price per face value of JPY100/Issue price of the stocks to be issued upon exercise of the share options). The daily price limit for exchangeable bonds where the underlying share certificates are listed on a financial instruments exchange is the daily price limit of such listed share certificates multiplied by exchange ratio (face value per JPY100/exchange price). Where the underlying share certificates are listed on other domestic financial instruments exchange, the daily price limit figured by multiplying the latest final price on such other domestic financial instruments exchange by the exchange price (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 3). In addition, the price limit on bonds is JPY1 (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 2-2).

The TSE may modify the allowed price limits for all or part of issues when it finds abnormal conditions in trades or when it finds or suspects that abnormal trading conditions (TSE Rules Concerning the Prices Limits on Bids and Offers, rule 5).

The OSE applies price limits on bids and offers with regard to government bonds futures transactions, interest rate futures transactions, index futures transactions, commodity futures transactions, securities options transactions, government bond futures options transactions, index options transactions and commodity futures options transactions.

(2) Regulatory Measures Concerning Securities Trades, Etc. and the Consignment Thereof

Pursuant to Rule 65 of the TSE Business Regulations, the TSE has the right to implement the following regulatory measures concerning securities trading and the entrustment of such securities trading in the TSE markets when it finds or suspects abnormal conditions in trading (TSE Rules on Regulatory Measures Concerning Securities Trading or Its Brokerage, rule 1):

(i) Limiting the increase of the security deposit ratio for margin sells or margin buys, or increase of the security deposit ratio for when-issued transactions, and limiting the use of margin securities in lieu of the security deposit;

(ii) Reducing the ratio to be multiplied by the market value where margin securities are deposited in lieu of a security deposit in a margin sale or margin buy or a when-issued transaction;

(iii) Where limits are imposed on the use of margin securities in a margin sale or margin buy, requiring trading participants to deposit in cash all or a portion of the security deposit that cannot be substituted with securities with the TSE;

(iv) Limiting or prohibiting margin sales or margin buys (including margin sales or margin buys conducted by trading participants);

(v) Limiting the total number of shares sold or purchased in when-issued transactions;

(vi) The following enumerated actions regarding the trading margin deposited by trading participants for when-issued transactions:

a. Moving up the trading margin deposit date;

b. Increase the amount of trading margin, and limit substitution of trading margin with securities; and
c. Progressively increase the trading margin where the total number of issues sold or purchased exceeds a certain level;

(vii) Accepting the deposits of the sold securities or purchase prices on the basis of the entrustment of customers, before the settlement date of the transaction;

(viii) Limiting or prohibiting trading participants from conducting sales or purchases for their own account (including sales and purchases based on discretionary trading agreements); and

(ix) Daily publication of the outstanding margin transactions.

The OSE also implements regulatory measures for the brokerage of government bonds futures transactions, interest rate futures transactions, index futures transactions, commodity futures transactions, securities options transactions, government bond futures options transactions, index options transactions and commodity futures options transactions.

The outstanding margin transactions will be published daily if an issue for which a margin transaction can be made becomes subject to an alert to investors and the TSE deems such publication to be necessary (TSE Business Regulations, art. 30), or if such issue is designated as a security on special alert (TSE Listing Regulations, art. 503, para. 1) (TSE Rules on Regulatory Measures Concerning Securities Trading, Etc. or Its Brokerage, rule 2).

Necessary measures regulating trading or the entrustment of trades in connection with issues under trade monitoring (TSE Rules Concerning Issue under Trade Monitoring, rule 4, para. 1). Furthermore, if the issue under trade monitoring is an issue eligible for margin transactions, the outstanding margin transactions will be disclosed daily (TSE Rules Concerning Issue under Trade Monitoring, rule 4, para. 2).

Chart 2-3 Price Limits in Trades in Share Certificates

Base Price					Daily Price Limit		
		Less than	JPY	100	Upward/Downward	JPY	30
JPY	100 –	″	JPY	200	″	JPY	50
JPY	200 –	″	JPY	500	″	JPY	80
JPY	500 –	″	JPY	700	″	JPY	100
JPY	700 –	″	JPY	1,000	″	JPY	150
JPY	1,000 –	″	JPY	1,500	″	JPY	300
JPY	1,500 –	″	JPY	2,000	″	JPY	400
JPY	2,000 –	″	JPY	3,000	″	JPY	500
JPY	3,000 –	″	JPY	5,000	″	JPY	700
JPY	5,000 –	″	JPY	7,000	″	JPY	1,000
JPY	7,000 –	″	JPY	10,000	″	JPY	1,500
JPY	10,000 –	″	JPY	15,000	″	JPY	3,000
JPY	15,000 –	″	JPY	20,000	″	JPY	4,000
JPY	20,000 –	″	JPY	30,000	″	JPY	5,000
JPY	30,000 –	″	JPY	50,000	″	JPY	7,000
JPY	50,000 –	″	JPY	70,000	″	JPY	10,000
JPY	70,000 –	″	JPY	100,000	″	JPY	15,000
JPY	100,000 –	″	JPY	150,000	″	JPY	30,000
JPY	150,000 –	″	JPY	200,000	″	JPY	40,000
JPY	200,000 –	″	JPY	300,000	″	JPY	50,000
JPY	300,000 –	″	JPY	500,000	″	JPY	70,000

JPY	500,000 –	〃	JPY	700,000	〃	JPY	100,000
JPY	700,000 –	〃	JPY	1,000,000	〃	JPY	150,000
JPY	1,000,000 –	〃	JPY	1,500,000	〃	JPY	300,000
JPY	1,500,000 –	〃	JPY	2,000,000	〃	JPY	400,000
JPY	2,000,000 –	〃	JPY	3,000,000	〃	JPY	500,000
JPY	3,000,000 –	〃	JPY	5,000,000	〃	JPY	700,000
JPY	5,000,000 –	〃	JPY	7,000,000	〃	JPY	1,000,000
JPY	7,000,000 –	〃	JPY	10,000,000	〃	JPY	1,500,000
JPY	10,000,000 –	〃	JPY	15,000,000	〃	JPY	3,000,000
JPY	15,000,000 –	〃	JPY	20,000,000	〃	JPY	4,000,000
JPY	20,000,000 –	〃	JPY	30,000,000	〃	JPY	5,000,000
JPY	30,000,000 –	〃	JPY	50,000,000	〃	JPY	7,000,000
JPY	50,000,000 –or more				〃	JPY	10,000,000

4 4 Cancellation of Securities Trading, Etc.

In financial instruments trading, it is the basic premise that contracts that are once effected shall not be cancelled and shall be settled, and the certainty of settlement is one of the bases of reliability of the financial instruments market. However, in cases a contract in a scale which cannot be normally assumed is effected due to errors and the settlement cannot be conducted for a long term, etc., the functions of a financial instruments market will be paralyzed and could cause a massive uproar.

Accordingly, if a trade, etc. is effected based on an erroneous order and the Exchange determines that the settlement thereof is extremely difficult and could cause confusion in the exchange market, etc., the Exchange may, as prescribed by the Exchange, cancel a trade, etc. (TSE Business Regulations, rule 13, para. 1 and para. 2; OSE Business Regulations, rule 25, para. 1 and para. 2).

Development of Systemization of Trades

In the past, the Exchange has conducted all trades in share certificates on the trading floor by manpower, but after the operation of the computer-based trading system targeting a part of the TSE second section issues in January 1982, the systemization has developed, and trading on the trading system has become mainstream (trading on the trading floor was completely abolished in April 1999 on the TSE and in July 1999 on the OSE).

The Exchange has renewed and improved the trading system from time to time such as by responding to the increase of transactions due to the spread of the Internet, and in recent years in particular, the widespread use of algorithm transactions (a transaction method of automatically repeating orders by computer programs using mathematical models) through IT development has required the trading system to respond to the speeding up of market order and contract processing or the rapid increase of transactions.

As a result, the TSE has been operating trading systems with high speed, reliability and expandability such as the Tdex+System (targeting options transactions; futures transactions added in November 2011) since October 2009, and arrowhead (targeting stocks, etc.) since January 2010. On the OSE, a derivatives trading system called J-GATE was put into operation in February 2011. The replacements of arrowhead made in 2015, 2019, and 2024 have further increased the system's reliability, usability and performance, and replacements were also made for J-GATE on July 19, 2016, and September 21, 2021.

In addition, the Exchange provides services to respond to the needs for faster transactions by market participants such as the collocation service (a service collocating the servers of the exchange and trading participants which minimizes the physical distance between the servers and contributes to the shortening and speeding up of time required for communication).

System Development by Exchanges for Persons Engaged in Low Latency Trading

In order to respond to the low latency trading on financial instruments markets in Japan, the FIEA was amended in 2017 to introduce the registration system for persons engaged in low latency trading(*), effective as of April 2018, and to develop a framework of regulations including system development, risk management, and provision of information to the regulatory authorities.

Following this legal amendment, exchanges have also developed various systems for persons engaged in low latency trading.

Specifically, in order to enable the exchange to understand the trading strategy according to which orders in low latency trading are placed, a trading participant that is to make a bid or order in low latency trading is required to disclose to the exchange that the bid or order is made for low latency trading, while indicating the classification of the trading strategy for low latency trading (TSE Business Regulations, rule 14, para. 1, item 7, etc.; OSE Business Regulations, rule 26, para. 1, item 2, etc.). Whenever a customer entrusts the sale and purchase of securities in low latency trading to a trading participant, the customer must give instructions to the trading participant regarding the fact that the entrusted transaction is low latency trading and the classification of the trading strategy for low latency trading (TSE Brokerage Agreement Standards, rule 6, para. 1, item 13 and para. 5; OSE Brokerage Agreement Standards, rule 9, para. 1, item 10 and para. 4).

Furthermore, when a self-regulation organization examines the details of the sale and purchase of securities in low latency trading on a financial instruments exchange market and requests the customer who conducts low latency trading to submit necessary documents and provide a factual explanation, the customer must do as requested (TSE Brokerage Agreement Standards, rule 56; OSE Brokerage Agreement Standards, rule 36), and the trading participant entrusted by the customer with the sale and purchase must implement appropriate measures to ensure that the customer responds to the self-regulation organization's request (TSE Trading Participant Regulations, rule 21-2; OSE Trading Participant Regulations, rule 19-2).

* The term "low latency trading" means (i) an act for which the determination on performance of the act is automatically made by an electronic data processing system, (ii) the provision of information necessary for conducting the purchase and sale of securities, etc. based on that determination to a financial instruments exchange, etc. is made by means of information and (iii) communications technology that is specified by Cabinet Office Ordinance as a method for shortening the time normally required for the provision of information (FIEA, art. 2, para. 41).

5 Clearing and Settlement Regulations

The Clearing and Settlement Regulations of the Exchange provide the rules for clearance and settlement of

securities trading, etc. on exchange markets pursuant to the provision in the Business Regulations which states "matters concerning the clearance and settlement or trades, etc. of securities conducted on the Exchange shall be provided for by the Clearing and Settlement Regulations" (TSE Business Regulations, rule 1-3, para. 2; OSE Business Regulations, rule 2, para. 2).

Under amendments to the Securities and Exchange Act made by the "Act Concerning the Coordination, Etc. of Laws Related to the Coordination of the Securities Markets Pursuant to the Reform of the Securities Settlement System, Etc." (the so-called "Securities Settlement System Reform Act") implemented in January 2003, the Japan Securities Dealers Association and the exchanges jointly established a central securities transaction clearing organization (hereinafter referred to as the "clearing organization") in order to clear transactions conducted on each exchange in a more uniform manner (the clearing organization is the Japan Securities Clearing Corporation (hereinafter simply referred to as the "JSCC"), which commenced operations in January 2003, merged with Japan Government Bond Clearing Corporation on October 1, 2013, and merged with Japan Commodity Clearing House Co., Ltd. on July 27, 2020.).

The TSE Clearing and Settlement Regulations appoint the JSCC as the designated clearing organization (TSE Clearing and Settlement Regulations, rule 3), and the details of the clearance or settlement of securities transactions are prescribed by the clearing organization's business method manual (TSE Clearing and Settlement Regulations, rule 4).

Meanwhile, as of July 16, 2013, the OSE's clearing function for market derivatives transactions was integrated into the JSCC through the organizational conversion upon the business integration between the TSE and the OSE.

Accordingly, the OSE Clearing and Settlement Regulations appoint the JSCC as the designated clearing organization (OSE Clearing and Settlement Regulations, rule 3), and the details of the clearance or settlement of market derivatives transactions are prescribed by the clearing organization's business method manual (OSE Clearing and Settlement Regulations, rule 4).

In this Section, the outline of the clearing and settlement system is explained. For additional details, please refer to the business method manual of the clearing organization.

5 1 Clearing Organization System

The framework of the clearing and settlement system consists of the following interrelated components: (i) settlement conducted between clearing participants (participants of the clearing organization) and the clearing organization (the clearing organization system); (ii) the realization of DVP (Delivery Versus Payment: a settlement method which eliminates principal risk (referring to the risk that the purchaser does not pay the price for the securities upon the delivery of the securities by the seller, or the risk that the purchaser, who has paid the price for the securities, is unable to acquire the securities or take back the principal of the payment in whole when the seller does not deliver the securities) by making the settlement of securities mutually conditional upon the receipt of funds) by interposing the clearing organization; and (iii) the realization of effective netting among multiple parties (multilateral netting) in settlement by interposing the clearing organization.

The trading of securities in financial instruments markets is a contract (promise) for the sale and purchase (exchange) of securities and funds, and is completed through physical transfer of those securities and funds, *i.e.*, "settlement." The agency that effectuates the transfer of rights to securities or funds is known as a "settlement

facility." For the settlement of securities, it is settlement facility such as the Japan Securities Depository Center, Inc., and for the settlement of funds, it is the fund settlement banks, or the Bank of Japan that handle the transfer of rights (settlement) that is completed by an account transfer. "Clearing" is a necessary function to complete this settlement in an efficient and safe manner, and providing such function is the *raison d'etre* of the "clearing organization."

In financial instruments markets, various market participants are continuously engaged in trading activities. If the transaction is settled directly with the counterparty to such transaction (the gross method), the volume of securities and funds necessary for settlement could be substantial, thereby imposing significant costs on the parties to the settlement (deliverer of securities and payer of funds).

To address this problem, in the trading of share certificates, etc., the multilateral trading relationship of these market participants is transformed into a bilateral relationship between each of them and the clearing organization by having the clearing organization act as counter party when exchanging the securities and funds to settle a trade. In other words, the clearing organization becomes the counterparty to the settlement in lieu of the actual party to the trade, and conducts the exchange with market participants by simultaneously assuming the obligations of one party to the trade (delivery of securities or payment of funds) and acquiring the corresponding rights of the other party (receipt of securities or funds).

Also, to achieve efficient delivery and receipt of securities and funds, the clearing organization conducts netting, in which it offsets corresponding volumes of securities and amounts of funds in transactions conducted by clearing participants the settlement dates of which are the same. After conducting the netting and based on the results of such netting, the clearing organization provides transfer directions to the settlement facility.

In this manner, substantial netting among a large number of participants (multilateral netting) is realized by transforming buy-sell relationships created by a large number of market participants into the bilateral relationships between clearing house and then conducting netting.

Further, the clearing organization provides a mechanism which guarantees the performance of the settlement by using the initial margin deposit.

These are the fundamental functions of the clearing organization.

5 2 Development of the Legal System

In January 2003, the Securities and Exchange Law was amended by the Securities Settlement System Reform Act and the legal basis for the clearing organization was clarified. Following the enactment of the Financial Instruments and Exchange Act in September 2007, the act now defines the business of assuming obligations arising from securities transactions from financial instruments business operators and registered financial institutions as the "financial instruments obligation assumption service" (FIEA, art. 2, para. 28), and stock companies that receive a license or approval to conduct the financial instruments obligation assumption service are positioned as "financial instruments clearing organizations" (FIEA, art. 2, para. 29).

In addition, the business of brokering transactions conducted by another person to the clearing organization, or "brokerage for clearing of securities, etc. (FIEA, art. 2, para. 27)" has been provided as a form of the financial instruments business (FIEA, art. 2, para. 8, item 5), thereby enabling persons other than trading participants on an exchange to similarly become clearing participants with the clearing organization regarding the brokerage for

clearing of securities, etc. in exchange transactions.

Further, the FIEA prescribes that, in cases where a clearing participant defaults on its settlement obligations and causes losses to the clearing organization, the clearing organization has the right to receive satisfaction ahead of other creditors out of the clearing deposit such as the initial margin deposit, etc. of the clearing participant (FIEA, art. 156-11). Additionally, to protect itself against losses in conducting the financial instruments obligations assumption service, the clearing organization must implement certain measures, such as stating in the business method manual that the clearing participant will ultimately be responsible for the entire amount of the loss (the mutual guarantee system by clearing participants) (FIEA, art. 156-10). If the default of settlement obligations by an insolvent clearing participant causes the clearing organization itself to fail, it could spark a systemic risk that could have a major impact on the entire settlement of securities trading, etc. The relevant laws were coordinated to see to it that this kind of situation does not occur.

5 3 Clearing Participants System

A person who possesses clearing qualifications is called a clearing participant. Qualifications for engaging in clearing of securities trading on the exchange market are classified into the following categories based on the type of transaction:

(i) Spot Clearing Qualifications
Clearing qualifications for securities transactions

(ii) Government Bond Futures, Etc. Clearing Qualifications
Clearing qualifications for government bond futures transactions, government bond options transactions and interest rate futures transactions

(iii) Index Futures, Etc. Clearing Qualifications
Clearing qualification for index futures transactions (excluding those in commodity index futures), index options transactions and securities option transactions

(iv) FX Clearing Qualifications*
Clearing qualification for exchange FX transactions

(v) Precious Metal Futures, Etc. Clearing Qualifications
Clearing qualification for precious metal futures transactions and precious metal futures options transactions

(vi) Rubber Futures, Etc. Clearing Qualifications
Clearing qualification for rubber futures transactions

(vii) Agricultural Futures Clearing Qualifications
Clearing qualification for agricultural futures transactions

(viii) Crude oil Futures Clearing Qualifications
Clearing qualification for crude oil futures transactions

(ix) ETF Special Clearing Qualifications
Clearing qualification for creating and exchanging ETFs

*** Following the temporary suspension of trading on the OSE's exchange FX margin trading**

market, there is no clearing participant qualified for FX clearing (for details, see "2.1 General Provisions" in this Chapter).

Clearing qualifications in each category are subdivided into clearing qualifications that do not allow the brokerage of securities, etc. clearing ("internal clearing qualifications"), and clearing qualifications that do allow the brokerage for clearing of securities, etc. ("external clearing qualifications").

In order to acquire a clearing qualification, it is necessary to file an application with the clearing organization and be approved. The clearing organization will conduct an examination as to the applicant's administrative organization, financial base and business execution system regarding its application for clearing qualifications.

Clearing participants are required to deposit clearing deposits, etc. such as the initial margin deposit, required by the clearing organization under the Clearing Participant Agreement and other rules and regulations in order to secure the performance of the clearing participant's obligations vis-à-vis the clearing organization. Clearing participants are required to submit periodic reports to the clearing organization containing financial information, etc. in order to allow the clearing organization monitor the status of their finances.

In addition, a clearing participant must notify the clearing organization in advance in the event that it will discontinue the financial instruments business, or dissolve in a merger or transfer its operations, etc. Further, a clearing participant must report to the clearing organization if the participant is likely to become insolvent or if it fails to meet certain prescribed financial criteria.

Moreover, the clearing organization may request clearing participants to submit a report or materials when the clearing organization investigates the status of the financial condition of clearing participants or the status of their compliance with the regulations. Additionally, the clearing organization may inspect the status of the business and finances of clearing participants and their books and records.

5 4 Brokerage for Clearing of Securities, Etc.

"Brokerage for clearing of securities, etc." means transactions conducted, pursuant to the provisions in the business method manual of the clearing organization, by a clearing participant upon an entrustment from a customer (a non-clearing participant that is a trading participant on an exchange) and for the customer's account, under which the customer acts as the agent of the clearing participant to consummate the transaction on the condition that the clearing organization will assume the obligations pertaining to the transaction (FIEA, art. 2, para. 27).

In other words, brokerage for clearing of securities, etc. is, in substance, a sale or purchase, etc. of securities by the non-clearing participant who entrusts the clearing participant with an act to execute a sale or purchase, etc. in the name of clearing participant in order to have the clearing participant conduct clearing between the clearing participant and the clearing organization. This differs from general brokerage activities in that the clearing participant is not expected to play a role in introducing the parties or adjusting the price of the trading, etc.; the non-clearing participant entrusting the transaction will have already determined the substantive details of the transaction.

When a quotation by a trading participant who is a non-clearing participant satisfies the Exchange regulations, the non-clearing participant may entrust the brokerage for clearing of securities, etc. to a clearing participant, and if the clearing participant accepted it, the transaction will be completed in the name of such clearing participant but

for the account of the non-clearing participant (such a clearing participant is referred to as an "external clearing participant").

5 5 Clearing Brokerage Contract

A non-clearing participant, when entrusting brokerage for clearing of securities, etc., must enter into a clearing entrustment contract with a clearing participant (TSE Trading Participant Regulations, rule 24-3; OSE Trading Participant Regulations, rule 25).

The clearing entrustment contract uses the template prescribed by the clearing organization pursuant to its regulations. The items to be listed in this contract include the fact that when a non-clearing participant purports to act as agent of the clearing participant to consummate a clearing-eligible transaction, the non-clearing participant applies for the brokerage for clearing of securities, etc. and such application was accepted by the clearing participant.

Furthermore, a non-clearing participant may enter into multiple clearing entrustment contracts with several external clearing participants, but the Exchange requires trading participants who are non-clearing participants to designate one firm (the designated clearing participant) from among those several clearing participants as a standing entrustee for the brokerage for clearing of securities, etc. (TSE Trading Participant Regulations, rule 24-4, para. 1; OSE Trading Participant Regulations, rule 27, para. 1). Also, in order to obtain the trading qualifications, the Exchange requires an applicant to either acquire clearing qualifications from the clearing organization, or if such applicant does not acquire clearing qualifications, to enter into a clearing entrustment contract and appoint a designated clearing participant (TSE Trading Participant Regulations, rule 5, para. 1; OSE Trading Participant Regulations, rule 32, para. 2).

5 6 Settlement Performance Guarantee System

The clearing organization conducts risk management relating to clearing participants by collecting collateral (initial margin deposit, etc.) sufficient to cover the risk of each clearing participant based on its transactional performance and by reviewing that amount on a periodic basis.

In the event that a clearing participant become insolvent, the losses caused by the failure of such clearing participant are indemnified in the following order: (i) initial margin deposit of the defaulting participant; (ii) in cases where a third party, such as the entities that operate each market, provides an indemnity for damages, the amount thereof; (iii) reserves for settlement guarantee of the clearing organization; and (iv) mutual guarantee among clearing participants (clearing participants other than defaulting participants compensate the rest of the losses).

6 Brokerage Agreement Standards

6 1 General Rules

When trading participants accept the entrustment of the securities trading, etc. on the exchange market, they must follow the brokerage agreement standards prescribed by the Exchange.

This is in response to the legal provision (FIEA, art. 133, para. 1), and the points are (i) the contracts for entrustment between trading participants and their customers for transactions at-exchange must be concluded according to the brokerage agreement standards; and (ii) the brokerage agreement standards shall be prescribed by the financial instruments exchanges and must be approved by the Prime Minister (the Commissioner of the Financial Services Agency) (FIEA, art. 149, para. 1; art. 194-7, para. 1). In other words, trading participants and customers must conclude the agreement on an equal footing, and the brokerage agreement standards standardize the contents of the agreement with a view to standardizing transactions on the exchange and to protect investors.

Therefore, not only trading participants but also customers, as co-equal parties to the brokerage agreement standards, are obligated to understand and comply with the standards.

However, in reality there are few customers who fully understand the contents of the brokerage agreement standards, so trading participants must actively encourage customers to conduct transactions only after they fully understand the brokerage agreement standards.

Below we will give an explanation focused on major points of the brokerage agreement standards.

6 2 Accepting the Entrustment of Transactions

When customers entrust trading, etc. of securities to a trading participant, they are obligated to provide their addresses, full names, etc. (TSE Brokerage Agreement Standards, rule 3; OSE Brokerage Agreement Standards, rule 4). This corresponds to the duty of the trading participant to conduct an examination into certain matters when it accepts entrustment of transactions under the provisions of Rule 21 of the TSE Trading Participant Regulations and Rule 19 of the OSE Trading Participant Regulations and is important from the perspective of the prevention of incidents.

In addition, at the time of the entrustment of securities transactions, a customer must give a clear instruction to a trading participant regarding the type of trading, the issue, the distinction between sales and purchases, the quantity, the price limit, the timing of the sale or purchase in trading session, the effective term of the contracted order and whether or not it is a short sale or margin transaction (TSE Brokerage Agreement Standards, rule 6, para. 1).

At the time of entrustment of the following types of transactions, the customer must give an instruction to the trading participant on the respective matters.

Transactions in government bonds: the issue, the distinction between sales and purchases, the quantity, the price limit, the timing of the sale or purchase in the trading session, the effective term of the contracted order (TSE

Brokerage Agreement Standards, rule 7).

Government bond futures transactions: the issue; the contract month; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, a.).

Interest rate futures transactions: the underlying financial indicator and the contract month (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, a-2.).

Index futures transactions: the underlying index; if the transaction concerned is based on the Nikkei Stock Average, whether the transaction is a large contract, mini contract or micro contract; if the transaction concerned is based on TOPIX, whether the transaction is a large contract or mini contract; the contract month; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, b.).

Commodity futures transactions: the underlying commodity; in the case of gold or platinum futures transaction, whether the transaction is physically delivered futures transaction or cash-settled futures transaction; the contract month (if the transaction concerned is a rolling-spot cash-settled futures transactions, a statement to that effect); and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, b-2.).

Securities options transactions: the underlying security; the quantity of an underlying security for one trading unit of the security option; whether the option concerned is a security put option or security call option; the contract month; the exercise price; the type of transaction executed by the exercise of the option (limited to flexible contract month trading) and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, c.).

Government bond futures options transactions: the underlying issue of the government bond futures contract effected by exercise; whether the option concerned is a government bond futures put option or government bond futures call option; the contract month; the exercise price; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, d.).

Index options transactions: the underlying index; if the index option concerned is based on the Nikkei Stock Average, whether the option is a Nikkei 225 large Option or Nikkei 225 mini Option, whether the option concerned is an index put option or index call option; the contract month; the exercise price; the type of calculation method of the option settlement price (limited to flexible contract month trading) and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, e.).

Commodity futures options transactions: the underlying commodity; whether the option concerned is a commodity futures put option or commodity futures call option; the contract month; the exercise price; and other required matters*1 (OSE Brokerage Agreement Standards, rule 9, para. 1, item 1, f.).

In the case of accepting a market derivatives transaction entrusted by a customer as mentioned above, the trading participant must obtain from the customer a written agreement for setting up futures/options trading account prepared in the form designated by the OSE (OSE Brokerage Agreement Standards, rule 5, para. 2).

*1"Other required matters" as referred to above include: whether the transaction concerned is for a new sale or new purchase, or resale or repurchase; in the case of strategy trading,*2 an instruction to that effect; the quantity; the limit of price (or limit of strategy price in the case of strategy trading); the conditions for validity or executed volume; when adding conditions to bids and offers, the conditions; the trading hours; the validity period of customer's order; and if the entrustment is for low latency trading, a statement to that effect (OSE Brokerage Agreement Standards, rule 9, para. 1, item 2 through item 10).

*2"Strategy trading" refers to a transaction conducted by a trading participant in the trading session, which is for simultaneous execution of sales or purchases in multiple contract months or of multiple issues pertaining to market derivatives transactions (limited to sales and purchases for the same customer's account or its own account) (OSE Business Regulations, rule 17, para. 1).

6 3 Delivery and Other Settlement Methods

(1) Cash Transactions

When entrusting trading of securities pertaining to cash transactions, customers must provide the sold securities or the purchase price to trading participants by a certain time mutually agreed between the trading participants and customers on the day when the transaction is concluded (TSE Brokerage Agreement Standards, rule 10).

(2) Regular Transactions

When entrusting trading of securities pertaining to regular transactions, customers must provide the sold securities or the purchase price to trading participants by 9:00 a.m. of the third day counting from the day when the transaction is concluded (TSE Brokerage Agreement Standards, rule 11, para. 1).

As regards regular transactions concluded on the following days, customers must provide the sold securities or the purchase price to trading participants by 9:00 a.m. of the fourth day counting from the day when the transaction is concluded (TSE Brokerage Agreement Standards, rule 11, para. 2):

(i) For convertible type bonds with share options or exchangeable bonds, the day prescribed by the TSE as the day for trading based on new exercise or exchange terms; and

(ii) For convertible type bonds with share options and exchangeable bonds with put options, the date prescribed by the TSE as the ex-rights date for the put option.

(3) When-Issued Transactions

For the entrustment of trading of securities pertaining to when-issued transactions, customers must provide the sold securities or the purchase price to members by 9:00 a.m. on the settlement day determined by the TSE (TSE Brokerage Agreement Standards, rule 13).

(4) Trading of Government Bonds

When customers initiate government bond transactions, they must deliver the government bonds to be sold or the purchase price to trading participants by the time and date designated by the trading participant (TSE Brokerage Agreement Standards, rule 14).

(5) Calculation of Daily Interest

In principle, for trading of bonds, convertible-type bonds with share options and exchangeable bonds, the daily interest up to the settlement date of such trading must be calculated by multiplying the total amount of the face value by the interest rate of the security divided by the number of days applied, and the accrued interest to the date of settlement must be added to the trading value (TSE Brokerage Agreement Standards, rule 16).

(6) Market Derivatives Transactions

In cases where a customer makes a settlement of government bond futures transactions, in the event that a customer incurs any loss, the customer shall pay the trading participant the amount of money equivalent to the amount of such loss by the time specified herein according to the type of settlement: if the customer makes the settlement by effecting resale or repurchase, by the time and date designated by the trading participant but no later

than the day following the day on which the trading day on which the resale or repurchase is effected ends; if the customer makes the settlement by delivery/payment for physically delivered futures transaction, by the time and date designated by the trading participant but no later than the day following the day on which the last trading day of the relevant contract month ends; and if the customer makes the final settlement for cash-settled futures transaction, by the time and date designated by the trading participant but no later than the final settlement date of the relevant contract month (OSE Brokerage Agreement Standards, rule 14-2-3, para. 3). For the settlement by delivery/payment for physically delivered futures transaction, a customer shall deliver the sold government bonds or pay the purchase prices to the trading participant by the time and date designated by the trading participant as necessary for the settlement by delivery/payment for physically delivered futures transaction (OSE Brokerage Agreement Standards, rule 14-10).

In cases where a customer makes a settlement of interest rate futures transactions and index futures transactions, in the event that a customer incurs any loss, the customer shall pay the trading participant the amount of money equivalent to the amount of such loss by the time specified herein according to the type of settlement: if the customer makes the settlement by effecting resale or repurchase, by the time and date designated by the trading participant but no later than the day following the day on which the trading day on which the resale or repurchase is effected ends; if the customer makes the final settlement, by the time and date designated by the trading participant but no later than the final settlement date of the relevant contract month (OSE Brokerage Agreement Standards, rule 14-12-4, para. 2 and rule 15, para. 2).

In cases where a customer makes a settlement of commodity futures transactions, in the event that a customer incurs any loss, the customer shall pay the trading participant the amount of money equivalent to the amount of such loss by the time specified herein according to the type of settlement: (i) if the customer makes the settlement by effecting resale or repurchase, by the time and date designated by the trading participant but no later than the day following the day on which the trading day on which the resale or repurchase is effected ends; (ii) if the customer makes the settlement by delivery/payment in physically delivered futures transactions, by the time and date designated by the trading participant but no later than the day following the day on which the last trading day of the relevant contract month ends; (iii) if the customer makes the final settlement in contract month cash-settled futures transactions, by the time and date designated by the trading participant but no later than the final settlement date of the relevant contract month transaction; (iv) if the customer makes the settlement by delivery on request in contract month cash-settled futures transactions, by the time and date designated by the trading participant but no later than the day following the day on which the delivery upon request is executed; and (v) if the customer makes a rollover in contract month cash-settled futures transactions, by the time and date designated by the trading participant but no later than the day following the day on which the rollover is made (OSE Brokerage Agreement Standards, rule 16-4, para. 4).

If a customer makes a settlement by delivery/payment in physically delivered futures transactions in gold, silver, platinum, palladium, rubber (RSS) or red bean, the customer shall provide the trading participant with the warehouse receipt for the sale to be settled by the delivery and the registration number prescribed in Article 57-2, Paragraph 4 of the Consumption Tax Act (hereinafter referred to as the "registration number") if the customer is the seller, or with the total transaction price for the purchase to be settled by the delivery if the customer is the purchaser, both by the time and date designated by the trading participant but no later than the day preceding the day on which the last trading day of the latest contract month transaction ends (OSE Brokerage Agreement Standards, rule 16-6, para. 1, rule 16-10, para. 1, and rule 16-16, para. 1).

If a customer makes a settlement by delivery/payment in physically delivered futures transactions in rubber

(TSR), the customer shall provide the trading participant with the delivery document for the sale to be settled by the delivery if the customer is the seller, by the time and date designated by the trading participant but no later than the day preceding the date of delivery/payment, or with the total transaction price for the purchase to be settled by the delivery if the customer is the purchaser, by the time and date designated by the trading participant but no later than the day preceding the date of shipment (OSE Brokerage Agreement Standards, rule 16-12, para. 1).

If a customer makes a settlement by delivery/payment in physically delivered futures transactions in soybean, the customer shall provide the trading participant with the warehouse receipt for the sale to be settled by the delivery and the registration number if the customer is the seller, or with the total transaction price and the amount equivalent to consumption tax for the purchase to be settled by the delivery if the customer is the purchaser, both by the time and date designated by the trading participant but no later than the day preceding the day on which the last trading day of the latest contract month transaction ends (OSE Brokerage Agreement Standards, rule 16-14, para. 1 and para. 3).

If a customer makes a settlement by delivery/payment in physically delivered futures transactions in corn, the customer shall provide the trading participant with the warehouse receipt for the sale to be settled by the delivery if the customer is the seller, or with the total transaction price for the purchase to be settled by the delivery if the customer is the purchaser, both by the time and date designated by the trading participant but no later than the day preceding the date of delivery/payment (OSE Brokerage Agreement Standards, rule 16-18, para. 1).

When a customer makes a settlement of securities option transactions, the customer shall pay the trading participant the trading prices for the purchase or the amount of money payable for receiving the assignment of the exercise of options (limited to the assignment of the exercise of options in securities options transactions for which the exercise can execute a contract for receiving an amount of money calculated based on the difference between the exercise price and the actual value) by the date and time designated by the trading participant but no later than the day following the contract date or the day following the exercise date (OSE Brokerage Agreement Standards, rule 17, para. 1 and para. 2). When a customer makes a settlement of sale or purchase of the underlying securities by exercising the securities options, the customer must deliver the money or securities involved in the sale or purchase of the underlying securities executed by the said exercise of the options to the trading participant no later than 9:00 a.m. on the fourth day counting from the exercise date (OSE Brokerage Agreement Standards, rule 19, para. 1).

When entrusting a purchase of government bond futures options or commodity futures options, a customer shall pay the trading participant the transaction price for the purchase by the time and date designated by the trading participant but no later than the day following the day on which the trading day on which the purchase is executed ends (OSE Brokerage Agreement Standards, rules 26-2-3 and 29-5).

When a customer makes a settlement of index options transactions, the customer shall pay the trading participant the option premium for the purchase or the amount of money payable for receiving the assignment of the exercise of options by the date and time designated by the trading participant but no later than the day following the day on which the trading day on which the transaction is executed ends or the day following the exercise date (OSE Brokerage Agreement Standards, rule 28).

6 4 When-Issued Transactions

Customers entrusting the trading participant for trading of when-issued transactions must state certain matters in a written agreement prepared in the form prescribed by the TSE, sign or affix its seal and submit it to the trading participant (TSE Brokerage Agreement Standards, rule 4, para. 1). Upon agreement between the trading participant and the customer, the customer may notify to the effect that he/she has consented to the details of the said written agreement presented by the trading participant to the trading participant via the Internet, and such notice shall be in lieu of the submission of the written agreement (TSE Brokerage Agreement Standards, rule 4, para. 2).

When the sale or purchase of when-issued transactions is concluded, the customer must deposit an amount at least 30% of the contract price as a security deposit by the date and time designated by the trading participant which would be no later than the noon on the third day counting from the date when the trade was concluded (TSE Brokerage Agreement Standards, rule 31, para. 1). The money to be submitted as a security deposit must be in Japanese yen or US dollars. The amount of security deposit to be submitted in US dollars shall be 95% of the contract price converted into the Japanese yen at the foreign exchange rate designated by the trading participant (TSE Brokerage Agreement Standards, rule 39-2 applied *mutatis mutandis* pursuant to rule 32)

However, when the sale and purchase positions of the same issue by the same customer are matched, the trading participant shall waive the right to require the customer to submit a security deposit in relation to the latter transaction (TSE Brokerage Agreement Standards, rule 31, para. 2), and must return the security deposit in relation to the former transaction at the request of the customer (rule 38, para. 1). In this case, if any computed loss arises due to offset trading, the customer must submit the loss amount (TSE Brokerage Agreement Standards, rule 38, para. 2).

The margin securities below may be used in lieu of a security deposit, and the substitute price thereof must be less than the amount obtained by multiplying the market price as of the day prior to the date contributed by a ratio (substitution ratio) enumerated below (TSE Brokerage Agreement Standards, rule 40 applied *mutatis mutandis* pursuant to rule 32).

<Margin Securities>	**<Substitution Ratio>** *"daiyō kakeme"*
(i) Share certificates, etc. listed on domestic financial instruments exchanges;	**..... 80%**
(ii) Government bonds;	**..... 95%**
(iii) Municipal bonds;	**..... 85%**
(iv) Bonds issued by juridical person pursuant to special enabling legislation:	
Government guaranteed bonds	**..... 90%**
Others	**..... 85%**
(v) Corporate bonds of listed companies (other than foreign corporations) on domestic financial instruments exchanges (limited to those for which a wholesale underwriting agreement was concluded with a financial instruments business operator upon issuance);	**..... 85%**
(vi) (Bonds with share options of a company (other than a foreign corporation) listed on a domestic financial instruments exchange (limited to those for which a wholesale underwriting agreement was concluded with a financial instruments business operator	

upon issuance) 80%

(vii) Exchangeable bonds that are listed on a domestic financial instruments exchange (limited to those for which a wholesale underwriting agreement was concluded with a financial instruments business operator upon issuance); 80%

(viii) Foreign government bonds listed on domestic financial instruments exchanges; 85%

(ix) Foreign municipal bonds listed on the domestic financial instruments exchanges; 85%

(x) Yen-denominated bonds of the International Bank for Reconstruction and Development (World Bank bonds); 90%

(xi) Yen-denominated bonds of the Asian Development Bank; 90%

(xii) Yen-denominated foreign bonds issued by foreign corporations (excluding issuers in (viii) through (xi), above) and listed on the domestic financial instruments exchanges; and 85%

(xiii) Investment trust beneficiary certificates and investment securities (limited to those listed on a domestic financial instruments exchange and those for which the Investment Trust Association, Japan announces market prices of previous day); and

Beneficiary certificates of bond investment trusts 85%

Others 80%

(xiv) Foreign share certificates, etc. listed on an exchange that is registered as a national securities exchange under Section 6 of the US Securities Act of 1934 (excluding securities similar to investment equity subscription rights or investment corporation bonds) 60%

Those with the latest market prices at the time of submission 70%

When the total amount of the security deposits received which is calculated by subtracting a computational loss amount (the computational loss amount obtained by subtracting the profit due to market fluctuations and the profit due to off-setting trading from the loss due to market fluctuations and the loss due to offsetting trading) and the amount to be paid by the customer for when-issued transactions from the total security deposits submitted by the customer exceeds 30% of the contract value of securities pertaining to the when-issued transactions, trading participants may allow customers to withdraw the surplus (TSE Brokerage Agreement Standards, rule 33, para. 1; rule 34).

Where a part of the securities pertaining to when-issued transactions is settled, when the total amount of the security deposits received from the customer exceeds 30% of the contract value of the securities pertaining to when-issued transaction (excluding the securities pertaining to the when-issued transactions to be settled), trading participants may allow customers to withdraw the surplus in such security deposits to be used for the settlement (TSE Brokerage Agreement Standards, rule 33, para. 2, item 1).

Where a part of the securities pertaining to when-issued transactions is settled and withdrawal is allowed for the settlement under the condition that all of the securities purchased in the when-issued transaction or the sales proceeds for the securities sold are deposited as a security deposit, trading participants may allow the customer to withdraw the security deposit only if the total amount of the security deposits received is at least 30% of the contract value of the securities pertaining to when-issued transactions of the customer (TSE Brokerage Agreement Standards, rule 33, para. 2, item 2).

Where all securities pertaining to when-issued transactions are settled, trading participants may allow customer

to withdraw all security deposit (TSE Brokerage Agreement Standards, rule 33, para. 2, item 3).

Where money or securities submitted as a security deposit are replaced with other property, trading participants may allow customers to withdraw the security deposit within the range of the substituted amount (TSE Brokerage Agreement Standards, rule 33, para. 2, item 4).

Where trading participants newly conduct when-issued transactions for customers and when the total amount of security deposits received exceeds 30% of the contract value of the securities pertaining to the when-issued transactions, the surplus can be allotted to the security deposit necessary for the new when-issued transactions (TSE Brokerage Agreement Standards, rule 33, para. 3).

When a computational profit is realized due to market fluctuations or offsetting trading, trading participants must not allow customers to withdraw the computational profit before the settlement of when-issued transactions or allot it to a security deposit to be newly submitted (TSE Brokerage Agreement Standards, rule 35).

When a computational loss has arisen due to market fluctuations or offset trading, trading participants may have customers additionally submit an amount equivalent to such loss as the security deposit (TSE Brokerage Agreement Standards, rule 36).

When a computational loss arises due to market fluctuations or offset trading and, as a result, the total amount of security deposits received falls below 20% of the contract value of the securities pertaining to when-issued transactions, trading participants must require their customers to submit an additional security deposit so that the amount of margin is raised to equal at least 30% of the contract value by the date and time designated by the trading participants which would be no later than the noon on the third day counting from the date when the calculation loss is incurred (TSE Brokerage Agreement Standards, rule 37, para. 1).

6 5 Margin Transactions

When customers wish to establish a margin transaction account regarding the entrustment of trading of securities, they must file an application and be approved for margin transactions by the trading participant (TSE Brokerage Agreement Standards, rule 5, para. 1).

When customers obtain approval from trading participants, the customers must enter certain items, sign or seal the margin account agreement prescribed by the TSE, and submit it to the trading participant (TSE Brokerage Agreement Standards, rule 5, para. 2). Upon agreement between the trading participant and the customer, the customer may notify the trading participant of the effect that he/she has consented to the details of the agreement presented by the trading participant via the Internet, and such notice shall be in lieu of the submission of the agreement (TSE Brokerage Agreement Standards, rule 4, para. 2 applied *mutatis mutandis* pursuant to rule 5, para. 3).

When customers who have a margin account do not specify that a transaction should be a margin transaction at the time of initiating the trade, trading participants cannot conduct such transaction as a margin transaction (TSE Brokerage Agreement Standards, rule 6, para. 2). Furthermore, in such cases, offsetting transaction cannot be used for the settlement (Cabinet Office Ordinance on Transactions Prescribed in Article 161-2 of the Financial Instruments and Exchange Act and Security Deposits for the Transactions, art. 10). Therefore, if customers wish to conduct margin transactions, they must clearly state this to trading participants.

When a sale or purchase using a margin transaction is concluded, customers must submit an amount at least

equal to the amount listed below in cash as a security deposit by the date and time designated by the trading participant which would be no later than the noon on the third day counting from the date when trading is concluded (TSE Brokerage Agreement Standards, rule 39):

(1) If no other security deposit has been received at the time of submission:
- **(i) If the amount obtained by multiplying 30% (in the case of a product designed to be linked to a leverage indicator, the rate obtained by multiplying 30% by the numerical value of the multiplying factor of the indicator (if the numerical value of the multiplying factor of the indicator is less than zero, the rate obtained by multiplying 30% by the numerical value calculated by deducting the numerical value of the multiplying factor of the indicator from zero)) by the contract price (hereinafter "normal minimum amount") is JPY300,000 or more, the said amount; and**
- **(ii) If the normal minimum amount would be an amount less than JPY300,000, JPY300,000;**

(2) If a security deposit has already been received at the time of submission:
- **(i) If the sum of the security deposits received and the normal minimum amount for the new margin transaction is JPY300,000 or more, the normal minimum amount; and**
- **(ii) If the sum thereof is less than JPY300,000, the amount obtained by adding the difference to the normal minimum amount.**

As well as the security deposit pertaining to when-issued transactions, the money to be submitted as the security deposit for margin transactions must be in Japanese yen or US dollars (TSE Brokerage Agreement Standards, art. 39-2). The same range of securities substituted for security deposit pertaining to when-issued transactions can be submitted in lieu of a cash security deposit for when-issued transactions, using the same substitution ratio (TSE Brokerage Agreement Standards, rule 40).

In addition, for margin transactions as well as with when-issued transactions, there are rules related to the withdrawal of security deposits and limits imposed on their withdrawal and allotment (it is, of course, necessary that the total amount of the security deposits is equal at least to JPY300,000, but a request for withdrawal cannot be accepted if it would reduce the security deposit to less than the normal minimum amount), the prohibition regarding withdrawal of an amount equivalent to the computational profit due to market fluctuations, etc., additional submission of an amount equivalent to the computational loss due to market fluctuations, and the maintenance of security deposit (for margin transactions, if the total of the security deposit received falls below 20% of contract value of the securities pertaining to margin transactions, trading participants must have customers submit an additional margin to keep the level at 20%.) (TSE Brokerage Agreement Standards, rule 44, rule 46, rule 47 and rule 48).

Lending of the sold securities or the purchase price, based on the sale price or the purchased securities and security deposit as collateral, shall be conducted on the settlement day of the sale or the purchase in such margin transaction (TSE Brokerage Agreement Standards, rule 41, para. 1). The repayment deadline is the next day after the lending, and if there is no notice of repayment by the day that is two days prior to that date, the deadline date is deferred daily. However, it cannot be deferred beyond the third day counting from the six-month corresponding date of the day when the sale or purchase is concluded using standardized margin transactions (meaning margin transactions that are conducted according to the rules prescribed by the TSE regarding broker loan rates and deadlines for deferred repayment; hereinafter the same) (TSE Brokerage Agreement Standards, rule 43).

If a trading participant lends the purchase price or the securities to be sold in a standardized margin transaction, it will collect the broker loan rate from the customer to whom it lends the securities to be sold at the rate announced by the TSE for excess lending issues at Japan Securities Finance Co., Ltd., and deliver this broker loan rate to the customer to whom it loaned the purchase price (TSE Brokerage Agreement Standards, rule 41, para. 2).

The computation period for the broker loan rate for standardized margin transactions is the period from the loan date until the date before the repayment date (TSE Brokerage Agreement Standards, rule 42).

If the repayment date pertaining to margin transactions in securities with the right to receive stock due to a stock split, etc. occurs the next day after the date such rights, etc. are allotted, repayment is made with share certificates with ex-rights (TSE Brokerage Agreement Standards, rule 49). If trading participants continue to lend money using standardized margin transactions to customers with respect to the securities with such rights, etc., the amount shall be calculated by subtracting the price of such rights, etc. determined by the TSE from the purchased contract price (partial repayment of the loan). If the loan of securities using standardized margin transactions is continued, the value of such rights, etc. determined by the TSE is subtracted from the sale price received as collateral (partial refund of collateral) (TSE Brokerage Agreement Standards, rule 50).

6 6 Delivery of Money in Foreign Currency

It is assumed that all deliveries of money (sale and purchase prices or transaction prices, consignment fees, etc.) between customers and trading participants with respect to the sale and purchase, etc. of securities are made in Japanese yen. However, if entrusted trading participants agree, the payment can be made in the foreign currency specified by the customer (TSE Brokerage Agreement Standards, rule 52; OSE Brokerage Agreement Standards, rule 32).

6 7 Default

In the event of default on the part of a customer (as shown in the following cases (1) and (2)), trading participants, at their discretion and using the customer's account, can conclude a sale contract or purchase contract (including, resale, repurchase, final settlement or exercise of rights), and if any loss is incurred because of this, trading participants can appropriate the customer's money or securities held for the customer or recorded in the account of the trading participant pursuant to the "Act on Transfer of Bonds, Shares, Etc." to compensate for such damage, and if there still remains any shortfall, they can request the payment of the shortfall to customers:

(1) Sale and Purchase of Securities (TSE Brokerage Agreement Standards, rule 53):
   (i) When customers fail to provide the sold securities or the purchase price by a prescribed deadline to trading participants;
   (ii) When customers fail to deposit the requisite security deposit or money corresponding to the loss amount if a computational loss is incurred regarding when-issued transactions by a prescribed deadline;
   (iii) When customers fail to deposit or pay the requisite security deposit or money to trading participants

regarding margin transactions by a prescribed deadline; and

(iv) When customers fail to repay or return to trading participants the purchase price or the sold securities that were loaned regarding margin transactions by a prescribed deadline;

(2) Market Derivatives Transactions (OSE Brokerage Agreement Standards, rule 33):

(i) When customers fail to submit/deposit or pay the requisite margin or the requisite money or transaction price regarding the purchase to trading participants by a prescribed deadline; and

(ii) When customers fail to deliver the sold government bond or the purchase price regarding the settlement by delivery/payment, deliver the commodity (including the warehouse receipt and other delivery document necessary for delivery/payment) or the purchase price, or deliver the settlement amount or the securities to be delivered regarding the exercise of the options by a prescribed deadline.

For when-issued transactions, margin transactions, government bond futures transactions, interest rate futures transactions, index futures transactions, commodity futures transactions, securities options transactions, government bond futures options transactions, index options transactions and commodity futures options transactions, detailed measures for self-help by trading participants are specifically supplemented in an agreement submitted by customers to the trading participants, in addition to the above.

7 Market Derivatives Transactions

Rules and systems for market derivatives transactions on the TSE and those on the OSE have been integrated upon the integration of the TSE derivatives market and the OSE derivatives market on March 24, 2014. This change has resulted in making a wide variety of derivatives products tradable on the single platform. Various other changes have been made, such as replacement for J-GATE on July 19, 2016, the introduction of new products (*e.g.*, JPX-Nikkei Index 400 Options), and extension of the time of the evening trading session, thus increasing convenience in accessing the derivatives market. On July 27, 2020, some of the commodities listed on TOCOM's commodity futures markets were transferred to OSE's markets. On September 21, 2021, replacement for J-GATE was made once again, further increasing the system's reliability and adding flexible products and functions. On September 21, 2022, the OSE launched holiday trading in the derivatives market from the perspective of enhancing convenience for investors through the provisions of hedging opportunities during national holidays and strengthening competitiveness of Japan's derivatives market. On May 29, 2023, along with the progress in small-amount investment, the product line was expanded by introducing Nikkei 225 micro Futures and Nikkei 225 mini Options, for which the notional principal is smaller than the conventional products.

7 1 Government Bond Futures Transactions

A government bond futures transaction is a type of transaction on financial instruments market in which a party makes a contract in accordance with standards and methods as established by persons operating a financial instruments market for the delivery of standardized instruments of government bonds (benchmarks established by standardizing the interest rate, maturity and other terms to facilitate market derivatives transactions (FIEA, art. 2,

para. 24, item 5); the same shall apply hereinafter) and consideration for them at a specified time in the future. When a resale or repurchase of the standardized instruments of government bonds which are the subject of the transaction is carried out, settlement may take place in the form of paying or receiving the differences (FIEA, art. 2, para. 21, item 1).

With futures transactions, necessary trading systems were installed such as the collection of margin money to confirm the security of transactions and daily mark-to-market to confirm the status of profits and losses on a daily basis. This system is important in light of the fact that futures transactions allow net cash settlements and are speculative in nature.

The Exchange instituted long-term government bonds futures transactions in 1985 in response to the increased necessity for a means of hedging risks as related to fluctuations in bond prices which accompanied the vast expansion of the bond market, as well as the increasingly liberalized and more internationalized financial markets in Japan. It was followed by securities futures trading in super-long-term government bonds in 1988 (suspended in September 2002) and mid-term government bonds in 1996. In March 2009, mini futures trading (FIEA, art. 2, para. 21, item 2) on the price of standardized long-term JGBs was instituted. In April 2014, securities futures trading in super-long-term government bonds were resumed. In April 2022, the tick size and the immediately executable price range for super-long-term government bond futures were revised in order to enhance convenience and stimulate trading.

7 2 Interest Rate Futures Transactions

An interest rate futures transaction is a transaction using a financial indicator calculated based on the interest rate on a monetary claim in which parties make a contract on the financial instruments market, in accordance with standards and methods established by a person operating a financial instruments market, for the delivery of cash that is calculated based on the difference between the value of the financial indicator specified when executing the contract and its actual value at a specified time in the future (FIEA, art. 2, para. 21, item 2).

In light of the growing needs of yen interest rate benchmarks following the permanent discontinuation of the JPY LIBOR, in May 2023, the Exchange instituted cash-settled 3-Month TONA Futures based on the three-month compounded TONA (Tokyo Over Night Average rate; published by the Bank of Japan).

7 3 Index Futures Transactions

An index futures transaction is a form of transaction on financial instruments market in which a party makes a contract in accordance with standards and methods as established by persons operating a financial instruments market for the delivery of cash that is calculated based on the difference between the value of the index specified when executing the contract and its actual value at a specified time in the future (FIEA, art. 2, para. 21, item 2).

The Exchange instituted index futures transactions based on the Nikkei Stock Average (Nikkei 225) and index futures transactions based on the Tokyo Stock Exchange Stock Price Index (TOPIX) in 1988 in response to the increased necessity for a means of hedging risks related to stock price fluctuations as well as the need to establish a

mechanism which would allow the Tokyo market to function more as a true international market. Later, it has begun futures transactions based on various indices as follows:

In November 2014, the Exchange instituted JPX-Nikkei Index 400 futures transactions, a new type of futures for which the underlying index is JPX-Nikkei Index 400 and which consist of stocks of companies with high appeal for investors, selected on the basis of ROE and operating profit. In July 2016, it further instituted TSE Mothers Index Futures transactions based on the TSE Mothers Index, a stock index of all issues of domestic common stocks listed on the TSE Mothers market(*), and then instituted JPX Prime 150 Index Futures in March 2024. In September 2021, trading with a flexible contract month, which had been available only for option trading, was introduced for some types of index futures trading.

* Along with the change of the name of "TSE Mothers Index" to "TSE Growth Market 250 Index" in November 2023, the name of the index futures based on this index has also been changed from "TSE Mothers Index Futures" to "TSE Growth Market 250 Index Futures."

7 4 Commodity Futures Transactions

A commodity futures transaction is a form of transaction conducted on a financial instruments market in accordance with the standards and methods specified by the entity operating the financial instruments market, in which the parties to the sale and purchase promise to deliver and take delivery of a commodity (meaning, among the commodities prescribed in Article 2, Paragraph 1 of the Commodity Derivatives Transaction Act, commodities specified by Cabinet Order as those which are deemed unlikely to be adversely affected, in terms of proper price formation, by the market derivatives transactions involving those commodities, and which are deemed conducive to the national economy if the market derivatives transactions involving those commodities are conducted in a financial instruments exchange market, by taking into consideration the existence or non-existence of measures for the stabilization of the price of those commodities in accordance with the provisions of laws and regulations and other conditions of price formation and supply and demand of those commodities (FIEA, art. 2, para. 24, item 3-3); the same shall apply hereinafter) and its value at a fixed time in the future, and the parties may make a settlement by delivering the difference in values if they resell or buy back the underlying commodity (FIEA, art. 2, para. 21, item 1); and other certain transactions.

In order to realize a comprehensive exchange enabling one-stop transactions in a broad range of products from financial instruments to commodities, the Exchange commenced trading in commodity futures on July 27, 2020. On April 27, 2022, the price increments of gold rolling-spot futures and platinum rolling-spot futures and the price limits for all commodity futures were reviewed.

7 5 Securities Options Transactions

A securities option transaction is a form of transaction on financial instruments market in which one of the parties (optionor) promises, in accordance with the standards and methods as established by persons operating a financial instruments market, to provide a securities option to the other party (optionee) and the optionee promises

to pay the consideration for the securities option (FIEA, art. 2, para. 21, item 3).

A securities option is essentially the right of the optionee (option holder) to execute between the parties, upon the manifestation of intention by the option holder, a sale and purchase of securities or a transaction in which the parties pay and receive an amount of money calculated based on the difference between the price predetermined as the price of the securities on the assumption that the option holder would manifest the intention to execute the transaction (the exercise price) and the actual price of the securities as of the time when the option holder actually manifests such intention (OSE Business Regulations, rule 3, item 3).

The Exchange instituted securities options trading on domestic share certificates in 1997 in order to offer a means of hedging risks associated with price fluctuations in individual share issues as well as to provide efficient opportunities for investing funds through the diversified investment instruments, while at the same time strengthening the function of the spot market.

Initiatives toward the Expansion of Securities Options Market

In general share transactions, profit can be gained when the share price rises. An attractive feature of options transactions is that profit can also be gained regardless of the rise or fall of the share price, or even when there is no price movement. In addition, investors can make investment with only a small amount of funds by taking advantage of the leverage effect, and they can also choose investment methods that fit their needs by combining multiple options.

Since it started handling securities options transactions in 1997, the Exchange has taken various initiatives to provide a wide range of investors, from individuals to institutional investors, with more opportunities to conduct efficient fund management using a variety of investment tools.

Major achievements made by the Exchange include: (i) the expansion of the scope of securities handled (2008); (ii) the setting up of the market maker scheme (2009 and 2019);* (iii) changes to the tick sizes for some exercise prices (2016 and 2022); and (iv) introduction of the position transfer system (for flexible contract month trading in 2018 and for regular contract month trading in 2021). As part of the measures to raise awareness of individual investors with regard to securities options, the Exchange makes available the data of settlement prices of securities options and the history data of implied volatilities (the latter data is available on the "Option Chart" page of the JPX website at: https://www.jpx.co.jp/markets/derivatives/option-chart/).

In June 2018, in addition to index options transactions, the Exchange introduced flexible contract months for options transactions for which the exercise date and exercise price can be flexibly set, while taking advantage of transactions in listed securities which are highly transparent and free of credit risk of the counterparty in over-the-counter transactions.

The volume of securities options transactions conducted on exchanges in Japan is still small as compared to that in the United States, but driven by these initiatives taken by the Exchange, the volume has been increasing. As of June 27, 2024, 224 issues were available as the underlying securities of securities options transactions.

Status of Securities Options Transactions in the United States

According to a report published by the OSE on July 29, 2016, titled "Research on Actual Use of Derivatives by Overseas Individual Investors" (by Nomura Research Institute, available at: https://www.jpx.co.jp/corporate/research-study/derivatives/index.html), individual investors are very active in trading securities

options in the United States. After the beginning of the COVID-19 pandemic in 2020, trading by individual investors including young investors was further expanded, driven by the rise of smartphone securities companies. In particular, option trading beginners take the covered call strategy, *i.e.*, purchasing and holding the underlying securities and selling call options, aiming to gain more yields from the underlying securities.

As mentioned above, the volume of securities options transactions conducted on exchanges in Japan is still small compared to that in the United States, but it has been increasing with regard to covered call trading by individual investors.

* Market maker: A system that creates a trading environment where market makers continually quote bids and offers for designated contracts so that investors can trade the contracts at any time.

7 6 Government Bond Futures Options Transactions

Government bond futures options transaction is a form of transaction on financial instruments market in which one of the parties (optionor) promises, in accordance with the standards and methods established by the person operating a financial instruments market, to grant the other party (optionee) the right for an option specified by the agreement and the optionee pay the consideration of that option (FIEA, art. 2, para. 21, item 3).

A government bond futures option is essentially the right of the optionee (option holder) to consummate a government bond futures transaction for the standardized government bonds between the parties upon the expression of intent of the optionee (OSE Business Regulations, rule 3, item 4).

The Exchange instituted trading in long-term government bond futures options in 1990 in response to diversified needs of investors, while at the same time responding to demands that Japan's market function more effectively as an international market.

7 7 Index Options Transactions

Index options transaction is a form of transaction on financial instruments market under which two parties enter into an agreement in accordance with the standards and methods established by the entity operating a financial instruments market whereby one party (optionor) grants an index option the other (optionee) specified by the agreement and the optionee pays the consideration for it (FIEA, art. 2, para. 21, item 3).

An index option is the right on the part of the party to whom it has been vested (the holder of rights) to carry out a transaction between the parties at will in which paying or receiving of cash is made as calculated based on the difference between the index predetermined as the price at which the right is exercised (the exercise price) and the actual value of the index at the time the actual transaction is carried out (the actual index) (OSE Business Regulations, rule 3, item 5).

The Exchange instituted trading in index options on the Nikkei Stock Average (Nikkei 225) and those on the Tokyo Stock Price Index (TOPIX) in 1989 following index futures transactions in order to respond to diversified

needs of investors while at the same time responding to demands that Japan's market function more effectively as an international market.

In May 2015, in response to the growing need for more precise hedging opportunities to manage risks from shorter term exposures (*e.g.,* releases of economic indicators and contingent event), and with a view to enhancing convenience for market players, the Exchange introduced Weekly Options based on the Nikkei Stock Average (Nikkei 225). While the exercise day comes the second Friday for the regular monthly options, it comes each Friday (except for the second Friday) for the weekly options.

Furthermore, the Exchange instituted trading in JPX Nikkei Index 400 options in July 2016 and also instituted trading in TSE Banks Index Futures and TSE REIT Index Futures as the types of transactions to which flexible contract months are applicable in June 2018.

7.8 Commodity Futures Options Transactions

A commodity futures options transaction is a form of transaction conducted on a financial instruments market in accordance with the standards and methods specified by the entity operating the financial instruments market, in which one party grants the other party the commodity futures option, and the other party promises to pay the consideration for that option (FIEA, art. 2, para. 21, item 3).

A commodity futures option is the right of the party to whom the option is granted (the acquiring party) to effect between the parties, by a declaration of intention, a transaction in which the parties shall pay/receive an amount of money calculated based on the difference between a numerical value of the price set in advance as a contract price for the declaration of intention (the exercise price) and the actual numerical value of the price at the time of the actual declaration of such intention (OSE Business Regulations, rule 3, item 5-2).

In order to realize a comprehensive exchange enabling one-stop transactions in a broad range of products from financial instruments to commodities, the Exchange commenced trading in commodity futures options on July 27, 2020.

7.9 Give-Up System

From the viewpoint of improving the convenience of futures/options trading (collectively referring to trades in "7.1. Government Bond Futures Transactions" through "7.7. Commodity Futures Options Transactions" above), the Exchange has introduced the Give Up System from 2007, which has enabled investors to have the clearing and settlement functions (management of positions, exchange of margins, etc.) consummated by orders performed by a trading participant (order executing trading participant) handled by another trading participant (clearing settlement trading participant).

Obligation of Centralized Clearing of OTC Derivatives Transactions

With the economic downturn precipitated by the Lehman Brothers bankruptcy in 2008, it was decided by the G20 that OTC derivatives transactions shall be cleared by a central clearing organization at least by the end

of 2012, in order to reduce the counterparty's credit risk and the systemic risk caused by the market participants' failure to the whole market.

In Japan, the FIEA was amended in November 2012, and the obligation of centralized clearing was imposed on CDS (Credit Default Swap) transactions related to iTraxx Japan, which is an index issue of CDS, and interest rate swap (IRS) transactions pertaining to yen-denominated LIBOR (London Interbank Offered Rate).

In July 2014, the JSCC further imposed the obligation of concentration of clearing under the FIEA with regard to IRS transactions pertaining to Euroyen TIBOR.

In addition, in December 2014, an amendment was made to the Cabinet Office Ordinance to include financial instruments business operators, etc. dealing in over-the-counter derivatives transactions of more than a certain amount in the scope of parties subject to the obligation of concentration of clearing.

JSCC's Initiatives for Clearing of OTC Derivatives Transactions

Amidst the movements toward the centralized clearing of OTC derivatives transactions following the Lehman Brothers bankruptcy as described above, the JSCC decided to conduct the clearing business of OTC derivatives transactions as a central clearing organization. Accordingly, prior to the amendment of the FIEA in November 2012, the JSCC commenced the clearing business of CDS transactions related to iTraxx Japan from July 19, 2011, and that of IRS transactions pertaining to yen-denominated LIBOR from October 9, 2012.

The JSCC further commenced the clearing services for the following types of transactions: IRS transactions pertaining to Euroyen TIBOR on February 25, 2013; OIS (overnight index swap) transactions on November 4, 2014; and single-name CDS transactions linked with single reference entities and IRS transactions pertaining to JPY TIBOR on December 15, 2014.

The JSCC is considering expanding the scope of subject transactions of OTC derivatives transactions, while paying attention to the international trends in regulatory measures for clearing organizations.

Following the permanent cessation of JPY LIBOR on December 31, 2021, and the permanent cessation of Euroyen TIBOR on December 30, 2024, IRS transactions pertaining to JPY LIBOR and Euroyen TIBOR are disqualified for clearing.

Meanwhile, in February 2014, the JSCC introduced a client clearing system which enables persons (clients) other than those belonging to the same corporate group including the entrusted clearing participant to entrust clearing for IRS transactions. It also introduced a cross-margining system in September 2015 with the objective of enabling cross-margining, *i.e.,* offsetting of risks arising in different transactions to be cleared (IRS transaction and JGB futures transaction), thereby reducing the collateral required of IRS clearing participants and IRS clearing clients.

The JSCC additionally included clearing clients in the scope of eligible users of the cross-margining system in January 2017, and also additionally included interest rate futures transactions in the scope of eligible transactions of the cross-margining system in March 2024, with a view to further enhance the efficiency in the collateral required of IRS clearing participants, etc.

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Introduction

Legally, the term "stock" or "shares" refers to one's status as a shareholder in a corporation. In other words, stock represents the owner's share in a corporation, and his or her rights as a shareholder.

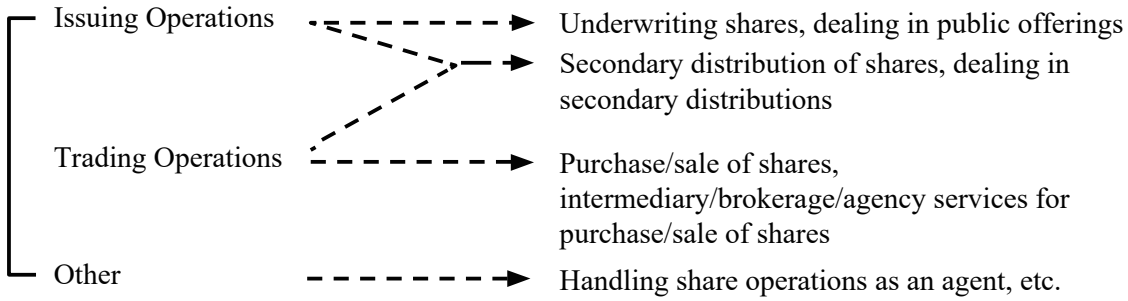
Stock is divided into units of one share, and the rights accompanying each share are equal unless more than one class of stock is issued, so that the extent of the rights is determined by the volume of shares held. From the shareholder's perspective, stock is a unit of investment; from the corporation's perspective, stock is a unit of capital. Investing in shares means becoming a shareholder by investing funds in a corporation in return for the shares issued by such corporation.

The primary rights of shareholders are: (i) voting rights; (ii) the right to demand the payment of dividends from retained earnings; (iii) rights to the residual assets of the corporation upon liquidation; and (iv) preemptive subscription rights (*shinkabu hikiuke ken*) (for details, see Volume 3, Chapter 3, "Stock Company Law in General").

What is the purpose for which general investors engage in share trading? They may be seeking a capital gain, which is a difference between the price at which they bought shares and the price at which they sold them. They may also be seeking an income gain, that is, a dividend from shares. In recent years, while market interest rates for deposits and savings have been extremely low since the Bank of Japan introduced the negative interest rate policy for its current account balances on January 29, 2016, some issues yield dividends as high as 5% or more. Some investors buy shares to obtain gift certificates for shareholders, whereas others use shares in margin transactions, in which they sell shares at a high price and buy them back at a low price. Thus, investors buy and sell shares for various purposes.

Shares are freely transferable (saleable). This means that while investors can invest in shares using short-term funds, companies are able to procure stable, long-term capital. Needless to say, if there were no secondary market where shares could freely circulate among sellers and purchasers at a fair price, not only would investors be unable to purchase shares with confidence, but issuing companies would also be precluded from procuring equity capital. Therefore, it is important that the respective functions be performed properly by each of the intermediaries, *e.g.*, financial instruments business operators, the financial instruments exchanges (hereinafter referred to individually as an "exchange") where orders of financial instruments are executed, the securities finance companies, which provide liquidity, and in addition, the financial instruments business firms associations, which are self-regulatory organizations that are formed from among financial instruments business operators, registered financial institutions and Specified Business Members.

The share operations performed by financial instruments business operators generally can be divided into the following:



This Chapter mainly explains the "share trading operations of financial instruments business operators"; but in this Chapter, "financial instruments business operators" shall be limited to persons conducting type 1 financial instruments business who are mainly engaged in securities-related business (securities companies under the former SEL).

Upon the introduction of digital share certificates, the issuance of share certificates in paper form by listed companies was abolished. However, the term "share certificate" (*kabuken*) is used in this Chapter as it is continuously used in the FIEA and other laws and regulations, regulations and rules of exchanges, and regulations and rules of the Japan Securities Dealers Association.

(Note) The following is a list of abbreviations for laws and orders that are used in this Chapter:

- Financial Instruments and Exchange Act = (FIEA)
- Order for Enforcement of the Financial Instruments and Exchange Act = (FIEAEO)
- Cabinet Office Ordinance on Definitions under Article 2 of the Financial Instruments and Exchange Act = (Definition Ordinance)
- Cabinet Office Ordinance on Financial Instruments Business = (FIBCOO)
- Cabinet Office Ordinance on Restrictions on Securities Transactions = (Securities Transaction Ordinance)
- Cabinet Office Ordinance on Transactions Prescribed in Article 161-2 of the Financial Instruments and Exchange Act and Security Deposits for the Transactions= (Security Deposit Ordinance)
- Act on Prevention of Transfer of Criminal Proceeds = (CPTPA)
- Act on the Use of Numbers to Identify a Specific Individual in Administrative Procedures = (My Number Act)
- Ordinance on Terminology, Forms, and Preparation Methods of Consolidated Financial Statements = (Consolidated Financial Statements Ordinance)
- Ordinance on Terminology, Forms, and Preparation Methods of Financial Statements = (Financial Statements Ordinance)
- Self-Regulatory Rules of the Japan Securities Dealers Association
  Rules Concerning Solicitation for Investments and Management of Customers, Etc. by Association Members = (Investment Solicitation Rules)
  Rules Concerning Establishment of Confidential Corporate Information Management System by Association Members = (Rules on Confidential Corporate Information)
  Rules Concerning Acceptance, Etc. of Deposit of Securities = (Deposit Rules)
  Rules Concerning Handling of Documents Delivery, Etc. Through Electromagnetic Method = (Document Delivery Rules)
  Rules Concerning Elimination of Relationships with Antisocial Forces = (Rules on Elimination of Relationships with Antisocial Forces)
  Rules Concerning Employees of Association Members = (Employee Rules)
  Rules Concerning Over-The-Counter Securities = (OTC Securities Rules)
  Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc. = (Professional Investors Solicitation Rules)
  Rules Concerning Equity-Based Crowdfunding Business = (Crowdfunding Rules)
  Rules Concerning Shareholders Community = (Shareholders Community Rules)
  Rules Concerning Phoenix Issues = (Phoenix Rules)

Rules Concerning Sale and Purchase, Etc. of the Listed Share Certificates, Etc. Conducted Outside of a Financial Instruments Exchange Market = (Off-Market Trading Rules)
Detailed Rules Relating to the Rules Concerning Sale and Purchase, Etc. of the Listed Share Certificates, Etc. Conducted Outside of a Financial Instruments Exchange Market = (Detailed Rules on Off-Market Trading)
Rules Concerning Handling of Cumulative Stock Investment and Mini Investment in Stocks = (Cumulative/Mini Stock Investment Rules)
Rules Concerning Foreign Securities Transactions = (Foreign Securities Rules)

1 Types of Transactions

Transactions in shares can be classified depending on the listing category of the traded shares and the market on which they are traded. Listing category refers to whether or not the shares are listed on an exchange, while the trading market refers to the categorization based on whether the share certificates are traded on or off the exchange. Furthermore, transactions involving over-the-counter securities, which involve shares not listed on an exchange, are called over-the-counter transactions.

Shares listed on an exchange and traded on the exchange ····· Exchange (Market) Trades
Shares listed on an exchange but traded outside of the exchange ··· Off-Exchange (Market) Trades
Trades of unlisted shares (over-the-counter securities) ····· Over-the-Counter Transactions

1 1 Exchange Trades

Facilities where securities can be purchased and sold on the spot in Japan include the Tokyo Stock Exchange (hereinafter referred to as the "TSE"), the Nagoya Stock Exchange (hereinafter referred to as the "NSE"), the Fukuoka Stock Exchange (hereinafter referred to as the "FSE") and the Sapporo Securities Exchange (hereinafter referred to as the "SSE"). Financial instruments exchange markets are hosted on each of these exchanges.

Trades on financial instruments exchanges are called exchange trades (trades on market) (for details, see Chapter 2, 3 "Securities Listing Regulations").

Exchange trades aim to increase the market liquidity of the listed shares and promote fair pricing by gathering all the buy/sell orders of customers (as well as financial instruments business operators themselves) on the exchange market, and matching the large volume of supply and demand for shares. However, in response to diversifying trading needs such as increasing size of order lots, etc., transactions other than those during trading sessions which are different from the transactions during trading sessions were introduced in November 1997. This enabled institutional investors making large volume trades to execute their trades without having an influence on other general investors.

A listing system is employed for the shares that trade on the exchanges, and in order to list its shares, the issuing company must submit a listing application that is subject to an eligibility examination conducted by the

relevant exchange, and the exchange will make a notification to the Prime Minister in relation to the listing (FIEA, art. 121).

Furthermore, post-listing issuing companies are obligated to report certain financial information, and are also required to disclose to investors in a timely manner other necessary company information (FIEA, Chapter II; Cabinet Office Ordinance on Disclosure of Corporate Affairs).

In order to ensure that the large volume of buy/sell orders for listed shares are executed fairly and smoothly, thus allowing the secondary markets to fully realize their potential, exchange trading (auction trading) employs the use of standardized terms (*e.g.*, session time, ask price method, trading unit, settlement methods).

Unless otherwise specified, the rules concerning exchange trading explained herein are based on the TSE's articles of association and related rules.

(1) Trading Hours

Stock trading is conducted during predetermined hours on every day except for holidays. Such hours are called trading hours.

(i) Holidays

The TSE is closed on the following holidays: Sundays; national holidays; if a national holiday falls on a Sunday, the first non-national holiday after that national holiday; the day between two national holidays; Saturdays; the first three days of the year; and December 31 (TSE/NSE/SSE/FSE Business Regulations, art. 3, para. 1).

(ii) Trading Sessions

The period of trading hours in the morning is called the morning session, and the period in the afternoon is called the afternoon session. The trading sessions for domestic shares on the TSE had been slightly different from those on other exchanges, but after the TSE extended the trading hours for the afternoon session as of November 5, 2024, changing the closing time to 15:30, the trading hours are currently the same on all exchanges (TSE/NSE/SSE/FSE Business Regulations, art. 2, para. 1, item 1).

	TSE/NSE/SSE/FSE
Morning session	9:00 - 11:30
Afternoon session	12:30 - 15:30

(2) Method for Concluding Trading Contracts

Trading is conducted under the double auction system, whereby purchase and sale orders are matched according to the principles of price and time priority (TSE Business Regulations, art. 10, para. 1).

As of November 5, 2204, the closing auction session was introduced. In this session, after a 5-minute order acceptance time (pre-closing session) from the close of *Zaraba* trading (at 15:25), an *Itayose* is conducted at 15:30 (TSE/NSE/SSE/FSE Business Regulations, art. 2, para. 1, item 1).

The contract prices of transactions executed at the exchanges (*i.e.*, highest, lowest, and closing prices) and the total trading volume are announced daily by the exchanges (FIEA, art. 130; TSE Business Regulations, art. 23).

(3) Increment of Bids and Offers

If a financial instruments business operator who participates in trading on an exchange (trading participant)

intends to execute a transaction in a trading session, it must make a bid or an offer (TSE Business Regulations, art. 14, para. 1). The increment of bids and offers for domestic shares in general is classified into 11 stages by price per share. For example, a bid or offer may be made in increments of JPY 1 when the price per share is JPY 3,000 or less, and JPY 5 when the price per share is more than JPY 3,000 but equal to or less than JPY 5,000. On the other hand, the increment for constituents of TOPIX 500 is subdivided, *e.g.,* JPY 0.1 when the price per share is 1,000 or less, and JPY 0.5 when the price per share is JPY 3,000 or less (TSE Business Regulations, art. 14, para. 3, item 1) (for details, see Volume 2, Chapter 2, "Articles of Incorporation and Various Regulations of the Exchanges").

TOPIX 500 is a market value-weighted floating share index calculated by JPX Market Innovation & Research (JPXI) which is composed of 500 issues with high liquidity selected by JPX Market Innovation & Research (TSE, Business Regulations, art. 14, para. 3, item 1 (b) (in parentheses)).

(4) Price Limits on Bids and Offers

Bids and offers shall not be made at prices exceeding the price limits defined by the Exchange in accordance with regulations (TSE Business Regulations, art. 14, para. 5). Specifically, the Exchange sets a price range which is called price limits on bids and offers or daily price limits, within which price fluctuations on a single day are limited on the basis of the previous day's closing price (base price). The price limits on bids and offers for shares are classified into 34 stages by the base price (TSE Rules Concerning Price Limits on Bids and Offers, art. 2, para. 1).

The limited price is called the "stop price." When the share price rises to the upper price limit, it is called "limit up," and when it declines to the lower price limit, it is called "limit down."

If the base price (previous day's closing price) of a particular share is not less than JPY700 and JPY 1,000 or less, the price limit is JPY 150. If the previous day's closing price is JPY 800, the limit up is JPY 950 and the limit down is JPY 650 (TSE "Rules concerning Price Limits on Bids and Offers," art. 2, para. 1; for details, see Volume 2, Chapter 2, "Articles of Incorporation and Various Regulations of the Exchanges").

(5) Trading Units

For domestic stocks, if a listed company has set a certain number of shares as one share unit, that number of shares shall be the trading unit; and if not, one share shall be the trading unit (TSE Business Regulations, art. 15, item 1 (a)).

There were eight trading units (1 share, 10 shares, 50 shares, 100 shares, 200 shares, 500 shares, 1,000 shares, and 2,000 shares) at the peak time. In April 2014, the classification was changed to comprise only two units, 100 shares and 1,000 shares. These units were unified into a single unit of 100 shares on October 1, 2018.

If there is only one unit, traders will no longer need to check the trading unit they are to use. The adoption of the single unit is also expected to considerably reduce mistakes in trading.

12 Off-Exchange (Market) Trading

In order to respond to the diversifying needs of investors as well as to increase inter-market competition, the duty to gather all trades on the exchange board was abolished in December 1998, and the trading of listed shares outside of the financial instruments exchange markets (hereinafter referred to as "off-exchange trading") commenced the same day.

Certain regulations are imposed on off-exchange trading that cover such matters as the duty of financial instruments business operators to report to the Japan Securities Dealers Association (hereinafter referred to as the "JSDA") and explain to their customers items deemed necessary such as delivery settlement conditions, etc. (Off-Market Trading Rules).

1 3 Over-the-Counter Transactions

The concept of over-the-counter transactions is loosely made up of two ideas: "trading conducted outside of the exchange (via the trading desks of financial instruments business operators) irrespective of the listing category of the securities involved," and "trading in securities that are not listed on an exchange."

"Over-the-counter securities," or securities that are not listed on an exchange, can be divided into: 1) "over-the-counter handled securities," requiring the issuer to meet a certain minimum level of disclosure, etc.; and 2) "over-the-counter securities other than over-the-counter handled securities." Furthermore, over-the-counter handled securities include Phoenix issues, securities for which financial instruments business operators may conduct investment solicitations on the condition that they conduct their own screening and provide quotations, etc. for the said issues. Over-the-counter securities other than over-the-counter handled securities include share certificates handled under the shareholders community system that is designed to support financing for community-based companies through trading in unlisted shares, and those handled in the equity-based crowdfunding business that falls within the category of type-I small amount electronic offering handling business (OTC Securities Rules, Phoenix Rules, Shareholders Community Rules, and Crowdfunding Rules).

2 Forms of Trading

The forms of share trades can be broadly categorized as follows:

2 1 Purchase or Sale of Shares (Principal Transactions)

Trades that a financial instruments business operator conducts on its own account are called principal transactions. Principal transactions are separated into trades that are executed on a market operated by an exchange, as is the case with brokered transactions below, and sales to customers or purchases from customers conducted outside of the exchange market (dealer transactions).

2 2 Brokerage for Purchase or Sale of Shares (Brokered Transactions)

Brokered transactions are transactions in which, upon receiving an order from a customer, a financial instruments business operator conducts a trade in its own name but for the customer's account. Since execution of the trade is entrusted to the financial instruments business operator, it is called a brokered transaction. Most customer buy/sell orders executed on the exchanges take this form.

2 3 Agency Services for Purchase or Sale of Shares

This means a form of transaction in which a financial instruments business operator executes a transaction in the name of a customer while disclosing the fact that the financial instruments business operator is acting as an agent and enters into an agency contract with the customer. Transactions executed by the financial instruments business operator as an agent in a tender offer bid also fall within this category.

2 4 Intermediating for Purchase or Sale of Shares

This means, upon a purchase or sale of shares, actions taken in an endeavor to facilitate a trade between the buyer and seller, *e.g.*, financial instruments business operators acting as middlemen in off-exchange market trades if requested to do so by a customer.

2 5 Intermediary, Brokerage, or Agency Services for Entrustment of Trading on Financial Instruments Exchange Markets

This includes transactions where, for example, a financial instruments business operator that is not a trading participant (or member) of an exchange (including a foreign exchange) receives an order from a customer to purchase or sell securities that are listed on that exchange, and the financial instruments business operator re-entrusts the order to a trading participant of the said exchange for execution.

3 Accepting a Trade

Several verification requirements are imposed on a financial instruments business operator when it accepts trades in securities, under a compliance framework that provides for matters such as investor protection and the prevention of unlawful transactions, etc.

To protect investors, financial instruments business operators are required to undertake appropriate investment

solicitations; for each transaction type, ensure relevant transaction commencement standards are satisfied (Investment Solicitation Rules, art. 6); deliver a document prior to conclusion of a contract (FIEA, the main clause of art. 37-3, para. 1); and inspect identifying documentation (Investment Solicitation Rules, art. 8). Similarly, a variety of conditions are imposed on the execution and settlement of orders from the viewpoint of investor protection, such as the requirement to prepare order slips (Investment Solicitation Rules, art. 18, para. 2) and deliver a document upon conclusion of a contract and on other occasions (FIEA, art. 37-4, para. 1).

From the standpoint of preventing unfair transactions, financial instruments business operators are required to confirm the customer's identity (CPTPA, art. 4; Investment Solicitation Rules, art. 5) at the time of accepting a trade to check whether the transaction falls within the transactions prohibited by the law and regulations, such as those concerning insider trading (FIEA, art. 166) and pseudonymous transactions (Investment Solicitation Rules, art. 13, para. 1).

Financial instruments business operators are also obligated to verify the identity of the customer (CPTPA, art. 4) in order to allow trades to be settled in an efficient manner.

In addition to customer verification, the matters to be observed upon accepting trades are many and varied, and include the duty to clarify in advance the mode of the transaction (FIEA, art. 37-2), verification of whether or not the transaction is a short sale (FIEAEO, art. 26-3, para. 2), finance regulations, and measures to ensure the transaction does not fall within one of the transactions prohibited by the laws and regulations, etc.

Moreover, under the Act on Sales of Financial Instruments, Etc. (the current name is "Act on the Provision of and the Development of Environment for Using Financial Services" (APFS)) that became effective in April 2001, if a financial instruments business operator wishes to sell (buy) securities to (from) a customer or engage in other transactions with a customer, the financial instruments business operator is required to explain the material matters regarding such transaction ((i) price fluctuation risk, (ii) credit risk, and (iii) restrictions on periods for the exercise of rights or contract cancellation for the said securities) prior to the sale (purchase).

In addition, the APFS has been amended in accordance with the implementation of the FIEA in September 2007.

Firstly, in addition to the existing "risk of losses in the principal," there are several new matters subject to accountability, including "material portions among the transaction scheme" and "the risk of losses in excess of the initial principal." Here the "risk of losses in excess of the original principal" means the "risk that the amount of a loss will exceed the amount of the customer margin or any other security deposit or other amount as prescribed by Cabinet Office Ordinance" as set forth in the FIEA. In addition, it has been provided that such explanation shall be in the method and extent necessary to be understood by the customer in light of the customer's knowledge, experience, status of assets and the purpose of execution of the sales agreement of such financial instrument.

Secondly, a provision to prohibit the provision, etc. of definitive judgments has been newly set forth. A financial instruments business operator, etc. shall owe no-fault liability with respect to the violation of accountability, and in such case, the amount of loss in the principal shall be presumed to be the amount of damages incurred by the customer. The provisions of the APFS concerning accountability liability for compensation for damages shall not apply to professional investors*.

*"Professional investors" mean (i) qualified institutional investors, (ii) the Government of Japan, (iii) the Bank of Japan, and (iv) Investors Protection Funds and other corporations prescribed by the Cabinet Office Ordinance (FIEA, art. 2, para. 31). Among these, "qualified institutional investors" mean institutional investors prescribed by Article 10 of the Definition Ordinance. Professional investors, set forth in categories

(i) through (iii) above, cannot switch over to become general investors, but such a transition can occur for category (iv), such as Investors Protection Funds and government-affiliated financial institutions, etc., upon their application. As of April 1, 2011, local governments were included in the scope of general investors who may shift to become professional investors (FIEA, art. 34-2 and art. 34-3; Definition Ordinance, art. 23).

3 1 Matters to Be Observed upon Accepting a Trade, Etc.

(1) Inspection of the Customer's Address, Name, Etc. and Identity Verification upon Transaction, and Presentation of the Individual Number

In accordance with the implementation of the Act Concerning the Verification, Etc. of Customer Identity, Etc. by Financial Institutions, Etc. and Prevention of Improper Use of Deposit Accounts, Etc. (hereinafter referred to as the "Customer Verification Act") in January 2003, financial instruments business operators are required by law to verify each customer's identity before commencing transactions with that customer. Thereafter, in March 2008, the Act on Prevention of Transfer of Criminal Proceeds (hereinafter referred to as the "CPTPA") fully came into force, implemented a comprehensive toughening of measures to prevent money laundering, the provision of funds for terrorism, etc. and also incorporated the content of the Customer Verification Act, with this law thereby being abolished.

Financial instruments business operators are required to maintain for customers, who conduct purchase and sale or other transactions in securities, "customer cards" on file, which contain certain information about each customer, such as the customer's name, address, and contact information, etc. (Investment Solicitation Rules, art. 5). Upon commencing transactions with the customer or at other occasions prescribed by the CPTPA, the financial instruments business operator must verify the identity of the customer by having the customer present or submit certain identifying documentation. Moreover, due to an amendment to the CPTPA, from April 1, 2013, financial instruments business operators must also verify other matters concerning the transaction, such as the purpose of the transaction and the customer's occupation (the verification of these matters in combination with the verification of the customer's identification data (name, address, date of birth, etc.) is referred to as "identity verification upon transaction"). In some cases, they have the obligation under law to verify the purpose of the transaction and the customer's occupation even when conducting a transaction with an existing customer.

Trading, etc. with or providing funds or other services to antisocial forces such as violent criminal organizations became prohibited under the rules which came into effect on July 1, 2010, and consequently, when opening an account, a financial instruments business operator is required to obtain an affidavit that the customer is not an antisocial force, and to enter into an agreement for the purpose of eliminating antisocial forces (Rules on Elimination of Relationships with Antisocial Forces, art. 3, art. 5 and art. 6).

In addition, under the My Number Act, the Income Tax Act, and other related laws, new customers who begin transactions with financial instruments business operators on or after January 1, 2016 are required to, among other procedures, present a document by which their individual numbers can be verified. Customers who have been conducting transactions with financial instruments business operators from before December 31, 2015 must present such documents no later than the point at which they receive the payment of proceeds for the transfer of shares or investment trusts, etc. or receive dividends, etc. for the first time on or after April 1, 2022 (My Number Act, art. 2,

para. 10; Income Tax Act, art. 224, para. 1 and art. 224-3, para. 1; Enforcement Order of the Income Tax Act, art. 336).

(Note) Upon the amendment to the Act on General Rules for National Taxes, starting from April 1, 2020, the Japan Securities Depository Center, Incorporated will provide the individual numbers and other information of its participants that it retains to issuers of shares, etc. or account management institutions upon their request.

(2) Investment Solicitation

When soliciting investments, financial instruments business operators must endeavor to conduct solicitations for investments that are compatible with the customer's intention and present condition, after fully ascertaining the customer's investment experience, investment objectives, financial resources, etc. (investment solicitation pursuant to the principle of suitability, Investment Solicitation Rules, art. 3, para. 2). Financial instruments business operators shall make sure the customer understands that he or she should engage in investments based on his or her own judgment and at his or her own responsibility (thorough implementation of the principle of self-responsibility, Investment Solicitation Rules, art. 4).

Furthermore, financial instruments business operators are prohibited from conducting acts of solicitation by telephone or visits at a time that customers feel inconvenienced (all customers are covered for mortgage securities, commodity funds and financial futures transactions, but only individual customers are covered for other transactions) (FIBCOO, art. 117, para. 1, item 7).

In addition, financial instruments business operators should make advertisements or other similar acts (this is a wide-ranging concept which includes the provision of the same content to many persons through means such as advertisements, postal mail, facsimile, e-mail, distribution of flyers and brochures, etc.) with clear and accurate representation of "existence of risk" in characters and figures in a size that is not substantially different from the largest size of those used in advertisements, etc., and are required to represent information on fees, risk information and other facts that are disadvantageous to customers; provided, however, that only the "existence of risk" and "that the document should be read carefully" need to be represented on TV/radio commercials, signs and novelty goods (FIEA, art. 37; FIEAEO, art. 16, para. 2; FIBCOO, art. 72, art. 73 and art. 77).

In addition, when entering into a contract for financial instruments transaction, a financial instruments business operator must provide to the customer in advance a document stating the outline of these transactions, charges and fees, etc., something to the effect that there is a risk of loss due to fluctuation in the market, etc., that the loss may exceed the amount of customer margin, etc. to be deposited, and cautionary matters to be notified to the customer (such document shall hereinafter be referred to as a "document to be delivered prior to conclusion of a contract"; FIEA, art. 37-3; FIBCOO, art. 82). Such document must state risk information, etc., in particular, in an easy-to-be-understood manner. The obligation to deliver such document shall not apply in cases where there are no issues from the standpoint of investor protection (such as where such a document has already been delivered in the past) (FIBCOO, art. 80).

With respect to the delivery of the document to be delivered prior to conclusion of a contract, acts of executing a contract without giving an explanation in the manner and to the extent necessary for a customer to understand risk information, etc. is prohibited (FIBCOO, art. 117, para. 1, item 1).

[Transaction Commencement Standards for Shares, Etc.]

With regard to the five types of high-risk transactions in shares, etc. namely, "margin transactions and when-issued transactions," "transactions of over-the-counter handled securities (Phoenix issues)," share option certificates transactions," "transactions, etc. related to the equity-based crowdfunding business," and "transactions in shareholders community issues," a financial instruments business operator must establish transaction commencement standards based on the principle of suitability, including the client's investment experience and the assets deposited (Investment Solicitation Rules, art. 6).

A financial instruments business operator must also establish transaction commencement standards for "foreign stocks margin transactions" which were introduced on July 1, 2022 (for details, see Chapter 1, 4-7"(8) Foreign Stocks Margin Transaction System").

(3) Prevention of Unlawful Transactions

(i) Prohibition on Acceptance of Insider Trading

Corporate insiders who are in the position where they can easily obtain material facts concerning the relevant listed company, etc. (including a listed company, etc. that is an investment corporation (hereinafter referred to as a "listed investment corporation, etc.")) are prohibited from trading, etc. in the specified securities, etc. of such listed company prior to the time at which those facts, which they have obtained by taking advantage of their position, are publicized (FIEA, art. 166).

Financial instruments business operators or their officers and employees must not knowingly accept an order from a customer when the customer's trade, etc. of securities falls or could fall within the definition of insider trading (FIEA, art. 166; FIBCOO, art. 117, para. 1, item 13).

[Corporate Insider, Etc.]

Under the FIEA, "corporate insider" means (a) an officer of a listed company, etc. (including the parent and subsidiary companies of a listed company, etc., and where the listed company, etc. is a listed investment corporation, etc., an asset management company of the listed company, etc. or a corporation in a specified relationship) (in the case of an accounting advisor that is a corporate entity, members of such entity), or an agent, employee or other worker of the listed company, etc.; (b) shareholders with the right to inspect the books and records of a listed company; (c) persons who have authority over a listed company, etc. pursuant to the applicable laws and regulations; (d) persons who have entered into a contract with a listed company, etc., and persons who are negotiating the conclusion of a contract; and (e) the officers and employees, etc. of a corporate entity that falls within terms (b) and (d) above. Further, anyone ceasing to have the status of a "corporate insider" shall be considered to retain such status for one year following such cessation (FIEA, art. 166, para. 1).

[Prohibition Against Insider Trading]

A corporate insider who has knowledge of a material fact of the business, etc. of a listed company, etc. must not trade in specified securities, etc. of such listed company, etc. before

such material fact is publicized (FIEA, art. 166, para. 1).

[Material Facts]

A material fact would include a decision by the organ that makes decisions on the execution of the operations of a listed company, etc., such as to make a public offering of shares, or to reduce the capital of the company, or a decision not to carry out a matter that had been decided. It would also include a change in the major shareholders. A specific listing is made in the FIEA, art. 166, para. 2 (a material fact pertaining to business or other matters) and the FIEAEO, art. 28 (a material fact pertaining to the decision by the organ of the listed company, etc. which is responsible for making decisions on the execution of the operations of the listed company, etc.), art. 28-2 (a material fact pertaining to an event that occurred to the listed company, etc.), art. 29 (a material fact pertaining to the decision by the organ of the subsidiary company of the listed company, etc. which is responsible for making decisions on the execution of the subsidiary company's operations) and art. 29-2 (a material fact pertaining to an event that occurred in the subsidiary company of the listed company, etc.), of other matters that might constitute a material fact (the same rules apply to regulate investment corporations, etc.) (for details, see Volume 1, Chapter 2, 12-4, "(1) (ii) Material Facts").

[Major Shareholder]

Shareholders who hold in their own name or in the name of another own at least 10% of the voting rights held by all the shareholders, etc. (provided, however, that shares held as part of trust property by a person engaged in the trust business, shares acquired by a financial instruments business operator in an underwriting or secondary distribution, and shares held by a securities finance company in the performance of its business shall be excluded) (FIEA, art. 163, para. 1; Securities Transaction Ordinance, art. 24).

[Publicized]

- **A material fact shall be deemed to have been publicized when a listed company has given notice of the material fact to the exchange on which it is listed, as required by the regulations of the said exchange, and when in accordance with certain requirements the material fact has been stated and made available for public inspection on the Internet via the website of the exchange (FIEAEO, art. 30, para. 1, item 2 and item 3).**

  The publication is completed when the material fact is posted on the Timely Disclosure Network (TDNet) operated by the TSE.
- **A material fact shall be deemed to have been publicized when 12 hours have passed since the material fact has been disclosed to two or more newspaper companies, etc. (FIEAEO, art. 30, para. 1, item 1, and para. 2).**
- **A material fact shall be deemed to have been publicized when it is stated in the prescribed documents of a listed company (*e.g.*, securities registration statement, shelf registration statement, annual securities report, extraordinary report, etc.) and made available for public inspection (FIEA, art. 166, para. 4).**

JSDA rules state that an Association Member must develop a system to control and manage insider trading by establishing internal rules on the prevention of insider trading and other means (Investment Solicitation Rules, art. 15, para. 7). Moreover, in order to prevent insider trading, Association Members must

endeavor to develop their internal administration systems concerning insider trading by such means as establishing internal rules concerning the management of unpublicized information in respect to issuing companies that have been acquired by its officers or employees in connection with its business operations, customer management and trading monitoring (Investment Solicitation Rules, art. 25).

In order to prevent insider trading, when a customer engages for the first time in trading, etc. in specified securities, etc. of a listed company, etc. as set forth in the FIEA at Article 166, the financial instruments business operator must require that the customer file a notification of whether it is a person as set forth below (hereinafter an "officer, etc. of a listed company, etc."). If the customer is an officer, etc. of a listed company, etc., the financial instruments business operator must, in accordance with the internal regulations of the financial instruments business operator, such as its rules on managing insider trading, create an insider registration card prior to the time of conduct of the trading, etc. of the specified securities, etc. of the listed company, etc. (Investment Solicitation Rules, art. 15, para. 1).

[Officer, Etc. of a Listed Company, Etc.]

(i) a. A director, accounting advisor, corporate auditor or executive officer (hereinafter collectively referred to as an "officer"), of a listed company, etc.;
b. An executive director or supervisory director of a listed investment corporation, etc.; or
c. An officer of an asset management company of a listed investment corporation, etc.

(ii) a. An officer of the parent company or a major subsidiary of a listed company, etc.; or
b. An officer of a major corporation in a specified relationship

(iii) A person which has ceased being any of the persons set forth in (i) or (ii) within the past year;

(iv) The spouse or housemate of a person set forth in (i);

(v) An employee or other staff of a listed company, etc. or an asset management company of a listed investment corporation, etc. who is in a position equivalent to an executive officer (excluding an executive director of a listed investment corporation, etc.) or other officer;

(vi) An employee or other staff of a listed company, etc. or an asset management company of a listed investment corporation, etc. in a department in which there is a high possibility of coming to know material facts concerning the business, etc. of the listed company, etc. (excluding (v));

(vii) An employee or other staff member of a parent company or major subsidiary of a listed company, etc., or a major corporation in a specified relationship who is in a position equivalent to an executive officer or other officers;

(viii) An employee or other staff member of a parent company or major subsidiary of a listed company, etc., or a major corporation in a specified relationship who is in a department in which there is a high possibility of coming to know material facts (excluding (vii));

(ix) A parent company or major subsidiary of a listed company, etc. or a major corporation in a specified relationship; or

(x) A major shareholder of a listed company, etc. (meaning a major shareholder recorded in the latest annual securities report or semiannual securities report)

[Matters to Be Stated on Insider Registration Cards]

(i) Name;

(ii) Address or domicile, and a mailing address;

(iii) Date of birth (limited to cases where the customer is a natural person);

(iv) Company name, title, and section; and

(v) Name and issue code of the listed company, etc. in which the customer falls under the definition of an officer, etc. of a listed company, etc.

An Association Member must have a customer promise to notify the Association Member without delay when there is any change concerning whether the customer falls within the category of officer, etc. of a listed company (Investment Solicitation Rules, art. 15, para. 3).

If an Association Member receives a customer's notification of change as to whether the customer falls within the category of officer, etc. of a listed company, it must revise the insider registration card without delay (Investment Solicitation Rules, art. 15, para. 4).

Moreover, on May 25, 2009, the JSDA launched the Japan-Insider Registration & Identification Support System (hereinafter referred to as "J-IRISS") from the perspective of preventing unfair trading, etc., and maintaining the transparency as well as the fairness of the markets. This system is designed to register and verify the information on officers of listed companies namely: (i) name; (ii) date of birth; (iii) address; (iv) company name; and (v) job title.

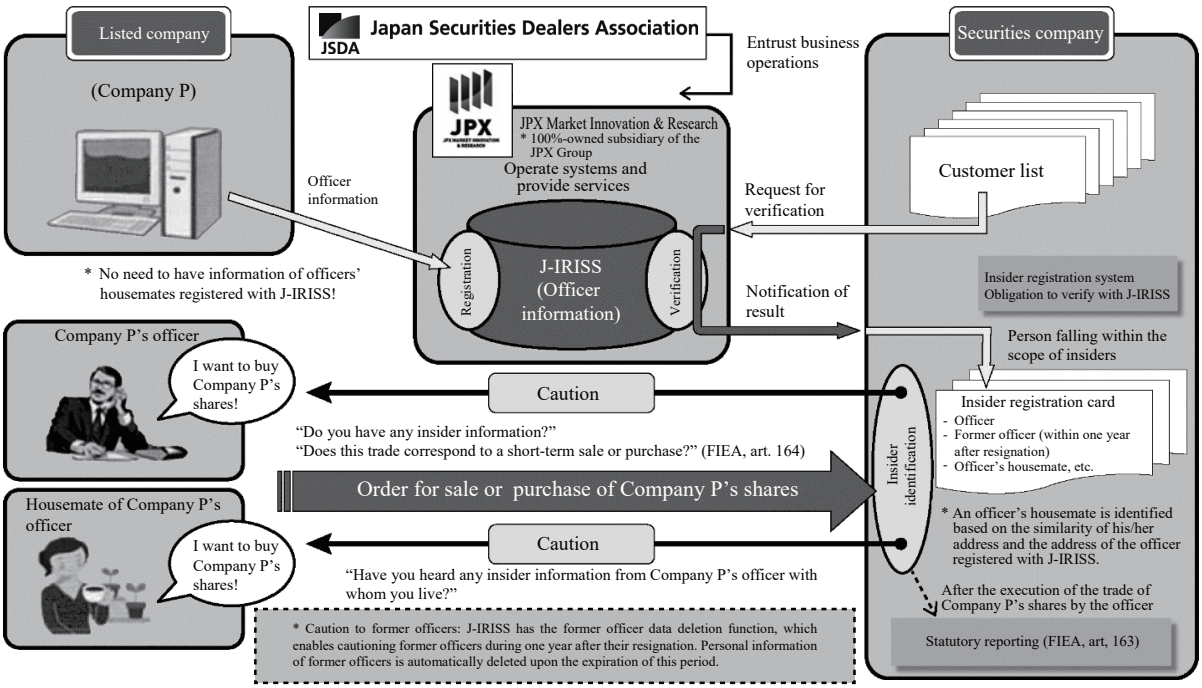
The number of companies registered to use this system increased from 267 at the end of May 2009, when the system was put into operation, to 3,553 as of August 13, 2024; 87.77% of all listed companies (4,048 companies) are now registered users.

Financial instruments business operators (securities firms) that are Association Members periodically access the database of the officer information of listed companies that has been registered with J-IRISS and compare and confirm that information with their customer information, thereby preparing insider registration cards and using them to prevent insider trading, for example.

Under the JSDA rules, an Association Member must verify the name, date of birth, and address of each customer (excluding juridical persons) who conducts sale and purchase, etc. of the specified securities, etc. of a listed company, etc. prescribed in Article 166 of the FIEA as stated in their customer card, with the data registered in J-IRISS at least once a year (Investment Solicitation Rules, art. 15-2, para. 1).

Specifically, an Association Member will compare the customer account information retained thereby with the information registered at the J-IRISS, and will confirm whether there are any officers, etc. of listed companies, etc. among the customers who hold their accounts with the member, by using the J-IRISS.

Scheme and Advantages of J-IRISS (conceptual diagram)



(Source) JSDA website

Based on the result of the verification, an Association Member must confirm whether the customer is an officer, etc. of a listed company, etc. and prepare the insider registration card without delay (Investment Solicitation Rules, art. 15-2, para. 2).

If an Association Member receives information from J-IRISS, it must not use such information for any purpose other than the preparation of an insider registration card (Investment Solicitation Rules, art. 15-2, para. 3).

J-IRISS also has the following advantages for a listed company:

(i) Preventing unintentional unfair trading by the officer of the listed company or any person living with the officer of a listed company(*1)

(ii) Raising an alert on non-compliance with the law

(iii) Preventing officers in listed companies from committing a legal or regulatory violation in connection with securities transactions(*2)

(*1) This program does not take the approach of refusing orders entirely from all customers who are registered. Instead, when an order is received from a registered customer for shares in the relevant listed company, unintentional unfair trading is prevented by confirming at the financial instruments business operator whether or not, *e.g.*, a "material fact" is known.

(*2) FIEA, art. 163: Fulfilling the duty to report trading by an officer, etc. of a listed company, etc.
FIEA, art. 164: *E.g.*, confirmation of whether there is a return of gains from short-swing transactions by an officer, etc. of a listed company, etc.

In accepting an order from a registered insider for a trade, etc. in the said company's specified securities, etc., the division responsible for trade monitoring should carefully inspect the trade by confirming the

customer's motive for the trade or checking a relationship with any confidential corporate information, based on the insider registration card as well as collected records (in paper or on electronic file) regarding confidential corporate information, etc.

The insider registration card may be prepared and kept by electromagnetic means (Investment Solicitation Rules, art. 15, para. 5). A customer card may also be used as an insider registration card as long as the customer card satisfies the particulars that are to be stated in the insider registration card (Investment Solicitation Rules, art. 15, para. 6).

Confidential Corporate Information

The FIBCOO defines "confidential corporate information" as "undisclosed important information concerning the operation, business or property of a listed company, etc. as prescribed in Article 163, Paragraph 1 of the FIEA that may have a significant influence on investors' investment decisions, and undisclosed information concerning a decision on the execution or suspension of a tender offer or any equivalent action to buy share certificates, etc." (FIBCOO, art. 1, para. 4, item 14).

"Confidential corporate information", for which Association Members are required to implement strict management, is regarded as a broader concept than "material facts and facts concerning tender offer, etc."

Therefore, the JSDA requires Association Members to prepare insider registration cards under the Investment Solicitation Rules (art. 15), and also require them to take measures under the Rules on Confidential Corporate Information, namely, clarification of the confidential corporate information management section (art. 3), establishment of internal rules (art. 4), procedures to be followed upon acquiring confidential corporate information (art. 5), management of confidential corporate information (art. 6), and enhancement of the management system (art. 7).

In 2012, multiple financial instruments business operators were charged for a number of violations of the relevant laws and regulations arising from the inadequacy of their internal rules for handling confidential corporate information, and were subject to administrative penalties given by the FSA.

Financial instruments business operators must reinforce their shields to protect confidential corporate information, generally called Chinese Walls (or firewalls).

In this respect, the JSDA's Rules on Confidential Corporate Information, Article 6 (Management of Confidential Corporate Information), have the following provisions:

(1) An Association Member must manage the confidential corporate information management section so that confidential corporate information is not communicated to other sections that do not need such information for their business, by *e.g.*, physically isolating the confidential corporate information management section from other sections (para. 1).

(2) An Association Member must manage documents that describe the confidential corporate information or information that could be confidential corporate information so that such documents are not communicated to other sections that do not need such information for their business, in a manner such as managing such documents in an isolated environment from other sections (para. 2).

(3) An Association Member must manage electronic files that contain confidential corporate information or information that could be confidential corporate information so that such electronic files are not communicated to other sections that do not need such information for their business, by *e.g.*, managing such electronic files in a way that people cannot easily view them (para. 3).

(ii) Prohibition on the Acceptance of Orders for Transactions Under a Fictitious Name or Name-Lending

An Association Member must not accept an order for purchase and sale or other transactions in securities with knowledge that the transaction is under a fictitious name (Investment Solicitation Rules, art. 13, para. 1; Employee Rules, art. 7, item 9). Furthermore, upon accepting a request for title transfer from a customer, the customer must not be allowed to use the company name of the Regular Member or the personal name of its relevant employee, or the name or address of, *inter alia,* a relative of the employee (Investment Solicitation Rules, art. 13, para. 2; Employee Rules, art. 7, item 8).

(4) Other Matters to Be Noted at the Time of Acceptance

(i) Duty to Clarify in Advance the Mode of Trading

Upon accepting an order from a customer for securities trading, the financial instruments business operator, etc. must clarify in advance whether the financial instruments business operator itself will act as counterparty to consummate the sale and purchase (a principal order), or whether it will perform intermediary, brokerage, or agency services to effect the said sale and purchase or transaction (an agency order) (FIEA, art. 37-2).

(ii) Short Selling Restrictions

No person shall conduct "short selling" in violation of the Cabinet Order. "Short selling" refers to selling securities despite the seller not being in possession of the securities or selling by borrowing the securities, or making entrustment, etc. or accepting an entrustment, etc. for such sales of securities (FIEA, art. 162, para. 1, item 1). This provision applies in cases where it is not clear whether the securities concerned may be provided without delay after the sales thereof (FIEAEO, art. 26-2).

As short selling restrictions, the temporary measures to prohibit Naked Short Selling and require the reporting and disclosure of short selling positions were introduced at the time of the financial crisis in 2008 (caused by the collapse of Lehman Brothers) and were extended on several occasions since then. However, in light of the regulatory trends in foreign countries, the FSA made a "Comprehensive Review of the Short Selling Regulations," including the adoption of the trigger method (*i.e.*, a framework whereby the price restriction (uptick rule) is applied only when the price falls below a certain threshold (10 percent fall in price relative to the previous day's closing price). As a result, the short selling restrictions were relaxed on November 5, 2013.

A. Confirmation of Backup with Borrowed Securities, Etc.

A member, etc. of a financial instruments exchange who has accepted the entrustment of short selling of borrowed securities shall not conduct such short selling if the member cannot confirm that settlement measures have been taken (FIEAEO, art. 26-2-2). This rule that prohibits naked short selling also applies to selling on its own account (FIEAEO, art. 26-2-2, para. 4). A customer is also required to clearly indicate to the financial instruments business operator that the settlement measures have been taken for the securities related to the short selling (FIEAEO, art. 26-2-2, para. 3).

These rules also apply to the selling of over-the-counter traded securities on an over-the-counter securities market established by the JSDA, and the selling of securities on the PTS (proprietary trading system) established by an approved financial instruments business operator (FIEAEO, art. 26-2-2, para. 6 and para. 7).

B. Obligation of Indication and Confirmation

When receiving an order for the sale of securities from a customer, the financial instruments business

operator must confirm whether the said sale is a short sale or not (FIEAEO, art. 26-3, para. 2 and para. 3; Employee Rules, art. 7, item 21). A duty is also imposed on the customer to clarify to the financial instruments business operator whether or not such sale is a short sale (FIEAEO, art. 26-3, para. 4).

The financial instruments business operator must clearly indicate to the exchange short sales performed on markets in cases where it conducts sales on its own account, or accepts short sales from its customer (FIEAEO, art. 26-3, para. 1; TSE Business Regulations, art. 14, para. 1, item 2).

These rules also apply to the selling of over-the-counter traded securities on an over-the-counter securities market established by the JSDA, and the selling of securities on the PTS (proprietary trading system) established by an approved financial instruments business operator (FIEAEO, art. 26-3, para. 6 and para. 7).

The share order systems of exchanges have all been computerized, so that if a financial instruments business operator inputs an order under "classification-short-sale," the system automatically flashes "short sale" on the terminal screen and checks the price.

C. Price in the Case of Short Selling, Etc.

Following the introduction of the trigger method for the price restriction on November 5, 2013, the price at which a short sale is made is an important factor in the short selling restrictions. First, we provide the definition of the price in the case of short selling.

a. Base Price

An exchange must notify its members, etc. of, and also disclose to the public, the daily total transaction volume on its markets and the highest price, lowest price, closing price, agreed figure, amounts of consideration, and other particulars, for each day and for each issue of the listed financial instruments, etc. (FIEA, art. 130). The amount calculated by a method specified by the Cabinet Office Ordinance (Securities Transaction Ordinance, art. 12) on the basis of the closing price or any price equivalent thereto is referred to as the base price (FIEAEO, art. 26-4, para. 1, item 1).

b. Trigger Method

As a result of the "Comprehensive Review of the Short Selling Regulations," the price restriction system (uptick rule) that was applicable to all issues at all times has been changed to a system that uses a trigger method on and after November 5, 2013, whereby the price restriction is applied only to such issues that meet certain conditions.

i. The price restriction is applied for the entire day immediately after a contract for an issue involved in a short sale is executed at a price lower than the base price as of a certain day by 10% or more as calculated on the basis of the previous business day's closing price, etc. (on the TSE, the said base price is the same as the "base price for the price limits for bids and offers") (such case is hereinafter referred to as "when the trading price falls below the trigger price") (FIEAEO, art. 26-4, para. 1, item 1; Securities Transaction Ordinance, art. 12, para. 5 and para. 6).

ii. When the trading price falls below the trigger price in the principal market of the issue involved in the short sale on a certain day, the price restriction is applied in all markets (including PTS) on which the said issue is traded all day on the following day (FIEAEO, art. 26-4, para. 1, item 2; Securities Transaction Ordinance, art. 12, para. 7). This measure takes place irrespective of whether the trading price falls below the trigger price on each market on the first-mentioned day.

On the other hand, if the trading price does not fall below the trigger price in the principal market of the said issue on a certain day, the price restriction is not applied and trading is

commenced in any market (including PTS) where the said issue is traded on the following day. This measure takes place irrespective of whether the trading price falls below the trigger price on each market on the first-mentioned day.

Principal Market

- The category of principal markets includes only those markets established by the TSE, the NSE, the FSE, and the SSE, excluding PTS.
- The market with the largest trading volume of securities over the past six months from the last day of each month can be the principal market (FIEAEO, art. 26-4, para. 1, item 2; Securities Transaction Ordinance, art. 12, para. 7).

c. When the Trading Price Does Not Fall Below the Trigger Price

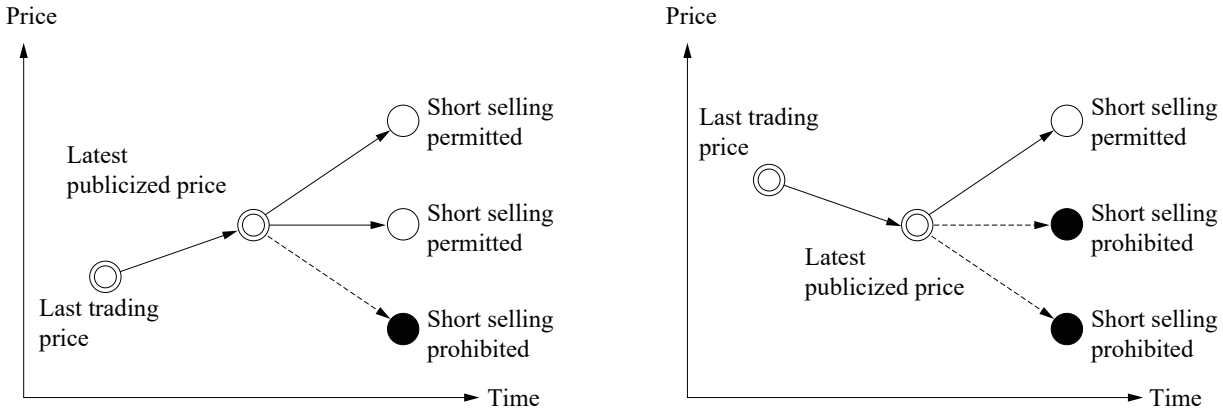
When the trading price does not fall below the trigger price, short selling is permitted irrespective of the latest price.

d. Application of the Price Restriction When the Trading Price Falls Below the Trigger Price

When a financial instruments business operator intends to make a short sale on his/her own account or make a short sale entrusted thereto, if the trading price falls below the trigger price, the financial instruments business operator must not make such a short sale at a price lower than the price that the exchange has publicized immediately before such short selling (hereinafter referred to as the "latest publicized price") (FIEAEO, the main clause of art. 26-4, para. 1).

However, the short selling at the latest publicized price is permitted if the said latest publicized price exceeds another price publicized by the exchange immediately before the publication of the said latest publicized price (FIEAEO, art. 26-4, para. 1, proviso).

Application of the Price Restriction to Short Selling After the Trading Price Falls Below the Trigger Price



When the Trading Price Is Determined by a Method Other Than the Method of Auction

The method for determining the trading price is the method by which a market maker quotes bids and offers on a regular and continuous basis, and is obliged to conduct sales and purchases

based on the said bid and offer quotes (Securities Transaction Ordinance, art. 12, para. 1).

The price to be determined by the said method is the highest bid price quoted by a market maker which was publicized immediately before a short sale of securities by the exchange that operates the market on which the said short sale is to be made with regard to the securities subject to the said short sale (hereinafter referred to as the "latest publicized best bid price") (Securities Transaction Ordinance, art. 12, para. 2).

The trading price is a price different from the latest publicized best bid price on the market, which was publicized immediately before the publication of the said last publicized best bid price by the exchange that publicized the said latest publicized best bid price, and which is the highest bid price quoted by a market maker (Securities Transaction Ordinance, art. 12, para. 3).

e. Transactions Exempted from the Short Selling Restrictions

There are three major types of transactions that are excluded from the short selling restrictions: (i) transactions exempted from the obligation to confirm a guarantee of borrowed securities (Securities Transaction Ordinance, art. 9-3); (ii) transactions exempted from the obligation of indication and confirmation in the case of short selling (Securities Transaction Ordinance, art. 11); and (iii) transactions exempted from the price restriction in the case of short selling (Securities Transaction Ordinance, art. 15).

Transactions Exempted from the Short Selling Restrictions

Transactions Exempted from Restrictions		Exemptions Applied/Not Applied		
		Obligation to Confirm with a Guarantee of Borrowed Securities	Obligation of Indication and Confirmation	Price Restriction
(a)	Financial instruments futures transactions among market derivatives transactions	○	○	○
(b)	When-issued transactions	○	○	○
(c)	Japanese government bonds, local government bonds, bonds issued by a corporation under a special law, and straight corporate bonds	○	○	○
(d)	Securities or certificates issued by a foreign government or a foreign person, that have the same characteristics as those of (c), as well as beneficiary certificates of securities in trust for which these securities are the entrusted securities	○	○	○

Transactions Exempted from Restrictions		Exemptions Applied/Not Applied		
		Obligation to Confirm with a Guarantee of Borrowed Securities	Obligation of Indication and Confirmation	Price Restriction
(e)	Among short sales of listed foreign securities, etc. (foreign investment securities, etc.) performed by a financial instruments business operator on its own account, where the financial instruments business operator purchases securities related to the short sale on a foreign financial instruments market, sales made in cases where continuous trading is conducted in order to secure smooth circulation, and sales to match purchase orders	○	○	○
(f)	Transactions in which a market maker makes a short sale on its own account on the financial instruments exchange market on which it quotes offer prices	○	○	○
(g)	Sales of securities, after purchase but before settlement of such securities, to settle the said sale with the said purchased securities	○	○	○
(h)	Sales of loaned securities (other than securities that were borrowed) in cases where it is clear that the said securities will be returned by the settlement date	○	○	○
(i)	Trading on a financial instruments exchange that is conducted outside of trading sessions (*e.g.*, ToSTNeT operated by the TSE, etc.)	○	○	○
(j)	Hedge sales (the exercise of the rights in bonds with share options, share option certificates, investment equity subscription right certificates or depositary receipts, the request to exchange exchangeable bonds, the exercise of the rights in share certificates with put options or share certificates subject to call, the decision to redeem shares in bonds with a clause for redemption in shares of another company, share split, etc., allotment of shares without contribution, allotment of new shares, etc. as a result of a merger, company split, share exchange, share transfer or share delivery, applications for public offering or secondary distributions of shares, purchases in when-issued transactions)	○	○	○

Transactions Exempted from Restrictions		Exemptions Applied/Not Applied		
		Obligation to Confirm with a Guarantee of Borrowed Securities	Obligation of Indication and Confirmation	Price Restriction
(k)	Change of the name of the holder of share certificates, change of the trading unit, replacement of old share certificates with new ones due to damage, defacement or change of the trade name	○	○	○
(l)	Hedge sales of the underlying shares of an ETF (Exchange Traded Fund) after a request to exchange ETF is made, and, in cases where an additional ETF is created, short sales of beneficiary certificates after a purchase application is submitted	○	○	○
(m)	Market making-like sales of ETFs and listed investment securities, etc.	○	○	○
(n)	Margin transactions	○	×	×
				○ Sales in margin transactions conducted by individual investors, etc. (excluding qualified institutional investors), the volume per transaction of which is equal to 50 times or less of the trading unit(Note 1)
(o)	Sales of securities of the same issue for hedge transactions conducted by financial instruments business operators that committed to purchase the securities held by the customer by VWAP(Note 2) guarantee transactions(Note 3) or VWAP target transactions; (Note 4)	○	×	○

Transactions Exempted from Restrictions		Exemptions Applied/Not Applied		
		Obligation to Confirm with a Guarantee of Borrowed Securities	Obligation of Indication and Confirmation	Price Restriction
(p)	Sales of share certificates of the same issue for arbitrage transactions between such securities and share certificates to be acquired through the exercise of rights in the securities (bonds with share options, share option certificates, investment equity subscription right certificates, depositary receipts, exchangeable bonds, and share certificates with put options)	○	×	○
(q)	Sales of share certificates of the same issue for hedge transactions between such securities and share certificates to be acquired through the exercise of rights in the securities (bonds with share options, share option certificates, investment equity subscription right certificates, depositary receipts, exchangeable bonds, and share certificates with put options)	○	×	○
(r)	Sales of multiple securities of different issues for arbitrage transactions pertaining to securities futures transactions or securities index futures transactions (where such securities to be sold are selected from among those closely tracking the securities index, etc. pertaining to the securities index futures transaction, etc.)	○	×	○
(s)	Sales of multiple securities of different issues for the hedging of securities index futures transactions, etc. (where such securities to be sold are selected from among those closely tracking the securities index, etc. pertaining to the securities index futures transaction, etc.)	○	×	○
(t)	Sales of securities of the same issue for arbitrage transactions pertaining to securities option transactions	○	×	○
(u)	Sales of securities of the same issue for the hedging of securities option transactions	○	×	○
(v)	Sales of ETFs for arbitrage transactions between ETFs that target the same securities index	○	×	○

Transactions Exempted from Restrictions		Exemptions Applied/Not Applied		
		Obligation to Confirm with a Guarantee of Borrowed Securities	Obligation of Indication and Confirmation	Price Restriction
(w)	Sales of index-tracking securities, etc. for arbitrage transactions between ETFs and the securities index	○	×	○
(x)	Sales of index-tracking securities, etc. for the hedging of ETFs	○	×	○
(y)	Sales of ETFs for arbitrage transactions pertaining to the securities index futures transactions or the securities index, etc. and ETFs	○	×	○
(z)	Sales of ETFs for the hedging of securities index futures transactions or index-tracking securities, etc.	○	×	○
(aa)	Sales of index-tracking securities, etc. for arbitrage transactions pertaining to ETF option transactions and the securities index, etc.	○	×	○
(bb)	Sales of index-tracking securities, etc. for the hedging of ETF option transactions	○	×	○
(cc)	Sales of ETFs, etc. for averaging the target securities index, etc.	○	×	○
(dd)	Sales of the share certificates of the target company, etc. for arbitrage transactions pertaining to the shares of a merging company, etc., and those of the target company, etc. based on the ratio of merger, share exchange, share transfer or share delivery	○	×	○
(ee)	Odd lot short sales	○	×	○
(ff)	Price averaging transactions between financial instruments exchanges	○	×	○

○: Exemptions applied ×: Exemptions not applied

(Note 1) Dividing an order of more than 50 trading units in an attempt to evade regulations in form may be deemed to be in violation of regulations.

(Note 2) VWAP (Volume Weighted Average Price) is the price calculated by a weighted average, using the contract prices executed on the exchange during the day and considering the trading volumes for each of the contract prices. VWAP is defined as an indicator reflecting the trading volumes of all transactions during the day and is widely recognized among institutional investors as a benchmark indicating an average contract price that is closer to actual trading conditions.

(Note 3) VWAP guarantee trading: A type of transaction that aims to guarantee VWAP-based executions.

Cross-match them with clients' sell or buy order at the pre-arranged VWAP net price (including brokerage commissions).

(Note 4) VWAP target trading: Aiming for VWAP, traders execute transactions in the auction market in which the name/number of stocks are pre-arranged, and cross-match them with clients' sell or buy orders at the VWAP of the execution result. Transactions at the VWAP net price of clients' execution results (including brokerage commissions) are also available.

D. Reporting and Publication System (Two Tier Model)

a. Providing Information on Short Selling (Reporting)

With regard to securities listed on a financial instruments exchange and designated by the Commissioner of the Financial Services Agency as having the risk of impairing fair price formation due to the large volume of short selling thereof (hereinafter referred to as the "designated securities"), a financial instruments business operator must report to the principal financial instruments exchange (meaning the person who operates the principal market; the same shall apply hereinafter) (i) the financial instruments business operator's balance and other information related to the designated securities for which the financial instruments business operator made a short sale on its own account; and (ii) the customer's balance and other information related to the designated securities for which the financial instruments business operator made a short sale as entrusted by the customer (FIEAEO, art. 26-5, para. 1).

b. Reporting of Information on Short Selling

A financial instruments business operator which has made a short sale of the designated securities must report its balance and other information related to the designated securities to the principal exchange by ten o'clock in the morning on the second day counting from the day of such short sale or change if: (i) as a result of said short selling, the outstanding short selling positions ratio of the designated securities reaches 0.2% or more and the number of outstanding short selling positions expressed in trading units (meaning the number obtained by dividing the number of outstanding short selling positions by the trading unit specified by the principal financial instruments exchange for the designated securities for which the short selling has been conducted) exceeds 50; or (ii) there are any changes in the outstanding short selling positions ratio (Securities Transaction Ordinance, art. 15-2 and art. 15-3).

The "number of outstanding short selling positions" mentioned above refers to, among the total number of the designated securities for which a short sale was made until the trading of the designated securities on a certain day is closed, the number of designated securities or of ownership rights of designated securities that must be acquired after said certain day (Securities Transaction Ordinance, art. 15-3, para. 2). The "outstanding short selling positions ratio" mentioned above refers to the figure obtained by dividing the number of outstanding short selling positions by the total number of the issued shares or the number of units in issue of the designated securities (Securities Transaction Ordinance, art. 15-3, para. 1, item 7).

c. Publication by Financial Instruments Exchanges, Etc. of Information on Short Selling

When the outstanding short selling positions ratio is 0.5% or more or when the outstanding short selling positions ratio is less than 0.5% and the latest outstanding short selling positions ratio is 0.5% or more, the principal exchange must publicize the relevant balance and other information without delay (FIEAEO, art, 26-5, para. 5; Securities Transaction Ordinance, art. 15-4, para. 1).

E. Settlement of Borrowing of Securities Pertaining to Short Selling

A person who has made a short sale of securities during a period from the time when a company publicizes a capital increase to the time when it decides the issue price of new shares, etc. must not settle the borrowing of the securities subject to such short sale by the new shares, etc. acquired as a result of such capital increase (FIEAEO, art, 26-6).

(iii) Prohibition of Stop Orders

A "stop order" refers to an order made to entrust, etc. a person with making an immediate purchase of securities if the market price rises above the market price at the time of the entrustment to at least the level that the entrusting person indicates, or with making an immediate sale of securities if the market price falls below the market price at the time of the entrustment to at least the level that the entrusting person indicates (FIEA, art. 162, para. 1, item 2). A stop order is not completely prohibited at present because, while it is prohibited for any person to make a stop order in a way that constitutes a violation of Cabinet Order (FIEA, the main clause of art. 162, para. 1), the relevant Cabinet Order has not been enacted. However, financial instruments business operators should have in place an adequate management system whereby they confirm, upon soliciting customers for investment or accepting or issuing orders, that the relevant orders will not hinder fair pricing of securities traded on markets or will not constitute unfair trading.

(iv) Check for Regulated Issues

A. Acceptance in a Period of Stabilizing Operations

Under the FIEA, no person shall conduct, in violation of the provisions of the Cabinet Order, a series of actions of trading, etc. of securities or the offering, commission or acceptance thereof, taken in the financial instruments markets for the purpose of pegging, fixing, or stabilizing the price of listed financial instruments, etc. in a financial instruments exchange market. Such acts are prohibited as a type of manipulation (prohibition against acts of market manipulation, etc.) (FIEA, art. 159, para. 3). In exceptional cases, however, for the purpose of facilitating a public offering of securities or solicitation for acquisition of securities targeting professional investors, or a secondary distribution of securities or solicitation for selling, etc. of securities targeting professional investors, transactions designed to stabilize the price of a security such as price support transactions are permitted under certain conditions. These transactions are called stabilization transactions (FIEAEO, art. 20).

The period during which stabilization transactions can be performed is known as the stabilization period, and is generally defined as the period from the day following the date of pricing relating to the public offering of securities or solicitation for acquisition of securities targeting professional investors, or the secondary distribution of securities or solicitation for selling, etc. of securities targeting professional investors until the last day on which applications for such public offering or secondary distribution will be accepted (for allotment to shareholders, until the paid-up date; FIEAEO, art. 22, para. 2, para. 3 and para. 4). In addition, the period from the day following the announcement date for the public offering of securities or solicitation for acquisition of securities targeting professional investors, or the secondary distribution of securities or solicitation for selling, etc. of securities targeting professional investors (limited to cases where there are 50 or more potential subscribers) until the paid-up date is generally known as the financing period. It is necessary to carefully monitor order acceptance and execution during the financing period, to ensure that no orders that may cause an artificial price formation are undertaken.

(Note) Stabilization Period

From the provisions of the FIEAEO, Article 22, Paragraph 2, the "stabilization period" can be construed as the "period of time from the day that is two weeks or 20 days before the due date of offering, to the date on which this period expires." In actual cases, however, the stabilization period is often set as a shorter period, such as only two days. Why does this happen?

The FIEAEO, Article 22, Paragraph 2 provides that "stabilization transactions shall not be conducted except during any of the following periods:"

(1) In the case of a public offering of securities
  (i) Public offering by granting shareholders an entitlement to the allotment of shares
    The period from the day that is two weeks before the date prescribed in the Companies Act, Article 202, Paragraph 1, Item 2 regarding the public offering (day for the application for subscription for the shares for subscription) to the payment date (FIEAEO, art. 22, para. 2, item 1 (a)).
  (ii) Public offering other than (i):
    The period from the day that is 20 days before the date of expiration of the offering period to the day on which the offering period expires (FIEAEO, art. 22, para. 2, item 1 (c)).

(2) If the issue price, etc. of the securities has not been determined before the start of the period referred to in (1), the stabilization transaction must not be conducted until the financial instruments exchange is notified by the issuer of the issue price, etc. (FIEAEO, art. 22, para. 3). Accordingly, the stabilization period in this case is shorter than the period referred to in (1).

(3) In the case referred to in (1), if the issue price, etc. of the securities is determined not by relying on any definite value but by multiplying, by a certain rate, the final price of the securities issued by the issuer of the securities on a certain day on which a financial instruments exchange market is operating, the stabilization transaction must not be conducted until the issuer notifies the financial instruments exchange of the definite value of the issue price, etc., notwithstanding the provisions of (1) (FIEAEO, art. 22, para. 4). Accordingly, the stabilization period in his case is shorter than the period referred to in (1).

(4) The notification of public offerings or secondary distributions shall, in principle, become effective 15 days after the day on which the Prime Minister receives the notification (FIEA, art. 8, para. 1). Because of this rule, the stabilization period is substantially reduced to only a few days.

a. Acceptance Falling Under the Prohibited Conduct of a Principal Underwriting Financial Instruments Business Operator (FIEAEO, art. 20, para. 2; FIBCOO, art. 117, para. 1, item 22)

I. Making purchases on one's own account

The principal underwriting financial instruments business operator is prohibited from making purchases on its own account during the stabilization period. However, this prohibition does not apply to the following: purchases based on the sale and purchase of securities effected by the exercise of the rights acquired or granted under the transactions of securities-related derivatives; stabilization transactions; purchases provided for in the regulations of a financial instruments

exchange as a purchase which would be necessary for facilitating smooth distribution of securities on the financial instruments exchange market established by such financial instruments exchange; or purchases which are regarded not to be based on an investment decision on the respective issues.

Accordingly, the principal underwriting financial instruments business operator cannot accept a transaction from a customer in which the financial instruments business operator would be the opposing party in the transaction.

Nevertheless, cumulative stock investments and mini stock investments may be accepted even though they would involve a purchase on the account of the financial instruments business operator, since they are considered as not being based on an investment decision in an individual issue (for details, see Volume 3, Chapter 2, 2-7, "(3) Cumulative Stock Investments," and this Chapter, "8 Mini Stock Investments").

II. Entrusting of purchases, etc. to another financial instruments business operator (excluding entrusting of brokerage for clearing of securities, etc.).

III. Accepting purchase orders for share certificates, etc. (excluding acceptance of entrustment of brokerage for clearing of securities, etc.) to be made for the account of the company that is the issuer of the securities involved in the stabilizing transaction.

IV. Accepting purchases on the account of officers or other persons of the issuing company who may commission a stabilization transaction (other than accepting entrustment of brokerage for clearing of securities, etc., purchases by way of a trade in securities that occurs due to the exercise of a right acquired or granted under a securities related derivatives transaction, and acceptance of stabilization transactions, etc.).

V. Purchases based on discretionary trading agreements (*e.g.*, excluding those regarded not to be based on an investment decision on the respective issues).

b. Prohibited Conduct of a Financial Instruments Business Operator That Engaged in or Accepted a Stabilization Transaction (FIBCOO, art. 117, para. 1, item 23)

A financial instruments business operator that engaged in or accepted, etc. a stabilization transaction is prohibited from accepting an offer to purchase or sell share certificates, etc. of the relevant issue or accepting a securities-related derivatives transaction, etc. relating to trading in the said securities, during the stabilization period, without declaring to the customer something to the effect that stabilization transactions have been conducted.

c. Other Prohibited Conduct of Trading Participants (Financial Instruments Business Operators) (TSE Rules Concerning Just and Equitable Principles of Trade, art. 7)

I. Accepting a purchase of securities conditioned on the execution of the transaction during the stabilization period, from a company that the financial instruments business operator knows to be the issuer of securities subject to stabilization transactions (limited to the acceptance of purchase orders for listed shares).

II. Accepting a purchase (other than stabilization transactions), conditioned on the execution of the transaction during the stabilization period, from a person the financial instruments business operator knows to be a person who may entrust such stabilization transaction.

III. Accepting purchases of securities (limited to public offering or secondary distribution in areas other than the territory of Japan) subject to stabilization transactions, from a person that the financial instruments business operator knows to be a foreign corporation that engages in

business similar to the financial instruments business in a foreign country and that has concluded an underwriting contract with the issuer of the securities.

IV. Conducting purchases on its own account or purchases pursuant to a discretionary trading agreement or entrusting purchases (excluding stabilization transactions), if notice has already been given to the financial instruments exchange from an issuer of securities (limited to public offering or secondary distribution in areas other than the territory of Japan) subject to stabilization transactions that the financial instruments business operator may entrust stabilization transactions.

B. Checks for Regulations on Margin Transactions

a. Self-Restraint of Solicitation for Restricted or Prohibited Issues in Margin Transactions

An Association Member must refrain from soliciting margin transactions (excluding reversing trade conducted for the settlement of the margin transactions) with respect to the following enumerated issues (Investment Solicitation Rules, art. 12, para. 2):

I. Issues that a financial instruments exchange or an Approved Member has restricted or prohibited from being used in margin transactions, and

II. Issues which a securities finance company has restricted or suspended from being used as lending securities, etc.

b. Measures in Cases Where Margin Transactions Are Accepted

Where an Association Member accepts a margin transaction mentioned in a. above and the following issues, it must inform the customer that the said measures are in effect, and explain the contents thereof (Investment Solicitation Rules, art. 12, para. 3):

I. Issues with respect to which a financial instruments exchange or an Approved Member has taken measures to raise the security deposit ratio for margin transactions involving the said issue (including *e.g.*, restrictions on substituting securities for security deposits); and

II. Issues for which a securities finance company has given a warning notice concerning the use as lending securities, etc.

An Association Member is under no obligation to provide an explanation in the following cases (Investment Solicitation Rules, art. 12, para. 4):

I. The customer is a person engaging in the investment management business;

II. The customer's transaction is conducted via an account where the person engaging in the investment management business gives instructions; or

III. The customer has notified the Association Member of its intention not to request an explanation in the future, and the Association Member finds that the customer fully understands that the issues in which the customer intends to conduct margin transactions may be subject to the measures set forth in a. I. or II. above or the measures set forth in b. I. or II. above.

(v) Prohibition on Separate Purchases During the Period a Tender Offer is in Effect (Cases of Purchases by Persons Other Than the Issuing Company)

Tender offerors, etc. are generally prohibited from engaging in purchases, etc. of the share certificates, etc. issued by the takeover target company during the offer period other than through the tender offer (FIEA, art. 27-5), and consequently, if a customer places an order to purchase share certificates, etc. in a target company once a tender offering has commenced, it will be necessary to confirm that the customer in question is not a tender offeror, etc.

3 2 Execution and Settlement of Orders (Delivery)

(1) Confirmation of Entrustment Order Details

Entrusted share orders often have several conditions imposed upon their execution. On the exchange, however, the brokerage agreement standards provide that a customer should give instructions to its financial instruments business operator (trading participant) regarding the following matters each time the customer entrusts a trade in securities (TSE Brokerage Agreement Standards, art. 6, para. 1):

a) **Type of trade (a statement to the effect that the order is an entrusted order);**
b) **Issue;**
c) **Classification of sale or purchase;**
d) **Quantity (trading unit);**
e) **Limits on price ("limit order" or "market order");**
f) **Time during the trading session to execute the sale or purchase (opening, close, range limit order (*hakarai*));**
g) **Effective period of an entrusted order (day order, good sale XX, GTW (good this week), etc.); and**
h) **Classification of a spot transaction or margin transaction.**

There are two major order methods of limiting price, **a limit order**, which specifies a price limit (lower limit in the case of a sale, or upper limit in the case of a purchase), and **a market order**, which does not so specify.

Customers are responsible for their decisions concerning the details of orders even when they conduct transactions as solicited by sales representatives.

When receiving orders for shares from customers, sales representatives must confirm the customers' understanding and intention with regard to the following matters.

a) **Classification of a principal (dealer) or entrusted trade (clarification of the transactional mode); and**
b) **Market where the transaction is to be executed (*e.g.*, TSE, NSE, FSE, SSE, proprietary trading system (PTS), intra-company trading system);**
c) **In case of a margin transaction, a statement to that effect, and the categorization as a standardized or negotiable margin transaction (position in a margin transaction);**
d) **In case of payment of the purchase price or the shares, etc. for sale in a margin transaction, a statement to that effect (repayment in a margin transaction);**
e) **In case of a sale without advance deposit, whether it is not a short sale; and**
f) **In case of high speed trading, a statement to that effect.**

Each securities firm has established its best execution policy and publicizes it. Sales representatives need to confirm and execute orders received from customers according to such policy (FIEA, art. 40-2).

Regulations stipulate that if a customer with a margin transaction account does not give instructions for the transaction to be carried out as a margin transaction the sale or purchase cannot

be treated as a margin transaction (TSE Brokerage Agreement Standards, art. 6, para. 2).

If a customer conducts high-speed trading, the customer must be registered with the Financial Services Agency as a "high-speed trader" (FIEA, art. 66-50).

(2) Preparation of Order Slips

Upon accepting a trade from a customer, the financial instruments business operator must prepare an order slip (FIEA, art. 46-2, art. 188; FIBCOO, art. 157, para. 1, item 3; art. 158, para. 2; Investment Solicitation Rules, art. 18, para. 2).

Matters to be stated on the order slip are as indicated in Chart 3-1 below.

Chart 3-1 Matters to Be Stated on Order Slips (FIBCOO Art. 158, Para. 1)

1. Whether the order is a dealer or broker (dealer in the event of a principal transaction).
2. In the event of an order from a customer, the personal or firm name of the customer.
3. Type of transaction:
   (i) Margin transaction or when-issued transaction (a statement to that effect and the payment deadline in the event of a margin transaction);
   (ii) *Gensaki repo* transactions (a statement to that effect, whether the transaction is in the start portion or the end portion, whether it is a broker *gensaki* or a dealer *gensaki,* and the yield over the term);
   (iii) Short selling of securities (a statement to that effect);
   (iv) Futures transaction (contract month or date of delivery, and whether a new or settlement or cancellation); or
   (v) Securities option transaction or a trade in bonds with options (rights exercise period, strike price, whether a put or a call, new, rights exercise, resale, repurchase or set-off, and contract month, etc.).
4. Issue (including the contract number of the contract agreement that states the financial instrument or financial index that is the object of the transaction, or the conditions of the transaction, and other information that identifies the object of the transaction).
5. Whether the order is a sell or buy.
6. Order volume (if there is no volume, then the number of cases, or the equivalent to the volume).
7. Contract volume (if there is no volume, then the number of cases, or the equivalent to the volume).
8. Whether the order is a limit or market order (and in the event of a limit order, including the price thereof and the effective period of the order).
9. The date and time of the order.
10. The date and time of the contract.
11. The contract price.

The method of preparation of order slips is prescribed in laws and regulations (FIBCOO, art. 158, para. 2). If certain requirements are met, it is also permissible to prepare the order slips as an electronic or magnetic record (by

inputting the relevant data directly into a computer) (FIBCOO, art. 158, para. 2, item 3).

Order slips must be classified into the customer's orders and proprietary orders, and preserved in files in date order. Order slips pertaining to the proprietary trading system (PTS) operations must be preserved in a distinctive manner (FIEA, art. 46-2; FIBCOO, art. 158, para. 2, item 4 (a) and (c)).

A different method is prescribed for the preservation of order flips for high-speed trading (FIBCOO, art. 158, para. 4).

Due to the concern over the expansion of dark pools for individual investors (electronically accessible forums for trading securities where pre-trade transparency is not ensured (price information is not disclosed)), it has been made obligatory for financial instruments business operators, etc. to explain to the customers the conditions for forwarding their orders to dark pools, provide them with information on the operation of dark pools, and prepare and preserve information necessary for ensuring the price improvement effects, for the purpose of grasping the actual state of orders placed with dark pools and protecting investors (FIBCOO, art. 70-2, para. 7, art. 158, para. 5 and para. 6; Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc., IV-3-1-2(10)).

(3) Preparation of the Document to Be Delivered upon Conclusion of a Contract

If an order from a customer has been executed and the sale or purchase has been completed, the financial instruments business operator must prepare a document delivered upon conclusion of a contract as provided for in the Cabinet Office Ordinance and deliver the same to the customer without delay (FIEA, art. 37-4). In this context, "without delay" means as promptly as possible. If delivery of the transaction report is delayed without good cause, it will be considered late. The financial instruments business operator must preserve a copy of the document (FIEA, art. 46-2).

(Note) Purposes of the preparation by financial instruments business operators, etc. of the document delivered upon conclusion of a contract and the duty to deliver:

(i) To allow the customer to promptly confirm whether the customer's order was faithfully executed (customer protection); and

(ii) Because share prices are highly volatile, to allow the customer to confirm that the trade was completed as per the customer's order, and to facilitate delivery (financial instruments business operator self-protection).

The matters to be stated in a document to be delivered upon conclusion of a contract may be provided by a method that uses an electronic data processing system or a method that uses other information communications technology, instead of the delivery, etc. of the paper document, as provided by Cabinet Order, if consent is obtained in writing or by electromagnetic means from the customer (FIEA, art. 37-4, para. 2; FIEAEO, art. 15-22, para. 1; FIBCOO, art. 56 and art. 57; Deposit Rules, art. 14, para. 1, item 3; Document Delivery Rules, art. 2 and Annex, 4). In the event that the above has been provided by electromagnetic means, the financial instruments business operator shall be deemed to have delivered the document to be delivered upon conclusion of a contract (FIEA, art. 37-4, para. 2; FIBCOO, art. 110, para. 2; Deposit Rules, art. 14, para. 1, item 3).

Where the customer is a corporation or other similar association, when the chief manager(Note) of the financial instruments business operator or an employee approved by the chief manager delivers the document to be delivered upon conclusion of a contract by hand directly to the customer's office, the document will be deemed to have been

sent by mail (Deposit Rules, art. 13, para. 2).

In addition, in cases prescribed by the Cabinet Office Ordinance as being considered as not causing disruptions for public interest or investor protection even if the document is not delivered to the customer in consideration of the contents of the contract for financial instruments transaction or other circumstances, the document does not need to be delivered (FIEA, art. 37-4, para. 1 *proviso*; FIBCOO, art. 110).

(Note) The chief manager is a responsible person in sales, inspection, auditing or administration department to be appointed in each business office or other office (Deposit Rules, art. 11, para. 5).

Chart 3-2 **Matters to Be Stated on the Document to Be Delivered upon Conclusion of a Contract**

<Common Matters to Be Stated in the Document to Be Delivered Upon Conclusion of a Contract (FIBCOO, art. 99)>

1. The trade name, business name, or name of the financial instruments business operator, etc.
2. The name of the business office or outlet of the financial instruments business operator, etc.
3. A summary of the contract for financial instruments transaction, cancellation or redemption
4. Date of formation, cancellation or redemption of the contract for financial instruments transaction
5. Matters concerning charges, etc. associated with forming, the contract for financial instruments transaction, or cancellation or redemption
6. Personal name or firm name of customer
7. Method by which customer will communicate with the financial instruments business operator, etc.

<Matters to be Stated in the Document to Be Delivered Upon Conclusion of a Contract, Depending on the Financial Instruments Involved (FIBCOO, art. 100 and art. 101)>

1. Common matters to be stated for purchase and sale or other transactions in securities

   Whether a dealer or broker trade, whether a buy or sell, etc., the issue, the contract volume, the unit price, the amount of consideration, the contract price or other monetary amount per contract unit, the monetary amount that the customer is to pay and the method of calculation, the type of transaction, and matters that are necessary in order to accurately state the content of the transaction.
2. Special provisions on matters to be stated in the event of purchase and sale or other transactions in securities

   In the event of a trade in securities, in addition to the matters set forth in 1. above, whether the trade is a cash transaction or a margin transaction, and if it involves a margin transaction, the payment deadline and whether it is new or a settlement.

(4) Delivery

After shares are traded, "delivery" occurs when the transaction is settled and a customer surrenders the purchase price and receives the share certificates, or surrenders the share certificates and receives the sales proceeds. Since listed shares have been digitized and these certificates are not issued, when a customer purchases shares of stock, these shares are entered or registered in the settlement account of the transacting financial instruments business operator (the securities firm) as "book-entry shares." When the reverse occurs and a customer sells shares, the decrease in shares is entered or recorded in the settlement account of the transacting financial instruments business operator.

Delivery in trading of regular transactions on the exchange takes place on the third business day counting from the date of the transaction (TSE Business Regulations, art. 9, para. 3).

Settlement of trading, etc. of securities that is executed on a market of an exchange will be conducted between the clearing participant (a financial instruments business operator, *i.e.*, a securities firm) and the Japan Securities Clearing Corporation (hereinafter referred to as the "JSCC") in accordance with the Business Rules of the JSCC (TSE Clearing and Settlement Regulations, art. 4).

The sales proceeds of securities that are sold are paid to the customer after the delivery date for the said transaction, and securities that are purchased are transferred to the account of the customer after the financial instruments business operator (trading participant) receives delivery from the settlement counterparty on the third business day counting from the contract date and concludes the necessary clerical procedures.

In principle, delivery and receipt of money pertaining to securities trading between a customer and a trading participant should be made in the Japanese yen, but a foreign currency designated by the customer may be used if the trading participant agrees to that effect (TSE Brokerage Agreement Standards, art. 52).

Credit cards are available for the settlement of equity-based crowdfunding transactions which are less likely to cause problems in terms of protection of investors (FIBCOO, art. 149, item 1(a)).

3 3 Commissions Pertaining to Share Trading

There are two basic forms that a transaction may take when a customer engages in share trading through a financial instruments business operator—brokered transactions (the financial instruments business operator is entrusted a trade, which it then executes) and dealer transactions (negotiated transactions made directly between the financial instruments business operator and the customer on off-exchange).

The amount of commission was formerly determined according to the "Brokerage Agreement Standards" established by the exchange based on the trading volume. Since October 1999, however, commissions and fees in share brokerage have been completely liberalized. Commissions are now determined based on an agreement between the financial instruments business operator and the customer.

In a dealer transaction, the financial instruments business operator may, as is the case with brokered trades, collect a commission determined based on an agreement with the customer, or not collect a separate commission and simply include an equivalent amount in the contract trading price.

4 Sale and Purchase of Shares on Financial Instruments Exchanges

4 1 Types and Outline of Share Trading on Financial Instruments Exchanges

Trading shares on an exchange can be classified according to (i) differences in the settlement date, such as in regular transactions, cash transactions and when-issued transactions, (ii) the extension of credit by a financial instruments business operator or a securities finance company, such as in spot transactions and margin transactions, and (iii) whether transactions take place during trading sessions, such as by transactions during trading sessions and transactions other than those during trading sessions.

(1) Classification According to Differences in the Settlement Date

(i) Regular Transactions

The most common transaction, where the transaction is completed and settlement occurs on the third business day counting from the trading contract was concluded (TSE Business Regulations, art. 9, para. 3).

(ii) Cash Transactions

Transactions where settlement takes place on the date the trading contract is concluded (TSE Business Regulations, art. 9, para. 2).

(iii) When-Issued Transactions

When-issued transactions are transactions targeted at the share certificates that an issuer (company) of domestic share certificates will newly issue through an allotment to shareholders, where trading takes place after the ex-rights date in the case of an offering to shareholders until the date determined by the exchange. All settlements of the transactions contracted during the said period take place on the third business day counting from the final day of when-issued transactions (TSE Business Regulations, art. 9, para. 7) (for details, see this Chapter, “4-2 When-Issued Transactions (Date-of-Issue Transactions)”).

DVP Settlement

DVP settlement was introduced on the TSE and OSE in May 2001 for settlement of transactions between financial instruments business operators on the exchange. DVP stands for Delivery Versus Payment, and settlement is conducted by “delivery of funds and securities simultaneously, or within the same day.” This removes the principal risk (the risk that the consideration for the funds or securities will not be received after they are delivered) arising from counterparty default (TSE Brokerage Agreement Standards, art. 15; JASDEC DVP Clearing Corporation Business Rules, art. 3). Following the integration of the spot (cash equity) markets of the TSE and OSE on July 16, 2013, DVP settlement on the OSE was discontinued.

(2) Classification According to the Extension of Credit

(i) Spot Transactions

Where an individual or corporation intends to engage in trading, when it sells securities it holds, or makes

a purchase of securities using its own funds, on its own account, the transaction is known as a spot transaction.

(ii) Margin Transactions

When an investor borrows money from a financial instruments business operator to buy securities, or when a financial instruments business operator borrows from a securities finance company, or alternatively, when securities are borrowed and then sold, the transaction is called a margin transaction (FIEA, art. 156-24, para. 1; TSE Business Regulations, art. 1-3. para. 3; for details, see this Chapter, "10 Margin Transactions").

(3) Classification According to Whether Transactions Occur During Trading Sessions

(i) Transactions During Trading Sessions **(Trading on a Market during Trading Session in the Exchange)**

Transactions during trading sessions involve trading by means of competitive sale and purchase (trading under auction system) (TSE Business Regulations, art. 10, para. 1). Trading under the auction system involves transactions that proceed through an individual competitive sale and purchase whereby all investor bid and ask orders for each issue at each price are gathered and processed by having the order with the lowest bid price and the order with the highest asked price match, according to the principles of price and time priority (TSE Business Regulations, art. 12, para. 2) (for details, see Chapter 2, 4.2 Trading Session "(3) Conclusion of Trading Contracts").

(ii) Transactions Other Than Those During Trading Sessions **(Trading on a Market Outside of Trading Sessions in the Exchange)**

In contrast to individual competitive sale and purchase as is conducted during trading sessions, buyers and sellers conducting transactions other than those during trading sessions will almost always reach an agreement with respect to price, volume, settlement dates, etc., and then close the contract through a cross trade. Transactions other than those during trading sessions are classified according to its content, such as single issue transactions, basket transactions, closing price transactions, and purchase transaction outside of trading sessions of company's own shares (TSE Special Regulations of Business Regulations and Brokerage Agreement Standards Concerning ToSTNeT Market, art. 4; for details, see this Chapter, "4-3 Transactions Other Than Those During Trading Sessions (Trading on a Market Outside of Trading Sessions in the Exchange)").

4 2 When-Issued Transactions (Date-of-Issue Transactions)

(1) Definition and Significance of When-Issued Transactions

When-issued transactions (Date-of-issue transactions)(Note) mean a transaction whereby a financial instruments business operator undertakes the sale or purchase, or other transaction with respect to unissued securities on behalf of the customer, and makes delivery of the said securities or the said certificates after the passage of a certain number of days following the issue of the said securities (Security Deposit Ordinance art. 1, para. 2).

When-issued transactions not only present a way to avoid the risk of price fluctuation to investors who hold rights under the shares which will ultimately be issued following the specified time period, but they are also useful in providing investors with a diversified means of investment. It is expected that smooth and fair pricing will be conducted by using this transaction type.

"Offset trade" means a trade in which the same issue of securities as the securities to be purchased in a when-issued transaction are sold in a corresponding amount prior to the delivery of the securities purchased, or the same issue of securities as the securities to be sold in a when-issued transaction are purchased in a corresponding amount prior to the delivery of the securities sold (Security Deposit Ordinance, art. 1, para. 4).

(Note) Although "When-Issued Transactions" and "Date-of-Issue Transactions" are different terms, they refer to the same transaction. The Security Deposit Ordinance and the NSE use the term "Date-of-Issue Transactions," while the TSE, the FSE and the SSE use the term "When-Issued Transactions". This text adopts "When-Issued Transactions".

(2) Securities Covered by When-Issued Transactions

Issues which are covered by when-issued transactions are new shares, issued by a domestic company that is currently listed on an exchange, accompanying a shareholder-allotted capital increase, for which the said issuing company has completed the necessary listing procedures and which the exchange approves.

(3) Trading Period and Settlement Date of When-Issued Transactions

Trading commences, in connection with instruments that are issued as a result of an allotment to shareholders, on or after the ex-rights date prescribed by the exchange, and is conducted until a date following the issuance of the new share certificates prescribed by the exchange.

Settlement takes place on the third business day counting from the final day for transactions (TSE Business Regulations, art. 9, para. 7). All contracts completed during the trading period are settled uniformly on the same settlement date.

However, if the exchange deems it necessary, the exchange may change the commencement day of transactions to a day which falls on or comes after a day specified as an ex-rights date (TSE Business Regulations, art. 9, para. 7, *proviso*).

(4) Acceptance of When-Issued Transactions

(i) When-Issued Transactions Agreement and Consent Forms

When a customer entrusts when-issued transactions to a financial instruments business operator, the customer must fill in the requisite matters on the Agreement Concerning the Commission of When-Issued Transactions in the prescribed form, and submit this form to the financial instruments business operator upon signing or sealing it (TSE Brokerage Agreement Standards, art. 4). In certain conditions, this can be carried out by electromagnetic means in lieu of the written agreement (TSE Brokerage Agreement Standards, art. 4, para. 2).

If the customer deposits securities in lieu of the security deposit, the financial instruments business operator must receive the consent of the said customer in writing, as provided for by Cabinet Office Ordinance, in cases where the financial instruments business operator offers the margin securities as collateral, or if it loans them to a third party (FIEA, art. 43-4).

(ii) Trading Unit in When-Issued Transactions

In principle, the trading unit is the number of shares the listed company determines as constituting one round lot (TSE Business Regulations, art. 15).

(5) Calculation of Security Deposit for When-Issued Transactions

Following the revision of the Security Deposit Ordinance and the TSE Brokerage Agreement Standards, a review of the calculation methods of security deposit for when-issued transactions was launched from January, 2013. As a result, when-issued transactions are now conducted more efficiently than before.

(i) Collection of Margin

Since when-issued transactions concluded during the trading period are settled after a considerable period of time, and coupled with the fact that the underlying securities in the transaction are unissued, they have a greater possibility of being used for speculative purposes. Therefore, in order to mitigate this tendency, regulations require that a certain amount of money be submitted as a security deposit with the financial instruments business operator.

When a trading order for a when-issued transaction is carried out, the financial instruments business operator must collect a security deposit equivalent to 30% or more of the contract price by a day and time designated by the financial instruments business operator no later than the noon on the third business day counting from the day on which the transaction is effected (TSE Brokerage Agreement Standards, art. 31, para. 1; FIEA, art. 161-2; Security Deposit Ordinance, art. 2, para. 1, item 2, art. 3 and art. 4).

The money to be submitted as a security deposit must be in the Japanese yen or US dollars. The amount of security deposit to be submitted in US dollars shall be 95% of the contract price converted into the Japanese yen at the foreign exchange rate designated by the trading participant (TSE Brokerage Agreement Standards, art. 32 and art. 39-2, para. 1 and para. 2)

The percentage of margin to be collected, etc. may be modified according to the regulations, etc.

(ii) Margin Securities

Security deposit is generally a cash deposit, but securities may also be used in lieu of cash (FIEA, art. 161-2, para. 2; Security Deposit Ordinance, art. 6). The type of such margin securities and their cash conversion ratio (called *daiyō kakeme*) will be determined in a manner similar to the regulations pertaining to margin transactions established by the exchanges (Security Deposit Ordinance, art. 6, para. 1, item 1; TSE Brokerage Agreement Standards, art. 32 and art. 40).

(iii) Variation Margins (Maintenance of the Security Deposit)

In cases where the total amount of security deposit received from a customer for when-issued transactions falls below 20% of the contract price of all securities involved in the when-issued transactions conducted by the customer, a financial instruments business operator must require the customer to deposit an additional security deposit, as a variation margin, sufficient to maintain the said total amount of security deposit at 30% of the said contract price, by a date and time designated by the financial instruments business operator no later than the “noon on the third business day counting from the day on which the implicit loss is incurred (TSE Brokerage Agreement Standards, art. 31, para. 1, art. 36 and art. 37, para. 1).

In cases where a customer was required to deposit an additional margin, and such customer conducted a purchase or sale which corresponds to the sell or buy position pertaining to his/her when-issued transactions by the due date of deposit of an additional margin, the financial instruments business operator may subtract the amount equivalent to 20% of the contract value of securities pertaining to such buy or sell positions from the security deposit that must be additionally deposited (TSE Brokerage Agreement Standards, art. 37, para. 2).

In cases where a financial instruments business operator requested a customer to deposit an additional security deposit, and received from the customer a margin of an amount equivalent to (i) losses from a purchase or sale which corresponds to the buy or sell position pertaining to the when-issued transactions and

(ii) the amount to be borne by the customer pertaining to the when-issued transactions, by the due date of deposit of an additional margin, the financial instruments business operator may subtract these amounts from the security deposit that must be additionally deposited during the period before the settlement of the when-issued transactions (newly introduced; TSE Brokerage Agreement Standards, art. 37, para. 3).

(iv) Withdrawal of Security Deposit, Etc.

With regard to money or securities which have been received from a customer as a margin pertaining to when-issued transactions, a financial instruments business operator is able to allow the customer to withdraw money up to the amount obtained by subtracting (A) an "amount equivalent to 30% of the contract value of all securities pertaining to the when-issued transactions of the customer" from (B) the "total amount of security deposit received pertaining to the when-issued transactions of the customer" (Security Deposit Ordinance, art. 7, para. 5; TSE Brokerage Agreement Standards, art. 33, para. 1).

In addition, with regard to money or securities which have been received from a customer as security deposit pertaining to when-issued transactions, a financial instruments business operator may allow the customer to withdraw such money or securities only in the following cases (Security Deposit Ordinance, art. 7, para. 6; TSE Brokerage Agreement Standards, art. 33, para. 2):

a. In cases of partial delivery of securities pertaining to when-issued transactions (limited to cases of withdrawing up to an amount equivalent to the amount obtained by subtracting (A) from (B) mentioned above);
b. In cases of partial delivery of securities pertaining to the when-issued transactions, subject to deposit of all securities purchased, or all money equivalent to the sales proceeds from securities sold, via the when-issued transactions pertaining to such partial delivery, as margin pertaining to when-issued transactions (limited to cases where (B) is equal to or larger than (A) after such deposit);
c. In cases of delivering all securities pertaining to when-issued transactions; or
d. In cases of replacing such money or securities in whole or in part.

Furthermore, when a financial instruments business operator conducts new when-issued transactions for its customer, it may allocate money or securities that have already been deposited from the customer as margin pertaining to when-issued transactions, to the amount of money or securities which should be deposited as margin pertaining to such new when-issued transactions, up to the following amount (Security Deposit Ordinance, art. 7, para. 7; TSE Brokerage Agreement Standards, art. 33, para. 3):

The amount obtained by subtracting:

(A) An amount equivalent to 30% of the contract value of all securities pertaining to the when-issued transactions of the customer; from
(B) The total amount of the security deposit received pertaining to the when-issued transactions of the customer.

(v) Calculation Method for the Amount of Deposited Margin

The total amount of security deposit received from a customer shall be calculated by subtracting the amounts mentioned in (A) to (C) below (Security Deposit Ordinance, art. 8; TSE Brokerage Agreement Standards, art. 34, para. 1). However, in the calculation of the total amount of security deposit received for the customer's when-issued transactions, the amount mentioned in (A) below pertaining to the when-issued transactions to be settled shall not be subtracted (TSE Brokerage Agreement Standards, art. 34, para. 1, *proviso*).

(A) The amount equivalent to the amount consisting of (i) the amount computed by deducting (a) profits

due to fluctuations of price of securities and profits due to offsetting transactions pertaining to when-issued transactions of the said customer from (b) losses due to fluctuations of prices of securities and losses due to offsetting transactions pertaining to when-issued transactions of the said customer, and (ii) the amount to be borne by a customer in relation to the when-issued transactions of the customer, including brokerage commissions;

(B) In cases where the customer is provided with credit for the customer's when-issued transactions, the amount equivalent to such provided credit; and

(C) In cases where the customer has remaining obligations to the financial instruments business operator after the settlement of securities pertaining to the when-issued transactions of the customer (including loans and other obligations related to new claims and other obligations with the financial instruments business operator), the amount equivalent to such remaining amount of obligations.

(6) Restriction on Withdrawal, Etc. of Computational Gains

If in when-issued transactions a computational gain arises as a result of a fluctuation of the market price of the relevant securities or as a result of an offsetting trade (*i.e.*, unrealized gains), cash or securities corresponding to such gain must not be delivered prior to the relevant settlement, or allotted to cash that is to be provided as a security deposit (Security Deposit Ordinance, art. 9, para. 1 and para. 2; TSE Brokerage Agreement Standards, art. 35).

(7) Return of Security deposits Pertaining to an Offsetting Trade

When a trading participant (financial instruments business operator) receives a request for the return of a security deposit from a customer whose short position and long position pertaining to when-issued transactions of the same issue match each other, the trading participant must return the security deposit pertaining to such matching quantity. Provided, however, that when a computed loss arises on the said trade, the customer is required to contribute moneys equal to the said loss (TSE Brokerage Agreement Standards, art. 38, para. 1 and para. 2).

(8) Settlement Methods

Settlement for when-issued transactions is conducted by 9:00 a.m. on the settlement date provided by the exchange by means of the sold securities (certificates) or purchase price (TSE Brokerage Agreement Standards, art. 13, para. 1).

Nevertheless, if a financial instruments business operator designates the time and date within the specified settlement period that has been separately stipulated by the JSCC when it has accepted a request from a customer to perform a when-issued transaction, the customer must deliver to the financial instruments business operator the sold securities certificates or the purchase amount by such time and date (TSE Brokerage Agreement Standards, art. 13, para. 2).

(9) Treatment of Computational Gain/Loss and Margin Pertaining to When-Issued Transactions (in the Case of a Transaction Between Clearing Participants)

(i) Treatment of Computational Gain or Loss

When a clearing participant (an entity that is qualified to settle its transactions through the JSCC) concludes a contract for when-issued transactions, it must exchange the difference between the contract price and the clearing price (meaning the price determined by the JSCC on the basis of the closing price on the

contract date) (the so-called "revalued difference") with the JSCC by the deadline for non-DVP settlement(Note) on the third business day following the contract date (JSCC Business Rules, art. 67).

In addition, where a difference arises between the settlement value for the current day compared to the settlement value for the prior day, a clearing participant is required to exchange an amount of cash equal to the difference with the JSCC by the deadline for non-DVP settlement on the third business day following the date the said difference arose (JSCC Business Rules, art. 68).

(Note) Securities subject to DVP settlement (share certificates issued by domestic corporations, preferred equity investment certificates, beneficiary certificates in an investment trust, convertible-type bonds with share options, etc.) are those for which the contracts can be settled by DVP settlement (the JSCC delivers the securities being cleared to the clearing participant entitled to them, within the amount of other securities and/or payment, etc. that the clearing participant delivers to the JSCC); securities other than securities subject to DVP shall be settled by non-DVP settlement (JSCC Business Rules, art. 47).

(ii) Treatment of Trading Margin

When a clearing participant concludes a contract for when-issued transactions, it must deposit with the JSCC a trading margin equal to or greater than the amount prescribed by the JSCC by 2:00 p.m. on the third business day following the contract date. Given, however, that regulations provide that if the clearing participant will conduct an offsetting purchase (sale) against its sale (purchase), then a deposit of margin calculated based on the net amount (the difference between total sales and total purchases) will suffice.

The trading margin may be deposited only in any of the currencies designated by the JSCC. In this case, the appraisal value of the trading margin deposited in a currency other than the Japanese yen is an amount equal to the value of the trading margin in that currency converted to Japanese yen at the telegraphic transfer spot buying rate (TTB) per 1 unit of that currency in the Tokyo foreign exchange market on the day which is two days before the day on which the trading margin is deposited, multiplied by a certain rate determined by JSCC.

Clearing participants may deposit securities in lieu of a cash trading margin as provided by the JSCC (JSCC Business Rules, art. 70, para. 1, para. 2 and para. 3).

(10) Measures to Be Taken in Cases of Settlement Default by Customer

A financial instruments business operator may, at its discretion, conduct a sale or purchase on a customer's account in order to carry out settlement for when-issued transactions if the customer does not deposit a security deposit which should be deposited, or an amount of money corresponding to a loss when it arises concerning when-issued transactions, to the financial instruments business operator (TSE Brokerage Agreement Standards, art. 53, para. 1).

If the financial instruments business operator has suffered a loss or damage in such transaction, the financial instruments business operator may appropriate money and securities which it holds for the customer or which are recorded in an account under the Book-Entry Transfer Act for such loss or damage. If there is still a shortage after such appropriation, the financial instruments business operator may claim the payment of such shortage amount from the customer (TSE Brokerage Agreement Standards, art. 53, para. 2).

4 3 Transactions Other Than Those During Trading Sessions (Trading on a Market Outside of Trading Sessions in the Exchange)

(1) Definition

Transactions other than those during trading sessions mean a trading system conducted over an electronic trading network system of an exchange, and contracts are usually completed using cross transactions based on an agreement between the seller and buyer regarding price, volume, etc. Ordinarily, this trading method is employed to execute block transactions of an individual issue or for basket transactions, which treats a portfolio comprising multiple issues as one set. The majority of transactions are concluded when the sell orders or buy orders of institutional investors correspond to the investment portfolio activities of financial instruments business operators.

Formerly, transactions other than those during trading sessions could not be conducted during the trading hours of the trading sessions, and were referred to as transactions outside of trading session hours, so that these transactions also used to be called "off-hours trades," or "off-hours transactions." However, at present, the transactions other than those during trading sessions for some single issue trading at TSE and NSE as well as basket trading at TSE are allowed to be conducted even during trading session hours.

After commencement on the TSE on November 14, 1997, transactions other than those during trading sessions have gradually been introduced on the OSE and NSE. Initially, contract processing was conducted by fax transmission between financial instruments business operators and the exchange, but now systems have been constructed consisting of ToSTNeT 1 (single issue transactions, basket transactions), ToSTNeT 2 (closing price transactions), and ToSTNeT 3 (purchase transaction outside of trading sessions of company's own shares) on the TSE, and N-NET on the NSE, which allow the financial instruments business operators to input the necessary data using the stock exchange terminals. Following the integration of the spot (cash equity) markets of the OSE into those of the TSE on July 16, 2013, the OSE discontinued handling spot transactions on J-NET. From the perspective of increasing the transparency of dark pools on the ToSTNeT market and enhancing the convenience for trading participants and investors, the trading system on the ToSTNeT market was revised (by introducing the Dark Pool Flag and VWAP trading between agency orders, clarifying the types of trading available for margin transactions, and adopting flexible trading dates), and the revision was put into operation on August 17, 2020.

Transactions other than those during trading sessions have two advantages: (i) trading can be conducted by cross transactions at the desired price and volume, and (ii) trading can be conducted outside of normal session hours. Regarding (i), there is the possibility that a cross transaction conducted during trading sessions cannot be accomplished at the desired price and volume due to the influence of the buy/sell orders of other market participants; however, since cross transactions under transactions in a market outside of trading sessions are processed separately, it is possible to engage in a transaction under the conditions desired. Furthermore, regarding (ii), since transactions other than those during trading sessions principally occur in the early morning, lunch break, and after the close each day, it is possible to decide on the transaction terms for transactions other than those during trading sessions after having seen the fluctuations in the market during trading sessions.

From the perspective of enhancing resilience so that, in the event of a system failure, a trading opportunity can be provided within the day of the failure if possible, and for the purpose of expanding the trading opportunity for investors and improving the market accessibility in view of the fact that trading hours in Japan are shorter than those in European countries, the United States, and Asian countries, the afternoon trading session was extended by changing the closing time from 15:00 to 15:30. Accordingly, the trading hours for ToSTNeT trading were also extended and the changes came into effect as of November 5, 2024 (for details, see "(Ref.) Comparison of Share

Transactions Other Than Those During Trading Sessions on the Major Exchanges" below).

(2) Transaction Coverage, Etc.

Transactions other than those during trading sessions are simply another kind of exchange transaction, and the issues of shares to be traded, settlement dates, utilization of margin transactions, etc. are basically the same as those for transactions during trading sessions. There are several types of settlements, T+0 and from T+2 to T+9. In other words, transactions other than those during trading sessions are not limited to trading in listed domestic and foreign shares, but also include bonds with share options, ETF (excluding purchase transactions other than those during trading sessions of a company's own shares), REITs, etc.

However, there are differences among trading hours, underlying volume, price limits, etc., depending on the exchange (for details, see "(Ref.) Comparison of Share Transactions Other Than Those During Trading Sessions on the Major Exchanges" below). Transactions other than those during trading sessions can be categorized depending on the trading method used into (i) single issue transactions, (ii) basket transactions, (iii) closing-price transactions, and (iv) purchase transactions other than those during trading sessions of company's own shares.

(i) Single Issue Transactions Outside of Trading Sessions

Cross transactions in a single issue. Originally, a single issue transaction could not be done unless the transaction was conducted above a certain multiple, such as 300 times the trading unit or more. Recently, however, as trading terms have been relaxed in response to investor needs, single issue transactions have become possible for any amount above the minimum trading unit. Transactions other than those during trading sessions can also be conducted on the TSE and the NSE, even during trading session hours. On the TSE and the NSE, these transactions may be conducted as margin transactions and loans for margin transactions, except for loans for margin transactions conducted as T+1 transactions on the ToSTNeT Market of the TSE. The same applies to basket transactions outside trading sessions.

(ii) Basket Transactions Outside of Trading Sessions

Basket transactions are deals that trade a portfolio comprising multiple issues as one set. Basket transactions outside of trading sessions can be used for portfolios composed of 15 or more issues, and a trading amount of JPY100 million or more. The content of rules of the major exchanges for basket transaction outside of trading sessions is similar for the most part. However, as of January 15, 2008 it has become possible to trade basket transactions during trading session hours on the TSE.

(iii) Closing-Price Transactions

Closing-price transactions are transactions conducted based on the closing price or VWAP. Particularly, ToSTNeT 2 and N-NET closing price transactions differ from regular transactions outside of trading sessions in that they allow orders to be placed for not only cross transactions, but also for sales only or purchases only. This feature means that investors who wish to buy or sell in a closing-price transaction issue their orders, and only when the terms of two orders match, a contract will be concluded, in conformity with the usual order time priorities. However, cross orders will have priority over other bid and offer orders. Margin transactions and loans for margin transactions may be used on the TSE and the NSE.

(iv) Purchase Transactions Other Than Those During Trading Sessions of Company's Own Shares

The NSE allows a company to conduct transactions other than those during trading sessions of company's own shares if prior disclosure of the transaction is made. Transactions other than those during trading sessions of company's own shares are to be conducted by executing the purchase offer after publishing the content of the purchase offer in advance on the day before the offer date if there is an expectation that there will be sales

from major shareholders, etc.

In the event of a company acquiring its own shares in the form of an advance announcement, the transactions by a company to acquire its own shares can be conducted through either of two programs: transactions other than those during trading sessions and N-NET closing price transactions outside of trading sessions. Nevertheless, short selling using margin transactions is not permitted for the transactions other than those during trading sessions, which to some extent prevents unforeseeable sell orders.

On January 15, 2008, the TSE commenced operation of a mechanism to allow transactions other than those during trading sessions (ToSTNeT 3) to be used by a company to purchase its own shares. Its use is limited to issuing companies acquiring their own shares. While the principle of time priority is strictly followed in the closing-price transactions, in ToSTNeT 3 the number of shares a seller is allocated is determined on the basis of the number of shares being purchased, using the allotment method prescribed by the TSE.

Neither margin transactions nor loan transactions can be used in a purchase transaction other than that during trading sessions of a company's own shares.

(Ref.) Comparison of Share Transactions Other Than Those During Trading Sessions on the Major Exchanges

As of November 5, 2024

Item		Tokyo Stock Exchange (ToSTNeT Market)
Single Issue Transactions		
	Trading Hours	8:20 - 18:00 (8:20 – 12:30 for T+1)
		VWAP Guarantee Trading, VWAP Target Trading and VWAP Trading between agency orders 8:20 - 9:00, previous day's VWAP (VWAP target not possible) 11:30 - 12:30, morning session VWAP 15:30 - 18:00, afternoon session and whole day VWAP (Until 12:30 for T+1)
	Trading Price	Price(Note 1) within 7% above or below the last contract price on auction market(Note 2) (Note 1) The special quote price or sequential special quote price if a special quote or sequential special quote exists (Note 2) If the figure calculated by multiplying the last contract price by 7% falls below JPY5, the price within JPY5 above or below of the last contract price applies uniformly.
		VWAP Guarantee Trading: the price obtained from the VWAP plus or minus the commission. VWAP Target Trading: The weighted average price that is the result of executions on the auction market, targeting the VWAP. (It is also possible to trade at a price that reflects the amount of commission on the weighted average price as a result of executions.) VWAP Trading between agency orders: VWAP designated for each trading time zone
	Quotation	Quotation units: Integral multiples of 1/10,000 of a yen Transactions are possible between the same participants or between different participants.
		VWAP Guarantee Trading, VWAP Target Trading and VWAP Trading between agency orders Quotation units: Integral multiples of 1/10,000 of a yen Only cross transactions between the same participants are possible.
	Trading Unit	At least the minimum trading unit on auction trading
	Trading Method	Specify matching conditions such as the matching counterpart (Trading Participant name), name of the stock, number of stocks and settlement date, and orders are matched when the quoted prices of each order match. (In case of cross trading between the same participants, the trade is concluded at the quoted price)
	Settlement	T+1~T+9 T+0 (Cross transactions between the same participants only)
Basket Transactions		
	Trading Hours	8:20 - 18:00 (8:20-12:30 for T+1)
	Trading Price	Within 5% above or below the base price computed from the last contract price on the auction market of the issues composing the basket
	Quotation	Quotation units: Integral multiples of 1/10,000 of a yen Transactions are possible between the same participants or between different participants
	Trading Unit	At least 15 issues, JPY100 million or more in trading
	Trading Method	Specify matching conditions such as the matching counterpart (Trading Participant name), name of the stock, number of stocks and settlement date, and orders are matched when the quoted prices of each order match. (In case of cross trading between the same participants, the trade is concluded at the quoted price).
	Settlement	T+1~T+9 T+0 (Cross transactions between the same participants only)
Closing Price Transactions		
	Trading Hours	(1) 8:20 - 8:45 (2) 11:30 - 12:15 (3) 15:30 - 16:30 Orders accepted from 8:20 to 16:30.
	Trading Price	8:20 - 8:45, closing price on the previous day (including a closing special quote price or a closing sequential special quote price, and if neither exists, the standard price on that day; hereinafter the same). Whole day VWAP of the previous day 11:30 - 12:15, closing price on the previous day, morning session VWAP 15:30 - 16:30, closing price on that day, afternoon session VWAP and whole day VWAP
	Quotation	Quotation units Closing trade: Same as on auction market VWAP Trades: VWAP calculated by TSE The order of quotations shall follow the principle of priority of time, provided that cross orders between the same participants shall have priority over other quotations. VWAP trades are only possible in the case of cross orders between the same participants.
	Trading Unit	At least the minimum trading unit in auction trading
	Trading Method	Time Priority basis (In case of cross orders between the same participants, the trade is concluded at the quoted price)
	Settlement	T+2
Purchase Transactions Other Than Those During Trading Sessions by a Company in Its Own Shares		
	Trading Hours	8:45 Sell orders accepted from 8:00 to 8:45.
	Trading Price	Closing price on previous day (including a closing special quote price or a closing sequential special quote price, and if neither exists, the standard price on that day)
	Quotation	Quotation units: Same as on the auction market First priority of quotation: Entrustment orders; Second priority: Personal orders Allocation to each trading participant in accordance with the above priority
	Trading Unit	At least the minimum trading unit on auction trading
	Trading Method	- Entrusted orders have the highest priority. - Allocate the minimum trading unit per trading participant in descending order according to the amount of orders. Multiply the balancing amount of each participant by the allotment ratio (buy order balance/total sell order balance) and allocate the integral result (dropping the decimals). Allocate minimum trading units in descending order according to the number after the decimals are dropped.
	Settlement	T+2

Item		Nagoya Stock Exchange (N-NET Market)
Single Issue Transactions		
	Trading Hours	8:20 - 16:30 *Orders are accepted and remain effective during the trading hours, except for transactions with the designated counterparty being effective only for 15 minutes.
	Trading Price	Within 7% above or below the most recent contract price (including special quotes) of a regular transaction on the auction market
	Quotation	Integral multiples of 1/10,000 of a yen per share
	Eligible Volume	At least the minimum trading unit on auction trading
	Trading Method	Cross trading: A transaction is effected upon placement of each order. Trading with the designated counterparty(Note): A transaction is effected when either a sell order or buy order matches an order that is placed to match it (limited to a transaction where the counterparties designated by both parties match).
	Settlement	T+2 T+0 (Cross-trading only)
Basket Transactions		
	Trading Hours	(1) 8:20 - 9:00 (2) 11:35 - 12:30 (3) 15:35 - 16:30
	Trading Price	Within ±5% based on the total price s of the issues composing the basket, computed from the closing prices, etc. on the auction market.
	Quotation	One yen per share for each issue composing the basket
	Eligible Volume	At least 15 issues, JPY100 million or more in trading
	Trading Method	A transaction is effected when either a sell order or buy order matches an order that is placed to match it
	Settlement	T+2 T+0 (Cross-trading only)
Closing Price Transactions		
	Trading Hours	Cross trades and actual trading (1) 8:20 - 9:00 (2) 11:35 - 12:30 (3) 15:35 - 16:30 Orders are accepted during the trading hours and remain effective during the respective trading hours (*e.g.* orders made in the morning session are no longer effective in the afternoon or evening session).
		When a company is acquiring its own shares at the public price announced in advance using the closing price on N-NET: Time during which orders are accepted: 8:20 - 9:00 Time during which orders are executed: Executed when a matching order occurs
	Trading Price	Trading hours (1), previous day's closing price (including special quotes) Trading hours (2), morning session closing price (including special quotes) Trading hours (3), closing price on that day (including special quotes) *If a closing price does not exist the NSE will determine this at such time as it occurs.
		When a company is acquiring its own shares at the public price announced in advance using the closing price on N-NET: Purchase by a company of its own shares at the public price announced in advance using the transactions other than those during trading sessions system for purchase of a company's own shares
	Quotation	Unit: Same as the auction market
	Eligible Volume	No requirement for a minimum purchase volume
	Trading Method	Cross trading: A transaction is effected upon placement of each order. Actual trading: A transaction is effected under the principle of priority of time each time a sell order and a buy order match during each period of trading hours (*zaraba* method).
	Settlement	T+2 T+0 (Cross-trading only)
Purchase Transactions Other Than Those During Trading Sessions by a Company in Its Own Shares		
	Trading Hours	Time during which orders are accepted: 8:20 - 8:45 Matching time: 8:45
	Trading Price	Closing price on the previous day of the purchase date (including a closing quotation price)
	Quotation	Unit: Same as the auction market 1st: Entrusted Order 2nd: Principal Order Allocated per trading participant in this order
	Eligible Volume	No requirement for a minimum purchase volume
	Trading Method	- Entrusted orders have highest priority. - Allocate the minimum trading unit per trading participant in descending order according to the amount of orders. Multiply the balancing amount of orders of each participant by the allotment ratio (buy order balance/total sell order balance) and allocate the integral result (dropping decimals). Allocate the minimum trading unit in descending order according to the number of the decimals which are dropped.
	Settlement	T+2

(Note) A "transaction with the designated counterparty" is a transaction conducted by a method wherein the seller and the purchaser are determined in advance and they designate the securities firm with which they make orders.

<Attention> On the ToSTNeT Market and the N-NET Market, margin transactions or loan transactions cannot be used for transactions other than those during trading sessions by a company in its own shares.

5 Over-the-Counter Share Transactions

Here, we shall discuss transactions in securities that are not listed on a financial instruments exchange market (hereinafter referred to as an "exchange", where appropriate).

Securities that are not listed on an exchange are defined as over-the-counter (OTC) securities (OTC Securities Rules, art. 2, item 1). Over-the-counter securities are classified into over-the-counter handled securities and other over-the-counter securities.

Over-the-counter transactions (sale and purchase or other transactions in over-the-counter securities) are conducted in the form of either brokered or dealer trades, with trading involving negotiated transactions between two Regular Members or a Regular Member and its customer.

Brokered trades are transactions that are entrusted from a customer to a Regular Member and consigned, etc., by the Regular Member to another Regular Member for execution.

Dealer transactions are transactions where the contract is established between the customer and the Regular Member acting as counterparty on its own account and does not consign, etc. the transaction.

For over-the-counter securities, it is prohibited to accept market orders, conduct margin transactions or engage in over-the-counter transactions of unissued over-the-counter securities (OTC Securities Rules, art. 13). However, for "transactions of unlisted authorized PTS issues or transactions of registered PTS issues" under the "Rules Concerning Transactions, Etc., of Unlisted Securities Over Proprietary Trading Systems (PTS)," the ordering method is specified by each PTS's rules (for details, see Chapter 1, 4-5 "Shares Related Matters" 1 Rules Concerning Over-the-Counter Securities).

○ Types of Over-the-Counter Securities

(1) Over-the-Counter Handled Securities

Within "over-the-counter securities" (share certificates, share option certificates, or bonds with share options (hereinafter referred to as "share certificates, etc.") that have been issued by domestic corporations in Japan which are not listed on financial instruments exchange markets), over-the-counter handled securities are those that have been issued by a company that is obligated to file securities reports or a company that prepares an explanatory note on business conditions in connection with the issuance of share certificates, etc. (OTC Securities Rules, art. 2, item 1 and item 4).

Association Members may solicit customers, etc. other than qualified institutional investors to invest in over-the-counter handled securities (limited to those for which prospectus must be prepared upon a public offering or secondary distribution) and those issued by issuers of listed securities if they meet certain conditions (OTC Securities Rules, art. 6, para. 1 and art. 7, para. 1). Previously, investment solicitation for over-the-counter handled securities had been permitted on condition of imposition of transfer restrictions, but this condition was abolished through the amendment of the OTC Securities Rules that came into effect as of July 1, 2022.

With regard to over-the-counter handled securities issued by issuers of listed securities, in substitution of the delivery of an explanatory document on securities information, etc., Association Members may use methods employing electronic information processing systems or other information technologies to provide customers with

the items of information to be stated in the explanatory document. In such cases, the Association Members shall be regarded as having delivered the explanatory document (OTC Securities Rules, art. 18, para. 1; Document Delivery Rules, art. 4).

Association Members must provide customers (excluding professional investors) who conduct transactions in over-the-counter handled securities for the first time as a result of their investment solicitation with sufficient explanation regarding matters such as the nature of over-the-counter handled securities and the structure of the transactions, and collect a written confirmation from the customers for transactions in over-the-counter handled securities to ensure that the transactions are conducted under the customers' judgment and responsibility (OTC Securities Rules, art. 6, para. 5 and art. 7, para. 2).

In substitution of the collection of a written confirmation concerning a transaction of over-the-counter handled securities, Association Members may use methods employing electronic information processing systems or other information technologies to receive the items of information to be stated in the document. In such cases, the Association Members shall be regarded as having collected the document (OTC Securities Rules, art. 17, para. 2; Document Delivery Rules, art. 4).

(2) Phoenix Issues

Phoenix issues are those over-the-counter handled securities (limited to those issued by an issuing company that is required to submit an annual securities report or issuing company that prepares an explanatory note on business conditions that meets certain requirements) for which the Regular Member intending to become the handling member has determined that it is necessary to offer an opportunity to sell to persons who have retained the securities since the time that the securities were listed on an exchange, and for which the JSDA designates the Association Member and a financial instruments intermediary as persons who are to carry out investment solicitation (OTC Securities Rules, art. 2, item 5; Phoenix Rules, art. 2, item 5).

Association Members other than the handling members are not allowed to conduct investment solicitations for Phoenix issues, with the exception of those involving offers to sell Phoenix issues on the account of a customer (Phoenix Rules, art. 20, para. 1).

(3) Over-the-Counter Securities Other Than Over-the-Counter Handled Securities

In principle, Association Members must not solicit customers to invest in over-the-counter securities other than over-the-counter handled securities. However, investment solicitation may be conducted in the following cases (OTC Securities Rules, art. 3):

(i) Investment solicitation is related to transactions or intermediary services for transactions of over-the-counter securities (excluding over-the-counter handled securities issued by an issuing company of the listed securities) conducted for the purpose of transferring management control, etc. (OTC Securities Rules, art. 3-2, para. 1);

(ii) Investment solicitation is conducted only towards qualified institutional investors (as specified in art. 2, para. 3, item 1 of the FIEA) on the condition that transfer restrictions should be imposed on the over-the-counter securities they acquire (OTC Securities Rules, art. 4, para. 1 and para. 2); the condition of imposing transfer restrictions for two years was abolished as of July 1, 2022, with regard to qualified institutional investors other than those set forth in the items of Article 4, Paragraph 2 of the OTC Securities Rules. As a result, such qualified institutional investors may be solicited to make investment in over-the-counter securities without any transfer restrictions being imposed on the over-the-counter

securities (OTC Securities Rules, art. 4, para. 3).

(iii) Investment solicitation is conducted only towards a small number of investors (less than 50 persons) and targeting professional investors who are capable of making corporate valuations (OTC Securities Rules, art. 4-2);

(iv) Investment solicitation is related to "shareholders community issues" under the Shareholders Community Rules and "share certificates handled in the equity-based crowdfunding business (type I small amount electronic offering handling business)" under the Crowdfunding Rules (Shareholders Community Rules, art. 2, item 5; and Crowdfunding Rules, art. 2); and

(v) Investment solicitation is related to over-the-counter securities, etc. prescribed in the Rules Concerning Solicitation of Professional Investors for Investment, Etc. in Over-The-Counter Securities, Etc.

6 Trades Off the Financial Instruments Exchange Market in Listed Share Certificates, Etc.

Trading off the financial instruments exchange market in the broad sense of the term involves one type of "over-the-counter transactions," and is principally done in cases where a financial instruments business operator engages in a purchase (or sale) as counterparty to a block sale order (or purchase order) received from an institutional investor, etc.

6 1 Differentiation from Trades on Financial Instruments Exchange Market

In general, trading on the financial instruments exchange market is conducted through the auction system, in conformity with the priority rules concerning price and time. In contrast, trades off the financial instruments exchange market (hereinafter referred to as "off-exchange" where appropriate) are not filtered through an exchange, but rather, in most cases, are conducted at the counters of financial instruments business operators through direct negotiations with the financial instruments business operator.

Accordingly, even if a trade on an exchange and a transaction off an exchange (hereinafter referred to as "off-exchange trades") were to be concluded at the same time, the price may vary. Also, it is necessary for the parties to arrange for delivery and settlement.

6 2 Compliance with Law and Regulations, Etc.

Rules for off-exchange trades are established in the "Rules Concerning Sale and Purchase, Etc. of the Listed Share Certificates, Etc. Conducted Outside of a Financial Instruments Exchange Market" and the "Detailed Rules Relating to the Rules Concerning Sale and Purchase, Etc. of the Listed Share Certificates, Etc. Conducted Outside of a Financial Instruments Exchange Market" of the JSDA. It is also necessary to comply with the FIEA and other relevant laws and regulations, and other miscellaneous rules in addition to the said rules when conducting off-

exchange trades (Off-Market Trading Rules, art. 3).

6 3 Forms of Trading

Many off-exchange trades are conducted through financial instruments business operators, whereby the financial instruments business operator acts as counterparty to conclude the trade in response to a customer order, which is a dealer transaction.

Apart from dealer transactions, there are brokered transactions in which a financial instruments business operator is entrusted a trade from a customer such as a transaction where the financial instruments business operator conducts intermediation to assist the parties to establish a trade (intermediary), a transaction where the financial instruments business operator will broker an entrusted order from the customer to another financial instruments business operator in its own name (brokerage), or a transaction where the financial instruments business operator carries out the order of the customer as its agent (agency services) (Off-Market Trading Rules, art. 1).

6 4 Eligible Listed Share Certificates, Etc.

The eligible listed share certificates, etc. refer to the following securities that are listed on a domestic exchange (Off-Market Trading Rules, art. 2, item 1):

(1) Share certificates;
(2) Contribution certificates (including preferred equity investment certificates);
(3) Convertible-type bonds with share options;
(4) Exchangeable bonds;
(5) Bonds with share options, and share option certificates;
(6) Investment trust beneficiary certificates, foreign investment trust beneficiary certificates;
(7) Investment securities, investment equity subscription right certificates, foreign investment securities; and
(8) Depositary receipts of foreign shares.

6 5 Exemption from Off-Market Trading Rules

The Off-Market Trading Rules do not apply to, out of off-exchange sales and purchases conducted by Regular Members and off-exchange sales and purchases for which the intermediary services, etc. are conducted by Association Members, a sale and purchase with a volume of less than one sale-and-purchase unit and any of the sales and purchases listed below (Off-Market Trading Rules, art. 4, para. 1 and para. 2):

(i) Purchase of listed shares, etc. through a tender offer made by an Association Member who is to serve as a purchaser of listed shares, etc. through a tender offer on behalf of a tender offeror;
(ii) Purchase of listed shares, etc. through a tender offer made by an Association Member who is to be a tender offeror;
(iii) Purchase of treasury shares through a tender offer made by an Association Member who is to be the issuing company of listed shares, etc.; and
(iv) Sale of listed shares, etc. in response to a tender offer.

Among off-exchange sales and purchases conducted by Regular Members and off-exchange sales and purchases for which the intermediary services, etc. are conducted by Association Members, a sale and purchase concluded in over-the-counter transactions of derivatives is also excluded from the application of the Off-Market Trading Rules (Off-Market Trading Rules, art. 4, para. 3).

In the event that any of the acts set forth in Article 118, item 1, (a) through (e) of the FIBCOO (referred to as "problematic conduct") were to take place in relation to a sale and purchase of listed share certificates, etc. entrusted to an Association Member from a customer, the Off-Market Trading Rules do not apply to an off-exchange sale and purchase for which the Association Member conducts intermediary services, etc. and which is conducted, with the customer's consent, between the customer's account and the account for handling problematic conduct in order to cancel the sales and purchase resulting from the problematic conduct or perform the obligation in compliance with the purpose of the customer's order (Off-Market Trading Rules, art. 4, para. 4).

6 6 Confirmation of Sale and Purchase Price and Record Keeping

Association Members (which in the case of Special Members shall be limited to Special Members that engage in financial instruments intermediary services; hereinafter the same in this section) must whenever engaging in off-exchange trades confirm that the prices or the amounts of money involved in transactions were appropriate and keep the record of those confirmations (Off-Market Trading Rules, art. 1 and art. 5).

6 7 Prohibition of Sale and Purchase, Etc. Imposed on Association Members

If information that is found to be likely to materially influence investors' investment decisions is circulating with regard to the share certificates, etc. listed on a financial instruments exchange or the issuer thereof, and an Association Member becomes aware that the financial instruments exchange plans to suspend or has suspended the sale and purchase of the listed share certificates, etc. on the grounds that the content of such information is unclear or that the financial instruments exchange finds it necessary to make such information public, the Association Member must not execute an off-exchange sale and purchase of the relevant listed share certificates, etc. until the financial instruments exchange resumes the sale and purchase of such listed share certificates, etc. (Off-Market Trading Rules, art. 6).

When an Association Member intends to conduct an off-market sale and purchase or intermediary, etc. thereof, it must have in place systems including a system for confirming information regarding the suspension of sale and

purchase of listed share certificates, etc. imposed by a financial instruments exchange (Off-Market Trading Rules, art. 6-2, para. 1).

An Association Member must also have in place a system wherein, if, after the trading hours on the exchange, it acquires information that is found to be likely to materially influence investors' investment decisions regarding listed share certificates, etc. or the issuer thereof, it will suspend an off-exchange sale and purchase of the relevant listed share certificates, etc. until the start of the trading hours for the listed share certificate, etc. (Off-Market Trading Rules, art. 6-2, para. 2).

Notwithstanding these rules, a Regular Member may conduct an off-exchange sale and purchase of listed share certificates, etc. with its overseas affiliate company, in order to transfer the position in the sale and purchase of the listed share certificates, etc. conducted by the Regular Member or its overseas affiliated company with the customer thereof (Off-Market Trading Rules, art. 6-2, para. 3).

6 8 Suspension of Sale and Purchase, Etc. Imposed by the JSDA

In any of the following cases, the JSDA may suspend an off-exchange sale and purchase to be conducted by a Regular Member and an off-exchange sale and purchase for which an Association Member conducts intermediary, etc. if it deems necessary and appropriate to do so for public interest or protection of investors (Off-Market Trading Rules, art. 6-5, para. 1), and the suspension of an off-exchange sale and purchase shall continue for a period as deemed necessary by the JSDA each time (Off-Market Trading Rules, art. 6-5, para.2):

(i) if any information that is found to be likely to materially influence investors' investment decisions is circulating with regard to listed share certificates, etc. or the issuer thereof, and the content of such information is unclear or the JSDA finds it necessary to make such information public;

(ii) if the JSDA finds something abnormal in the status of sale and purchase or finds the risk thereof, or finds it inappropriate to allow the sale and purchase to be continued for control purposes; or

(iii) if the JSDA finds it necessary to suspend the sale and purchase, etc. for other reasons.

An Association Member must not execute an off-exchange sale and purchase while the JSDA is suspending an off-exchange sale and purchase (Off-Market Trading Rules, art. 6-5, para. 3).

6 9 Report and Announcement, Etc. of Sale and Purchase, Etc. (Reports and Public Announcement, Etc. of Off-Exchange Sale and Purchases Other Than Those Conducted Through Approved Business)

(1) Reporting and Publication System

The JSDA manages and operates a system for reporting off-exchange trading and for publishing price information, etc. in connection with off-exchange trading (hereinafter referred to as the "Reporting and Publication System") (Off-Market Trading Rules, art. 2, item 4).

(2) Report on Sale and Purchase, Etc.

Whenever a Regular Member makes an offer for the sale or purchase of listed securities outside of a financial instruments exchange market (hereinafter referred to as "offers") simultaneously to a large number of persons

(excluding cases where a Regular Member makes such offer through their approved business), the Regular Member must report the following to the JSDA through the Reporting and Publication System: name of issues, distinction between sale and purchase pertaining to the offer, price pertaining to the offer (the highest price for the issue in the case of an offer for purchase; the lowest price for the issue in the case of an offer for sale), volume pertaining to the offer, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 7, para. 1).

If a Regular Member concludes an off-exchange sale or purchase (excluding cases where a Regular Member concludes such sale or purchase through the approved business), the Regular Member must report the following to the JSDA through the Reporting and Publication System: name of issues; sale and purchase price; sale and purchase volume; date and time when the sale and purchase is concluded, distinction between sale and purchase, distinction between dealing and broking; name of the financial instruments exchange where a standard price pertaining to off-exchange sale or purchase is published and the price; the counterparty to the sale and purchase; distinction between a cash transaction and a margin transaction (for details, see this Chapter, "10. Margin Transactions"); in the case of a margin transaction, distinction between a standardized margin transaction and a negotiable margin transaction; if the Regular Member intends to conduct the sale or purchase in order to repay the purchase price or return the securities for sale that have been lent thereto in margin transactions, a statement to that effect; and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 7, para. 2). In the event of an offer or trade that is made between 8:10AM and 4:59PM on a business day, the report must be made within five minutes after the offer was made or the trade was carried out, and if at other times the report must be made within a certain period of time (Off-Market Trading Rules, art. 7, para. 3).

(3) Correction or Cancellation of Report on Sale and Purchase, Etc.

If a Regular Member intends to correct or cancel the report on an offer for off-exchange sale and purchase or the report of a sale and purchase, it must immediately report such correction or cancellation to the JSDA through the Report and Publication System (Off-Market Trading Rules, art. 8, para. 1).

(4) Publication, Etc. of Sale and Purchase Price, Etc.

The JSDA shall, (i) immediately upon receiving from a Regular Member a report of an offer for sale or purchase, or (ii) promptly upon receiving from a Regular Member a report of a sale or purchase, notify the Regular Member of and publicly announce the following: in the case of (i), name of issues, distinction between sale and purchase pertaining to the offer, price pertaining to the offer, volume pertaining to the offer, time when the offer is made, and other matters the JSDA deems necessary; or in the case of (ii), name of issues, sale and purchase price, sale and purchase volume, date and time when the sale and purchase is concluded, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 9, para. 1 and the main clause of para. 2). Nevertheless, if the total price of the trade is JPY5 billion or more in one issue, because the possibility exists that publication of the same may have an impact on the market, and be to the significant disadvantage of parties to the trade, the announcement will be made at 4:00PM on the following business day (Off-Market Trading Rules, art. 9, para. 2 (*proviso*), and the Detailed Rules on Off-Market Trading, art. 6).

The JSDA shall, in accordance with the reports on offers and the reports on corrections or cancellations pertaining to offers, sum up and publicize on a daily basis the sale and purchase prices and volumes of each issue of listed share certificates, etc. and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 9, para. 3).

The JSDA shall, in accordance with the reports of off-exchange sales and purchases concluded and the reports

on corrections or cancellations of sale and purchase reports which pertain to sales and purchases, sum up and publicize on a daily basis the sales and purchase volumes of each class of the listed share certificates, etc., the sale and purchase prices and volumes of each issue, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 9, para. 4).

6 10 Explanation to Customers

When an Association Member receives an order from a customer for off-exchange trades, the Association Member must make an explanation in advance to the customer of the matters that the Association Member deems to be necessary, such as conditions relating to delivery settlements (Off-Market Trading Rules, art. 18).

6 11 PTS (Proprietary Trading System)

(1) What is PTS?

PTS is a form of off-exchange transaction.

PTS is an "electronic trading market" operated by a financial instruments business operator under the approval of the Prime Minister in accordance with the provisions of the FIEA, with investors or financial instruments business operators placing orders, and conducting trades on this PTS (FIEA, art. 2, para. 8, item 10 and art. 30). If financial instruments business operators provide an electronic trading market for unlisted securities and the scale of trading is limited, they do not need to obtain authorization, but are allowed to operate a PTS by registering for the type-I financial instruments business (FIEA, art. 30, *proviso*).

The word PTS first came into use in the United States, and is an abbreviation of Proprietary Trading System. In Japan, this is translated as "*shisetsu torihiki shisutemu.*"

In light of the report of the JSDA's Study Group on the PTS Margin Transaction and the public comments, the FSA decided to lift the ban on margin transactions at PTSs on April 1, 2019, on conditions that appropriate measures to prevent conflicts of interest have been taken ("Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc.," IV-4-2-1, (ii) A. f.).

The JSDA revised the Off-Market Trading Rules on March 19, 2019, and thereby lifted the ban on margin transactions at PTSs as of July 16, 2019 (for details, see this Chapter, "10-2 (9) PTS Margin Transactions").

As Osaka Digital Exchange Co., Ltd., a company funded by major securities companies, started the PTS operating business on July 27, 2022, there are currently three Approved Members engaging in this business of trading stocks, including Cboe Japan Limited and JAPANNEXT Co., Ltd.

From July 1, 2023, unlisted securities for professional investors are allowed to be handled under the PTS (FIEAEO, art. 1-7-3, item 3, (b)). On the same day, the "Rules Concerning Transactions, Etc., of Unlisted Securities Over Proprietary Trading Systems (PTS)" came into effect and the PTS became available for trading unlisted securities. However, the explanations in the next section and the following sections do not cover a PTS for unlisted securities.

(2) PTS Price Fixing Methods

Pricing on the PTS is determined either by the following methods or by methods similar to these.

Under the FIEA, PTS is "sale or purchase in securities or intermediary, brokerage or agency services for the same that is performed using an electronic data processing system and through a method of determining the price that is as set forth below, with numerous persons at the same time, either as the party on one side or each as parties" (FIEA, art. 2, para. 8, item 10):

a) Auction (double auction trades) method (the total volume of securities traded must satisfy the standard stipulated by cabinet order (FIEAEO, art. 1-10));
b) For listed securities, methods using the trading price on the exchange where the said securities are listed;
c) For securities traded over-the-counter, a method using the trading price in the securities that is publicly announced by the JSDA;
d) Methods using the price determined based on negotiations between the customers;
e) In cases where the limit order presented by the customer matches with the limit order presented by another customer who will act as counterparty to the transaction, methods using the limit order presented by the said customer; and
f) Where a financial instruments business operator presents multiple bid/ask quotes for a single issue by itself or another financial instruments business operator, methods using the price based on such multiple bid/ask quotes (excluding cases in which more than one financial instruments business operator is constantly presenting bid/ask quotes, and has an obligation to trade based on the bid/offer quotes).
(FIEA, art. 2, para. 8, item 10 for a) through d); and FIEA, art. 2, para. 8, item 10 and the Definition Ordinance, art. 17 for e) and f)

(3) Rules Concerning Transactional Fairness and Investor Protection

Although PTS is operated by Approved Members, since financial instruments business operators do not possess self-regulatory functions, the following conditions are imposed on PTS approval from the standpoint of ensuring transactional fairness and protecting investors (Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, Etc., IV-4-2-1):

(i) External Announcement of Pricing Information

Best quotes and transaction pricing, etc. on the said PTS must be announced in a manner allowing comparison with other PTS, and through methods allowing unrestricted external access in real time.

(ii) Quantity Criteria Pertaining to Transaction Volume

If in a PTS business that determines prices according to a method other than an auction the securities that are traded on the said system are listed on an exchange, where the ratio of the average daily trading value in the most recent six months to the total trading value on all stock exchanges is 10% or more with respect to the individual issue, and is 5% or more of the total, measures must be implemented to:

a) Enhance and upgrade the programs that carry out trade management and monitoring for the purpose of assuring fairness in transactions;
b) Put in place systems equivalent to default loss reserve systems at exchanges in order to protect the

certainty of settlement; and

c) Conduct sufficient and periodic verification in order to preserve the security/accuracy of the system's capacity, etc.

Moreover, where in the most recent six months, the above ratio is 20% or more with respect to an individual issue, or 10% or more of the total, the license to open a financial instruments market has to be obtained.

Auction-method transactions on the PTS must follow the standards prescribed separately by Cabinet Order (FIEAEO, art. 1-10).

(iii) Other

The volume of monthly transactions (percentage, etc.) for each type and issue of securities shall be reported to the Commissioner of the Financial Services Agency (Director-General of the Local Finance Bureau). Also, adequate measures with respect to internal control regime, programs on, *e.g.*, the duty to explain to customers, achieving security and accuracy of the capacity, etc. of the system, and policies on, *e.g.*, preventive steps on order to protect the confidentiality of transaction information must be implemented.

(4) Development of Systems for Suspension of Sale and Purchase in the Approved Business

An Approved Member must have in place a system for confirming the existence of the information regarding the suspension of a sale and purchase of listed share certificates, etc. imposed by a financial instruments exchange, during the hours for handling the Approved Business (Off-Market Trading Rules, art. 6-4, para. 1).

An Approved Member must have in place systems necessary for suspending an off-exchange sale and purchase of listed share certificates, etc. in the Approved Business immediately in the following cases (Off-Market Trading Rules, art. 6-4, para. 2):

(i) If the Approved Member becomes aware of the information regarding the suspension of a sale and purchase of listed share certificates, etc. imposed by a financial instrument exchange;

(ii) If any information that is found to be likely to materially influence investors' investment decisions is circulating with regard to listed share certificates, etc. or the issuer thereof, and the content of such information is unclear or it is deemed necessary to make such information public;

(iii) If the Approved Member finds something abnormal in the status of sale and purchase or finds the risk thereof, or it is deemed inappropriate to allow the sale and purchase to continue for control purposes;

(iv) If an operational failure occurs with the trading system used in the Approved Business, and it is deemed difficult to allow the sale and purchase to continue due to a failure occurring with the Approved Member's facilities used for sale and purchase of listed share certificates, etc. or for other reasons; or

(v) If redemption by drawing is made with regard to convertible-type bonds with share option, and the suspension of a sale and purchase thereof is deemed necessary.

When an Approved Member suspends an off-exchange sale and purchase under the Approved Business, it must immediately publicize the name and code of the issue subject to the suspension of an off-exchange sale and purchase, the period of and reasons for the suspension, and other particulars that the JSDA deems necessary, by such method as making them freely accessible from the outside (Off-Market Trading Rules, art. 6-4, para. 3).

If an Approved Member suspends or resumes an off-exchange sale and purchase of listed share certificates etc. under the Approved Business, it must report to the JSDA, without delay, the name and code of the issue subject to the suspension of an off-exchange sale and purchase, the period of and reasons for the suspension, and other particulars that the JSDA deems necessary (Off-Market Trading Rules, art. 6-4, para. 4).

(5) Report and Publication of Off-Exchange Sale and Purchase Through Approved Business

(i) Report on Offer

When an Approved Member makes an offer through the approved business, it must report the following matters to the JSDA through the Report and Publication System by 8:30 a.m. on the business day following the date of the offer: name of issues, distinction between sale and purchase pertaining to the offer, price pertaining to the offer (the highest price for the issues in case of an offer for purchase as of the date of the offer or the lowest price for the said issues in case of an offer for sale as of the date of the offer), volume pertaining to the offer, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 10, para. 1 and para. 2).

(ii) Report on Sale and Purchase

An Approved Member must report the following matters regarding a sale and purchase concluded in the approved business to the JSDA through the Report and Publication System by 8:30 a.m. on the business day following the date of the conclusion of the sale and purchase: name of issues, sale and purchase price, sale and purchase volume, date and time when the sale and purchase is concluded, distinction between sale and purchase, distinction between dealing and broking, name of the financial instruments exchange where a standard price pertaining to off-exchange sale or purchase is published and the price, the counterparty to the sale and purchase, and other matters the JSDA deems necessary.

If the sale and purchase concluded by an Approved Member in the approved business is a margin transaction at the PTS, the Approved Member must report the following matters in addition to those mentioned above to the JSDA through the Report and Publication System by 8:30 a.m. on the business day following the date of the conclusion of the sale and purchase: distinction between a cash transaction and a margin transaction at the PTS; in the case of a margin transaction at the PTS, distinction between a PTS Standardized Margin Transaction and a PTS Negotiable Margin Transaction; and if the Approved Member intends to conduct the sale or purchase in order to repay the purchase price or return the securities for sale that have been lent thereto in PTS Margin Transaction, a statement to that effect (Off-Market Trading Rules, art. 11, para. 1, para. 2, and para. 3).

(iii) Correction or Cancellation of Report on Sale and Purchase, Etc.

When an Approved Member intends to make correction or cancellation of a report on an offer for off-exchange sale and purchase or report on a sale and purchase, it must report such correction or cancellation immediately to the JSDA through the Report and Publication System (Off-Market Trading Rules, art. 12, para. 1).

(iv) Publication, Etc. of Sale and Purchase Price, Etc.

When the JSDA receives from an Approved Member a report on an offer or a report of cancellation of an offer through the approved business, it shall immediately notify the Approved Members of the following matters: name of issues, distinction between sale and purchase pertaining to the offer, price pertaining to the offer, volume pertaining to the offer, time when the offer is made, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 14, para. 1). When the JSDA receives from an Approved Member a report on a sale and purchase or a report of correction or cancellation of a sale and purchase report, it shall immediately notify the Approved Members of the following matters: name of issues, sale and purchase price, sale and purchase volume, date and time when the sale and purchase is concluded, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 14, para. 2).

The JSDA shall, in accordance with the reports on offers through the approved business and the reports on corrections or cancellations regarding offers, sum up and publicize on a daily basis the sale and purchase

prices and volumes pertaining to the offers for each issue of listed share certificates, etc. and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 14, para. 3).

The JSDA shall, in accordance with the reports on sales and purchases concluded through the approved business and the reports on corrections or cancellations of sale and purchase reports which pertain to sales and purchases, sum up and publicize on a daily basis the sales and purchase volumes of each class of the listed share certificates, etc., the sale and purchase prices and volumes of each issue, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 14, para. 4).

(v) Notification of Use of Report and Publication System

If an Approved Member intends to report an offer made or sale and purchase concluded through the approved business using the Report and Publication System, it must notify the JSDA of the intention to use the system in advance in a designated form (Off-Market Trading Rules, art. 15, para. 1).

(vi) Making Available for Inspection of the Price, Etc. of Offers and Sale and Purchase Price, Etc. Through Approved Business

If an Approved Member makes an offer through the approved business, it must make the following information available for inspection within five minutes from the offer, using the website of the Report and Publication System: name of issues, distinction between sale and purchase pertaining to the offer, price pertaining to the offer, volume pertaining to the offer, time of the offer, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 17-2, para. 1; Detailed Rules Related to Off-Market Trading Rules, art. 7, para. 1).

If an Approved Member concludes a sale and purchase through the approved business, it must make the following information available for inspection within five minutes from the conclusion of the sale and purchase, using the website of the Report and Publication System: name of issues, sale and purchase price, sale and purchase volume, date of the conclusion of sale and purchase, and other matters the JSDA deems necessary (Off-Market Trading Rules, art. 17-3, para. 1; Detailed Rules Related to Off-Market Trading Rules, art. 7, para. 1).

An Approved Member must ensure that the information on the price, etc. pertaining to an offer and the sale and purchase price, etc. that it has made available for inspection will be accurate and updated (Off-Market Trading Rules, art. 17-2, para. 2, and art. 17-3, para. 2).

An Approved Member must take the measures mentioned above with regard to the price, etc. pertaining to an offer and sale and purchase price, etc. in a manner that such information is comparable with the information provided by other Approved Members (Off-Market Trading Rules, art. 17-2, para. 3, and art. 17-3, para. 2).

An Approved Member must immediately notify all Participating Members involved in the Approved Business of the price and other particulars concerning an offer of an off-exchange sale and purchase under the Approved Business as well as the sale and purchase price and other particulars of the concluded sale and purchase (Off-Market Trading Rules, art. 17-4).

A Participating Member is a Regular Member who can intermediate an order from a customer that is to be executed under the Approved Business conducted by an Approved Member (Off-Market Trading Rules, art. 2, item 9).

(6) Others

If an Approved Member conducts short sales (excluding margin transactions) on its proprietary trading system,

it must establish a method and system for eliminating unfair sale and purchase, etc. involving short sales and describe such method and system in its operational method statement (Off-Market Trading Rules, art. 6-6, para. 1).

If an Approved Member conducts a short sale (excluding margin transactions) on its proprietary trading system, and it receives an order for the short sale from its customer (excluding a Participating Member), it must confirm that, in connection with the securities that are subject to the short sale, settlement measures (the settlement measures prescribed in Article 26-2-2 of the FIEAEO, such as confirmation of a guarantee of borrowed securities) have already been taken (Detailed Rules Related to Off-Market Trading Rules, art. 2, para. 1).

7 Cumulative Stock Investments

7 1 Definition of Cumulative Stock Investments

Cumulative stock investment is a system for purchasing a predetermined issue of shares, etc. on a certain date at a fixed amount each month (joint purchase cumulative investment) (FIEA, art. 35, para. 1, item 7; Cumulative/Mini Stock Investment Rules, art. 1).

This system enables investors to make investments in shares, etc. with a small amount of funds. Since it is designed to purchase the predetermined amount of shares, etc. on a monthly basis, it is expected to encourage long-term stable investments, and increase individual shareholdings.

In addition, by investing in multiple issues, investors can customize their portfolio and mitigate risks. When they make purchases via accounts under the NISA program (the tax exemption program for small-amount investments), they can receive a tax exemption for the dividends and capital gains from the invested shares (in order to enjoy tax exemption for dividends, investors must designate the method of receiving dividends in proportion to the number of shares held in their accounts).

Issues that investors can purchase through cumulative stock investment are those selected by a financial instruments business operator (hereinafter referred to as "selected issues") (Model Contract for "General Contract on Cumulative Stock Investment," art. 5, para. 1).

7 2 Features of Cumulative Stock Investments

(1) Allowing Investments in Shares, Etc. to Be Made with Minimal Amounts

In general, investment under the cumulative stock investment system can be made with the minimum amount of JPY 10,000 per month, in increments of JPY 1,000.

(2) Purchasing a Predetermined Amount of Shares, Etc. of a Specific Issue on the Designated Date Each Month

Purchases are made by the dollar cost averaging method,[(Note)] that is, purchasing a fixed monetary amount of shares, etc. of a specific issue on the designated date on a monthly basis, *e.g.*, 20th day of each month, regardless of

the trends of the share price level.

(Note)

The dollar cost averaging method refers to an investment method in which a fixed monetary amount is used to make periodic and continuous share investments without regard to market conditions or timing, etc.

Under this method, when the share price is high, fewer shares will be purchased, whereas when the share price is low, more shares will be purchased. In the long run, the average purchase price per share will be lower than periodic purchases made for a set number of shares.

(3) No Restriction on Selling Shares

In principle, investors may sell at any time all or part of the shares purchased under the cumulative stock investment system (the number of shares to be sold must be an integer, in principle). When investors seek to sell these shares, the financial instruments business operator must execute the transaction on a price in the predetermined exchange on the predetermined execution day of such sell order (FIBCOO, art. 66, item 5; Cumulative/Mini Stock Investment Rules, art. 6, para. 1).

7 3 Structure of Cumulative Stock Investment Contracts

(1) Conclusion of Cumulative Stock Investment Contract

(i) When a handling financial instruments business operator receives an order for a cumulative stock investment from a customer, it must conclude a transaction contract with the said customer based on the general contract on cumulative stock investments (hereinafter referred to as "general contract on cumulative stock investment") predetermined by the handling financial instruments business operator (Cumulative/Mini Stock Investment Rules, art. 3, para. 1).

(ii) When a handling financial instruments business operator concludes a contract on cumulative stock investment with the customer, it must deliver the general contract on cumulative stock investment to the customer in advance (Cumulative/Mini Stock Investment Rules, art. 3, para. 2).

(iii) Regardless of (i) and (ii) above, when a handling financial instruments business operator receives an order for a cumulative stock investment from another financial instruments business operator, it must conclude a cumulative stock investment contract with the said other financial instruments business operator (Cumulative/Mini Stock Investment Rules, art. 3, para. 3).

(2) Purchase Method under the Cumulative Stock Investment Contract Concluded with Customers

When a financial instruments business operator executes a purchase order using funds deposited by the customer, it must execute the transaction properly, while paying attention to the following points (Cumulative/Mini Stock Investment Rules, art. 4) :

(i) When a financial instruments business operator executes a purchase order through a financial instruments exchange market, it must perform the transaction continuously under a certain plan and not based on individual investment decisions (Cumulative/Mini Stock Investment Rules, art. 4, item 1).

(ii) When a financial instruments business operator executes a purchase order on a dealer transaction in response to the purchase order within a branch, it must perform the transaction continuously under a certain plan and not based on individual investment decisions, at a price in the predetermined financial instruments exchange market on the predetermined execution date of the purchase order (Cumulative/ Mini Stock Investment Rules, art. 4, item 2).

(iii) If the price for executing a purchase order is to be determined based on the price in the financial instruments exchange market, it must be set as either the price within a range of best quotes during a certain period of time or the VWAP on the financial instruments exchange market (Cumulative/Mini Stock Investment Rules, art. 4, item 3). Under a general contract, the contract price may be set as the opening price of the purchase order execution day (Model Contract for "General Contract on Cumulative Stock Investment," art. 7, para. 2, item 2).

(3) Amount to Be Paid

The maximum purchase amount of an issue by a customer under the cumulative stock investment contract executed between a financial instruments business operator and a customer must be less than JPY2 million (Cumulative/Mini Stock Investment Rules, art. 5).

(4) Sale

(i) When a financial instruments business operator receives an offer for sale from a customer, it must execute the transaction on a price during a certain period of time on the predetermined financial instruments exchange market on the predetermined execution day of such sell order (Cumulative/Mini Stock Investment Rules, art. 6, para. 1).

(ii) If the price for executing a sell order is to be determined based on the price on the financial instruments exchange market, it must be set as either the price within a range of best quotes during a certain period of time or the VWAP on the financial instruments exchange market (Cumulative/Mini Stock Investment Rules, art. 6, para. 2). Under a general contract, the contract price may be set as the opening price of the sell order execution day (Model Contract for "General Contract on Cumulative Stock Investment," art. 9, para. 3).

(5) Segregated Management of Proprietary Shares in Cumulative Stock Investment

(i) A financial instruments business operator must manage share certificates that are jointly owned by several customers separately from other securities, and manage the portion held by each customer and dividends from such portion in the account set up specifically for each customer (Cumulative/Mini Stock Investment Rules, art. 7, para. 1).

(ii) A financial instruments business operator must manage its proprietary share certificates in the cumulative stock investment units separately from its proprietary share certificates other than those in the mini stock investment units (Cumulative/Mini Stock Investment Rules, art. 7, para. 2).

(iii) A financial instruments business operator must manage share certificates that are jointly held with customers in the cumulative stock investment units separately from its proprietary share certificates other than those in the cumulative stock investment units (FIBCOO, art. 66, item 4; Cumulative/Mini Stock Investment Rules, art. 7, para. 3).

(iv) When any share certificates are to be transferred between the cumulative stock investment units and other

units as a result of sale and purchase transactions in cumulative stock investment, a financial instruments business operator must conduct such transfer in a single trading unit prescribed by the financial instruments exchange (Cumulative/Mini Stock Investment Rules, art. 7, para. 4).

(v) As a method for the management of deposits, a financial instruments business operator must provide in a cumulative stock investment contract that the fruits derived from the money paid and securities deposited by the customer, and the money which the financial instruments business operator keeps custody of due to acceptance of redemption shall be treated as the cumulative investment deposit and shall be subject to accounting separately from any other deposit (FIBCOO, art. 66, item 2).

(6) Others

Under the general contract, when the portion held by a customer in the shares purchased by the customer in the cumulative stock investment account reaches the number of sharers constituting one share unit (*i.e.,* the portion held by the customer in the purchased shares reaches the number of shares constituting one share unit as of the day on which the customer's rights as a shareholder are fixed (record day)), such portion shall be divided into those constituting a share unit and an odd lot, and those constituting a share unit are not covered by the cumulative stock investment contract (Model Contract for "General Contract on Cumulative Stock Investment," art. 10, para. 5). More specifically, when the number of shares purchased by a customer in the cumulative stock investment account reaches the number of shares constituting one trading unit, these shares are transferred to the customer's book-entry transfer account.

8 Mini Stock Investments

8 1 Definition of Mini Stock Investments

Mini stock investments are transactions concluded between a customer and a financial instruments business operator for a number of shares less than the normal trading unit prescribed by an exchange, using standardized purchase methods and the book-entry transfer system of shares, etc. (Cumulative/Mini Stock Investment Rules, art. 1).

In order for the stock market to fulfill its role sufficiently, it is desirable that it be appealing and reliable for investors. In addition to fulfilling the three basic principles of convenience (marketability), stability, and profitability, it must also enable participation from a broad class of investors. To accommodate such needs, the mini stock investment program was founded in September 1995 as a system that would enable stock investment with a small amount of funds.

8 2 Features of Mini Stock Investments

The distinguishing features of the mini stock investment program become clearer when contrasted with the cumulative stock investment system explained in the previous section.

Mini stock investments allow automated purchases at any time for a number of shares as odd-lot shares, and allows the shares purchased to be sold as odd-lot shares. This method enables portfolio management similar to basket management for several issues, even where investments funds are relatively small.

8 3 Structure of Mini Stock Investment Contracts

(1) Conclusion of Mini Stock Investment Contract

(i) When a handling financial instruments business operator receives an order for a mini stock investment from a customer, it must conclude a contract with the customer based on the general contract on Mini Stock Investments (hereinafter referred to as "general contract on mini stock investment") (Cumulative/Mini Stock Investment Rules, art. 3, para. 1).

(ii) When a handling financial instruments business operator concludes a mini stock investment contract with the customer, it must deliver the general contract on mini stock investment to the customer in advance (Cumulative/Mini Stock Investment Rules, art. 3, para. 2).

(iii) Regardless of (i) and (ii) above, when a handling financial instruments business operator receives an order for a mini stock investment from another financial instruments business operator, it must conclude a mini stock investment contract with the said other financial instruments business operator (Cumulative/Mini Stock Investment Rules, art. 3, para. 3).

(2) Transaction Unit, Etc.

The trading unit for mini stock investments conducted between a handling financial instruments business operator and a customer shall be determined in accordance with the following:

(i) The transaction unit is set at 1/10 of one trading unit of share certificates as prescribed by the exchange (hereinafter referred to as the "mini trading unit") (Cumulative/Mini Stock Investment Rules, art. 8, item 1);

(ii) The maximum number of shares of the same issue that can be accepted from a customer on the same business day is limited to the number of units calculated by multiplying one mini trading unit by nine (Cumulative/Mini Stock Investment Rules, art. 8, item 2); and

(iii) Notwithstanding the provisions of (i) above, as regards to the sales of share certificates less than one mini trading unit allotted as a result of a consolidation of shares, capital decrease or share split, or non-compensated share allotment, etc., the transaction may be made in such number of shares (Cumulative/Mini Stock Investment Rules, art. 8, item 3).

(3) Eligible Issues

A handling financial instruments business operator selects shares from among those for which share certificates

are listed on an exchange and which are subject to the unit system as issues eligible for transactions pertaining to the mini stock investment system (hereinafter referred to as the "selected issue") (Cumulative/Mini Stock Investment Rules, art. 9).

(4) Compliance

A handling financial instruments business operator must comply with domestic laws and regulations, the various rules and resolutions of the JSDA, the exchanges, and the Japan Securities Depository Center, Incorporated (hereinafter referred to as "JASDEC") when engaging in mini stock investment transactions with customers (Cumulative/Mini Stock Investment Rules, art. 2).

(5) Order Methods (Model Contract for "General Contract on Mini Stock Investment")

A customer must clearly advise the financial instruments business operator regarding the following matters upon placing a buy/sell order under a contract on mini stock investment (Model Contract, art. 4, para. 1, item 4):

(i) Issue;
(ii) Classification of sale or purchase; and
(iii) Volume.

Furthermore, the financial instruments business operator may suspend the acceptance of orders for a certain period under the following circumstances (Model Contract, art. 4, para. 2):

A) Where due to trading restrictions, etc., the handling financial instruments business operator or the designated financial instruments business operator cannot execute sales orders or purchase orders for the said issue on the exchange;
B) Where the issuing company of the said issue amends the number share unit prescribed by its articles of incorporation;
C) Where the closing period of the issuing company of the said selected issue nears, the period announced in advance by the handling financial instruments business operator; or
D) When other unavoidable circumstances arise, the period until the said circumstance can be rectified.

(6) Contract Date and Delivery Date

With respect to a mini stock investment, the contract date is the next business day from the date when a customer places an order (the order date) (Cumulative/Mini Stock Investment Rules, art. 14, para. 1). The third business day counting from the contract date is the delivery date (Cumulative/Mini Stock Investment Rules, art. 14, para. 2).

(7) Contract Price

The contract price of a mini stock investment between a financial instruments business operator and the customer is determined based on the price on the predetermined exchange (hereinafter referred to as the "designated exchange") on the contract date (Cumulative/Mini Stock Investment Rules, art. 15, para. 1).

If the contract price is to be determined using the price on the designated exchange, it is set as either the price within a range of best quotes during a certain period of time or the VWAP on the designated financial instruments exchange (Cumulative/Mini Stock Investment Rules, art. 15, para. 2). In the model contract, the buy/sell price is set at the opening price or the VWAP on the designated exchange for the next trading day after the day the trade order was made.

(8) Segregated Management of Proprietary Shares in Mini Stock Investments

A financial instruments business operator must manage, among the share certificates managed in accounts opened by the JASDEC, the share certificates pertaining to mini stock investments in the entry book of mini stock investment units (hereinafter referred to as "the mini stock investment units") (Cumulative/Mini Stock Investment Rules, art. 11, para. 1).

The financial instruments business operator must manage its proprietary share certificates separately from the customer portions of share certificates in the mini stock investment units (Cumulative/Mini Stock Investment Rules, art. 11, para. 2). Also, the financial instruments business operator must manage its proprietary share certificates in the mini stock investment units separately from its proprietary share certificates other than those in the mini stock investment units (Cumulative/Mini Stock Investment Rules, art. 11, para. 3).

When any share certificates are to be transferred between the mini stock investment units and other units as a result of sale and purchase transactions in the mini stock investment units, the financial instruments business operator must conduct such transfer in a single trading unit prescribed by the exchange (Cumulative/Mini Stock Investment Rules, art. 11, para. 4).

The treatment when a transaction cannot be established, delivery settlement methods, treatment of rights such as dividends, treatment of voting rights, etc., limitations on the exercise of odd lot share repurchase rights, etc., treatment where rights are granted, treatment in cases of a share consolidation or share split, etc., treatment of shareholder preferences, treatment of in the case of de-listing, etc., and treatment of reduction of investment unit, are generally determined by the standard agreement prepared by each financial instruments business operator.

When the number of shares of an issue deposited by a customer to the mini stock investment account at a financial instruments business operator reaches the number of shares constituting that issue's single trading unit, irrespective of whether the customer so requests, the financial instruments business operator must transfer the portion of such shares corresponding to the integral multiple of single trading units of the said issue held in the mini stock investment to a book-entry transfer account (not mini stock investment account) in the customer's name (Cumulative/Mini Stock Investment Rules, art. 16, para. 1).

9 Listing of Shares

Listing of shares is an immensely effective means for investors to freely trade shares in the stock markets, and for companies to expand their ability to procure funds and bolster their financial base.

A listing of shares involves a company making a listing application to any of the exchanges located nationwide, and after proceeding through an examination by the exchange, notifying with the Prime Minister and listing the shares.

In order to make a listing, the issuing company must satisfy the "Listing Criteria" prescribed by the exchange to which it is making the application.

9 1 Merits of a Listing

Some of the major advantages to making a listing are as follows:

(1) Expanded Fundraising Capability

As companies expand, their demand for funds increases, but a listing makes it possible to procure the requisite funds from general investors using direct finance.

(2) Improvement in Social Credibility

By being subject to the scrutiny of an exchange, companies boost their credibility with customers, financial institutions and the public in general, which can be advantageous in expanding their business transactions and recruiting employees, etc.

(3) Public Relations for Companies

When shares are listed, the company name, share price, and business conditions are publicized in newspapers, magazines, TV, etc., which can result in tremendous PR opportunities, which is not only an advantage in securing talented personnel, but also improves the work motivation on the part of employees.

(4) Expansion of Asset Protection Functions

The price of shares formulated in the exchange, etc. serves as an important backdrop to a variety of operative legal acts, and insures the fairness of computations regarding asset protection, inheritance, and gifts, etc., while liquidity, and collateral value increase.

(5) Establishment of Management Control Systems

Public companies are required to establish management-control systems at or above a certain minimum level. This contributes to the company profitability by further improving the establishment of management control systems in the company organization.

9 2 Listing of Shares and Determination of IPO Price

As for listing new shares, an allocation, etc. of the offered shares is made prior to the listing, by means of a public offering or secondary distribution or acquisition or sale or allocation to a third party, etc. of the shares. However, in regulation of the exchange on which the listing is to take place, there are necessary provisions to achieve fairness in bringing the shares public.

There are two methods of determining the IPO price (the price of the initial public offering, etc. prior to listing): the “book-building” method and the “competitive bid” method (TSE Securities Listing Regulations, art. 222, Enforcement Rules for Securities Listing Regulations, art. 246).

(1) Determination of Offering Price Using the Book-Building Method

If an initial listing applicant (the prospective public company) as well as a financial instruments business operator who is a principle underwriting participant(note) will conduct book-building, they shall determine the preconditions of the IPO price (meaning the range of prices, etc. presented to investors when conducting an examination of prospective investor demand for the offering) taking into account a comprehensive consideration of the financial condition and business performance of the prospective public company as well as the opinions of persons having specialized knowledge and experience in connection with investment in securities and other information and opinions that are of reference in determining the IPO price (TSE Enforcement Rules for Securities Listing Regulations, art. 256).

Thereafter, they determine the IPO price when making the public offering or secondary distribution prior to listing, by taking into account a comprehensive consideration of the facts and circumstances, including but not limited to the status of investor demand ascertained through the book-building process and the risks that may arise as a result of fluctuations in the securities market during the period until listing, as well as prospective demand (TSE Enforcement Rules for Securities Listing Regulations, art. 247).

Since the full-fledged introduction in 1997 of book-building, all companies have been setting their IPO prices using this method.

(Note) A principal underwriting participant refers to a financial instruments business operator, etc. that is a trading participant on the exchange and which enters into a principal underwriting agreement (meaning the principal underwriting agreement or the agreement by which the handling of the public offering or secondary distribution will be carried out), in connection with the public offering or secondary distribution (TSE Enforcement Rules for Securities Listing Regulations, art. 2, para. 3, item 24 and item 25). It is generally called the "managing securities company."

(2) Determination of IPO Price Through Competitive Bidding

In a competitive bid, the general investors must participate in the bidding for 50% or more of the number of shares to be issued in the public offering, etc. (number of shares publicly offered), with the IPO price being determined by those bids (TSE Enforcement Rules for Securities Listing Regulations, art. 259).

Bidding proceeds on a competitive basis, in which the financial instruments business operators that are general trading participants relay the bids received from investors (TSE Enforcement Rules for Securities Listing Regulations, art. 261). In the bidding process, the minimum price (minimum bid price) is the price obtained by having the prospective public company (company scheduled to list) and the principal underwriting participant select two or more listed companies that are comparable to the prospective public company (including at least one company selected by the exchange), and then multiplying the amount computed under the comparable company weighted formula by 85% (TSE Enforcement Rules for Securities Listing Regulations, art. 259, para. 2, item 3 and Exhibit 6: Standards for Computing Price Based on Comparative Companies).

The IPO price after bidding closes is determined by the company applying for listing and the principal underwriting participant based on the price derived from the weighted average of the winning bid prices (the weighted average price winning bid) by comprehensively taking into account the facts and circumstances including but not limited to the implementation status of the said bid, the risks that may arise during the period before listing, and the estimates of demand following the bid (TSE Enforcement Rules for Securities Listing Regulations, art.

247).

10 Margin Transactions

The Japanese margin transactions system, modeled on U.S. margin transactions, has been in place since June 1951. The feature of this system is that it effectively enables net cash settlement, even though trading is cast in the form of spot transactions.

With the digitization of share certificates, certificates in paper form have been abolished in the case of a listed company. However, for example, as the FIEA and other laws and regulations, as well as exchange regulations and rules of the JSDA, still refer to "share certificates," we use the term "share certificates" in this section to refer to both digital and paper-form share certificates.

10 1 Outline of Margin Transaction System

(1) Purpose of Margin Transactions

To process share trading smoothly and formulate fair pricing, it is desirable for a large volume of supply and demand to be concentrated in a central location. However, because the actual volume of supply and demand is insufficient to achieve those objectives, the introduction of so-called speculative supply and demand is indispensable. At the same time, a certain amount of speculation must be tolerated in order to spur such speculative supply and demand.

Considering the objectives of the FIEA, which is to secure the proper development of the national economy and to protect investors, financial instruments markets should be investment markets. However, investment and speculation are inextricably linked, and not only is the total prohibition of speculative transactions impossible, but an abundance of restrictions can also impede their aim to effectuate the circulation of securities, and obstruct the management of financial instruments markets.

Margin transactions introduce this speculative supply and demand by allowing customers to use borrowed funds or loaned shares in return for a specified deposit amount, and if the danger of overheating the markets arises, speculation can be dealt with by manipulating the maintenance margin, etc.

(2) Definition of Margin Transactions

Margin transactions are defined as the "sale and purchase or other transactions in securities conducted through the extension of credit from a financial instruments business operator to a customer" (FIEA, art. 156-24). The extension of credit means a loan or other advance of money or securities to the customer (including other financial instruments business operators).

In other words, when a customer engages in securities trading, the financial instruments business operator loans the securities sold or the purchase price to the customer (extension of credit) to make delivery, which enables a person who does not actually have the securities or money to engage in such trading.

"Sale and purchase and other transactions in securities" covers a broad scope of trades, and legally is not

limited to on-exchange or off-market trades. However, in practice, margin transactions are limited to the trading of certain issues selected based upon exchange regulations, etc. Margin transactions are prohibited with regard to the following securities: share option certificates; investment securities; investment equity subscription right certificates; securities which have fallen under the delisting criteria; other issues that the exchange deems inappropriate; and securities in transactions of off-auction distribution (TSE Margin/Loan Trading Regulations, art. 3 and art. 4).

At present, margin transactions can be conducted for foreign stocks listed on domestic exchanges, and since July 1, 2022, margin transactions has been available for foreign stocks that meet certain requirements, such as being listed on the New York Stock Exchange (for details, see this Chapter, "11-3 Foreign Stocks Margin Transaction System").

(3) License for Margin Transactions

A person who intends to engage in the business of lending money or securities as necessary for the settlement of margin transactions by utilizing clearing systems of an exchange shall obtain a license from the Prime Minister (FIEA, art. 156-24).

(4) Types of Margin Transactions

(i) Standardized Margin Transactions

These are margin transactions that have traditionally been conducted, in which target issues are shares, etc. listed on an exchange, where the issues, broker loan rate, repayment period and method for the treatment of rights are uniformly determined by the exchange in its rules (Margin/Loan Trading Regulations and Brokerage Agreement Standards) (TSE Margin/Loan Trading Regulations, art. 2, para. 1). Since no particular stipulation is made in connection with the interest rate, it can be determined freely between a customer and a financial instruments business operator. The financial instruments business operator may borrow share certificates, etc. to sell or the purchase price of securities from a securities finance company through the clearinghouse of the exchange (hereinafter referred to as a "loan transaction") (TSE Margin/Loan Trading Regulations, art. 1).

A securities finance company is a stock company specializing in securities financing under the FIEA, which engages in the business of lending money or securities necessary for the settlement of margin transactions to financial instruments business operators, with the license granted by the Prime Minister. At present, Japan Securities Finance Co., Ltd. (hereinafter referred to as the "JSF") operates as a financial securities company.

Moreover, as this type of transaction allows for the use of loan transactions, its trading volume is heavy compared to negotiable margin transactions.

Issues for which standardized margin transactions are allowed are referred to as standardized margin transaction issues, which include the following: (a) share certificates (including preferred equity investment certificates and foreign depositary receipts); (b) real estate investment trust (J-REIT: listed real estate investment trust) securities; (c) indicator-linked investment trust (exchange traded fund (ETF)) beneficiary certificates; (d) foreign investment trust beneficiary certificates; (e) foreign investment securities; (f) beneficiary certificates of a beneficiary certificate issuing trust; (g) beneficiary certificates of a foreign beneficiary certificate issuing trust; and (h) indicator-linked securities trust (exchange traded note (ETN)) beneficiary certificates (TSE Margin/Loan Trading Regulations, art. 7; TSE Business Regulations, art. 2, para.

1, item 1).

(ii) Negotiable Margin Transactions

These are margin transactions in which the underlying securities are share certificates, etc. listed on an exchange and which are carried out with the broker loan rate, repayment date and interest rate agreed upon (negotiable) between a customer and a financial instruments business operator (TSE Margin/Loan Trading Regulations, art. 2, para. 2).

However, loan transactions cannot be used to settle this type of margin transaction (TSE Margin/Loan Trading Regulations, art. 11).

(iii) PTS Margin Transaction (for details, see this Chapter, "10-2 (9) PTS Margin Transactions")

(5) Structure of Margin Transactions

In trading share certificates, etc., the most general and largest volume of trading occurs through regular transactions. In a regular transaction, settlement takes place on the third business day counting from the contract date, at which time the purchase price or sold share certificates, etc. are delivered, and the purchased share certificates, etc. or sales proceeds are received, to close out the trade (TSE Business Regulations, art. 9, para. 3).

In a margin transaction, the customer submits a predetermined margin (security deposits) as security and receives a loan from the financial instruments business operator of the necessary funds or share certificates, etc. to conduct settlement of such regular transactions. The funds loaned or share certificates, etc. will be repaid by a date fixed in advance, and repayment can be made by either net cash settlement if a party makes an offsetting trade in the interim (unless a margin transaction is explicitly ordered, net cash settlement may not be made (Security Deposit Ordinance, art. 10)), or through *genbiki* or *genwatashi,* which means repayments from cash on hand (meaning the customer's receipt of actual share certificates, etc. purchased and collateralized) or by delivery of the equivalent share certificates, etc. borrowed (meaning customer's receipt of proceeds of shares sold and funds collateralized).

Financial instruments business operators may procure the funds loaned or share certificates, etc. with their own inventory or by engaging in a loan transaction with a securities finance company, but loan transactions can only be used in standardized margin transactions, and in cases of a negotiable margin transaction, the financial instruments business operator must procure the loan or share certificates, etc. from its own inventory, and where it cannot, the use of that margin transaction may be restricted (for details, see this Chapter, 10-2(5) "(iii) Loans of Securities Finance Companies (Loan Transactions)").

10 2 Margin Transactions in Listed Issues

(1) Actual Practice of Margin Transactions

(i) Delivery of Explanatory Documents Concerning Margin Transactions

When executing a contract for financial instruments transaction, financial instruments business operators, etc. must deliver documents stating matters prescribed by laws and regulations (documents to be delivered prior to conclusion of a contract) to the customer in advance (FIEA, art. 37-3). If they are to execute a contract for margin transactions, they must deliver such documents prior to conclusion of the contract concerning margin transactions with the customer.

A margin transaction, where a customer can trade 3.3-fold of his/her own funds at the maximum, can

bring greater profits and losses than those arising in a spot transaction (cash transaction). In particular, margin sale is a high-risk, high-return transaction that could produce unlimited losses. In light of such nature, financial instruments business operators, etc. must fully explain the risk of margin transactions to customers. They must also explain that margin transactions are not covered by the cooling-off system (FIEA, art. 37-6, para. 1; FIEAEO, art. 16-3, para. 1).

(ii) Establishment of Margin Transaction Commencement Standards

Article 40 of the FIEA provides that financial instruments business operators, etc. may not conduct solicitations considered as inappropriate in light of the customer's knowledge, experience, financial standing and purposes for executing the contract for financial instruments transaction (principle of suitability). In addition, since the trading of securities through margin transactions can easily become tainted with a speculative aura, the JSDA considers that margin transaction customers should be carefully selected from those customers with sufficient investment experience and financial resources, and requires each financial instruments business operator to set up "Margin Transaction Commencement Standards" based on the size of the deposited assets, investment experience, and other matters deemed necessary (Investment Solicitation Rules, art. 6, para. 1, item 1).

Also, margin transactions by officers or employees of a financial instruments business operator are prohibited (Employee Rules, art. 7, item 4; TSE Margin/Loan Trading Regulations, art. 5).

(iii) Written Agreement for Establishment of a Margin Transaction Account and Consent Form

Customers who engage in margin transactions must open a margin transaction account with their financial instruments business operator. Requests to open an account may be made orally, but when the financial instruments business operator approves the request, the customer itself must individually complete the requisite matters on the "Written Agreement for Establishment of a Margin Transaction Account" in the form specified by the exchange, sign or seal the agreement, and submit it. An English version of this written agreement may be used only with the consent of the trading participant. In lieu of the submission of this written agreement, the financial instruments business operator may receive the information that should be contained in the written agreement by the designated electromagnetic means if the customer has approved this in writing or by electromagnetic means (TSE Brokerage Agreement Standards, art. 5; TSE Agreement for Setting up Margin Transaction Account, art. 25). Furthermore, when conducting margin transactions at PTSs, customers must submit a "Written Agreement on Margin Transactions at the PTS" to their financial instruments business operators, in addition to a "Written Agreement for Establishment of a Margin Transaction Account" (Off-Market Trading Rules, art. 6-9).

In addition, if a salesperson receives a completed Written Agreement for Establishment of a Margin Transaction Account, he must deliver a copy of the said agreement to that customer (Employment Regulations on the part of each of the financial instruments business operators).

When a financial instruments business operator makes an agreement to conduct a margin transaction, it must receive a security deposit from the customer (FIEA, art. 161-2, para. 1; Security Deposit Ordinance, art. 4). Securities may also be used in lieu of a cash margin (FIEA, art. 161-2, para. 2). If the financial instruments business operator plans to rehypothecate the margin securities received, or loan them to another person, it must receive the written consent of the said customer (FIEA, art. 43-4).

In lieu of receiving a written consent from a customer, a financial instruments business operator may obtain consent by means of using an electronic data processing system or by any other means using information and communications technology pursuant to the provisions of laws and regulations (FIEA, art.

43-4, para. 3).

(iv) Content of the Written Agreement for Establishment of a Margin Transaction Account

The purpose of the Written Agreement for Establishment of a Margin Transaction Account is to ensure that the parties, in executing trading pertaining to margin transactions, agree to follow the provisions relevant to the conditions of margin transactions in: (i) the FIEA and other laws and regulations; (ii) the various rules and resolutions of the JSDA; (iii) the brokerage agreement standards, articles of incorporation, business regulations, other miscellaneous rules and the resolutions of the stock exchanges; and (iv) conventions.

Major items are described below:

a) Restrictions Under Lending Regulations

In standardized margin transactions, financial instruments business operators must undertake the measures prescribed under lending regulations of a securities finance company. An example of such measures is an extension, etc. where an application is made for repayment of financing when there is a shortage of lending securities (TSE Agreement for Setting up Margin Transaction Account, art. 6).

b) Disposition of Security Deposit, Etc.

When the liabilities assumed under a margin agreement are not performed by the prescribed time, the financial instruments business operator can liquidate the security deposit, etc., without any notice or warning whatsoever, and without resort to any legal foreclosure procedures. An example of such default is the case when the security deposit falls below minimum maintenance and additional margin is not received, etc. (TSE Agreement for Setting up Margin Transaction Account, art. 10).

In addition, notwithstanding the terms of the agreement, in cases where the margin securities are loaned or hypothecated, a written consent from the customer must be received in accordance with the law (FIEA, art. 43-4).

In lieu of receiving a written consent from a customer, a financial instruments business operator may obtain consent by means of using an electronic data processing system or by any other means using information and communications technology pursuant to the provisions of laws and regulations (FIEA, art. 43-4, para. 3).

(v) Order Instructions for Margin Transactions

Each time a customer with a margin transaction account places a buy/sell order, he must instruct a financial instruments business operator that the transactions be done as a margin transaction. Orders without this instruction cannot be done as margin transactions (Security Deposit Ordinance, art. 10; TSE Brokerage Agreement Standards, art. 6, para. 1, item 9 and para. 2). Also, each time a financial instruments business operator receives an order for a margin transaction from a customer, it must confirm the type of margin transaction the customer intends to conduct, *i.e.*, either a standardized margin transaction (including PTS Standardized Margin Transaction) or a negotiable margin transaction (including PTS Negotiable Margin Transaction) (Investment Solicitation Rules, art. 7; TSE Brokerage Agreement Standards, art. 6, para. 3). Moreover, a transaction not explicitly ordered as a margin transaction cannot make use of net cash settlement through offsetting transactions (Security Deposit Ordinance, art. 10).

(vi) Term of Repayment

The term of repayment (return/repayment deadline) for a standardized margin transaction shall be within six months. For a negotiable margin transaction, the term is set by an agreement between the financial instruments business operator and the customer (TSE Brokerage Agreement Standards, art. 43; TSE Margin/

Loan Trading Regulations, art. 2).

(vii) Issues Which May Be Used in Margin Transactions

Exchanges prohibit margin transactions in share option certificates, investment securities (excluding preferred equity investment certificates), investment equity subscription right certificates, securities that fall under the delisted standards and other inappropriate issues (TSE Margin/Loan Trading Regulations, art. 3), which effectively limits the issues able to be used in margin transactions to listed share certificates. Margin transactions may also be conducted in foreign shares if they are listed on a domestic exchange. In addition, it is also possible to engage in margin transactions in real estate investment trust (J-REIT) securities, indicator-linked investment trust (exchange traded fund (ETF)) beneficiary certificates, infrastructure funds as well as indicator-linked securities trust (exchange traded note (ETN)) beneficiary certificates. Similarly, whereas any listed share certificate may be used in a negotiable margin transaction, in the case of a standardized margin transaction, even if the underlying security is a listed share certificate, it is limited to the standardized margin issues selected by that exchange (TSE Margin/Loan Trading Regulations, art. 7). Furthermore, off-auction lot sales/purchases cannot use margin transactions at all (TSE Margin/Loan Trading Regulations, art. 4).

The outline of the TSE's selection criteria and disqualification criteria for standardized margin transaction issues is provided below, focusing on common shares listed on the main markets.

Outline of Selection Criteria and Disqualification Criteria of Standardized Margin Issues (TSE)

A) Timing of selecting a stock, etc. as a standardized margin transaction issue

The selection of a standardized margin transaction issue shall be made on the next business day immediately following the day on which the first contract price is determined after listing (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, art. 4, para. 1). However, the selection shall be made on the day of listing with regard to issues listed via another market (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, art. 4, para. 3, item 3).

B) Criteria for selecting a stock, etc. as a standardized margin transaction issue

A stock, etc. shall be selected as a standardized margin transaction issue from issues other than those already selected as standardized margin transaction issues if it satisfies each of the following requirements (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, art. 2, para. 1):

(i) The first contract price of the stock, etc. has been determined after listing;
(ii) The amount of net assets held by the issuer as of the last day of the most recent business year is a positive number;
(iii) The stock, etc. is not deemed to be delisted on and after the selection date referred to in A);
(iv) The stock, etc.is not designated as a security on alert, a security under supervision, or a security to be delisted;
(v) The stock, etc. is not under the grace period for delisting;
(vi) The stock, etc. is not subject to regulatory measures for trading or margin transaction; and
(vii) The stock, etc. is not deemed inappropriate to be a standardized margin transaction issue.

C) Exceptions to the criteria for selecting a stock, etc. as a standardized margin transaction issue

Regardless of the provisions of B), a stock, etc. shall be selected as a standardized margin training issue if

it falls under any of the following cases (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, art. 2, para. 2 through para. 6):

(i) Where the stock, etc. to be listed pursuant to the provisions of Article 207 of the TSE Securities Listing Regulations ("Listing Examination") as well as preferred shares, etc. issued by the issuer of the said shares, etc. satisfy each of the requirements mentioned in (i) and (iii) to (vii) of B) at the time of the first selection examination (limited to that conducted in a period from listing until the first securities report is submitted after listing);

(ii) Where the stock, etc. falls under the case of technical listing*;

* Technical listing on the Standard Market is each of the following cases:

- Where a listed stock, etc. is delisted due to dissolution caused by a merger of a listed company on the Standard Market, and the newly created company or the surviving company, or the parent company of the surviving company pertaining to such merger applies for listing (TSE Securities Listing Regulations, art. 208, item 1); and
- Where a listed company on the Standard Market becomes a wholly-owned subsidiary of another company by a stock swap, stock transfer and other means or comes to be in a state specified by the Enforcement Rules as being equivalent to this, and such other company or the parent of such other company applies for listing (TSE Securities Listing Regulations, art. 208, item 3).

(iii) Where the stock, etc. to be listed is to be delivered in exchange for class stock subject to wholly call, etc.;

(iv) Where a listed company, which is not an issuer of a standardized margin transaction issue, absorbs a listed company, which is an issuer of standardized margin transaction issues, through a merger, or where it carries out a stock swap which results in a listed company which is an issuer of a standardized margin transaction issue, becoming its wholly-owned subsidiary, and the stock, etc. of the listed company that is not the issuer of the standardized margin transaction issue satisfies each of the requirements mentioned in B), (ii) through (vii) at the time of the first selection examination of the stock, etc. after completion of the merger or stock swap.; and

(v) Where the stock, etc. that is listed on another market satisfies each of the requirements mentioned in B), (ii) through (vii) at the time of the first selection examination of the stock, etc.

D) Criteria for disqualification of a stock, etc. as a standardized margin transaction issue

A stock, etc. shall be disqualified as a standardized margin transaction issue if it falls under any of the following conditions (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, rule 5):

(i) Where the stock, etc. is other than an issue for which the amount of net assets of the issuer as of the last day of the most recent business year (in the case of an issue selected as a standardized margin transaction issue pursuant to the provisions of the provisions of Article 2, Paragraph 2 of the TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions (mentioned in C), (i)), limited to the first or any subsequent business year after listing) is a positive number;

(ii) Where the stock, etc. is determined to be delisted; or

(iii) Where the stock, etc. is deemed inappropriate to be a standardized margin transaction issue.

(viii) Issues for Loans for Margin Transactions

Among standardized margin transaction issues, issues that further satisfy certain standards may be selected as issues for loans for margin transactions (both cash and securities loans may be obtained from a securities finance company) by exchanges. Even issues that are not selected as issues for loans for margin transactions, however, may receive financing from a securities finance company (a company which loans the necessary funds or share certificates, etc. to a financial instruments business operator in a margin transaction) with respect to a standardized margin issue.

A margin transaction is a trading transaction in which the financial instruments business operator extends credit to a customer. In order for the financial instruments business operator to supply the funds or securities necessary to extend credit to its customer, the financial instruments business operator can draw such funds or securities from its own inventory, and may also procure them from a securities finance company in the case of standardized margin transactions. Such transactions between financial instruments business operators and securities finance companies are called loan transactions (TSE Margin/Loan Trading Regulations, art. 1). "Issues for loans for margin transactions" means issues with respect to which a loan of cash and securities may be received in a loan transaction, and they are selected by exchanges from among the standardized margin issues (TSE Margin/Loan Trading Regulations, art. 10).

The outline of the TSE's selection criteria and disqualification criteria for issues for loans for margin transactions is provided below, focusing on common shares listed on the main markets.

Outline of Selection Criteria and Disqualification Criteria of Issues for Loans for Margin Transactions (TSE)

A) Timing of selecting a stock, etc. as an issue for loans for margin transactions

The selection of an issue for loans for margin transactions shall be made, on a monthly basis, on the first day (if such first day falls on a non-business day, it shall be moved down accordingly) of the sixth month counting from the month containing the last day of the issuer's business year (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, rule 4, para. 2).

(i) Periodical selection (selection made for listed issues for each accounting period)
On the first day of the sixth month counting from the month containing the closing day (art. 4, para. 2)
(Note) The periodical selection may be postponed until the last day of the eighth month counting from the month containing the said day (art. 4, para. 5).

(ii) Early selection (selection made for new issues to be listed)
a. issues listed via another market: the day of listing (art. 4, para. 3, item 3)
b. share certificates, etc. (excluding issues which had been listed on other financial instruments exchanges in Japan): the sixth business day counting from the day on which the first contract price after listing is determined (art. 4, para. 3, item 5)
(Note) The early selection may be postponed for six months from the said selection day (art. 4, para. 5).

B) Criteria for selecting a stock, etc. as an issue for loans for margin transactions

A stock, etc. which is a standardized margin transaction issue shall be selected as an issue for loans for margin transactions from issues other than those already selected as issues for loans for margin transactions if it satisfies each of the following requirements (the different requirements apply to a foreign stock, etc.; TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin

Transactions, rule 3):

(i) The stock, etc. has been listed for more than six months;

(ii) The number of tradable shares is not less than 17,000 units;

(iii) The number of shareholders (meaning the number of persons holding one or more units of the issue) is not less than 1,700;

(iv) The trading volume, etc. of the stock, etc. during, in principle, the past six months backdated from the last day of the second month immediately following the month containing the last day of the fiscal year of the issuer, satisfies either of items a. or b. below:

a. The average monthly trading volume is not less than 100 units on the market of the TSE and the rate of active trading days* is 80% or more; or

b. Where, on a market of the TSE or any domestic exchange other than the TSE, the average monthly trading volume of the stock, etc. is not less than 100 units and its rate of active trading days is 80% or more, and on the TSE market, its average monthly trading volume is not less than 50 units and its rate of active days is 40% or more;

* The rate of active trading days means the rate of the number of active days (which is the number of days when the issue is traded) to the number of trading days.

(v) The stock, etc. is not deemed to be delisted on and after the selection date referred to in A);

(vi) The stock, etc. is not designated as a security on alert, a security under supervision, or a security to be delisted;

(vii) The stock, etc.is not under the grace period for delisting;

(viii) The stock, etc. is not subject to regulatory measures that restrict trading;

(ix) The stock, etc. is not deemed inappropriate to be an issue for loans for margin transactions according to its number of shares available for loan trading; and

(x) The stock, etc. is not deemed inappropriate to be an issue for loans for margin transactions.

C) Exceptions to the criteria for selecting a stock, etc. as an issue for loans for margin transactions

Regardless of the provisions of B), a stock, etc. shall be selected as an issue for loans for margin transactions if it falls under any of the following cases (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, rule 3, para. 3, para. 4, para. 5, para. 6, para. 7, and para. 8):

(i) Where the stock, etc. falls under the case of technical listing, and satisfies the following requirements:

- The issuer has not fallen into a state of having liabilities in excess of assets as of the last day of the most recent business year;
- The stock, etc. satisfies the requirements set forth in (vii), (ix) and (x) of B);
- The stock, etc. is expected not to fall within the category of an issue with the number of tradable shares being less than 10,000 units as of the last day of the first business year ending after listing (a different requirement applies to foreign stocks, etc.);
- The stock, etc. is expected not to fall within the category of an issue with the number of shareholders being less than 1,200 as of the last day of the first business year ending after listing; and
- The average monthly trading volume during, in principle, the past six months backdated from the last day of the month immediately following the month containing the day of listing of the

stock, etc. is not less than 100 units either on another Japanese financial instruments exchange or a foreign financial instruments exchange, etc., and the number of active days accounts for 80% or more of the number of trading days during the period;

(ii) Where the stock, etc. to be listed is to be delivered in exchange for class stock subject to wholly call, etc.;

(iii) Where a listed company, which is not an issuer of an issue for loans for margin transactions, absorbs a listed company, which is an issuer of issues for loans for margin transactions, through a merger, or where it carries out a stock swap which results in a listed company, which is an issuer of issues for loans for margin transactions, becoming its wholly-owned subsidiary, and the stock, etc. of the listed company that is not the issuer of the issue for loans for margin transactions satisfies the following requirements at the time of the first selection examination of the stock, etc. after completion of the merger or stock swap:

- The issuer has not fallen into a state of having liabilities in excess of assets as of the last day of the most recent business year;
- The stock, etc. satisfies the requirements set forth in (v) through (x) of B);
- The stock, etc. is expected not to fall within the category of an issue with the number of tradable shares being less than 10,000 units (in the case of foreign share certificates, etc., the number of listed share certificates, etc. being less than 20,000 units) as of the last day of the first business year after the merger or stock swap; and
- The stock, etc. is expected not to fall within the category of an issue with the number of shareholders being less than 1,200 as of the last day of the first business year after the merger or stock swap;

(iv) Where the stock, etc. that is listed on another market satisfies each of the following requirements at the time of the first selection examination of the stock, etc.; and

- Where the period between the day on which the stock, etc. is listed on another Japanese financial instruments exchange to the day on which it is listed on the TSE exceeds six months:
- Where the stock, etc. satisfies the requirements set forth in B), (ii), (iii), and (v) through (x).
- Where the average monthly trading volume of the stock, etc. is no less than 100 units and its rate of active trading days is 80% or more in any other Japanese financial instruments exchanges during, in principle, the past six months backdated from the last day of the month immediately preceding the month containing the listing date of the stock, etc. on the TSE.

(v) Where the stock, etc. (excluding an issue listed on another Japanese financial instruments exchange) satisfies the requirements set forth in B), (ii), (iii), and (v) through (x) at the time of the first selection examination after listing.

(vi) Where the stock, etc. falls under the case of technical listing for which the record date for shareholders, etc. is not the last day of a business year, and it satisfies the following requirements:

- The stock, etc. is expected not to fall within the category of an issue with the number of tradable shares being not less than 10,000 units as of the first record date for shareholders, etc. after listing (a different requirement applies to foreign stocks, etc.); and
- The stock, etc. is expected not to fall within the category of an issue with the number of shareholders being less than 1,200 as of the first record date for shareholders, etc. after listing;

(vii) Where a listed company, which is not an issuer of an issue for loans for margin transactions and

for which the record date for shareholders, etc. is not the last day of a business year, absorbs a listed company, which is an issuer of issues for loans for margin transactions, through a merger, or where it carries out a stock swap which results in a listed company, which is an issuer of issues for loans for margin transactions, becoming its wholly-owned subsidiary, and the stock, etc. of the listed company that is not the issuer of the issue for loans for margin transactions satisfies the following requirements at the time of the first selection examination of the stock, etc. after completion of the merger or stock swap:

- The stock, etc. is expected not to fall within the category of an issue with the number of tradable shares being less than 10,000 units as of the first record date for shareholders, etc. after the merger or stock swap (a different requirement applies to foreign stocks, etc.); and
- Where the stock, etc. is expected not to fall within the category of an issue with the number of shareholders being less than 1,200 as of the first record date for shareholders, etc. after the merger or stock swap.

D) Criteria for disqualification of a stock, etc. as an issue for loans for margin transactions

A stock, etc. shall be disqualified as an issue for loans for margin transactions if it falls under any of the following conditions (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, rule 6):

(i) Where the number of tradable shares is less than 8,500 units; or in the case of a foreign stock, etc. (limited to those listed on multiple markets) the number of listed shares is less than 20,000 units;

(ii) Where the number of shareholders is less than 1,200;

(iii) Where the trading volume of a foreign stock, etc. falls under any of the conditions prescribed in the following sub-items a. or b.:

a. The average monthly trading volume for each year backdated from the last day of December is less than 10 units; or

b. Where no trade was executed for the past three months backdated from the last day of each month.

(iv) Where the stock, etc. is other than an issue for which the amount of net assets of the issuer as of the last day of the most recent business year (in the case of an issue selected as a standardized margin transaction issue pursuant to the provisions of the provisions of Article 2, Paragraph 2 of the TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions ("Outline of Selection Criteria and Disqualification Criteria of Standardized Margin Issues (TSE)," C), (i)), limited to the first or any subsequent business year after listing) is a positive number;

(v) Where the stock, etc. is determined to be delisted; or

(vi) Where an issue is deemed inappropriate to be an issue for loans for margin transactions.

E) Special Provisions for Criteria for Disqualification of Stocks, Etc. as Issues for Loans for Margin Transactions

Notwithstanding the criteria for disqualification of stocks, etc. as issues for loans for margin transactions, a stock, etc. shall not be disqualified as an issue for loans for margin transactions in the case where, in principle, the stock, etc. falls under any of the provisions of (i) or (ii) of D), except when it is found to have fallen under these provisions within the period of one year counting from the day following the last day of a business year containing the day on which the stock, etc. falls under the relevant provisions (hereinafter referred to as the "grace period") (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin

Transactions and Loans for Margin Transactions, rule 7, para. 1).

With regard to the application of the abovementioned provisions to an issue for which the record date for shareholders, etc. is changed to a date other than the last day of a business year within the grace period, and an issue for which the record date for shareholders, etc. is not the last day of a business year, the numbers of shareholders and tradable shares as of the record date for shareholders, etc. pertaining to the business year to which the last day of the grace period belongs shall be deemed to be those numbers as of the last day of the grace period (TSE Rules Concerning Selection of Stocks Eligible for Standardized Margin Transactions and Loans for Margin Transactions, rule 7, para. 2).

(ix) Unit of Trading in Margin Transactions

The trading unit for margin transactions is the number of shares that a listed company fixes as one round lot (If a company does not fix it, the trading unit refers to one share.) (TSE Business Regulations, art. 15, item 1).

(2) Security Deposit Requirements on Margin Transactions

The rules concerning security deposit requirements on margin transactions are provided in the FIEA, the Security Deposit Ordinance and the TSE Brokerage Agreement Standards.

(i) Collection of Security Deposit

The FIEA states that the percentage at which a financial instruments business operator must collect a security deposit from the customer pertaining to a margin transaction shall be set by the Prime Minister in consideration of fair and equitable trades (FIEA, art. 161-2); provided, however, that in practice the Prime Minister delegates his/her authority to the Commissioner of the Financial Services Agency (FIEA, art. 194-7). Specifically, Cabinet Office Ordinance (Security Deposit Ordinance, art. 2) prescribes that in the case of margin transactions, the security deposit ratio shall be thirty per cent (in the case of ETFs and ETNs where the securities pertaining to margin transactions are linked with a leverage indicator, etc., the number obtained by multiplying 30% by a set multiplying factor (if the set multiplying factor is less than zero, the number calculated by deducting the set multiplying factor from zero)) and also prescribes other matters concerning security deposit requirements. Exchanges also prescribed certain matters concerning margin transactions that govern trading participants or members, with a license or approval from the Prime Minister, and provide that when a trade is concluded in a margin transaction, a security deposit of 30% (if the securities pertaining to the margin transactions are those related to a leverage indicator, etc., the rate obtained by multiplying 30% by the multiplying factor of the leverage indicator (if the multiplying factor of the leverage indicator is less than zero, the rate obtained by multiplying 30% by the value calculated by deducting the multiplying factor of the indicator from zero)) or more of the contract price must be collected from the customer by a date and time designated by the financial instruments business operator no later than the noon on the third business day counting from the day on which the transaction is effected (FIEA, art. 161-2, para. 1; Security Deposit Ordinance, art. 2, para. 1, item 1, and art. 4; TSE Brokerage Agreement Standards, art. 39).

When a trade is concluded in a T+1 margin transaction on the ToSTNeT market, a security deposit must be collected from the customer by a date and time designated by the financial instruments business operator no later than noon on the second business day counting from the day on which the trading contract is concluded (Special Regulations of Business Regulations and Brokerage Agreement Standards Concerning ToSTNeT Market, art. 8, item 1, b., art. 31-2).

The money to be submitted as a security deposit must be in Japanese yen or US dollars. The amount of security deposit to be submitted in US dollars shall be 95% of the contract price converted into Japanese yen at the foreign exchange rate designated by the trading participant (TSE Brokerage Agreement Standards, art. 39-2, para. 1 and para. 2).

In addition, in order to restrict the use of margin transactions by investors with small assets levels, the minimum security deposit requirement is JPY300,000 (FIEA, art. 161-2; Security Deposit Ordinance, art. 3; TSE Brokerage Agreement Standards, art. 39). In other words, even if 30% of the contract price would result in a number below JPY300,000, the necessary margin is JPY300,000. Also, at each exchange, in cases where the use of margin transactions is deemed to be excessive, etc., restrictive measures such as raising the security deposit ratio or establishing a cash collateral ratio may be instituted (TSE Business Regulations, art. 65; the Rules on Regulatory Measures Concerning Securities Trading, etc. or Its Brokerage, art. 1, item 1, item 2, item 3 and item 4).

(ii) Margin Securities

Generally security deposits must be made in cash, but securities may be substituted in lieu of cash and the cash conversion ratio varies depending on the type of margin securities (FIEA, art. 161-2, para. 2; TSE Brokerage Agreement Standards, art. 40, para. 1) (for the cash conversion ratios (*daiyō kakeme*), the same as in Chapter 2, "6-4. When-Issued Transactions").

Also, the cash conversion ratio can be modified under the regulations of an exchange or the internal rules of a financial instruments business operator (the JSDA allows its Regular Members to change the loan-to-value ratio of substitute securities at their discretion under certain requirements, as provided in the Rules Concerning Change, etc. of Assessment Rates for Substitute Securities Related to Margin Transactions).

Finally, the valuation of these margin securities cannot exceed the market price on the day before deposit multiplied by the applicable cash conversion ratio (TSE Brokerage Agreement Standards, art. 40, para. 2).

The market prices of margin securities are prescribed in accordance with the classification of securities enumerated as follows (TSE Brokerage Agreement Standards, art. 40, para. 3).

	Securities	Market Price
1	Out of share certificates set forth in a), convertible bond-type bonds with share options set forth in f), exchangeable bonds set forth in g), and investment trust beneficiary certificates and investment securities set forth in m), those listed on a financial instruments exchange in Japan:	Last price on a financial instruments exchange in Japan (in cases where a quote is displayed on a financial instruments exchange in Japan, the last quote price)
2	Out of investment trust beneficiary certificates and investment securities set forth in m), those whose market price of the previous day is published by the Investment Trusts Association, Japan	Market price published by the Investment Trusts Association, Japan
3	Out of securities other than the securities referred to in 1 and 2, those whose Reference Statistical Prices for OTC Bond Transactions are published by the JSDA	The average value of the Reference Statistical Prices for OTC Bond Transactions published by the JSDA (in the case of inflation-linked government bonds, the value obtained by multiplying said average value by an interlocking coefficient published by the Ministry of Finance)
4	Out of securities other than the securities referred to in 1 to 3, those listed on a financial instruments exchange in Japan	Last price on a financial instruments exchange in Japan (in cases where a quote is displayed on a financial instruments exchange in Japan, the last quote price).
5	Foreign share certificates, etc. set forth in n)	Closing price or quotation price (the price converted into Japanese yen at the foreign exchange rate designated by the trading participant

(iii) Security deposit Calculation

The amount of money to be deposited with a financial instruments business operator by a customer as a margin is calculated by deducting any amount of credit extended to the customer for a margin transaction in addition to the extension of credit equivalent to the contract price of the securities pertaining to the margin transaction (Security Deposit Ordinance, art. 5).

(Example)

The security deposit in a case where the contract amount is JPY20 million would be calculated as follows:

A) Where there is no existing share position (no committed securities):

Contract Amount (JPY20 million)	×	Security Deposit Ratio (30%)	=	Minimum Maintenance (JPY6 million)

The security deposit would be JPY6 million. If that entire amount is substituted with securities (assume listed share certificates with a cash conversion ratio (*daiyō kakeme*) of 80%), the minimum market price necessary for the share certificates would be computed as follows:

Minimum Share Maintenance (JPY6 million)	÷	Cash Conversion Ratio of Listed Share Certificates (80 %)	=	Minimum Market Price of Share Certificates (JPY7.5 million)

Thus, the security deposit required under this contract would be JPY6 million in cash or JPY7.5 million in securities (listed share certificates).

One can also calculate the total possible position(Note) using assets on hand.

(Note) In this section, this refers to a buy position or a sell position in margin transactions.

For example, if one has cash on hand of JPY4 million and listed share certificates with a market price of JPY10 million:

a. Cash conversion value of listed share certificates:

Market Price of Listed of Share Certificates on Hand (JPY10 million)	×	Cash Conversion Ratio of Listed Share Certificates (80 %)	=	Cash Conversion Value Margin Securities (JPY8 million)

b. The amount able to be allotted to margin:

Cash in Hand (JPY4 million)	+	Cash Conversion Value of Margin Securities (JPY8 million)	=	Security Deposit (JPY12 million)

c. Calculation of the total stock position that is possible from this security deposit:

Security Deposit (JPY12 million)	÷	Ratio of Security Deposit Collected (30%)	=	Total Possible Position (JPY40 million)

Therefore, the total share position that is possible is JPY40 million.

B) Where there is an existing share position (securities committed):

a. Cases where the security deposit received is insufficient to cover the existing position

When the security deposit received is insufficient to cover the existing position, the minimum maintenance can be computed using the formula described above (contract amount ×ratio of security deposit collected). That is:

Contract Amount	×	Ratio of Security Deposit Collected	=	Minimum Maintenance
(JPY20 million)		(30%)		(JPY6 million)

As in A) above, the security deposit would equal JPY6 million.

b. Cases where the security deposit exceeds the amount necessary to cover the existing share position

Even in cases where the security deposit is in excess of the amount needed to cover the existing position, the minimum maintenance can be computed using the basic formula described above (contract amount × ratio of security deposit collected).

Provided, however, that the excess security deposit may be allocated to the margin on a new position (this is often used in practice), and in such a case the amount to be collected is the amount after deducting the excess security deposit from the minimum maintenance:

Current Security Deposit (Note 1)	–	Valuation Loss (Note 2)	–	Margin Transaction Advances (Note 3)	=	Security Deposit Received
(JPY9 million)		(JPY1 million)		(JPY200,000)		(JPY7.8 million)

Security Deposit Received	–	Contract Amount of Existing Position (Note 4)	×	Security Deposit Ratio	=	Excess Security Deposit
(JPY7.8 million)		(JPY18 million)		(30 %)		(JPY2.4 million)

Minimum Maintenance	–	Excess Security Deposit	=	Amount to be Collected
(JPY6 million)		(JPY2.4 million)		(JPY3.6 million)

Now, the new total possible position can be calculated from this excess security deposit as follows:

Excess Security Deposit	÷	Ratio of Security Deposit Collected	=	Total Possible New Position
(JPY2.4 million)		(30 %)		(JPY8 million)

The new possible share position is JPY8 million.

(Notes) 1. Where margin securities are deposited, the current margin is the cash conversion value computed by multiplying their respective cash conversion ratios (*daiyō kakeme*) by the market

value as of the day immediately preceding the day on which such computation is made.

2. The valuation loss is computed by subtracting the market value as of the day immediately preceding the day on which such computation is made from the contract amount for the existing share position. However, if there are valuation gains on the other shares in the account, the valuation loss will be the amount net of such gains, and the total amount of any commissions, interest, broker loan rate, etc., other amounts charged to the customer. In the case of a net valuation gain, such amount cannot be added.
3. Amounts which remain unpaid after settlement concerning a margin transaction, etc.
4. Contract amount for existing share position obtained through an offsetting settlement (whose settlement date has not arrived) is excluded.

(iv) Variation Margin

When the total amount of security deposit received from a customer for a margin transaction declines in value to below 20% of the contract amount of all securities involved in the margin transactions conducted by the customer, a financial instruments business operator must require the customer to deposit an additional security deposit sufficient to maintain the said total amount of security deposit, by a date and time designated by the financial instruments business operator no later than the noon on the third business day counting from the day on which such loss amount is incurred (TSE Brokerage Agreement Standards, art. 48, para. 1). Such security deposit to be additionally deposited is referred to as variation margin, or generally a "margin call." The 20% in this case is called the minimum maintenance of the margin.

In cases where a customer files a request for settlement of an unsettled account subject to such computed loss by a date and time designated by the financial instruments business operator no later than the noon on the third business day counting from the day on which the implicit loss occurred (in cases of settlement by any method other than offsetting transactions, limited to cases where the financial instruments business operator received money or securities necessary for settlement from the customer), the financial instruments business operator may subtract an amount equivalent to 20% of the contract amount of securities for which such request for settlement was filed from the security deposit that must be additionally deposited (TSE Brokerage Agreement Standards, art. 48, para. 2).

In cases where a financial instruments business operator received from a customer of a margin of an amount equivalent to (i) losses from offsetting transactions pertaining to an unsettled account subject to the computed loss, and (ii) the amount to be borne by the customer pertaining to such unsettled account, by a date and time designated by the financial instruments business operator no later than the noon on the third business day counting from the day on which the implicit loss occurred, the financial instruments business operator may subtract these amounts from the security deposit that must be additionally deposited during the period before the settlement of such offsetting transactions (TSE Brokerage Agreement Standards, art. 48, para. 3).

Where any computed loss arises, a financial instruments business operator may require that the customer deposit an additional security deposit corresponding to that loss even if the total amount of security deposit received does not fall below the 20% minimum maintenance level (TSE Brokerage Agreement Standards, art. 47).

The formula for calculating the variation margin deposit is as follows:

Security Deposit Received − (Valuation Loss + Advances Coincidental to the Margin Transaction)
= Security Deposit Received Balance (A)
Contract Amount × Security Deposit Minimum Maintenance of 20%
= Security Deposit in cases of a 20% Minimum Maintenance (B)
Cases where a variation margin is required = (A) < (B)
Security deposit to be collected additionally (margin call) = (B) − (A)

(Sample Question) Customer A purchased on margin 10,000 shares of Company B at JPY1,000 per share, and submitted an initial cash margin of JPY3 million. Thereafter, a valuation loss of JPY2 million arose with respect to the Company B shares due to market fluctuations. What is the amount of variation margin Customer A must submit?

Security Deposit Received (JPY3 million) – Valuation Loss (JPY2 million) = Security Deposit Received Balance (JPY1 million)

Contract Amount (JPY10 million) × 20% = Security Deposit Required for Minimum Maintenance (JPY2 million)

Security Deposit Required for Minimum Maintenance (JPY2 million) – Security Deposit Received Balance (JPY1 million)

= Variation Margin Amount (JPY1 million)

Answer: Variation Margin Amount = JPY1 million

(v) Withdrawal, Etc. of Margin

A security deposit not only functions as the collateral for an extension of credit, but also as security against any loss amounts, and as such, in the past, the money or securities deposited as margin could not, in principle, be withdrawn or used as a security deposit to new margin transactions before the settlement day of the open stock position.(Note) However, following the revision to the Security Deposit Ordinance and the TSE Brokerage Agreement Standards, it is now possible to withdraw a security deposit before the settlement day. This dramatic change has greatly increased efficiency in raising funds for margin transactions.

Specifically, with regard to money or securities which have been received from a customer as a security deposit pertaining to a margin transaction, a financial instruments business operator is now able to allow the customer to withdraw money or securities up to the amount obtained by subtracting (A) an "amount equivalent to 30% of the contract amount of all securities pertaining to the margin transactions of the customer (or JPY300,000 if such amount is less than JPY300,000)" from (B) the "total amount of security deposit received pertaining to the margin transaction of the customer" (Security Deposit Ordinance, art. 7, para. 1; TSE Brokerage Agreement Standards, art. 44, para. 1).

With regard to money or securities which have been received from a customer as a security deposit

pertaining to a margin transaction, a financial instruments business operator may allow the customer to withdraw such money or securities only in the following cases (Security Deposit Ordinance, art. 7, para. 2; TSE Brokerage Agreement Standards, art. 44, para. 2):

a. In cases of partial settlement pertaining to an unsettled account (limited to cases of withdrawing an amount equivalent to the amount obtained by subtracting B) from A) as mentioned above);
b. In cases of partial settlement of unsettled accounts (excluding settlement by offsetting purchase or sale), subject to deposit of all securities purchased, or all money equivalent to the sales proceeds of securities sold, via the margin transaction pertaining to such unsettled accounts to be settled, as a security deposit pertaining to a margin transaction (limited to cases where B) is equal to or larger than A));
c. In cases of settling all unsettled accounts; or
d. In cases of replacing such money or securities in whole or in part.

Furthermore, when a financial instruments business operator conducts a new margin transaction for its customer, it may allocate money or securities that have already been deposited from the customer as a security deposit pertaining to a margin transaction, to the amount of money or securities which should be deposited as a security deposit pertaining to such new margin transaction, up to the following amount obtained by subtracting (Security Deposit Ordinance, art. 7, para. 3; TSE Brokerage Agreement Standards, art. 44, para. 3)

A) an amount equivalent to 30% of the contract amount of all securities pertaining to the margin transactions of the customer; and B) if the amount of security deposit that should be deposited is less than JPY300,000 (the amount mentioned in A)), the difference between this amount and JPY300,000); from: C) the total amount of security deposit received pertaining to the margin transaction of the customer.

Accordingly, it is now possible to conduct margin transactions many times during one day by depositing only a single security deposit. Thus, investors, especially those called day traders, can leverage their limited amount of money and enjoy more opportunities and convenience in relation to their investment.

It is prohibited to withdraw money or securities in an amount equivalent to a computed profit arising due to market fluctuations or use the amount of such computed profit as a margin for other open stock positions (Security Deposit Ordinance, art. 9; TSE Brokerage Agreement Standards, art. 46).

(Note) This is the number of contracts that are unsettled in margin transactions, which is referred to as an open position. This consists of buy positions, otherwise known as open buy positions, which are unsettled purchases in margin transactions, and sell positions, otherwise known as open sell positions, which are unsettled sales in margin transactions.

(3) Loans and Interest in Margin Transactions

(i) Extension of Credit (Loans)

Following a customer application, the actual extension of credit by a financial instruments business operator takes place on the settlement (delivery) date, the third business day counting from the date the trade was concluded. Thus, on the settlement date for the transaction, share certificates or their purchase price are loaned to the customer. The loan is not made based on the net amount of the contract price minus the security deposit submitted to the financial instruments business operator by the customer, but on the contract price for the transaction or the said securities sold (TSE Brokerage Agreement

Standards, art. 41, para. 1).

Also, the loaned share certificates or the purchase price are not physically handed over to the customer; instead, the financial instruments business operator stands in place of the customer and advances the share certificates or purchase price on the delivery date for the transaction, and makes delivery via (the JSCC which is the financial instruments clearing center that is designated by) the stock exchange (TSE Clearing and Settlement Regulations, art. 3 and art. 4).

When a customer is a buyer in the delivery settlement (borrows the purchase price), he or she receives the purchased share certificates, and where a customer is a seller (borrows share certificates), he or she receives the proceeds from their sale. Again, however, these are not directly delivered to the customer, but the financial instruments business operator holds the loaned moneys or shares as collateral. This means that the loan between the customer and the financial instruments business operator is secured by both the security deposit initially deposited and the purchased share certificates or sales proceeds (TSE Written Agreement for Establishment of a Margin Transaction Account, art. 4).

(ii) Margin Interest, Margin Share Lending Premium and Broker Loan Rates

In cases where a customer receives an extension of credit from a financial instruments business operator (conducts a margin transaction), he or she receives/pays the interest rate or margin share lending premium calculated at the rate determined by the financial instruments business operator (TSE Document Delivered Prior to Conclusion of a Contract for Margin Transaction (sample form)). Also, when a securities finance company has a shortage of issues for loans for margin transactions (a condition where its loaned shares exceed its borrowed shares in its loan transaction balances), and procures those share certificates with an interest expense, the customer will receive/pay the interest at the broker loan rate (TSE Margin/Loan Trading Regulations, art. 8; TSE Brokerage Agreement Standards, art. 41, para. 2).

a) Interest

A customer who purchases shares on margin (buyer) will pay interest to the financial instruments business operator on the loan of the purchase price, and a customer who sells shares on margin (seller) will receive interest from the financial instruments business operator on the sales proceeds. The interest for standardized margin transactions was uniformly prescribed on the exchange, but starting in 1999, interest rates on margin loans have been totally deregulated, and like negotiable margin transactions, the financial instruments business operator and the customer are free to determine the interest rate upon agreement.

b) Margin Share Lending Premium

Margin share lending premium was introduced in May 2002 for the purpose of maintaining a fair distribution of premiums between sellers and buyers. A margin share lending premium is a payment from a seller to a financial instruments business operator representing the expense incurred in connection with borrowing shares, and not to a buyer unlike the broker loan rate. Under the rules of the JSF, this is referred to as “interest on loans for loan transactions” (JSF Loan Transaction Lending Regulations, art. 23, para. 3).

c) Broker Loan Rate (Premium)

In a loan transaction between a financial instruments business operator and securities finance company, an issue in which the number of shares loaned (open sell position) is greater than the number of shares on which funds are borrowed (open buy position) is called an excess lending issue (on financial instruments exchange markets established by the TSE and at PTSs, an “excess lending issue” is an issue

in which the total number of shares loaned as calculated by aggregating the number of shares loaned on each financial instruments market is greater than the total number of shares on which funds are borrowed as calculated by aggregating the number of shares borrowed on each financial instruments market). The securities finance company will endeavor to rectify this situation with respect to the excess lending issue (hereinafter referred to as the "shortage") by having the financial instruments business operator make additional borrowing, or by receiving the repayment of shares loaned, etc. However, if the shortage still cannot be rectified, the securities finance company will procure the shares by paying the broker loan rate to a third party to complete the loan. This broker loan rate is generally called the "per diem premium" (*gyakuhibu*).

The broker loan rate is calculated in terms of *sen* (1/100 of JPY1) per share, collected from the seller (open sell position) and paid to not only the party from whom the shares were procured, but also the buyer (open buy position).

The receipt/payment of the broker loan rate arising from the loan transaction, and also with respect to the margin position, is collected from the customer who borrowed shares (open sell position) at a rate equal to the broker loan rate, and paid to the customer who borrowed the purchase price (open buy position) (TSE Margin/Loan Trading Regulations, art. 8; TSE Brokerage Agreement Standards, art. 41, para. 2; JSF Loan Transaction Lending Regulations, art. 23, para. 5).

In a negotiable margin transaction, the broker loan rate can be determined freely between the financial instruments business operator and the customer.

d) Procedures for Determining the Broker Loan Rate

The broker loan rate is determined on the day following the date of the loan transaction application, and the required procedures (performed the day following the date of the loan transaction application) are described below (in the case of JSF).

With regard to an excess lending issue, JSF will announce the number of excess shares of stock (on financial instruments exchange markets established by the TSE and at PTSs, the "number of excess shares of stock" is the number of shares by which the total number of shares loaned as calculated by aggregating the number of shares loaned on each financial instruments market is greater than the total number of shares on which funds are borrowed as calculated by aggregating the number of shares borrowed on each financial instruments market) by the start of the morning session on the exchange on the day following the date of the application (JSF Loan Transaction Lending Regulations, art. 14, para. 2 and para. 4, JSF Handling of Excess Lending Issues in Loan Transactions).

With respect to an excess lending issue, financial instruments business operators can make an additional application for return of the borrowed shares or make an additional application for financing from 8:30AM to 10:00AM on the following day (JSF Handling of Excess Lending Issues in Loan Transactions). In this case, a broker loan application for financial instruments exchange markets established by the TSE and PTSs should be made concurrently along with those additional applications. If the shortage is rectified by this additional application, the phrase "full amount" (a condition where the number of shares loaned is the same as the number of shares on which funds are borrowed) will be displayed.

Broker loan applications are accepted at a broker loan rate which does not exceed the maximum rate specified in the "Maximum Rate Table" shown below (per share; hereinafter the same except for the "broker loan rate (per investment unit)" in the below table). However, in the bidding of share loan

applications for issues for which a notice of caution has been issued or for which loan applications have been restricted or suspended, as well as for share loan applications placed after 9:30AM, the premium charge shall be JPY5 or more per share (for issues whose trading unit (meaning the trading unit designated by the TSE; hereinafter the same) is not one share, the premium charge should be set no higher than the value calculated by dividing JPY5 by the trading unit, and if this value is less than 5 *sen,* the premium charge should be 5 *sen*).

The broker loan rate should be JPY5 per share (for issues whose trading unit is not one share, the premium charge should be set no higher than the value calculated by dividing JPY5 by the trading unit, and if this value is less than 5 *sen,* the premium charge should be 5 *sen*).

Broker loan applications and additional applications shall be allocated to the excess lending shares in the following order:

(i) Additional applications for repayment of loaned shares and additional applications for loans—Appropriations are made in the order of application.

(ii) Applications for broker loans—Those with the lowest premium charges should be appropriated first. Where the premium charges are the same, then the appropriations are made in the order of application. If the applications have been made at the same time, then the order of application is made by drawing lots and all orders accepted prior to 9:30AM are considered to have been made at 9:30AM.

Where the number of shares needed to fill the broker loan applications for an issue has been met at a broker loan rate of not more than JPY50 per share (and in the event of issues that have a trading unit of other than one share, this shall be the amount obtained by dividing by the trading unit, and if this amount is 50 *sen* or less it shall be 50 *sen*), the highest of the broker loan rates assigned to the applications becomes the broker loan rate for that issue.

Where the necessary shares cannot be procured by broker loan applications, the closing time for applications is extended until 10:30AM, and a premium charge of more than JPY50 per share shall be collected. If the necessary shares are successfully procured by broker loan applications, the highest of the broker loan rates assigned to the applications becomes the broker loan rate for that issue.

If it is still not possible to procure the necessary shares, or if it is believed to be appropriate to procure some or all of the necessary shares without using the methods mentioned above, the broker loan rate in connection with the relevant shares will be set at the highest rate set forth below (for details, see "(Ref.) Issues that Increase Magnification of the Maximum Rate" below). In this event, JSF will in connection with the quantity of the shortfall in the necessary shares procure the share certificates using separate negotiations with voluntary transaction counterparties, or another method, while working in close cooperation with the exchange, etc.

If it is still impossible to procure the necessary share certificates, even by taking these measures, JSF may extend the deadline for an application for broker loans and that for an application for the repayment of loaned shares (JSF Handling of Excess Lending Issues in Loan Transactions).

[Maximum Rate Table]

I. Share Certificates, Preferred Equity Investment Certificates, J-REITs, Infrastructure Funds, Foreign Share Certificates, Country Funds, Depository Receipts of Shares, Etc.

Investment Unit (Loan Price×Trading Unit)	Not More Than JPY50,000	Over JPY50,000
Maximum Broker Loan Rate (per investment unit)	JPY100	JPY100 plus JPY20 for each complete multiple of JPY10,000 over JPY50,000

The rate that is the maximum broker loan rate on the investment unit in the table above divided by the trading unit shall be the maximum of the broker loan rate per share (the maximum lending rate). If the maximum broker loan rate is JPY1.00 or less, the said rate shall be JPY1.00, and if the calculated maximum broker loan rate is over JPY1.00, the said rate shall be rounded up to an integral multiple of JPY0.1.

II. ETFs, Etc. (Excluding Infrastructure Funds)

Investment Unit	Not More Than JPY10,000	More Than JPY10,000 and Not More Than JPY50,000	Over JPY50,000
Maximum Broker Loan Rate (per investment unit)	JPY60	JPY60 plus JPY10 for each complete multiple of JPY10,000 over JPY10,000	JPY100 plus JPY20 for each complete multiple of JPY10,000 over JPY50,000

The rate that is the maximum broker loan rate on the investment unit in the table above divided by the trading unit will be the maximum lending rate. If the maximum broker loan rate is JPY0.6 or less, the maximum lending rate will be JPY0.6, and if the calculated maximum broker loan rate is over JPY0.6, the maximum lending rate will be rounded up to an integral multiple of JPY0.1.

(Ref.) Issues that Increase Magnification of the Maximum Rate

Applicable Conditions		Applicable Magnification	Applicable Period
(i)	Issues for which a date of ex-dividends or ex-rights has been determined, or issues that JASDEC(Note 1) has given notice to all shareholders pursuant to the Act Concerning Book-Entry Transfer of Bonds, Shares, Etc. in connection with share certificates that will be handled in the book-entry transfer services.	I, II 2	Loan request portion that is made from 6 business days through 2 business days prior to the applicable date(Note 2).
		I, II 4	Loan request portion that is made on the business day immediately preceding the applicable date(Note 2).
(ii)	Issues for which a notice to beneficial shareholders of foreign share certificates, etc. has been made pursuant to the "Regulations Concerning Custody and Book-entry Settlement of Foreign Share Certificates, Etc." of JASDEC in connection with foreign share certificates or deposited securities handled by JASDEC in its services with respect to custody and book-entry settlement of foreign share certificates, etc. (excluding (i))	I, II 2	Loan request portion that is made from 6 business days through 2 business days prior to the applicable date(Note 3).
		I, II 4	Loan request portion that is made on the business day immediately preceding the applicable date(Note 3).
(iii)	Issues for which a caution has been issued in connection with the use of loan shares, etc.	I, II 2	The loan request portion from the day following the notice date to the date on which such caution is revoked.
(iv)	Issues for which a restriction or suspension of offer of loan transactions has been made.	I, II 2	The loan request portion from the effective date through the day before the day on which the restriction or suspension is lifted
Issues which meet the conditions under (i) or (ii), and (iii) or (iv).		2 of (i) or (ii)	The period of (i) or (ii) plus the relevant period of (iii) or (iv).
Where there is a risk that the difficulty in procuring loaned share certificates could interfere with the delivery settlement.		I, II 10	The period of the emergency action.
Where due to extreme fluctuation in market conditions of shares or sudden shortages of shares, there are excess lending issues with highly excessive share loans, or where there is such a risk.		I, II 4	The period of the emergency action.
Excess lending issues with extremely excessive share loans, or where there is such a risk.		I, II 10	The period of the emergency action.

(Notes) 1. Japan Securities Depository Center, Inc.
2. Meaning the date of becoming ex-dividends or ex-rights for regular transactions, or the business day preceding the date relevant for the purpose of determining the shareholders in connection with the notice to all shareholders.
3. Meaning the business day preceding the date relevant for the purpose of determining the beneficial shareholders of foreign share certificates, etc.

e) Calculation Period for Interest, Margin Share Lending Premium and the Broker Loan Rate

The calculation period for interest, margin share lending premium and the broker loan rate is: a) in the case of interest and margin share lending premium, the computation is made for the period from the delivery date that is the third business day counting from the date on which a new transaction is effected, through the delivery date that is the third business day counting from the date on which a transaction for

repayment is effected, including the first and last days; b) in the case of broker loans, the computation is made for the accumulated broker loan rates during the period from the delivery date that is the third business day counting from the date on which a new transaction is effected, to the day preceding the delivery date that is the second business day following the date on which a transaction for repayment is effected (TSE Brokerage Agreement Standards, art. 42; JSF Loan Transaction Lending Regulations, art. 23).

The computation method of the interest and broker loan rate is as follows:

$$\text{Interest Rate} = \frac{\text{Contract Amount} \times \text{Number of Days} \times \text{Annual Rate}}{365} \quad \text{(Fractions less than JPY1 are rounded off)}$$

$$\text{Margin Share Lending Premium} = \frac{\text{Contract Amount} \times \text{Number of Days} \times \text{Annual Rate}}{365} \quad \text{(Fractions less than JPY1 are rounded off)}$$

$$\text{Broker Loan Rate} = \text{Accumulated Broker Loan Rates During the Calculation Period} \times \text{Number of Shares}$$

(4) Term and Settlement of Margin Transactions

(i) Deferral of Open Share Position in Margin Transactions

The repayment date for a loan of share certificates sold or the purchase price in a margin transaction is the day following the day of lending (meaning the delivery date that is the third business day counting from the contract date), and if the customer does not give notice for repayment to the financial instruments business operator two business days prior to such date (the day following the contract date), the repayment date will be deferred for each day (except for non-business days of the exchange) for which such notice is not given.

Provided, however, that in the case of standardized margin transactions, the repayment date cannot be deferred beyond the third business day counting from the corresponding day in the sixth month from the date the underlying transaction was concluded. When there is no such corresponding day, the last day of the month, or in the case of a holiday, the previous business day shall be the repayment date (TSE Brokerage Agreement Standards, art. 43).

Finally, in the case of a negotiable margin transaction, the customer and financial instruments business operator can freely set the repayment date, without regard to the six-month limitation used for standardized margin transactions.

(ii) Repayment (Settlement) Methods in Margin Transactions

Customers may repay their open sell positions or open buy positions in margin transactions through offsetting settlement (net cash settlement) or delivery settlements (delivery of equivalent shares borrowed or delivery of cash on hand).

a) Offsetting Settlement

This is a method whereby a customer repays using share certificates by repurchasing share certificates sold for an open sell position (new sale) (as discussed in a. below), or repays using cash

acquired through the resale of shares purchased for an open buy position (new buy) (as discussed in b. below), and the difference is paid or received.

b) Methods Using Delivery Settlement

This is a method whereby a customer delivers actual shares (*genwatashi,* delivery of equivalent share certificates on hand) for an open sell position (new sale) (as discussed in c. below) and receives their sales proceeds collateralized, or pays equivalent cash (*genbiki,* delivery of cash on hand) for an open buy position (new buy) (as discussed in d. below) and receives share certificates collateralized.

Furthermore, when repayment is performed, the liquidation amounts will be computed in the following manner, with delivery taking place on the third business day counting from the date of notice of repayment:

a. Where shares for the short position are repurchased
   Gain/Loss − Brokerage Commission (including an amount equal to the Consumption Tax) + Interest − Margin Securities Lending Premium − Broker Loan Rate = Net Amount Received/Paid
b. Where shares for the long position are resold
   Gain/Loss − Brokerage Commission (including an amount equal to the Consumption Tax) − Interest + Broker Loan Rate = Net Amount Received/Paid
c. When shares for the short position are repaid through delivery of equivalent shares borrowed
   Sale Price − Brokerage Commission (including an amount equal to the Consumption Tax) + Interest − Margin Securities Lending Premium − Broker Loan Rate = Net Amount Received
d. Where shares for the long position are repaid through delivery of cash on hand Purchase Price + Brokerage Commission (including an amount equal to the Consumption Tax) + Interest − Broker Loan Rate = Net Amount Paid

In addition to the above, a management fee (margin transaction management fee or administrative fee) is incurred separately, for handling both open buy and open sell positions, every month from the new contract date, which is to be paid upon total settlement. The amount of this fee ranges from JPY110 to JPY1,100 (inclusive of consumption tax at 10%), but there is no need to pay it if the transaction is settled within one month from the contract date.

(5) Financial Instruments Business Operators and Securities Finance Companies

(i) Functions of Securities Finance Companies

In order for margin transactions to realize their full potential, ample funds and share certificate reserves are necessary, but since financial instruments business operators cannot fully satisfy this demand with their own funds and share certificates on hand, they must borrow either funds or share certificates.

As a result, securities finance companies were established as specialist institutions to efficiently supply financial instruments business operators with the necessary funds and share certificates for margin transactions.

(ii) Definition of a Securities Finance Company

A securities finance company is a special financial institution under the FIEA, licensed by the Prime Minister to engage in the business of lending financial instruments business operators funds or share certificates necessary to settle margin transactions, through the settlement mechanism built in the exchange (FIEA, art. 156-24).

A notification must be filed with the Prime Minister if determination or amendment of the conditions of loans for funds or securities is desired (FIEA, art. 156-28, para. 2). Moreover, the Prime Minister shall order an amendment thereto in a case such as when it is recognized that these terms have become inadequate in view of general economic conditions (FIEA, art. 156-29), and a notification system for concurrent businesses has also been implemented (FIEA, art. 156-27, para. 1 and para. 2).

(iii) Loans of Securities Finance Companies (Loan Transactions)

Loans to financial instruments business operators from a securities finance company in standardized margin transactions are called loan transactions.

The firms that can utilize the loans in relation to standardized margin transactions from JSF, which is a securities finance company, are limited to the following: financial instruments business operators that are trading participants or members of the exchange (hereinafter referred to as "financial instruments business operators"); customers of financial instruments business operators approved to operate PTSs; financial instruments business operators entrusted by non-clearing participants to conduct financial instruments market transactions through brokerage for clearing of securities, etc.; and registered financial institutions entrusted by non-clearing participants to conduct financial instruments market transactions through brokerage for clearing of securities, etc. (JSF Loan Transaction Lending Regulations, art. 1). When financial instruments business operators transact with JSF, they must submit a written agreement in advance. A person who has submitted a written agreement is referred to as a loan trading participant. Among loan trading participants, financial instruments business operators and registered financial institutions: both of which are entrusted by non-clearing participants to conduct financial instruments market transactions through brokerage for clearing of securities, etc. must submit to the JSF in advance a "written agreement on loan transactions, etc. through brokerage for clearing" provided separately (JSF Loan Transaction Lending Regulations, art. 2).

In order to receive a loan, financial instruments business operators must apply to JSF for the issue, number of shares, and other requisite matters by the prescribed time on a day at least two business days prior to the day on which they intend to receive the loan (JSF Loan Transaction Lending Regulations, art. 7). As a general rule, applications are made online (entry of the requisite items).

The loan price is determined based on the closing price on the application date (the day two business days prior to the lending date) (JSF Loan Transaction Lending Regulations, art. 15; JSF, Criteria for Determining the Loan Price). Credit amounts and loan share substitution amounts (the amount equivalent to the market price of the share certificates to be received in a broker loan) are computed by multiplying this price for lending/borrowing by the number of shares in the loan application (JSF Loan Transaction Lending Regulations, art. 19).

Finally, if a financial instruments business operator intends to repay cash or share certificates, etc. that it has been loaned in a loan transaction, an application for the issue, the number of shares of the relevant issue, and other requisite matters must be submitted to JSF by the prescribed deadline on the repayment application date (the day two business days prior to the repayment date) (JSF Loan Transaction Lending Regulations, art. 8).

(iv) Loan Collateral

Financial instruments business operators must submit the loan collateral computed by multiplying a certain percentage (30% as of October 2020) by the amount of the lending securities or loan amounts by noon on the date of the loan (JSF Loan Transaction Lending Regulations, art. 18, para. 1). Margin securities may be used in lieu of loan collateral (JSF Loan Transaction Lending Regulations, art. 18, para. 2).

Furthermore, since the loan collateral and the security deposit by the customer with the financial instruments business operators are similar in nature, if the stock exchange amends the minimum maintenance or cash conversion ratio (*daiyō kakeme*) as a restrictive measure for margin transactions, JSF will implement similar restrictive measures for loan transactions (collection of an increased loan collateral, restriction or suspension of loans, or a request for repayment of cash or share certificates, etc. that have been loaned) (JSF Loan Transaction Lending Regulations, art. 4 and art. 18, para. 4).

Money or share certificates loaned are not directly exchanged between the financial instruments business operators and JSF, all transactions are conducted coincidental to settlement of regular transactions through the clearing organization on the exchange, and the loan is executed on the delivery date (JSF Loan Transaction Lending Regulations, art. 16).

Loan trading participants (financial instruments business operators) who receive a loan of cash provide share certificates, etc. equivalent to the amount being lent (loan collateral share certificates, etc.), and loan trading participants who receive a loan of share certificates provide an amount of money equal to the price of the share certificates being lent (proceeds of lending shares, etc.), together with the loan collateral, to JSF, which holds them (JSF Loan Transaction Lending Regulations, art. 19, para. 1).

JSF may at its discretion lend the loan collateral share certificates, etc. that have been deposited, or provide the same as collateral, or may exercise the rights stated on the share certificates, etc. (JSF Loan Transaction Lending Regulations, art. 19, para. 2).

A loan transaction with a loan trading participant is based on the loan price on the application date, and since the day following the loan date is fixed as the loan transaction repayment date, if the loan trading participant does not apply for the repayment, it is processed automatically as if the loan trading participant had applied for repayment and simultaneously been granted a new loan. Therefore, even if no loan application is made, if the loan price changes, the net difference (updated difference or updated difference on broker loan) will still be exchanged with the loan trading participant (JSF Loan Transaction Lending Regulations, art. 17). This daily modification of the cash and lending securities at the loan price, and the exchange of the net difference, is referred to as a "mark to market."

In other words, when the loan price increases, financial instruments business operators that received a cash loan (buyers) will be delivered the difference over the loan price multiplied by the number of shares (amount equivalent to the price increase gain) as a loan increase, and money equal to the difference between the loan price multiplied by the number of shares (amount equivalent to the price increase loss) will be collected as additional proceeds of lending shares, etc. from the financial instruments business operators that received a loan of lending securities (sellers). Conversely, when the loan price is decreased, the reverse operation is performed for all loan transactions.

The intent of the mark to market is to prevent losses due to settlement default in addition to do away with burdensome computations by settling computational gains and losses on a daily basis.

(6) Treatment of Rights in Margin Transactions

During the loan relationship in margin transactions between financial instruments business operators and customers, or between financial instruments business operators and JSF, the share price may occasionally drop due to (i) ex-dividends, or (ii) the grant to the shareholder of rights to receive shares, etc. through a share split, etc. or rights in share options, etc. (hereinafter collectively referred to as the "right to receive shares through a share split, etc."); however, since this decrease is due to special factors, the gain or loss of a seller and buyer should be adjusted

accordingly through appropriate treatment.

(i) Ex-Dividends

Where shares in a customer's open sell position (sell side) or open buy position (buy side) go ex-dividend before the position is settled (when a new share position has been created but not settled), the financial instruments business operator will collect the amount equal to the after-tax dividend amount as the ex-dividends adjustment amount from the sell side (margin selling customer) after the dividend (a dividend from retained earnings) to be paid by the issuing company is fixed, and pay it to the buy side (margin buying customer) (TSE Rules for Treatment of Rights Pertaining to Standardized Margin Transactions, art. 2, para. 1). The reason for this payment is that the customer (sell side) would have received the dividends on those shares if they had not been loaned by the financial instruments business operators, and when the customer later physically delivers those shares or returns share certificates acquired through an offsetting transaction, the shares will decline in value by the dividend amount, requiring the sell side to compensate that portion.

The buy side receives the ex-dividends adjustment amount because even though it submitted the purchased share certificates to the financial instruments business operators as collateral, it has the right to receive dividends paid on the shares. Later, at the time of repayment, the sell side will have a gain due to the decline in value by an amount corresponding to the dividend payment, and the buy side will have a loss of the difference due to the ex-dividends, resulting in an offset of loss and gain between the parties.

This relationship is similar to the one between JSF and loan trading participants under Loan Regulations: the rights attached to the share certificates purchased through a loan belong to the loan trading participant who received financing, and the loan trading participant that borrowed the shares is obligated to present such rights to JSF. However, such rights may be treated as otherwise provided based on an agreement with the exchange, etc. (JSF Loan Transaction Lending Regulations, art. 20).

(ii) Right to Receive Shares Through a Share Split, Etc.

In cases where a financial instruments business operator continues to loan money or share certificates in a standardized margin transaction to a customer, and the securities have attached the right to receive shares through a share split, etc. (or in cases where shares for the customer's open sell position or open buy position go ex-rights before settlement), in principle the financial instruments business operator shall pay to the customer purchasing on margin, as of the allocation date of the right to receive shares as a result of a share split, etc. in the issues, cash in the amount equivalent to the value of the right to receive the shares from a share split, etc. as prescribed by the exchange (hereinafter referred to as the "right treatment value"), and collect the same from the customer selling on margin. This cash amount shall be in accordance with the amount of the right treatment value deducted from the contract price (the right treatment value will be delivered by deducting the right treatment value from the purchase proceeds lent in connection with the standardized margin transaction for the customer purchasing on margin, and such value will be collected by deducting the right treatment value from the sale proceeds that are the collateral for the standardized margin transaction for the customer selling on margin) (TSE Rules for Treatment of Rights Pertaining to Standardized Margin Transactions, art. 4).

Also, if the repayment date for securities under a standardized margin transaction with the attached right to receive shares through a share split, etc. falls after the allotment date for the said right to receive shares through a share split, etc., the receipt/delivery of share certificates is carried out with ex-rights share certificates (TSE Brokerage Agreement Standards, art. 49 and art. 50). If new shares are added in an integer multiple of the trading unit, the quantity of shares offered for sale or purchase will increase in accordance with

the allocation ratio, and the contract price will decline.

If an allocation of new shares is made that is not in an integer multiple of the trading unit, the treatment method will be handled as below:

a) Treatment of Shares for the Open Sell Position

If shares for the open sell position go ex-rights before they are settled, a customer will be deemed to have paid an amount equal to the new share premium by subtracting the right treatment value from the contract price, and instead, the customer does not have to make repayment of the right to receive shares through a share split, etc. attached to the borrowed shares. However, the customer cannot deliver the new shares received in a capital increase in kind and receive the right treatment value with shares for the open sell position.

b) Treatment of Shares for the Open Buy Position

If shares for the open buy position go ex-rights before they are settled, there are two methods for adjusting the loan: the "subscription to new shares, etc." and "cash settlement."

a. Subscription to New Shares, Etc.

"Subscription to new shares, etc." can be said to be an application to receive rights in kind (receipt of the actual securities) when a customer wishes to acquire the right, etc. to receive shares of stock by way of a share split, etc. that is allocated to purchased shares of stock that have been deposited with the financial instruments business operators. Stated differently, the customer pays an amount of money equal to the right treatment value (repayment) correspondingly reducing the purchase price (borrowed funds) in exchange for acquiring the rights.

The buy side customer who desires to subscribe to new shares, etc. may apply to the financial instruments business operators for new shares up to the number of shares in the open buy position. The financial instruments business operators must then apply to JSF by the prescribed deadline on the final day of trades with the rights (the deadline for applications from customers of financial instruments business operators may be accelerated by the time needed for the financial instruments business operators to complete procedures for the application to JSF).

When the number of shares applied for exceeds the new share issue, the number of shares allotted will be prorated in accordance with the number of shares applied for, and although new shares may not be allotted due to the transactional structure (the status of the buy side and sell side including the respective volumes and ratios of their outstanding balances), customers cannot raise an objection in such cases. If the shares to be allotted to the shares in the position (including share positions allotted on a pro rata basis) are odd-lot shares, new share certificates will not be issued, and, consequently, the new share certificates cannot be subscribed.

Accordingly, in some cases, the subscription to new share rights, etc. and cash settlement methods may occur simultaneously for the same share positions. When the rights are allotted, the customer must pay to the trading participant the price of new share subscription rights (right treatment value × number of old shares) on the third business day counting from the ex-rights date. Where the "subscription to rights" method is not used, the transaction will be processed entirely through cash settlement (TSE Rules Concerning the Treatment of Rights Pertaining to Standardized Margin Transactions; JSF Guidelines for Treatment of Rights to Receive Shares through Share Split, etc. in Loan Trading).

b. Cash Settlement

Cash settlement means that a customer orders the sale of the right to receive shares through a share split, etc. allotted to the purchased shares, and uses the sales price (right treatment value) to repay part of the purchase price (borrowed funds).

While the customer cannot acquire the right to receive shares through a share split, etc., the customer is able to have the amount of the loan reduced accordingly (the amount equal to the new share premium).

c) Treatment at JSF

Treatment at JSF is provided for in the "Guidelines for Treatment of Rights to Receive Shares through Share Split, etc. in Loan Trading."

The foregoing relationship is similar to the one between loan trading participants and JSF. JSF will accept applications from loan trading participants that borrowed shares to accept the new shares up to the number of borrowed shares until the final cum rights date for the new shares delivered to JSF by the issuing company with respect to its lending excess. When the number of shares applied for exceeds the number of the shares delivered, JSF makes a prorating in accordance with the number of shares applied for.

Similar to what occurs between financial instruments business operators and the customers, if new shares to be allotted to the borrowed shares are odd-lot shares, applications to subscribe for the new shares will not be accepted. If the number of shares applied for is fewer than the number of shares to be allotted, JSF conducts an auction for the remaining shares.

The payment or receipt of the price for the preemptive subscription rights is conducted at the same time as the exchange of the updated difference of the loan price on the ex-rights date.

With regard to complimentary tickets for shareholders and other benefits conferred to shareholders, JSF provides in its Guidelines that voting rights at a shareholders meeting, shareholder's right to inspect account books, complimentary ticket for shareholders, and any other benefits accompanying securities involved in loan transactions shall not be treated as rights of shareholders.

(7) Regulations on Margin Transactions

The margin transaction system aims to create supply and demand for securities through a loan of either the purchase price or share certificates necessary to settle a trade, thereby contributing to improving market functions such as smooth stock circulation and fair price formulation. Although the structure is set as a simple lending and borrowing transaction, it results in the creation of credit through the system of crossing orders, and combined with the loan repayment term and the long and short interests in the market and speculation on the prepayment trends, it can strongly influence share prices. For this reason the exchanges carry out the following administration in order to promote the sound operation of the margin transaction system. The JSDA rules provide for self-restraint in solicitation of restricted issues and the obligation to explain upon acceptance (for details, see this Chapter, 3-1(4) (iv) "B. Checks for Regulations on Margin Transactions").

(i) Establishment and Operation of Guidelines (Daily Quotation Standards)

In order to prevent excessive usage, etc. of margin transactions, daily quotation standards are established. The exchange designates those issues which it determines as being covered by the standards to be "daily quotation issues" and announces these together with the margin transaction balance.

(ii) Issue under Trade Monitoring System and Daily Announcement of Margin Transaction Balance

Together with entry into force of the "System of Disclosure of Large Volume Holding of Share Certificates, Etc." (the so-called 5% rule) (FIEA, art. 27-23), the TSE implemented the issue under trade monitoring system, and where an issue is designated through this system (hereinafter referred to as "issues under trading monitoring") and can be used for margin transactions, the margin transaction balance for such issue is announced daily (TSE Rules Concerning an Issue under Trade Monitoring, art. 2, and art. 4, para. 2).

(iii) Regulations on Margin Transactions

When there are abnormal situations, such as radical fluctuations in share price due to excessive use of margin transactions, correctional measures, such as an increase in the security deposit ratio or increased collateral requirements, are taken. In addition, measures may be taken to flexibly restrict or suspend margin transaction sales or purchases depending on the situation.

These regulations are imposed by the TSE's regulatory measures (TSE Business Regulations, art. 65; Rules on Regulatory Measures Concerning Securities Trading, etc. or Its Brokerage) and the "Guidelines Concerning Measure to Raise the Security Deposit Ratio, etc.":

a) Raising the Security Deposit Ratio or Restrictions on the Substitution of Securities

This involves raising the security deposit ratio for all issues or a particular issue, and collecting an additional security deposit. Alternatively, financial instruments business operators may be required to collect all or part of the security deposit in cash (referred to by terms such as cash collateral, cash deposit, or collateral cash deposit, hereinafter referred to as the "cash collateral").

There are four stages of measures to raise the security deposit ratio. The primary measure is to raise the ratio by the following values, and the secondary and subsequent measures are to further raise the ratios by the same values (TSE Guidelines Concerning Measure to Raise the Security Deposit Ratio, etc.):

Security deposit ratio: 20%

Of which, cash collateral: 20%

b) Lowering the Cash Conversion Ratio of Margin Securities

This involves modifying the cash conversion ratio (*daiyō kakeme*) of margin securities.

c) Deposit of Cash Collateral

This involves trading participants making a deposit to the TSE in cash in the amount equivalent to some or all of the cash collateral if restrictions have been imposed on substituting securities for a security deposit.

d) Restriction or Prohibition on Selling or Purchasing through Margin Transactions

This involves the outright restriction or prohibition on margin transactions (TSE Business Regulations, art. 65; Rules on Regulatory Measures Concerning Securities Trading, etc. or Its Brokerage, art. 1).

Also, with regard to loan transactions, this involves restrictive measures such as restricting or suspending the lending of funds or securities by securities finance companies, which has the same effect as the direct restriction of margin transactions (JSF Loan Transaction Lending Regulations, art. 4).

(8) Measures in the Case of Breach of Margin Transaction Contracts

After a financial instruments business operator executes an order for a margin transaction entrusted from a customer, if the customer (i) does not deposit the security deposit by the specified date; (ii) does not deposit any additional margin; or (iii) does not repay the loaned cash or securities relating to the margin transaction, the

financial instruments business operator may, at its discretion, close out the customer's position (TSE Brokerage Agreement Standards, art. 53.).

Similarly, between loan trading participants and JSF, where the loan trading participant does not (i) pay the net difference on an updated loan price; (ii) make payment of the interest or broker loan rate; (iii) repay loaned cash or securities; or (iv) replace defective collateral securities (purchased securities), JSF can appropriate the sales proceeds on a disposition of the collateral or collateral securities to the repayment of the loan trading participant's debt (JSF Loan Transaction Lending Regulations, art. 22). In this case, if the debt cannot be satisfied even after the disposition, repayment will be received from the settlement funds of its clearing participant in accordance with the business rules of the clearing organization (JSCC).

(9) PTS Margin Transactions

Following the introduction of margin transactions at PTSs on July 19, 2019, the definitions of the terms related to PTS Margin Transaction have been established.

(i) PTS Margin Transaction

PTS Margin Transaction is a margin transaction in which a Regular Member extends credit to a customer for off-exchange sale and purchase through the approved business[*1] conducted by Approved Members[*2] (Off-Market Trading Rules, art. 2, item. 10).

*1 Approved business: The proprietary trading system operation business conducted by a Regular Member who obtains approval of proprietary trading system operation business (Off-Market Trading Rules, art. 2, item. 6).

*2 Approved Member: Regular Member who obtains approval (of the Prime Minister) for proprietary trading system operation business for the listed share certificates, etc. (Off-Market Trading Rules, art. 2, item. 5).

(ii) PTS Standardized Margin Transaction

PTS Standardized Margin Transaction is a margin transaction at PTS that is conducted according to the following rules in terms of the broker loan rate and the limit for extension of the return/repayment deadline (Off-Market Trading Rules, art. 2, item. 11):

a. Broker loan rate: The uniform rate designated by the TSE for each issue applies;
b. Limit for extension of the return/repayment deadline: The return/repayment deadline shall be a day following the day of lending by the Regular Member, and if such return/repayment is not notified within two business days before the deadline, it shall be extended to the next day sequentially; provided, however, that the deadline may not be extended beyond the third business day counting from the corresponding day that is six months after the day on which a sale or a purchase was effected in the margin transaction at the PTS.

(iii) PTS Negotiable Margin Transaction

PTS Negotiable Margin Transaction is a margin transaction at PTS that is conducted according to an agreement between the Regular Member and the customer in terms of the broker loan rate and the limit for extension of the return/repayment deadline (Off-Market Trading Rules, art. 2, item. 12).

(iv) PTS Loan Transaction

Loan transactions can also be conducted with regard to margin transactions at PTS. A PTS loan

transaction is a transaction wherein a Participation Member or a person entrusted by a Participation Member with brokerage for clearing of securities, etc. borrows money or securities necessary for the settlement of any of the following transactions from a securities finance company designated by an Approved Member by utilizing the clearing systems of a financial instruments exchange market established by TSE (Off-Market Trading Rules, art. 2, item. 13):

a. PTS standardized margin transactions; or

b. Sale and purchase of securities conducted by the Participation Member on its own account.

Article 6 of the JSF "Loan Transaction Lending Regulations" provide that "The issues of share certificates, etc. available for loan transactions are specified through consultation with the exchange, etc." Issues for PTS loan transactions are issues that conform to the selection criteria established by the Approved Member and the securities finance company among issues for loans for margin transactions selected by the TSE (Off-Market Trading Rules, art. 6-7, para. 4). Among issues for PTS standardized margin transactions selected by the Approved Member, issues other than issues for PTS loan transactions are treated as issues for PTS loan transactions (for long positions only) (JSF's internal rules).

(10) Operational Rules for PTS Margin Transactions

When an Approved Member handles PTS Margin Transactions, it must prepare Operational Rules for PTS Margin Transactions which provide for the scope of Participating Members who may handle PTS Margin Transactions, the hours when PTS Margin Transactions are available, and the criteria for selection of issues for PTS Standardized Margin Transactions and issues for loan transactions at PTSs, and have its Participating Members comply with such rules (Off-Market Trading Rules, art. 6-7, para. 1).

11 Foreign Securities Transactions

The investing public have been allowed to invest (excluding investments to participate in management) in select foreign securities listed on overseas markets since July 1971, and thereafter, restrictions concerning foreign securities investments have gradually been removed, through listing foreign securities on the TSE (December 1973) to improve the efficiency of foreign securities investment, and piecemeal expansion of the number of overseas market investment targets. Also, beginning December 20, 1991, the foreign investment securities (a "country fund"—a corporate-type, closed-end investment trusts whose purpose is to invest in securities in a certain country or region, in other words investment company shares) was listed on the OSE.

Following the integration of the cash equity markets of the OSE into those of the TSE as of July 16, 2013, the country fund market of the OSE was also integrated into that of the TSE, which was newly established. At present, no country fund is listed on the market.

Since July 1, 2022, foreign stocks margin transactions have started operation.

11 1 Establishment of a Foreign Securities Transaction Account

When a financial instruments business operator accepts an order (including dealing in public offerings or secondary distributions or dealing in private placements) from a customer for a foreign securities (in this context, foreign share certificates, foreign share option certificates, foreign bonds with share options, foreign investment securities, foreign ETFs, and foreign depositary receipts, etc. (Foreign Securities Rules, art. 2)) transaction, upon executing an agreement concerning transactions in foreign securities, the financial instruments business operator must first deliver an "Agreement on Foreign Securities Trading Account" (hereinafter referred to as the "Account Agreement") to the customer (except for a professional investor in the case that the investor will acquire foreign securities through dealing in private placement) in a format established by each financial instruments business operator respectively (a format that meets requirements specified in JSDA rules as well as financial instruments exchanges' brokerage agreement standards) (the financial instruments business operator shall not be required to deliver the Account Agreement to a customer if it has already delivered the Account Agreement to the customer and the customer does not request the additional delivery of the Account Agreement), and receive an application from the customer to establish a trading account pursuant to this Account Agreement. In this case, the financial instruments business operator must ensure that the fact that it has received an application from the customer can be confirmed by receiving an application form from the customer stating that the customer wishes to establish a trading account pursuant to the Account Agreement or by any other method specified by the Association Member (Foreign Securities Rules, art. 3, para. 2 and para. 3). In accordance with the TSE Brokerage Agreement Standards, it is a principle that a trading participant must receive an application form from a customer for establishing a foreign securities trading account, and under certain conditions, it may receive an application by electromagnetic means, instead of receiving an application form (TSE Brokerage Agreement Standards, Rule 3-2. para. 1 and para. 4).

Since April 1, 2005, the "Account Agreement" form as respectively prepared by each financial instruments business operator has come to be used instead of the form prepared by the JSDA and the financial instruments exchanges. Consequently, of the following, items that correspond to the above are typical treatments.

Financial instruments business operators process the execution of foreign securities trading, etc. based on customer orders, settle the trading price, and act as the custodian, etc. of the said foreign securities in a manner that they have made explanations to the customer and obtained the customer's approval pursuant to Article 3, Paragraph 9 of the Foreign Securities Rules (Foreign Securities Transaction Account) (Foreign Securities Rules, art. 4, TSE Brokerage Agreement Standards, art. 28-3).

When receiving an order for a transaction in foreign securities (other than those which make disclosures based on the FIEA of Japan), financial instruments business operators must explain to the customer the fact that said foreign securities are not subject to the disclosure obligations under the FIEA. The method of explanation may be by statement in the Account Agreement or the document to be delivered prior to conclusion of a contract (Foreign Securities Rules, art. 6, para. 4).

The above mentioned delivery of an Account Agreement and collection of an application form for establishing a trading account may be made, *e.g.*, by a method using an electronic data processing system, such as the Internet, instead of in paper form (Foreign Securities Rules, art. 48, para. 1, item 1 and para. 2, item 1; Electromagnetic Document Delivery Rules; TSE Brokerage Agreement Standards, art. 3-2, para. 3 and para. 4).

11 2 Modes of Foreign Securities Transactions

Foreign securities transactions conducted by general investors can be classified into **domestic entrustment transactions, foreign transactions** and **domestic over-the-counter transactions**, depending on the mode of the transaction.

A domestic entrustment transaction involves foreign shares of stock, etc. that are listed on a domestic exchange, and are prescribed in, *e.g.*, the Business Regulations and the Brokerage Agreement Standards of the exchange. Foreign transactions and domestic over-the-counter transactions involve transactions in foreign securities except for those that are traded on a domestic financial instruments exchange market. These are consequently prescribed by the JSDA "Rules Concerning Foreign Securities Transactions."

(1) Domestic Entrustment Transactions

A domestic entrustment transaction means a transaction in foreign securities listed on a domestic exchange.

The trading, etc. of foreign securities on the exchange is executed similarly to domestic securities transactions in accordance with the Exchange Business Regulations. However, some of the major differences between foreign securities and domestic securities are listed below:

(i) Types of Trades

There are only two types of trades for foreign securities: a) same-day settlement transactions; and b) regular transactions (TSE Business Regulations, art. 9, para. 1, item 2).

The delivery date in a sale and purchase of foreign securities is the third business day counting from the contract date except for cases where a different treatment is separately agreed on with the customers (Foreign Securities Rules, art. 3, para. 6, item 2).

(ii) Trading Units

Trading units are based on share price, and units of 1,000 shares, 500 shares, 100 shares, 50 shares, 10 shares or one share are used in accordance with the rules adopted on the securities exchange (TSE Rules Regarding Trading Units of Foreign Stocks, art. 2, para. 1; Business Regulations, art. 15, item 1(b)). The trading units of foreign ETFs and foreign ETNs are set at 100 units, 10 units and 1 unit (TSE Rules Regarding Trading Units of Foreign Stocks, art. 2, para. 2).

(iii) through (vii) below describe an outline of the "Business Regulations Relating to the Depository and Book-Entry Transfers of Foreign Share Certificates, etc." established by the JASDEC in accordance with the Act Concerning Book-Entry Transfer of Bonds, Shares, Etc., Article 9 Paragraph 1, *proviso,* and the Order for Supervision of General Book-Entry Transfer Institutions, Article 6, Paragraph 2, Item 3, focusing on the provisions regarding the JASDEC's custody services for foreign share certificates.

(iii) Settlement

Settlement is conducted in the same manner as domestic share certificates. Foreign share certificates traded on the exchange are deposited with the offshore custodian of the issuing company under title of the JASDEC; financial instruments business operators (account management institutions for foreign share certificates, etc.) make settlement by account transfer using their accounts established with the JASDEC.

Therefore, settlement of the foreign share certificates traded on exchanges is processed through the clearing procedure at the JSCC and then booked through the instructions from the exchange to the JASDEC as

a transfer from the JASDEC account of the financial instruments business operators that handled the sell order to the JASDEC account of the financial instruments business operator that handled the buy order.

(iv) Treatment of Dividends, Etc.

In cases where the rights for dividends, etc. are granted, a financial instruments business operator must submit a list of the names and addresses, etc. of its customers to the JASDEC, and the JASDEC will notify the transfer agent (trust bank) for the said issue.

In the case of a cash dividend, an offshore custodian of the JASDEC initially receives the cash dividend, and the dividend is paid in yen to the customer (the beneficial shareholder of foreign share certificate, etc.) through the Japanese bank handling the dividend payments.

In the cases of a share dividend, if a customer is to pay the amount equivalent to the withholding tax on the said share certificates, an offshore custodian of JASDEC initially receives the share dividend and transfers it into the foreign securities transaction account of the customer through a financial instruments business operator. However, in the case of fractional shares where a customer is not responsible for withholding tax, the offshore custodian of JASDEC will sell those securities and pay the sales proceeds to the customer through a transfer agent.

(v) Treatment of Share Options and Other Rights

In cases where share options are granted and Japanese shareholders are also able to exercise the rights under the share options, an offshore custodian of the JASDEC receives the share options and a customer exercises the rights under the share options through a financial instruments business operator.

Shares received in a share split, bonus issues, etc. are also transferred into the customer's foreign securities transaction account, but fractional shares will be disposed of by sale.

(vi) Change of Custody (Transfer) of Share Certificates

Where a customer sells share certificates purchased in a domestic entrustment transaction (deposited with the offshore custodian of the JASDEC) on a foreign securities market, or where the said shares are returned, the financial instruments business operator will first change (transfer) the custody of the said share certificates from the offshore custodian of JASDEC to which the financial instruments business operator uses, and then sell or return them to the customer.

(vii) Other

Documents concerning the shareholders' general meeting, business reports, etc. and other miscellaneous notices from the issuing company are sent to the reported addresses of customers from the transfer agent. The JASDEC will exercise voting rights at the shareholders' general meeting if the customer so instructs. However, in the absence of an instruction, the JASDEC will not exercise voting rights. For some issues, the detailed information of the shareholders meeting is disclosed on the exchange's website and it may not be delivered to the beneficial shareholders in the form of a document.

(2) Foreign Transactions

A foreign transaction refers to a transaction to execute a trading order in foreign securities (excluding foreign investment trust securities) by means of intermediary, brokerage or agency services towards a financial instruments market of a foreign country (including an over-the-counter market) as well as a transaction of brokering an order for the sale in response to a tender offer of foreign securities (meaning making offers to purchase foreign share certificates, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds or soliciting offers to sell them to various unspecified persons, and then effecting the purchase of foreign

share certificates, etc., foreign share option certificates, foreign investment equity subscription right certificates or foreign bonds, outside of a foreign financial instruments exchange market (Foreign Securities Rules, art. 2, para. 1, item 18).

If a financial instruments business operator brokers a sale by a customer in response to a tender offer of foreign securities, the financial instruments business operator must explain the following matters to the customer and obtain the customer's approval orally or in writing (Foreign Securities Rules, art. 3, para. 9):

a) The tender offer is not conducted through the procedure under the FIEA;
b) The offer to sell will not be cancelled on or after the date designated by the Association Member;
c) The amount of consideration for the sale in response to the tender offer (or the method of determining the amount of consideration if the amount of consideration is not yet determined at the time of offer);
d) The planned amount of purchase by the purchaser;
e) The terms for execution of the tender offer and the handling of the case where an offer to sell is made beyond the planned amount of purchase;
f) The handling of the contract date;
g) The scheduled date of payment of the sales proceeds and the handling of the case where the sales proceeds are paid in a foreign currency;
h) The foreign securities for which an offer to sell is made in response to the tender offer will not be sold separately without the Association Member's approval;
i) The handling of fees for an offer to sell in response to the tender offer and the taxation procedure for the sales proceeds; and
j) Any matters other than those prescribed in a) to i) above are governed by the provisions concerning a tender offer prescribed by the purchaser and the Account Agreement.

Moreover, an Association Member must handle matters such as the execution of trades, etc. in foreign securities pursuant to an order by a customer, the settlement of the proceeds of the trade and the custody of the foreign securities in a manner that the Association Member has explained to the customer and regarding which it has obtained the customer's approval pursuant to the Account Agreement or Article 3, Paragraph 9 of the Foreign Securities Rules (Foreign Securities Rules Article 4).

(i) Issues for Which a Financial Instruments Business Operator Is Able to Make Solicitations to Customers

Foreign securities for which a financial instruments business operator is able to solicit customers (excluding qualified institutional investors and certain types of business corporations) include foreign securities which are traded on or are expected to be traded on a qualified foreign financial instruments market, and which satisfy certain requirements. The term "qualified foreign financial instruments market" means a foreign financial instruments exchange market or foreign over-the-counter market which a financial instruments business operator has determined to have satisfied the requirements set forth in (ii) and to not present a problem from the perspective of protecting investors (Foreign Securities Rules, art. 7, para. 1, para. 2 and para. 3).

(ii) Requirements of Qualified Foreign Financial Instruments Markets

A qualified foreign financial instruments market must satisfy the following requirements. Securities for which transactions are conducted on a foreign financial instruments exchange market or foreign over-the-counter market and for which a financial instruments business operator conducts foreign transactions are referred to as "traded securities" (Foreign Securities Rules, art. 7, para. 4):

a) The trading price of the traded securities can be obtained;
b) The financial statements or other financial information for the issuer of the traded securities can be obtained;
c) There is a supervisory governmental agency or similar institution that supervises the financial instruments exchange market of the foreign country or over-the-counter market of the said foreign country;
d) It is possible to receive/remit the purchase price, the sales price, returns, etc. of the traded securities; and
e) There is an institution which conducts custody functions for the traded securities.

(iii) Transactions in Practice

While customers are supposed to give instructions to financial instruments business operators regarding the type of trade and the manner and location to execute the buy/sell, because the order is placed with an overseas market, the date/time of the order may differ from the contract date/time due to time differences, etc. Therefore, the contract date is fixed as the day when the financial instruments business operator confirms the execution of the buy/sell order at the place of execution (if such day is a non-business day, the first business day following the said day).

Generally, settlement for foreign transactions takes place on the third business day counting from the contract date, which is the same as settlement for domestic transactions. The exchange of money pertaining to the contract is conducted in yen or a foreign currency designated by the customer, to the extent the financial instruments business operator can meet the request. Conversion between foreign currency and yen is in principle made using the exchange rate determined by the financial instruments business operator on the contract date (Foreign Securities Rules, art. 3, para. 6, item 1, item 2, item 13 and item 14).

Financial instruments business operators must establish internal rules concerning handling charges and endeavor to put in place an internal control framework that includes internal inspections and auditing, as well as to engage in appropriate conduct of business in order to secure the transparency and fairness of foreign securities (Foreign Securities Rules, art. 9).

(iv) Custody of Share Certificates and Treatment of Rights

Share certificates purchased by customers are deposited under the name of a financial instruments business operator with the offshore custodian designated by the financial instruments business operator.

The financial instruments business operator first receives dividends, etc. on securities in custody on behalf of the customer and then pays them to the customer. If share options are granted, these are generally disposed of through a sale and the sales proceeds are paid to the customer.

Yen conversion of foreign currency amounts received by the customer is made using the rate determined by the financial instruments business operator on the date the financial instruments business operator confirms the receipt of the full amount (Foreign Securities Rules, art. 3, para. 6, item 3, item 6, item 7, item 13 and item 14).

A financial instruments business operator shall notify a customer of the following facts that may significantly impact the position of the customer: (a) notification of facts that may significantly impact the position of shareholders, etc. such as issuance of shares for subscription, a share split or a consolidation of shares; (b) notification of dividends, etc.; and (c) notification in connection with important items on the agendas of general meetings of shareholders, such as proposed mergers (Foreign Securities Rules, art. 3, para. 6, item 9).

(v) Delivery of Documents by Electronic or Magnetic Means

A financial instruments business operator may use methods employing electronic data processing systems or other information technologies to provide the items of information to be stated in a document such as the Account Agreement, instead of the delivery, etc. of the paper document. In such cases, the Association Member shall be regarded as having delivered the document (Foreign Securities Rules, art. 48, para. 1; Document Delivery Rules).

Instead of collecting a paper document under Article 3, Paragraph 9 of the Foreign Securities Rules, a financial instruments business operator may use methods employing electronic data processing systems or other information technologies to receive the items of information to be stated in the document. In such cases, the Association Member shall be regarded as having collected the document (Foreign Securities Rules, art. 48, para. 2; Document Delivery Rules).

(vi) Other

A financial instruments business operator must preserve notices from an issuing company and other materials, etc. for three years (one year with respect to foreign CDs and foreign CPs) and make them available for inspection, and must deliver the materials, etc. upon request by a customer (Foreign Securities Rules, art. 6, para. 1, para. 2, and para. 3).

(3) Domestic Over-the-Counter Transactions

A domestic over-the-counter transaction means an over-the-counter transaction in Japan of foreign securities (excluding foreign investment trust certificates) (Foreign Securities Rules, art. 2, para. 1, item 19), *i.e.*, a transaction in foreign securities in which a financial instruments business operator trades as a principal with an investor.

The foreign securities for which a financial instruments business operator is permitted to solicit customers are the same as those for foreign transactions.

(i) Securing Transactional Fairness

Financial instruments business operators must, when conducting a domestic over-the-counter transaction for foreign share certificates, etc. (other than issues that are listed on a domestic securities market) with a customer, conduct the transaction at a fair price, computed in a reasonable manner and based on the market price (internal market price) and must ensure the fairness of such transaction (Foreign Securities Rules, art. 11, para. 1). Also, where a customer so requests, a summary explanation of the method, etc. of calculating the trading price shall be provided orally or in writing (Foreign Securities Rules, art. 11, para. 4).

Moreover, in order to achieve transparency and fairness in domestic over-the-counter transactions, a financial instruments business operator must set forth in its internal regulations stipulations concerning appropriate contract management, etc. of domestic over-the-counter transactions and endeavor to put in place an internal administration framework that includes internal inspections and auditing, as well as to engage in appropriate conduct of business (Foreign Securities Rules, art. 9).

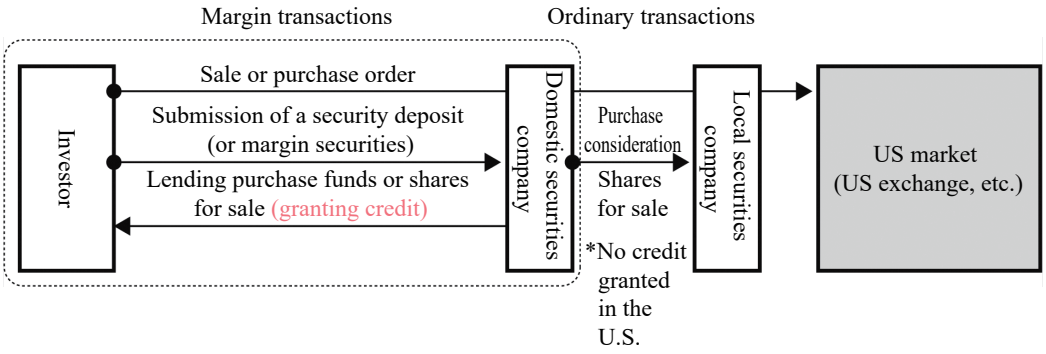
(ii) Settlement, Etc.

Settlement for domestic over-the-counter share certificates is conducted through an account transfer (Foreign Securities Rules, art. 10), and share certificates in custody are treated in a manner similar to foreign transactions. Also, yen conversion, treatment of rights, etc. follow the same methods used for foreign transactions.

11 3 Foreign Stocks Margin Transactions

Foreign stocks margin transactions introduced on July 1, 2022, are margin transactions for which a Regular Member conducts the intermediary, brokerage or agency service for the sale and purchase of securities on a foreign financial instruments exchange by granting credit to a customer in Japan, and for which the Regular Member or the customer does not receive credit from the local securities dealer (meaning a foreign securities service provider prescribed in Article 58 of the FIEA acting as the counterparty with which a Regular Member conducts the intermediary, brokerage or agency service for the sale and purchase of securities on a foreign financial instruments exchange) (Foreign Securities Rules, art. 2, para. 1, item 23).

Chart 3-3 Conceptual Diagram of Foreign Stocks Margin Transactions



(Source) JSDA website

Foreign shares, etc. that are eligible to be traded in foreign stocks margin transactions are limited to those listed on a qualified foreign financial instruments market in the United States (Foreign Securities Rules, art. 31, para. 1).

Foreign stocks margin transactions are subject to stricter regulations than margin transactions in domestic stocks (for details, see Chapter 1, 4-7 “(8) Foreign Stocks Margin Transaction System”).

Differences between Domestic Stocks Margin Transactions and Foreign Stocks Margin Transactions

	Domestic stocks margin transactions (standardized margin transactions)	Foreign stocks margin transactions
Eligible stocks	Issues selected by the securities company from among stocks, etc. listed on a domestic securities exchange	Issues selected by the securities company from among the issues that conform to the JSDA's guidelines for selecting issues, from among stocks, etc. listed on a US exchange
Account management	Domestic stocks margin transaction account	Foreign stocks margin transaction account (an account separate from a domestic stock margin transaction account)
Minimum margin rate	30% of the contract price (subject to the Security Deposit Ordinance)	50% of the contract price (subject to the Security Deposit Ordinance; the rate is set under the Foreign Securities Rules)
Minimum margin	JPY 300,000 (subject to the Security Deposit Ordinance)	Amount designated by the Regular Member (in US dollars) * Must be equivalent to or more than JPY 300,000
Minimum maintenance margin rate	20% of the contract price (subject to the TSE rules)	30% of the contract price (subject to the Foreign Securities Rules)

12 Securities Investment Computations

12 1 Stock Yield

Stock yield, also referred to as dividend yield, means a percentage of the amount of the annual received dividend divided by the amount invested (the acquisition cost of shares).

Dividends are distributions of retained earnings to the shareholders of a joint stock company, or the retained earnings so distributed.

Since dividends are paid to those persons who are recorded as shareholders in the shareholder register as of the "date of right allotment," it is necessary to purchase the necessary number of shares by the final trading day for cum rights, two business days prior to the "date of right allotment." The share price is the ex-dividend price on the business day preceding the "date of right allotment".

Ordinarily, dividends are paid at a certain amount per share.

The stock yield is given by the following formula:

Formula <1>

$$\textbf{Stock Yield} = \frac{\text{Annual Dividend per Share}}{\text{Share Price}} \times 100$$

If the share price is calculated based on expected yield using Formula <1>, it is possible to know the price to pay for the shares in order to obtain the expected yield. This share price is called the break-even price:

Formula <2>

$$\textbf{Break-Even Price} = \frac{\text{Annual Dividend per Share}}{\text{Desired Yield}}$$

(Sample Question) Prospective annual dividend per share is JPY10 and the market price of the share is JPY500. What is the dividend yield of this share?

Based on Formula <1> $\dfrac{\text{JPY10}}{\text{JPY500}} \times 100 = \underline{2\%}$

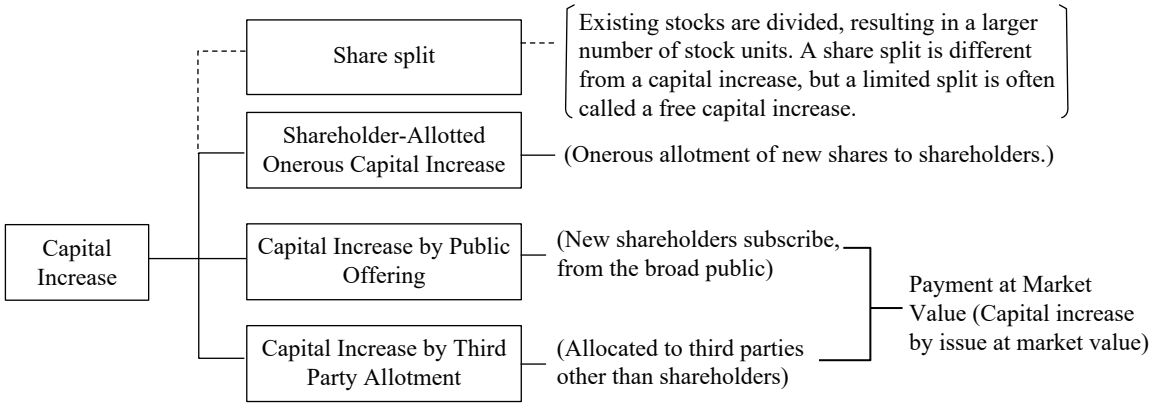
(Sample Question) I would like to purchase shares with a prospective annual dividend of JPY4 so that I earn an annual yield of 2.5%. What would the limit price on the share be?

Based on Formula <2> $\dfrac{\text{JPY4}}{0.025} = \underline{\text{JPY160}}$

12 2 Cum Rights, Ex-Rights Market Prices

Chart 3-4 gives the format for capital increases at corporations.

Chart 3-4 The Format for Capital Increases



Of the capital increases, in the case of the share split and shareholder-allocated onerous capital increase, the old shares are traded at a price that includes the right to the new share allotment up to the second business day prior to the date when the new shares are allocated (the third business day prior to the date in cases where the allotment date falls on a holiday). This is called the **cum rights market price**.

Thereafter, from the first business day prior to the new share allotment date (the second business day prior to

the date in cases where the allotment date falls on a holiday), the share no longer has the right to the new share allotment. The price, therefore, decreases by the value of the right, and is called the ex-rights market price.

The formula for calculating the prospective ex-rights market price is as follows:

Formula <3>

$$\textbf{Ex-Rights Market Price} = \frac{\text{Cum Rights Market Price} + (\text{Paid-up Amount for New Shares} \times \text{Allotment Ratio})}{1 + \text{Allotment Ratio}}$$

As shown in Formula <3>, in order to calculate the prospective ex-rights market price of the shares subject to the capital increase under certain conditions, it is enough to know three variables, *i.e.*, the current cum rights market price, the paid-up amount for the new shares and the allotment ratio. The **paid-up amount for the new shares** means the amount to be paid per share in order for the new share to be allocated and the **allotment ratio** means how many new shares are allotted to each outstanding share.

Cum rights market price means the current value of the company per share. Multiplication of the paid-up amount for new shares by the allotment ratio shows how much will be newly paid into the company per current share. In other words, the numerator of Formula <3> is the value of a current share after the capital increase.

The denominator is the number of shares by which the current number of shares will increase after the capital increase. That is, the right side of Formula <3> is the per-share value of the company after the capital increase divided by the number of shares after the capital increase.

The formula for calculating the ex-rights market price in the case of a share split would be as follows:

Formula <4>

$$\textbf{Ex-Rights Market Price} = \frac{\text{Cum Rights Market Price}}{\text{Split Ratio}}$$

In addition, combining and transposing Formula <3> and Formula <4> can provide a formula for calculating the cum rights market price from the ex-rights market price under certain conditions.

Formula <5>

$$\textbf{Cum Rights Market Price} = \text{Ex-Rights Market Price} \times (1 + \text{Allotment Ratio}) - (\text{Paid-up Amount for New Shares} \times \text{Allotment Ratio})$$

Formula <6>

$$\textbf{Cum Rights Market Price} = \text{Ex-Rights Market Price} \times \text{Split Ratio}$$

(Sample Question) A share with a market price of JPY1,200 will be split 1 : 1.2 What would be the prospective ex-rights market price?

Using Formula <4>,

$$\frac{\text{JPY1,200}}{1.2} = \underline{\text{JPY1,000}}$$

(Sample Question) The cum rights market price of a certain share prior to a 1 : 1.5 split was JPY1,500. If the ex-rights market price was JPY1,100, how much did the price increase over the cum rights market price of JPY1,500?

Using Formula <6>,

JPY1,100 × 1.5 = JPY1,650 (cum rights market price calculated from the ex-rights market price)

JPY1,650 − JPY1,500 = JPY150

12 3 Price/Earnings Ratio (PER)

The net profit per share for the current term is an index by which the profitability of companies is measured.

In a "consolidated profit and loss statement" and "consolidated statement of comprehensive income" to be prepared for a consolidated fiscal year starting on April 1, 2015, and thereafter, the revised presentation method applies with regard to a "net profit for the current term": "net profit for the current term before minority shareholder profit or loss adjustment" is now presented as "net profit for the current term," and "net profit for the current term" under the previous standards is now presented as "amount of net profit for the current term attributable to owners of a parent" (Consolidated Financial Statements Ordinance, art. 65, para. 4). In the case of non-consolidated financial statements, there is no change in the presentation method and the term "amount of net profit for the current term" is maintained (Financial Statements Ordinance, art. 95-5, para. 3).

The Consolidated Financial Statements Ordinance provides: "The amount obtained by adjusting the amount of net profit for the current term or the amount of net loss for the current term by adding or subtracting the amount that represents non-controlling interests in the amount of net profit for the current term or the amount of net loss for the current term must be stated as the amount of net profit for the current term attributable to owners of a parent or the amount of net loss for the current term attributable to owners of a parent" (Consolidated Financial Statements Ordinance, art. 65, para. 4).

Where details of the account settlement for a business year, an interim accounting period, a consolidated accounting year, or an interim consolidated accounting period are settled, a listed company must disclose such details immediately using the "Earnings Report," etc. The format of disclosure by means of an earnings report may be chosen from among the four types of formats, i.e. the Japanese standards (consolidated), Japanese standards (non-consolidated), International Financial Reporting Standards (IFRS; consolidated) and US standards (consolidated), depending on the accounting standards adopted by the listed company and also from between the table style and the free description style. The definition of the term "net profit for the current term" differs among these four types of disclosure formats. In the section below, "net profit for the current term attributable to owners of a parent" in consolidated financial statements is used to explain what is usually called "net profit for the current term."

Formula <7>

$$\textbf{Net Profit per Share for the Current Term} = \frac{\text{Current Term Net Profit (After Tax)}}{\text{Total Number of Outstanding Shares}}$$

This is also called EPS (Earnings Per Share). The higher the EPS, the higher the profitability of the company.

The Price/Earnings Ratio (P/E Ratio or PER) is an index for the price of shares being traded relative to the net profit per share for the current term.

The P/E Ratio is given by the following formula:

Formula <8>

$$\textbf{Price/Earnings Ratio (PER)} = \frac{\text{Share Price}}{\text{Net Profit per Share for the Current Term}} \text{ (times)}$$

For example, if the net profit per share for the current term of Company A is JPY20 and the share price is JPY400, the P/E Ratio, according to Formula <8>, would be 20 times.

If the share price of Company B in the same industry is also JPY400, but the net profit per share for the current term is JPY25, the P/E Ratio is 16 times. Judging from the P/E Ratio, Company B is a better buy than Company A.

Also, in general, the P/E Ratio tends to be higher for a company with a higher rate of growth in company profits; however, whether the P/E Ratio for an individual issue is high or low depends on the industry and how the market perceives growth potential and profitability. For this reason, one method for evaluating the share price, and for deciding if the P/E Ratio of a certain issue is high or not, is to compare the current P/E Ratio with the trend for that specific issue for the past several years, and to determine where the current P/E Ratio fits into the trend. If it is positioned closer to the upper limit considering the trend, this would be a warning sign. On the other hand, if it is closer to the lower limit and there is potential for improvement in performance, then, it would be a good buy.

(Sample Question) If a company has capital of JPY20 billion (outstanding number of shares: 400 million shares), its net profit for the current term is JPY12 billion and the share price of the company is JPY900, what is the net profit per share for the current term and the Price/Earnings Ratio (P/E Ratio)?

Using Formula <7>,

$$\text{Net Profit per Share for the Current Term} = \frac{\text{JPY12 billion}}{\text{400 million shares}} = \underline{\text{JPY30}}$$

Using Formula <8>,

$$\text{P/E Ratio} = \frac{\text{JPY900}}{\text{JPY30}} = \underline{\text{30 times}}$$

12 4 Price/Cash-Flow Ratio (PCFR)

The price of a share divided by the cash flow per share is called the "Price/Cash-Flow Ratio" (PCFR).

Cash flow normally means the flow of money over a certain period, as is implied in the term, and is defined by Cabinet Office Ordinance as "the increase or decrease in funds (cash(Note 1) or cash equivalents(Note 2))" (Financial Statements Ordinance, art. 8, para. 18, and para. 19; Consolidated Financial Statements Ordinance, art. 2, item 13 and item 14)

(Notes) 1. The cash here includes current accounts, ordinary deposits and other deposits that the depositor may withdraw without waiting a certain period of time, and electronic payment instruments.
2. Cash equivalents mean short term investments that can easily be converted to cash and for which there is little risk of fluctuation in value.

Nevertheless, the cash flow that is used in the PCFR normally uses the monetary amount of net profit plus depreciation costs.

An indicator consisting of the share price and the aforementioned EPS (net profit per share for the current term), *i.e.*, the Price/Earnings Ratio (P/E Ratio), is generally used to determine the level of a share price in investment analysis. Since current net profit is easily influenced by differences in depreciation methods, it is not possible to evaluate whether it is supported by cash flow, *i.e.*, the "profit quality."

The PCFR has attracted attention as an investment analysis indicator using cash flow which is also emphasized in diversified international investment.

The fundamental theory of PCFR is the same as PER: the higher the PCFR, the more expensive the share; the lower the PCFR, the more the share is selling at a bargain. The difference with the PER is that since PCFR is calculated using cash flow determined by adding back depreciation expenses to the after-tax profit, it is more useful in making judgments about the growth potential, etc. of the company.

For example, suppose that a company establishes a new division to develop a new technology with a large future potential. In this case, it looks like a good investment, but if the development requires a large amount of expenses, profits would shrink. If you looked at the PER in this case, it would show that the share is somewhat pricey. However, looking at the PCFR reflected by the investment amount, the resulting figure would show that the share is not that expensive. In such cases, one is able to incorporate the growth potential into the calculation.

Formula <9>

$$\textbf{Price/Cash-Flow Ratio} = \frac{\text{Share Price}}{\text{Cash Flow per Share}}$$

Assume that "Cash flow = Current Net Profit + Depreciation Expenses."

(Sample Question) What is the Price/Cash-Flow Ratio (PCFR) for a company (one closing per year) with capital of JPY20 billion (400 million issued and outstanding shares), current net profit of JPY12 billion, depreciation expenses of JPY2 billion, and a share price of

JPY1,470?

$$\text{Cash Flow per Share} = \frac{\text{JPY12 billion} + \text{JPY2 billion}}{\text{400 million shares}} = \text{JPY35}$$

Accordingly, under Formula <9>:

$$\text{Price/Cash-Flow Ratio} = \frac{\text{JPY1,470}}{\text{JPY35}} = \underline{\text{42 times}}$$

<Reference>

A "cash flow statement" is one of the basic financial statements, and must state the condition of cash flow divided into the categories of, *e.g.*, (1) cash flow from business activities, (2) cash flow from investment activities, and (3) cash flow from financial activities (Financial Statements Ordinance, art. 112; Consolidated Financial Statements Ordinance, art. 83).

The sum of (1) and (2) is referred to as "free cash flow." It is the amount of money that a company earns from activities such as manufacturing and sales, minus the company's expenditures for investment such as plant and equipment, and is also referred to as "net cash revenue." This free cash flow can be used, *e.g.*, to pay interest bearing debt, or as funds for increased distributions.

■Concerning Net Assets, Equity and Shareholders' Equity■

(Example of Relevant Portion of Non-Consolidated Balance Sheet)	(Example of Relevant Portion of Consolidated Balance Sheet)
NET ASSETS	NET ASSETS
I. Shareholders' Equity	I. Shareholders' Equity
1. Paid-in Capital	1. Paid-in Capital
2. Capital Surplus	2. Capital Surplus
(1) Capital reserve	
(2) Other capital surplus	
Total Capital Surplus	
3. Profit Surplus	3. Profit Surplus
(1) Profit reserve	
(2) Other profit surplus	
XX Reserves	
Profit Surplus Carried Forward	
Total Profit Surplus	
4. Treasury shares	4. Treasury shares
Total Shareholders' Equity	Total Shareholders' Equity
II. Valuation, Conversion Difference Amount, Etc.	II. Other Accumulated Comprehensive Income
1. Other valuation differential on securities	1. Other valuation differential on securities
2. Deferred hedging gain or loss	2. Deferred hedging gain or loss
3. Differential on revaluation of land	3. Differential on revaluation of land
	4. Account for conversion adjustment on foreign exchange
	5. Cumulative amount for adjustment of retirement benefit
Total of Valuation, Conversion Difference Amount, Etc.	Total of Other Accumulated Comprehensive Income
III. Share Awards	III. Share Awards

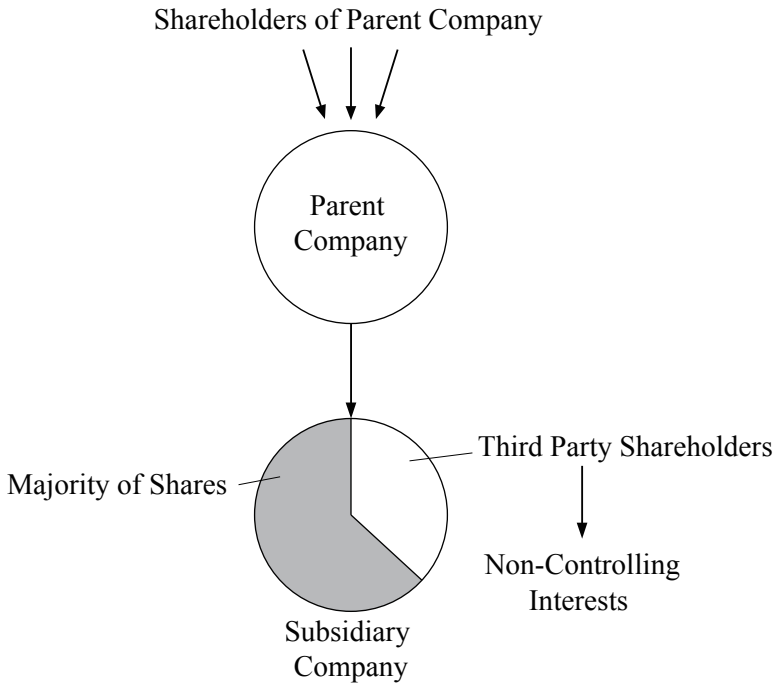
IV. Share Options	IV. Share Options
	V. Non-controlling shareholder interests
TOTAL NET ASSETS	TOTAL NET ASSETS

In the past, net assets ("*jun shisan*") were referred to as equity or shareholders' equity, but the meanings of these terms have come to differ with, *inter alia,* the New Accounting Standards (announced on August 10, 2005) and the Companies Act (which came into force and effect on May 1, 2006) and other regulations. The item "non-controlling shareholder interests," which was previously referred to as "minority shareholder interests," represents a portion of a consolidated subsidiary company's capital which is not equity of the company submitting consolidated financial statements (Consolidated Financial Statements Ordinance, art. 2, item 12). The item "other accumulated comprehensive income" in the consolidated financial statements (Consolidated Financial Statements Ordinance, art. 43-2) is equivalent to "valuation and translation adjustments, etc." in non-consolidated financial statements (Financial Statements Ordinance, art. 67).

Equity refers to net assets minus the amount of share options, share awards and non-controlling shareholder interests (only in the case of consolidated financial statements) (Cabinet Office Ordinance on Disclosure of Corporate Affairs; Form 2). Shareholders' equity equals the paid in capital plus the surpluses.

This can be expressed as an inequality as follows: Net assets ≥ Equity ≥ Shareholders' equity

Chart 3-5 Figure for a Company with Non-Controlling Shareholders' Interests



12 5 Price/Book-Value Ratio (PBR)

While current net earnings per share are an indicator of the profitability of the company, net assets per share (BPS: Book-Value Per Share) is used as an index to measure the company's value from a financial aspect. Net assets can be obtained by subtracting liabilities such as debts and corporate bonds from the total assets.

The Book-Value Per Share expresses the value of the company's assets. It is said that the larger the BPS, the greater the value of the company's assets.

In contrast, the Price/Book-Value Ratio (PBR) shows by how many multiples of BPS the share is being purchased.

Formula <10>

$$\textbf{Price/Book-Value Ratio} = \frac{\text{Share Price}}{\text{Book-Value per Share}} \text{ (times)}$$

If the PBR is 1, it means the share price of the company is at the same level as the value of the assets (liquidation value).

(Sample Question) What is the Price/Book-Value Ratio (PBR) for a company (one closing per year) with total assets of JPY50 billion, total liabilities of JPY20 billion, 50 million shares of issued and outstanding stock where the price of its share is JPY600?

Since Net Assets = Total Assets − Total Liabilities

= (JPY50 billion − JPY20 billion) = JPY30 billion,

The Net Assets per share = JPY30 billion/50 million shares = JPY600 Accordingly, using Formula <10>:

$$\text{Price/Book-Value Ratio} = \frac{\text{Share Price}}{\text{BPS}} = \frac{\text{JPY600}}{\text{JPY600}} = \underline{1 \text{ times}}$$

12 6 Return on Equity (ROE)

ROE (Return on Equity) illustrates, from the viewpoint of the shareholder, the performance and how the funds invested in the company are managed. If this rate is lower than the general level of the interest rate, shareholders do not have any incentive to invest in the company because it reflects the company's profitability.

Companies initially are established with capital to purchase the necessary equipment and materials to conduct business and produce a profit. The shareholders' ownership in a company includes not only the initial start-up capital, but also shareholders' equity such as legal reserves and retained earnings, etc. accumulated thereafter. Therefore, a company with a steadily improving ROE would attract an increase in capital or an enrichment of the internal reserves.

ROE is calculated by starting with net profit for the current term and dividing by the net assets less the amount of share options and non-controlling shareholder interests (only in the case of consolidated balance sheets) (Cabinet Office Ordinance on Disclosure of Corporate Affairs; Form 2).

Formula <11>

$$\textbf{Return on Equity} = \frac{\text{Net Profit for the Current Term (Annualized)}}{\text{Equity* (Average of the Beg./End Period)}} \times 100\ (\%)$$

*Equity = Net Assets – (Share Options + Non-Controlling Shareholder Interests)

(Note) A profit/loss statement represents the process through which a company has earned profit within a certain period of time. Accordingly, in the financial analysis of P/L items, an average is taken for the amount of capital employed within such period, and the average of the beginning/end period is generally used as a simplified method.

In the past, ROE, or return on equity, was called "return on shareholders' equity" but with the coming into force of the Companies Act on May 1, 2006, "shareholders' equity," "equity" and "net assets" have come to indicate different content, with "shareholders' equity" not equaling all net assets but being a more limited portion.(Note)

(Note) If the "return on shareholders' equity" were to continue to be used, the standard for ROE would be switched, presenting the risk of a lost in continuity. For this reason, the ROE is to be calculated on the basis of equity.
Although the Cabinet Office Ordinance refers to this as the ROE, the TSE refers to this as the "ratio of net return to equity for the current term." Following the amendment to the Consolidated Financial Statements Ordinance, the TSE has revised the calculation formula for the ratio of net return to equity for the current term as follows in order to maintain the continuity of consolidated financial statements: "net profit for the current term attributable to owners of a parent/equity (average between the beginning and end of the term)" (TSE, Aggregation of Earnings for the Term Ending March 2016, Overview of the aggregation method; Guidelines for Preparation of Earnings Reports and Quarterly Earnings Reports, April 2024). There has been no revision to the format under Item 2 of the Cabinet Office Ordinance on Disclosure of Corporate Affairs.
The "shareholders' equity ratio" has been replaced with the "equity to total assets ratio" under the Cabinet Office Ordinance.

$$\text{Equity to Total Assets Ratio} = \frac{\text{Equity}}{\text{Total Assets}} \times 100\ (\%)$$

(Sample Question) What is the ROE of a company (one closing per year) at the end of the current period if its "equity (end of period)" and "net profit" were as shown below?

(Unit: JPY1 million)

	Equity (End of Period)	Current Net Profit
Current Period	2,800	300
Previous Period	2,000	100

Since the equity as of the end of the previous period becomes the equity in the beginning of the current period, the average of the beginning period/end period = (JPY 2,000 million + JPY 2,800 million)/2 = JPY2,400 million.

Accordingly, under Formula <11>:

$$\text{Return on Equity} = \frac{\text{JPY300 million}}{\text{JPY2,400 million}} \times 100 = \underline{12.5\%}$$

12 7 Return on Assets (ROA)

As with ROE, ROA (Return on Asset(s)) is one of the indicators of the profitability of a company used to gauge the company's business activities. This is also referred to as "return on total assets" or "return on total capital."

It is an indicator to measure how much profit has been produced against total assets (total capital) invested by the company in its business activities on an annual basis.

Formula <12>

$$\textbf{Return on Assets} = \underbrace{\frac{\text{Net Profit for the Current Term}}{\text{Sales}}}_{\text{(Profit Margin on Sales)}} \times \underbrace{\frac{\text{Sales}}{\text{Total Assets (Ave. of the Beg./End Period)}}}_{\text{(Total Asset Turnover)}} \times 100\ (\%)$$

$$= \frac{\text{Net Profit for the Current Term}}{\text{Total Assets (Ave. of the Beg./End Period)}} \times 100\ \ (\%)$$

(Sample Question) What is the return on assets (ROA) of a company (one closing per year) having total assets of JPY40 billion (no change between the previous term and the current term), sales of JPY36 billion, and net profit for the current term of JPY1.8 billion?

From Formula <12>:

$$\text{Return on Assets} = \frac{\text{JPY1.8 billion}}{\text{JPY36 billion}} \times \frac{\text{JPY36 billion}}{\text{JPY40 billion}} \times 100 = \underline{4.5\%}$$

(Note) As investor relations information, some listed companies disclose the ROA on the basis of their business income rather than net profit.

$$\text{Business Income on Assets} = \frac{\text{Business Income*}}{\text{Total Assets (Average of the Beg./End Period)}} \times 100\ (\%)$$

* Business income = operating income + interest income + dividends income

12 8 Earnings-Price Ratio

The earnings-price ratio is the inverse of the price-earnings ratio (PER) (*i.e.*, the profit per share divided by the share price), and expresses the after tax profit as a percentage of the share price.

The dividend yield is determined by dividing the amount of the dividends per share by the share price; however, the payment of dividends is subject to the company's dividend policy. Therefore, the earnings price ratio is founded on the concept that using profit instead of dividends in the numerator provides a more accurate picture of the company's financial position, and represents business earnings per share.

Formula <13>

$$\textbf{Earnings-Price Ratio} = \frac{\text{Current Term Net Profit per Share}}{\text{Share Price}} \times 100\ (\%)$$

12 9 Yield Spread (Difference in Yield)

This is an indicator to compare the earnings-price ratio and long-term interest rates on long-term government bonds, etc. The narrower the yield spread becomes, the more undervalued the share price may seem.

Formula <14>

$$\textbf{Yield Spread} = \text{Yields of Long-Term Bonds} - \text{Earnings Price Ratio}$$

12 10 The EV/EBITDA Multiple

EBITDA (pronounced "ee-bitt dee-ay" or "ee-bitt-da") stands for Earnings Before Interest, Taxes, Depreciation and Amortization, and is a profit indicator devised to compare the profitability of companies on an international scale. "EBITDA" is a measure of profit that reduces to the extent possible international differences in interest levels, tax rates and accounting standards for items such as depreciation methods. Recently EBITDA has become one of the most often used tools in enterprise valuation, and stands on par with Profit/Loss Statement profit.

Formula <15>

EBITDA = Pre-Tax Profits + Interest Payable + Depreciation/Amortization Expenses

In valuing a particular share, analysts use the enterprise multiple EV/EBITDA, which looks at Enterprise Value (or "EV (Enterprise Value)," which equals market capitalization + interest-bearing debt − cash and deposits − short-term securities) as a multiple of EBITDA.

Formula <16>

$$\textbf{EV/EBITDA Multiple} = \frac{\text{EV}}{\text{EBITDA}}$$

The enterprise multiple is used for transnational comparisons of companies in the same industry. The lower the multiple, the greater the possibility that the share is undervalued; conversely, the higher the multiple, the more likely that the share is overvalued. For example, if American Company A has an EV/EBITDA multiple of nine, and Japanese Company B has a multiple of eight, the share in American Company A can be said to be overvalued in relation to Japanese Company B.

(Sample Question) What is the EV/EBITDA multiple of a company that has capital of JPY90 billion, a market capitalization of JPY850 billion, profit surplus of JPY40 billion, cash and deposits on hand (including short-term securities) of JPY50 billion, interest-bearing debt of JPY650 billion, and EBITDA of JPY170 billion?

(Note) Fractions of more than two digits are rounded off.

EV = JPY850 billion (Total Current Market Value) + JPY650 billion (Interest-Bearing Debt) − JPY50 billion (Cash and Deposits + Short-Term Securities) = JPY1,450 billion

Accordingly, under Formula<16>:

$$\text{EV/EBITDA Multiple} = \frac{\text{JPY1,450 billion}}{\text{JPY170 billion}} = \underline{\text{8.5 times}}$$

12 11 Average Share Price and Share Indexes

(1) Simple Average (Simple Average Share Price)

The simple average share price is the aggregate share price of the issues covered divided by the aggregate number of issues and would be computed as follows:

$$\textbf{Simple Average Share Price} = \frac{\text{Total Share Price of All Issues Covered}}{\text{Number of Issues Covered}}$$

The simple average share price for all issues listed on the TSE Prime Market is published.

It is simple to calculate, and convenient as a measure of the increase and decrease of the share price in general. However, share prices decrease every time there is an ex-rights issue for capital increases. Since this is not based on fluctuations in market conditions, the share price loses continuity and therefore, there is the disadvantage of not being able to form comparisons with past prices. The Nikkei Stock Average is designed and calculated to compensate for this disadvantage, and to maintain share-price continuity.

(2) Nikkei Stock Average (Nikkei Average, Nikkei 225)

The Nikkei Stock Average is calculated by averaging the share price of the 225 most representative and liquid shares selected from among shares listed on the TSE Prime Market and also, to maintain continuity, adjusting for the ex-rights market price for capital increases, etc. The Nikkei Stock Average has a long history and it is used as the most general index for share prices.

Since the Nikkei Stock Average is a simple average, it is easily influenced by fluctuations of prices of high-priced issues.

For example, assuming the share prices of Company A, Company B and Company C are JPY300, JPY200 and JPY100 respectively, the simple average of these prices would be computed as follows:

$$\frac{\text{JPY300} + \text{JPY200} + \text{JPY100}}{3} = \underline{\text{JPY200}}$$

If Company A performs a 1 : 2 share split, the share price of Company A, *i.e.* its ex-rights market price will be JPY150 regardless of the fluctuation in market conditions. A simple average in this case would be:

$$\frac{\text{JPY150} + \text{JPY200} + \text{JPY100}}{3} = \underline{\text{JPY150}}$$

In order to maintain continuity to the share price, the denominator needs to be changed:

$$\frac{\text{JPY300} + \text{JPY200} + \text{JPY100}}{3} = \frac{\text{JPY150} + \text{JPY200} + \text{JPY100}}{\text{X}}$$

X = 2.25, in other words, the denominator becomes $\underline{2.25}$.

Therefore, the answer is derived by multiplying the simple average after ex-rights by 3/2.25 or by a multiplier of approximately 1.33. In this respect, the Nikkei Stock Average is calculated with an adjusted denominator in order to maintain its continuity. When the capital increase goes ex-rights, the initial denominator (225) is adjusted downward; as a result, the current denominator is a 30. 58944682 (as of April 1, 2024). Also, since the 225 composite issues in the Nikkei Stock Average are revised periodically, when certain issues are replaced, the denominator is revised as described above.

(Review of the Nikkei Stock Average)

Until April 1, 2022, the Nikkei Stock Average had been "calculated by taking the average among the 225 issues representative of the issues listed on the TSE First Section." Since April 4, 2022, as a result of the TSE market restructuring, it has been "calculated by taking the average among the 225 issues representative of the issues

listed on the TSE Prime Market."

Before change	After change
The Nikkei Stock Average is calculated by totaling the stock prices of the component issues as "converted at the constructive face value," and then dividing the total by the "denominator." Adopted stock price of each component issue = Stock price × (50 ÷ constructive face value) Nikkei Stock Average = Total of the adopted stock prices of the component issues ÷ denominator	The Nikkei Stock Average is calculated by totaling the stock prices of the component issues as adjusted by the "stock price conversion factor," and then dividing the total by the "denominator." Adopted stock price of each component issue = Stock price × stock price conversion factor Nikkei Stock Average = Total of the adopted stock prices of the component issues ÷ denominator

In addition, in order to improve the accuracy of the calculation of the index values, the number of decimal places of the denominator has been increased from three to eight (the denominator is rounded to the eighth decimal place). This new rule has applied in the first review of the denominator since June 2022.

(3) Tokyo Stock Price Index (TOPIX)

This is a stock price index calculated using market capitalization weighting. The amount of the increase or decrease of the total market value on issues selected by JPX Market Innovation & Research (JPX Market Innovation & Research, Inc. (JPXI) has been newly established as a non-exchange subsidiary with the aim of pursuing the creation of market services that contribute to better functionality and efficiency across the board. Starting from April 1, 2022, JPXI calculates indexes such as TOPIX) from among those listed on the TSE Market compared to the total market value at a base date, serves to indicate the movement of the price of all shares in the market. In other words, by looking at changes to the asset value of the overall stock market, changes to share prices can be seen.

In terms of calculation methodology, TOPIX uses January 4, 1968 (closing price) as a base calculation date, on which the base of the index was set at 100, and the index is calculated for all subsequent dates.

Historically, TOPIX has been used as an index calculated through a comparison of the sum of share prices multiplied by the number of shares for all issues listed on the First Section of the TSE Market; that is, the total market value at the time of calculation (share price × number of shares) compared to the base market value (aggregate market value on the base date (January 4, 1968)). This calculation of TOPIX includes so-called "fixed shares" which are shares viewed as being, as a practical matter, unavailable for trades in the market, and it was anticipated that this might cause unbalanced supply and demand in the formation of prices for those issues constituting TOPIX. In October 2005, a free-floating share index was introduced to improve this situation, and in July 2006 the migration was completed.

* "Fixed shares" refer to those shares held by a section of shareholders for which the possibility of being traded in the market is considered low due to a business strategy.
* "Free-floating shares" refer to listed shares excluding fixed shares, or shares for which there is a possibility of being traded in the stock market.

$$\textbf{Tokyo Stock Price Index} = \frac{\text{Total Current Market Value at the Time of Index Calculation}^{(\text{Note})}}{\text{Base Market Capitalization}} \times 100$$

(Note) Basis for the number of shares
- Number of shares for the TOPIX = all listed shares × free-floating share ratio

* The free-floating share ratio = 1 − fixed share ratio (fixed shares/number of shares) Periodic review at every financial period and extraordinary review will be made.

(Review of TOPIX)

The TSE market segments was changed as of April 4, 2022. TOPIX constituents as of the business day before the market restructure (April 1, 2022) will continue to be TOPIX constituents regardless of their selected market segment. However, constituents with a tradable share market capitalization (TSMC) of under JPY10 billion will be designated as "phased weighting reduction constituents." Their weighting will be reduced in stages starting at the end of October 2022, and they will be removed from the index around four years later at the end of January 2025.

The transition will be carried out in stages until January 2025, in consideration of the impact on index users and the market, etc.

Designations as phased weighting reduction constituents will be re-evaluated, to reflect any positive changes in TSMC that may have occurred.

Companies which list for the first time during the transition period (April 2022 to the end of January 2025) will become TOPIX constituents only if they list on the Prime Market. However, TSE plans to expand the scope of TOPIX constituents to include shares listed on the Standard Market and the Growth Market.

The Market Capitalization Weighted TOPIX (Ex-TOPIX) will continue to be available. It was launched on the day that the concept of free float weight (hereinafter "FFW") ratios was introduced to TOPIX (October 31, 2005) as an alternative TOPIX for which FFW had not been introduced, using the closing price from October 28, 2005 as TOPIX's closing price.

(4) TOPIX 100

TOPIX 100 is a market value-weighted index obtained by dividing TOPIX constituents into seven groups based on their size and according to certain standards. TOPIX 100 is composed of 100 issues from the constituents of TOPIX; i.e., TOPIX Core 30 with highest market capitalization and liquidity, and 70 issues selected by JPXI from among the constituents of TOPIX 100 as of the base date.

It is calculated by assuming the level as of April 1, 1998, as 1,000 points.

(5) TOPIX High Dividend Yield 40

TOPIX High Dividend Yield 40 Index is composed of the latest 40 issues with actual dividend yields being relatively high among the TOPIX 100 issues.

These constituents are selected by JPXI based on the actual dividends of each issue and on the stock prices on the periodic selection base dates. The TOPIX High Dividend Yield 40 Index is calculated by assuming the level as of August 25, 2017, as being 1,000 points. Its constituents are regularly replaced once a year (which is on the last business day in June).

(6) JPX-Nikkei Index 400 (JPX-Nikkei 400)

JPX-Nikkei Index 400 is a new index composed of issues of 400 companies that meet requirements of global investment standards, such as efficient use of capital and investor-focused management perspectives and high appeal for investors. It is calculated by JPXI and Nihon Keizai Shimbun as a float-adjusted market value-weighted index.

The calculation started on January 6, 2014, assuming the level as of August 30, 2013 (the base date) as 10,000 points.

JPX-Nikkei Index 400 constituents are selected from common stocks listed mainly on the Prime Market, Standard Market, and Growth Market of the TSE. This index is a new type in that high-achieving companies measured by performance indicators, such as ROE (return on equity) and operating earnings, are mainly selected as its constituents. Specifically, constituents are selected through screening (screening by eligibility criteria and screening by market liquidity indicator), scoring based on quantitative indicators, and scoring based on qualitative indicators.

A review for issue replacement is conducted on the last business day of August each year with the last business day of June as the base date.

$$\textbf{JPX-Nikkei Index 400} = \frac{\text{Total Market Capitalization for the Index at the Time of Calculation}}{\text{Base Market Capitalization}} \times \text{Base Point}$$

* Second decimal place (rounding off to second decimal place)

JPX-Nikkei Index 400 is delivered in real time, per second, via the TSE's Market Information System.

(7) Major Stock Indices Newly Introduced upon Market Restructuring

Upon the changes in the market segmentation as of April 4, 2022, the main stock indices which have been launched are as follows.

(i) TSE Prime Market Index

The TSE Prime Market Index is a stock index calculated by free-float adjusted market capitalization which is composed of the common stocks of all issues listed on the TSE Prime Market. There is no periodic review of the constituents. Issues which have made initial listings on this market will be included in the constituents on the last business day of the month following the month containing the listing date, whereas issues which transfer from another market segment will be included on the transfer date. Constituents which are delisted or designated as Securities to be Delisted, or transfer to a different segment will be removed.

(ii) TSE Standard Market Index

The TSE Standard Market Index is a stock index calculated by free-float adjusted market capitalization which is composed of the common stocks of all issues listed on the TSE Standard Market. The rules for inclusion and removal of the constituents are the same as the TSE Prime Market Index.

(iii) TSE Growth Market Index

The TSE Growth Market Index is a stock index calculated by free-float adjusted market capitalization which is composed of the common stocks of all issues listed on the TSE Growth Market. The rules for inclusion and removal of the constituents are the same as the TSE Prime Market Index.

(iv) TSE Prime Market Composite Index

The TSE Prime Market Composite Index is a stock index calculated by free-float adjusted market capitalization which is composed of all "domestic common stocks," "domestic preferred equity contribution securities," "participation-type domestic classified stocks," and "foreign stocks listed only on TSE" listed on the TSE Prime Market. The rules for inclusion and removal of the constituents are the same as the TSE Prime Market Index.

(v) TSE Growth Market Core Index

The TSE Growth Market Core Index is a stock index calculated by using a stock price average which is composed of constituents selected from among those listed on the TSE Growth Market based on their levels of market capitalization, trading value, and financial standing. Newly included issues are adjusted so that the weight on the weight reference date is 5%. The eligible issues are all domestic common stocks listed on the Growth Market. A periodical review is conducted on the last business day of October every year. The base date is the last business day of August, and the 18 issues with the highest market capitalization of all constituents on the base date, excluding those listed on markets other than the Growth Market, will continue to be included. To reach the number of 20, issues will be added based on the following inclusion criteria in descending order of market capitalization: (1) an FFW ratio must be at least 0.2; and (2) issues which are in the bottom 10% of issues on the Growth Market (based on no. of issues) for trading value for the most recent year to date are ineligible. Constituents which are delisted, those designated as Securities to be Delisted or those designated as Securities on Alert will be removed. The TSE Growth Market Core Index is expected to be the successor of the TSE Mothers Core Index.

(vi) TSE Standard Market TOP20 Index

The TSE Standard Market TOP20 Index is a stock index calculated by using a stock price average which is composed of constituents selected from among those listed on the TSE Standard Market based on their levels of market capitalization, trading value, and financial standing. Newly included issues are adjusted so that the weight on the weight reference date is 5%. The eligible issues are all domestic common stocks listed on the Standard Market. The rules for inclusion and removal of the constituents are almost the same as the TSE Growth Market Core Index. The TSE Standard Market Top20 Index is expected to be the successor of JASDAQ-TOP20.

(8) Other Share Indexes

Other indexes of shares calculated by JPXI include the following: Size-based TOPIX Sub-Indices, TOPIX Newly Calculated Index Series, TOPIX Sector Indices, TOPIX Leveraged and Inverse Indices, Market Capitalization Weighted TOPIX, TSE REIT Index, and TSE Infrastructure Funds Index.

Indexes calculated by Nihon Keizai Shimbun (Nikkei) include the following: Nikkei Stock Index 300, Nikkei 500 Stock Average, Nikkei JAPAN 1000, Nikkei 225 Dividend Point Index, Nikkei 225 Total Return Index, Nikkei 225 Leveraged Index, Nikkei 225 Inverse Index, and Nikkei Stock Average Volatility Index.

Indices of shares listed on the NSE include the Nagoya Stock Price Index (composite and Nagoya issues respectively for both the Premier Market and the Main Market).

12 12 Delivery Amount for Share Trading

When a sale or purchase contract for shares is concluded, the settlement (delivery) takes place on the second business day counting from the contract date. This payment is calculated by adding a brokerage commission (it is subtracted in the case of a sale), which should be paid to the financial instruments business operator that conducted the trade of securities, to the contract price (share price × number of shares).

The brokerage commission on trades in shares was completely deregulated in October 1999, and is determined by each financial instruments business operator.

(Sample Question) When placing a market order to purchase 7,000 shares of Company A, a contract for 5,000 shares at JPY1,000 and a contract for 2,000 shares at JPY1,010 are concluded on the same day. What is the delivery amount in this case?

* Assume that the brokerage commission is calculated in accordance with the following table. Further assume that even if more than one contract is concluded for the same issue in a single day, the brokerage commission is to be calculated on the total amount of the values for the various contracts with these being treated as one order.

Contract Amount	Brokerage Commission
≤JPY1 million	Total contract amount×1.150%
>JPY1 million≤JPY5 million	Total contract amount×0.900%+JPY2,500
>JPY5 million≤JPY10 million	Total contract amount×0.700%+JPY12,500
>JPY10 million≤JPY30 million	Total contract amount×0.575%+JPY25,000
>JPY30 million≤JPY50 million	Total contract amount×0.375%+JPY85,000

(Note) ・Amounts less than one whole yen are rounded off.
・An amount corresponding to the consumption tax is added.

Contract Price for the Company A Share:
(JPY1,000 × 5,000 shares) + (JPY1,010 × 2,000 shares) = JPY7,020,000
Brokerage Commission: JPY7,020,000 × 0.700% + JPY12,500 + Amount Equivalent to Consumption Tax= JPY61,640 + (JPY61,640 × 10%) = JPY67,804
Delivery Amount: JPY7,020,000 + JPY67,804 = JPY7,087,804

(Sample Question) 10,000 shares of Company B share were purchased at JPY600 per share. What is the delivery amount in this case?

* Assume that the brokerage commission is to be calculated as 0.5% of the trading price.

Contract Price for Company B Share: JPY600 × 10,000 shares = JPY6,000,000
Commission:
JPY6,000,000 × 0.5% + Amount Equivalent to Consumption Tax
= JPY30,000 + (JPY30,000 × 10%) = JPY33,000
Delivery Amount: JPY6,000,000 + JPY33,000 = JPY6,033,000

(Sample Question) What is the delivery amount when 50,000 shares of Company C Share are sold for JPY200 per share?

* Assume that the brokerage commission is to be calculated as a flat JPY50,000 per order irrespective of trading price.

Contract Price for Company C Share: JPY200 × 50,000 shares = JPY10,000,000
Brokerage Commission:
JPY50,000 + Amount Equivalent to Consumption Tax
= JPY50,000 + (JPY50,000 × 10%) = JPY55,000
Delivery Amount: JPY10,000,000 – JPY55,000 = JPY9,945,000

* Tax on capital gain of listed shares, etc. is not considered.

12 13 Margin Transactions and Security Deposit/Minimum Maintenance

(Sample Question) I want to purchase 10,000 shares at their market price of JPY1,200 on margin transaction. If I am going to substitute share certificates listed on a stock exchange for the security deposit, what must the minimum market price for this share be (assume the security deposit ratio is 30% and the cash conversion ratio (*daiyō kakeme*) for this share is 80%)?

Contract Amount: JPY1,200 × 10,000 shares = JPY12,000,000
Required Margin: JPY12,000,000 × 30% = JPY3,600,000
JPY3,600,000÷80% = JPY4,500,000

(Sample Question) I purchased on margin transaction 10,000 shares of Company A share for JPY1,000 per share, and contributed Company B share with a market price at the time of JPY7.5 million with margin securities for cash margin. If the value of the Company B share used as security deposit thereafter falls to JPY5 million, how much will the

Company A share purchased have to decline in value until it drops below the minimum maintenance, requiring a margin call (assume the cash conversion ratio (*daiyō kakeme*) for share is 80%)?

The minimum maintenance derives from the calculation, Security Deposit Amount − Valuation Loss on Position = Contract Amount 20%, and if we substitute X for the Valuation Loss on Position, we can solve the equation for X as below:

JPY5,000,000 × 80% − X = JPY10,000,000 × 20%
JPY4,000,000 − X = JPY2,000,000
∴X = JPY2,000,000

If the Valuation Loss on Position exceeds JPY2 million, it will drop below the minimum maintenance level. So,

JPY10,000,000 − JPY2,000,000 = JPY8,000,000
JPY8,000,000 ÷ 10,000 shares = JPY800

Therefore, if the share price of Company A falls below JPY800, a margin call will be necessary.

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1 Basic Knowledge Concerning Bonds

1 1 Bonds and Their Features

(1) Definition of Bonds

Bonds are certificates issued by a national government, local government, government sponsored entities, corporations, financial institutions or other organizations which procure a large amount of funds at one time from the investing public at large. Such certificates are in exchange for the funds in order to clarify the terms and conditions of the financing, such as the repayment of principal and the payment of interest.

Bond issuance is exemplified by the usual relationship between a borrower and a lender of funds: the issuer is the debtor (borrower) while the investors (bondholders) are the creditors (lenders), and the bond is equivalent to an IOU.

However, bond issuance generally has the following features that distinguish them from the usual money loan for individuals:

(i) A large number of investors invest under a uniform set of conditions;
(ii) The issuer can procure a large amount of funds at one time; and
(iii) Bonds are standardized as securities, which give the right to claim repayment of the principal as well as the right to claim the payment of interest, and which allow holders to transfer to a third party their status as creditor by the sale of such securities at any time.

Whereas bonds are a means for procuring funds from the standpoint of the issuer, they are an investment target from the standpoint of the investor who purchases bonds. Therefore, the characteristics of bonds must, of course, be evaluated from both sides.

While bonds were traditionally issued as certificates in the form of physical pieces of paper, paperless processing has come into use due to recent advances in information and communication technology, which makes it possible to digitally record the monetary amount of bonds held by investors as well as conditions such as repayment of principal and payment of interest to the ledger in which the rights belong to the investors, instead of issuing certificates that indicate these matters on their faces. As a result, bonds are now issued as book-entry transfer bonds. Some bonds are issued as security tokens (digital bonds) using blockchain technology.

This kind of paperless processing does not, however, change the nature of "bonds," which represent securities by which the entity raising the funds is committed to redeeming a large number of investors' bonds under a uniform set of conditions. Moreover, the state in which the rights an investor holds in connection with a bond can be transferred by sale to another investor is also managed only in the form of an increase or decrease in the amount retained as entered on the ledger.

(2) Bonds as a Means of Procuring Funds

Just as different issuers, such as national governments, local governments, government sponsored entities, corporations, and financial institutions have different characteristics, simply stating that "bonds are a means of

procuring funds" belies the differences in the reasons why various entities seek out funds through bond issuance. In general, bonds have the following features:

(i) Funds procured by bond issues are most often redeemed on a medium to long-term basis;
(ii) Borrowing from a financial institution is another way to raise a large amount of long-term funding at one time; however, a bond issuance is often preferable due to the amount and conditions for issuance. This is a function of the nature of bonds, which is comprised of multiple creditors, and the free transferability of rights; and
(iii) In addition to issuing bonds, a private corporation can raise long-term stable funds through issuing new shares with capital increase. In contrast to capital increase, where the funds obtained can be used semi-permanently, bonds must be redeemed (that is, funds must be repaid) upon maturity.

(3) Bonds as Investments

The important thing in selecting bonds or any other investment, such as bank deposits, loan trusts, investment trusts, shares or land, etc., is to meticulously test the investment product from three perspectives: profitability, safety, and convertibility into cash.

(i) Profitability

Normally, bonds pay a specific rate of interest throughout the entire period from the issuance to the redemption of the bond. Bonds with interest accrued at a rate that is promised upon their issuance are called "fixed rate bond." The interest rate for fixed rate bonds does not change despite changes in the financial market environment or the issuer's business performance.

It is this feature that fundamentally differentiates bonds from other investment products such as land, buildings, or shares, whose future expected return is uncertain. In summary, as a means of systematic fund management, fixed rate bonds are unsurpassed.

Fixed rate bonds are often said to be resilient when interest rates are falling; this is because the bondholders are promised a long-term fixed rate of interest, and thus, are able to benefit from capital appreciation in the bonds in addition to interest income under a decreasing interest rate environment. Conversely, however, bonds are vulnerable to the financial environment such as rising interest rates or inflation.

On the other hand, bonds for which interest rates fluctuate depending on the economic situations or interest rate environment are called "floating rate bonds." Interest accrued on these bonds increases when the interest rate goes up, and decreases when the interest rate goes down. Therefore, the forecast for the future trends in interest rates is an important factor when examining profitability of floating rate bonds.

It may depend on whether it is a fixed rate bond or a floating rate bond, or the interest rate trends, but comprehensively speaking, bond investments are more advantageous than savings deposits in terms of the earning potential, *i.e.*, level of return that is expected from them. The reason being that first, bonds can pay a relatively high interest amount since they enable the issuer to procure long-term stable funds. Second, bonds can omit the margins for intermediaries since bonds are a direct investment between the bond issuer and the investors.

(ii) Safety

Ordinarily, bonds have a maturity date, and the issuer covenants to repay the principal when that date

arrives. Regardless of how the financial market environment or the bond market prices change during the interim, bondholders ordinarily can recoup the bond principal in full simply by waiting for the maturity date to arrive.

However, if the issuer falls into financial distress or its operating results deteriorate, interest payments on the bonds can be delayed, and in some cases the issuer cannot redeem the bond principal. These types of circumstances are referred to as a default on bonds. In fact, during 2001, defaults on the Argentine government bonds, as well as bonds issued by Mycal and bonds issued by Enron in the U.S. caused major problems. Moreover, the defaults occurred one after another in the unprecedented financial crisis since 2008, causing attention to come to focus on the credit risk of the issuer.

Therefore, to prepare for the worst scenarios, some types and issues of bonds come with the following kinds of guarantees or security interests in order to ensure that bond interest and principal payments will be made on schedule:

A.	Government Guarantee:	These are bonds for which the government guarantees the payment of principal and interest.
B.	General Collateral:	These are bonds secured by a type of general lien that allows the holder to receive preferential repayment from all the issuer's assets that takes priority over other creditors. These include the government sponsored entity bonds (agency bonds) issued by public agencies, electric company bonds issued by electrical power companies, telegraph and telephone bonds issued by NTT, etc.
C.	Secured Mortgage:	These are bonds secured by a mortgage (managed by a mortgage trustee company) on specific assets such as property, factories, and ships owned by the issuer

On the other hand, most general corporate bonds, etc. issued in public offerings are unsecured bonds.

(iii) Convertibility into Cash

Prices of bonds are relatively stable, despite their market fluctuations, due to the assurance that the interest rate will not change from issuance to maturity, and the assurance that the principal can be collected in full upon maturity. In addition, bonds can be cashed in prior to maturity by selling them. The convertibility of a bond into cash can be referred to as liquidity.

As a rule, pre-maturity conversion of bonds into cash shall be made at the market value that changes from hour to hour. Therefore, the principal amount collectable prior to maturity could fall or rise, depending on the financial conditions at that time, the supply and demand of the bonds themselves or creditworthiness of the issuer.

For the conversion of bonds into cash prior to maturity, the existence of an investor who will purchase such bonds to be sold by the current investor is indispensable. It is generally said that the more creditworthy and well-known a bond is, the larger the issue amount and the broader the investor base holding the bond, the more liquidity that bond will have.

Chart 4-1 Criteria for Selecting Financial Products (The Most Important Factors)

(Unit: % of households)

	Profitability	Because of High Yield	Because of Future Capital Appreciation Potential	Safety	Because of Guaranteed Principal	Because Distributors as Financial Institutions are Trustworthy and Reliable	Liquidity	Because Conversion for Cash is Easy	Because of Freedom to Make Deposits and Withdrawals, Even in Small Amounts	Because Products are Easily Understandable	Other
2014	16.7	11.7	4.9	45.7	29.5	16.3	25.1	6.0	19.1	3.1	7.9
2015	17.6	11.9	5.6	46.1	29.3	16.8	23.1	6.0	17.2	3.2	8.4
2016	17.5	12.1	5.4	45.7	29.9	15.8	24.7	6.7	18.0	2.4	7.9
2017	18.7	12.9	5.9	46.6	30.1	16.5	21.0	5.5	15.5	3.2	9.1
2018	17.6	11.3	6.2	41.8	27.8	14.0	25.8	5.7	20.1	2.2	9.9
2019	19.0	11.5	7.5	41.9	28.2	13.6	22.9	6.1	16.8	2.6	10.8
2020	22.0	12.4	9.5	37.2	26.5	10.6	24.5	7.3	17.2	4.1	9.6
2021	34.9	18.7	16.1	29.2	22.2	7.0	21.0	8.5	12.4	4.1	10.9
2022	35.9	19.8	16.1	29.7	22.9	6.8	20.2	8.3	11.9	4.4	9.8
2023	35.1	19.9	15.2	30.0	22.9	7.0	20.4	7.6	12.8	5.1	9.5

(Source) Prepared based on "Public Opinion Survey on Financial Behavior of Household Account" in 2023 conducted by the Central Council for Financial Services Information.

1 2 Types of Bonds

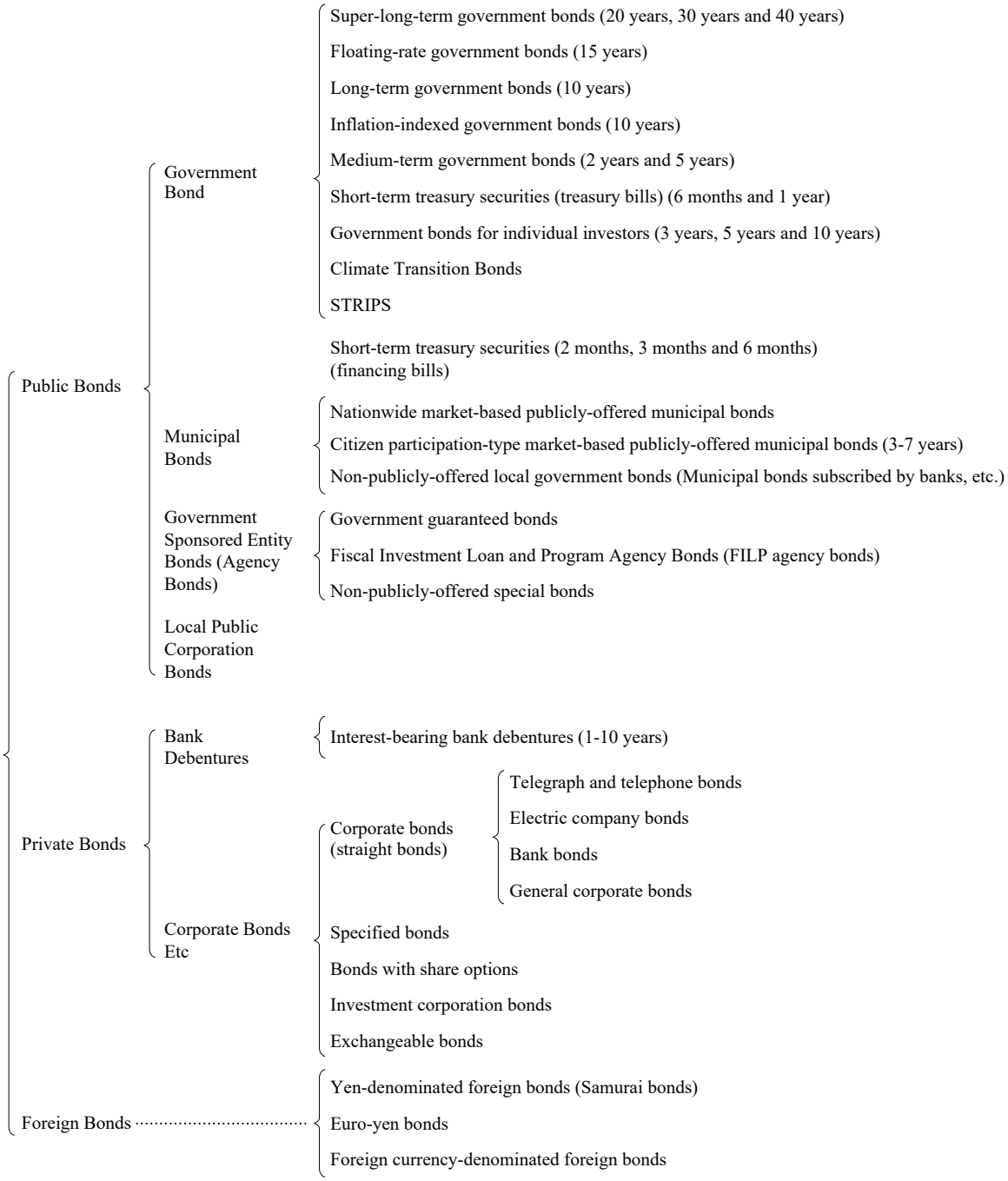
There are various standards for categorizing bonds. These include, for example, differences in the issuer's type of business, method of offering, whether the bond is secured or unsecured, interest-bearing or discounted, length until maturity, and so on.

It might be considered fundamental and practical to categorize bonds based mainly on the issuer's type of business, with additional factors considered as needed. Basically, there are **public bonds** issued by the national government and local governments, etc.; **private bonds** issued by private companies; and **foreign bonds** issued by foreign governments or foreign corporations, etc. Public bonds are composed of **Japanese government bonds**, issued by the national government; **municipal bonds** (also referred to as "**local government bonds**"), issued by local governments; **government sponsored entity bonds (agency bonds)**, issued by incorporated administrative agencies or governmental special companies under enabling legislation; **local public corporation bonds**, issued by public corporations established by a local government. Private bonds are composed of: **bank debentures**, issued by financial institutions under special enabling legislation such as the Long-Term Credit Bank of Japan Act, etc.; **corporate bonds**, issued by private corporations; **specified bonds**, issued by specific purpose companies; and **investment corporation bonds**, issued by investment corporations (See Chart 4-2).

By checking the amount of bonds outstanding, one can see the scale of the bond market and its breakdown into these categories.

As of the end of FY2023, more than 90% of the approximately JPY1,386 trillion in bonds outstanding were public bonds. In particular, Japanese government bonds represented over 80% of the entire bond market (see Chart 4-3 and Chart 4-4).

Chart 4-2 Major Types of Bonds



(1) Government Bonds

Just as the name indicates, Japanese government bonds are bonds issued by the national government, and are considered to have the highest credit rating of all types of bonds.

Major government bonds that are publicly issued include super-long-term government bonds, long-term government bonds, inflation-indexed government bonds, medium-term government bonds, short-term treasury securities, and government bonds for individual investors. In addition, there are government compensation bonds, issued by the national government in lieu of cash payments for liabilities assumed by the national government under a specific statute in order to fulfill a specific national policy objective. These are, in most cases, characterized by being subject to a restriction on transfer and thus, having a low degree of liquidity.

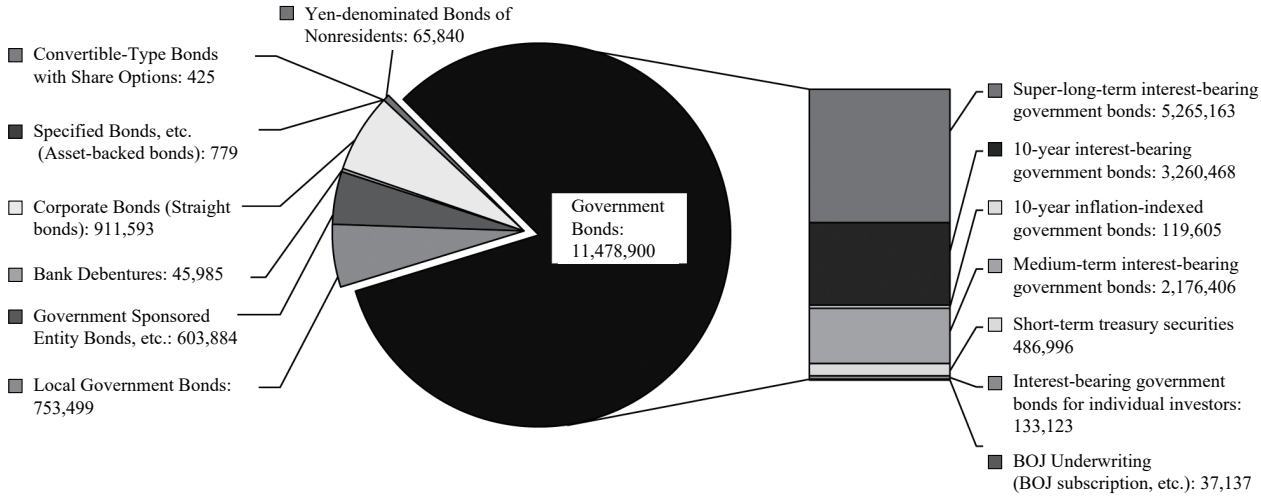
Chart 4-3 Issued Amounts and Outstanding Amounts by Bond Type

			Amount Issued During FY2023		Outstanding Amount at End of FY2023	
			JPY100 million	(%)	JPY100 million	(%)
Government Bonds	Open Market Issues	Super-long-term interest-bearing government bonds	370,766	16.2	5,265,163	38.0
		10-year interest-bearing government bonds	384,359	16.8	3,260,468	23.5
		10-year inflation-indexed government bonds	9,996	0.4	119,605	0.9
		Medium-term interest-bearing government bonds	700,543	30.6	2,176,406	15.7
		Short-term treasury securities	486,996	21.3	486,996	3.5
		Interest-bearing government bonds for individual investors	34,034	1.5	133,123	1.0
		(Sub-total)	1,986,706	86.8	11,441,763	82.8
	BOJ Underwriting (BOJ subscription, etc.)		19,999	0.9	37,137	0.3
	(Sub-total)		2,006,705	87.7	11,478,900	82.8
Municipal Bonds	Publicly-Offered Local Government Bonds		55,273	2.4	640,287	4.6
	Underwritten by Banks, Etc. (As securities)		6,851	0.3	113,211	0.8
	(Sub-total)		62,124	2.7	753,499	5.4
Government Sponsored Bonds, Etc.	Government-Guaranteed Bonds		19,620	0.9	178,132	1.3
	FILP Agency Bonds, etc.		28,680	1.3	425,752	3.1
	(Sub-total)		48,300	2.1	603,884	4.4
Bank Debentures			8,572	0.4	45,985	0.3
Corporate Bonds (Straight Bonds)			147,791	6.5	911,593	6.6
Specified Bonds, Etc. (Asset-Backed Bonds)			0	0.0	779	0.0
Convertible-Type Bonds with Share Options			227	0.0	425	0.0
Yen-Denominated Bonds of Nonresidents			14,991	0.7	65,840	0.5
Total			2,288,712	100.0	13,860,910	100.0

(Notes) 1. Excluding short-term government securities ("financing bills") within short-term treasury securities. Super-long-term interest-bearing bonds include 15-year floating-rate government bonds. Publicly-offered local government bonds include joint-issue bonds and citizen publicly-offered bonds.
2. The figures indicated in the total column may not be consistent with the actual totals due to rounding down to the nearest billion for amounts or to one decimal place for percentages.

(Source) Prepared based on the "Issuing, Redemption and Outstanding Amounts of Bonds" compiled by the JSDA and "Public Offering and Underwritten by Banks, Etc. Local Government Bonds Issuance, Redemption, and Outstanding Amount" in the "Japan Local Government Bond Association Report" compiled by the Japan Local Government Bond Association.

Chart 4-4 Outstanding Amount at End of FY2023 (Unit: JPY100 million)



(Source) Prepared based on the "Issuing, Redemption and Outstanding Amounts of Bonds" compiled by the JSDA and "Public Offering and Underwritten by Banks, Etc., Local Government Bonds Issuance, Redemption, and Outstanding Amount" in the "Monthly Local Government Bond Report" compiled by the Japan Local Government Bond Association.

(i) Super-Long-Term Government Bonds (20, 30 and 40-Year Interest-Bearing Government Bonds)

These are super-long-term government bonds issued with a maturity of 20, 30 or 40 years. Those with a maturity of 20 or 30 years are issued under a public auction method by a price competitive auction, while those with a maturity of 40 years are issued under a public auction method by a competitive yield auction.

From FY2007, the auction method for 30-year interest-bearing government was changed to a price competitive auction from the competitive yield auction that had been in place until that time.

40-year interest-bearing government bonds were first issued in November 2007.

(ii) Long-Term Government Bonds (10-Year Interest-Bearing Government Bonds)

This is the core issue of bond markets in Japan, in both the primary and secondary markets. The issuance terms and secondary market yield of these bonds form a benchmark for government bonds with different maturities and for other domestic bonds. Today, the public auction method by price competitive auction is used for issues.

(iii) Medium-Term Government Bonds (2-Year and 5-Year Interest-Bearing Government Bonds)

These are issued under a public auction method by a price competitive auction. Currently, there are two types being issued, 2-year and 5-year maturities.

(iv) Short-Term Treasury Securities (Treasury Discount Bills, or TDB)

Previously, discount short-term government bonds and short-term government securities were issued. However, beginning in February 2009, these securities have been combined into short-term treasury securities. These are issued according to a discount formula determined by price competitive auction in order to even out the redemption of government bonds and to facilitate the rolling over of borrowing, and to provide support funds for temporary shortfalls in cash within the general account and the various special accounts of the national government. The maturity periods are two months, three months, six months and one year. Since January 2016, not only corporations, but also individuals have become eligible to own these securities.

At present, two-month TDBs, three-month TDBs and six-month TDBs are issued as short-term government securities under the Administrative Regulation for Government Funds Procurement and six-month TDBs and one-year TDBs are issued as discount short-term government bonds under the Ministerial Ordinance on Issuance of National Government Bonds. Two-month TDBs, three-month TDBs and six-month TDBs, which are issued as short-term government securities, are institutionally not included in the category of "government bonds."

(v) Floating-Rate Government Bonds

Floating-rate government bonds are bonds with a maturity of 15 years, two interest payment dates per year, and a coupon that changes in accordance with market conditions. Specifically, the interest rate is calculated by deducting a value of α that is determined in advance by the Ministry of Finance, from the standard interest that is calculated on the basis of the average auction price of 10-year interest-bearing government bonds, at the auction that is held immediately prior to determining the interest rate of the floating-rate government bonds. The value of α remains unchanged through to maturity even if the coupon is modified. These bonds have not been issued after the issuance in May 2008.

Any of the government bonds described in (i) through (v) above that are issued under a public auction method by a price competitive auction can also be partially issued in small amounts by noncompetitive auction.

(vi) Government Bonds for Individual Investors

Government bonds for individual investors are government bonds that limit purchasers to individuals.

Floating interest rate type government bonds with a maturity of 10 years have been issued from March 2003, and fixed interest rate type government bonds with a maturity of 5 years have been issued from January 2006, while fixed interest rate type government bonds with a maturity of 3 years have been issued from July 2010. At present, these bonds are offered monthly in the purchase unit of JPY10,000 starting from a face value of JPY10,000. From December 2011 until May 2013, these three types of government bonds offered to individuals had been issued as reconstruction government bonds offered to individuals. In addition, from April 2012 until January 2013, floating interest rate type reconstruction support government bonds with a maturity of 10 years offered to individuals had also been issued.

Floating interest rate type government bonds with a maturity of 10 years make payments at a floating interest rate two times annually, and for those issued in July 2011 and afterwards, the interest rate level is the base rate (the compound interest yield calculated based on the average contract price of 10-year fixed rate bonds at the last auction that took place in the month preceding the month in which the calculation period of the interest rate starts)(Note) multiplied by 0.66 (the minimum interest rate is 0.05%). (With regard to the reconstruction support government bonds mentioned above, which have characteristics of floating interest rate type bonds with a maturity of 10 years, the minimum interest rate (0.05%) shall apply for the initial three years from the issuance irrespective of the market climates, and the bondholders were conferred commemorative coins three years after the issuance, in proportion to the outstanding balance of bonds they hold.)

(Note) However, for the interest on the first payment date, this shall be the auction that took place immediately before commencement of the offering period.

Chart 4-5 **Comparison of Government Bonds for Individual Investors ("Fixed Interest 3-Year," "Fixed Interest 5-Year," and "Floating Interest 10-Year") and Government Bonds Sold by the New Teller-Window Sales Method**

	Fixed Interest 3-Year Government Bonds for Individual Investors	Fixed Interest 5-Year Government Bonds for Individual Investors	Floating Interest 10-Year Government Bonds for Individual Investors	Government Bonds Sold by the New Teller-window Sales Method
Purchasers, etc.	Limited to individuals; offer price is JPY100 per JPY100 of face value amount; minimum face value amount is JPY10,000, in units of JPY10,000.			No limit of purchasers; offer price is from JPY 50,000, in units of JPY 50,000
Maturity	3 years	5 years	10 years	2 years/5 years/10 years
Redemption amount	JPY100 for JPY100 of the face value amount (same if redemption before maturity)			JPY100 for JPY100 of the face value amount
Interest	Fixed interest [paid twice per year (semi-annually)]		Floating interest [paid twice per year (semi-annually)]	Fixed interest [paid twice per year (semi-annually)]
Interest rate level	Base rate – 0.03% (Note 4)	Base rate – 0.05% (Note 4)	Base rate ×0.66 (Note 3)	Decided by the Ministry of Finance based on the market interest rate trend upon each issuance
Minimum interest rate	0.05%			No guarantee for minimum interest rate
Redemption before maturity	Redemption before maturity is possible at any time if it is after the second interest payment date (1 year after issue).			Salable on the market at any time (generating profit or loss)
Exception to limitations on redemption before maturity	Redemption before maturity is possible even if it is before each of the interest payment dates set forth above if the holder has died or where the holder has suffered a major natural disaster.			
Redemption amount if redeemed before maturity	Face value amount + amount of accrued interest – already paid interest corresponding to the two most recent interest payments (before deducting tax) × 0.79685 (In the case of issues with no adjustment for the first interest payment at the time of purchase) (Excluding redemptions before maturity in accordance with the exception to the limitations on redemption before maturity)			Market price. If the market interest rate rises after the purchase, the market value could decline and result in generating a loss upon the sale before maturity. If the market interest rate declines, the market value could rise and result in generating a profit upon the sale before maturity.
Frequency of Issue	Monthly			

(Note 1) It is possible that there will be no bond offerings at times such as when the interest rate declines.
(Note 2) Tax is levied on the interest on bonds at the rate of 20.315% at the time of receipt. However, tax exemption is available under the tax-exempt savings schemes for persons with disabilities (so-called "*Maruyu*" and "*Tokubetsu Maruyu*").
(Note 3) The base rate is the yield at the average price in the last auction of 10-year fixed-rate JGBs held by the month preceding the month in which the interest rate calculation period starts (for the initial interest rate, the last auction held by the day on which the public offering period starts).
(Note 4) The base rate is the assumed yield on 5-year or 3-year fixed-rate JGBs calculated based on the market yield two business days prior to the public offering period starts.
(Source) Prepared based on the Ministry of Finance's website.

Fixed interest rate type bonds with a maturity of 5 years make payments at a fixed interest rate two times annually, and the interest rate is the base rate (projected yield on 5-year fixed interest rate government bonds calculated based on the market interest rate two business days prior to commencement of the offering period (the date of the auction of 10-year fixed interest rate government bonds)) minus 0.05 percent. The fixed interest type bonds with a maturity of 3 years make payments at a fixed interest rate two times annually, and the interest rate is the base rate (projected yield on 3-year fixed interest rate government bonds calculated based on the market interest rate two business days prior to the commencement of the offering period (the date of the auction of 10-year fixed interest rate government bonds)) minus 0.03 percent. For both types, the minimum interest rate is set at 0.05 percent.

There is a restriction on redemption before maturity for government bonds for individual investors. These bonds cannot be redeemed for one year after issuance. While the national government will repurchase the government bonds at face value upon redemption before maturity, an amount corresponding to a certain amount of interest will be deducted. The characteristics of government bonds have been improved as of April 2012.

In addition to government bonds offered directly to individual investors, individual investors can also purchase the same interest-bearing government bonds as those traded on the market. These government bonds are sold by a new teller-window sales method.

In the case of the new teller-window sales method, government bonds are offered at prices designated by the Ministry of Finance, as in the case of the offering handling method, but the solicitation handling institutions are not required to purchase unsold bonds. Government bonds sold by this new teller-window sales method are referred to as "new teller-window-sold government bonds."

The chart shows the comparison between government bonds offered for individual investors and government bonds sold by the new teller-window sales method.

(vii) Inflation-Indexed Government Bonds

With a typical fixed-rate interest-bearing government bond, the amount of principal at the time of issuance remains unchanged until redemption, and the interest rate, too, is constant for all interest payments. The amount of each interest payment is therefore equal, and the final interest payment and the original principal amount (par value) are paid upon redemption.

In contrast, the principal amount of an inflation-indexed government bond varies with trends in the consumer price index (CPI). In other words, if the CPI rises after the issue of an inflation-indexed government bond, then the principal amount of the said bond will rise commensurate with the rate of increase in the CPI (we hereinafter refer to the post-increase or post-decrease principal amount as the "inflation-adjusted principal amount").

The amount paid to the bondholder upon redemption is the inflation-adjusted principal amount. Interest payments are made biannually, and the amount of each interest payment is calculated by multiplying the inflation-adjusted principal amount at the time of the interest payment by the coupon rate. The coupon rate, which is set at the time of issuance, remains constant for all interest payments. An increase in the inflation-adjusted principal amount due to an increase in the CPI will, therefore, result in an increase in the amount of the interest payment.

Due to the impact of the collapse of Lehman Brothers in 2008, the market environment became extremely tough and the issuance of inflation-indexed government bonds was suspended. From October 2013, the issuance of a new type of inflation-indexed government bonds with a guarantee of principal (deflation floor)

and with revised product characteristics has begun.

Ownership was limited to corporations, etc. such as qualified institutional investors, etc. From January 2015, individual investors are also allowed to own these bonds, which will reach maturity in January 2016 and thereafter.

(viii) Climate Transition Bonds

Climate Transition Bonds have been created with the objective of achieving over JPY 150 trillion of public-private investments in the decade from 2023 to 2032. About JPY 2 trillion of these bonds will be issued and will be backed by financial resources to be obtained via the introduction of carbon pricing. Including refinancing bonds, they will be redeemed by FY2050, the target year for achieving carbon neutrality.

(viii) Children Special Bonds (Special Bonds for Child and Child Care Support)

The issuance of Children Special Bonds (Special Bonds for Child and Child Care Support) will start in FY2024 in order to fundamentally strengthen policies supporting children and child-rearing. These bonds will be issued on an as-needed basis in order not to be short of financial resources until stable financial resources are secured by FY2028.

The government bonds mentioned above are issued in order to supplement the national budget and are categorized as follows, depending on the law governing their issuance ((a) to (e) for (i) to (vii), (f) for (viii), and (g) for (ix)):

(a) Public Finance Act (art. 4, para. 1, *proviso*)

Construction government bonds (bonds that are issued in order to be allotted to sources of capital for public projects, capital contributions and loans which will take the form of national assets).

(b) Special Laws for Each Year

Special deficit financing government bonds (so-called "deficit bonds" that are government bonds which are issued under a special law in order to obtain funds to use in expenditures other than public projects, etc., where a revenue shortfall is expected despite the tax revenues, non-tax revenues, etc. as well as funds raised by the construction bonds).

(c) Act Concerning Special Accounts (art. 46, para. 1 and art. 47)

Refund bonds (government bonds that are issued in order to secure the funds necessary to finance refunds for the consolidation or redemption of government bonds for each fiscal year).

(d) Act Concerning Special Accounts (art. 62, para. 1)

Fiscal investment and lending special account government bonds (so-called "*zaitō* bonds" that are issued for allocation to financial sources for the purpose of managing the fiscal loan funds program).

(e) Act on Special Measures for Securing Financial Resources Necessary for Implementing Measures for Reconstruction in Response to the Great East Japan Earthquake (art. 69, para. 1 and para. 4)

Reconstruction bonds (government bonds issued for the purpose of securing the financial resources necessary for reconstruction in response to the Great East Japan Earthquake).

(f) Act for Promoting a Smooth Transition to a Decarbonized Growth-Oriented Industrial Structure

(g) Child and Child Care Support Act

Government bonds, excluding Climate Transition Bonds, are issued as the same type of financial products regardless of the classification of the law governing their issuance, and their creditworthiness or characteristics do not change depending on the difference in the governing law. On the other hand,

Climate Transition Bonds have been issued as a new type of financial product that is compliant with international standards.

(x) STRIPS

Securities companies, etc. can separately sell the principal and interest portions of some of the interest-bearing government bonds that were issued after January of 2003. Corporations such as institutional investors are the major purchasers for both the principal and interest portions. Since January 2016, individuals have become eligible to buy these bonds.

(2) Municipal Bonds (Local Government Bonds)

Municipal bonds are bonds that are issued by local governments such as prefectures, cities, towns and villages, and municipal bonds and national government bonds are collectively referred to as public bonds. Categorizing municipal bonds further, there are: "**nationwide market-based publicly-offered municipal bonds**" that are publicly offered broadly to ordinary investors through security companies or banks etc.; "**municipal bonds underwritten by banks, etc.**" that are directly underwritten by a few parties such as particular private financial institutions; "**citizen participation-type market-based publicly-offered municipal bonds**" issued by some local governments mainly for purchase by individuals; and "**municipal compensation bonds**" that are issued as an alternative to cash to owners of land that must be purchased for the projects to be conducted by local governments.

Borrowings other than those cast in the form of bonds, such as borrowings from government funds, the Japan Finance Organization for Municipalities or particular private financial institutions are sometimes referred to as municipal bonds. Most funds procurement in the open market is made in the form of bonds.

Among municipal bonds, nationwide market-based publicly-offered municipal bonds are best known. They are held widely, and thus have a high degree of liquidity. As of the end of August 2024, the 61 entities listed below, consisting of some prefectures and all Cabinet Order-designated cities, are qualified to issue nationwide market-based publicly-offered municipal bonds.

Prefectures (41)	Hokkaido, Iwate, Miyagi, Akita, Fukushima, Ibaraki, Tochigi, Gunma, Saitama, Chiba, Tokyo, Kanagawa, Niigata, Toyama, Ishikawa, Fukui, Yamanashi, Nagano, Gifu, Shizuoka, Aichi, Mie, Shiga, Kyoto, Osaka, Hyogo, Nara, Wakayama, Tottori, Shimane, Okayama, Hiroshima, Tokushima, Kochi, Fukuoka, Saga, Nagasaki, Kumamoto, Oita, Miyazaki, Kagoshima
Cabinet Order Designated Cities (20)	Sapporo, Sendai, Saitama, Chiba, Yokohama, Kawasaki, Sagamihara, Niigata, Shizuoka, Hamamatsu, Nagoya, Kyoto, Osaka, Sakai, Kobe, Okayama, Hiroshima, Kitakyushu, Fukuoka, Kumamoto

In addition, "joint-issue market publicly-offered municipal bonds," which are bonds issued jointly by bodies eligible to issue publicly-offered municipal bonds, began being issued in April 2003.

As of the end of August 2024, the following 37 bodies participate in this type of joint issuance:

Prefectures (24)	Hokkaido, Miyagi, Fukushima, Ibaraki, Saitama, Chiba, Kanagawa, Niigata, Fukui, Nagano, Gifu, Shizuoka, Aichi, Mie, Kyoto, Osaka, Hyogo, Nara, Okayama, Hiroshima, Tokushima, Kumamoto, Oita, Kagoshima
Cabinet Order Designated Cities (13)	Sapporo, Sendai, Chiba, Kawasaki, Niigata, Shizuoka, Hamamatsu, Kyoto, Osaka, Kobe, Hiroshima, Kitakyushu, Fukuoka

Municipal bonds underwritten by banks, etc. are issued by a large number of issuers because even cities and wards are eligible to issue the bonds. However, most of the municipal bonds underwritten by banks, etc., are issued in small amounts. Also, the municipal bonds underwritten by banks, etc. have a lower degree of recognition than nationwide market-based publicly-offered municipal bonds. In addition, the municipal bonds underwritten by banks, etc. tend to be held by certain specified bondholders. Therefore, municipal bonds underwritten by banks, etc. are less liquid than nationwide market-based publicly-offered municipal bonds.

Citizen participation-type small-market-based publicly-offered municipal bonds, which have been issued since FY2002, are being broadly sold even to investors who previously had little interest in municipal bonds, and the attractiveness of municipal bonds is being widely reappraised.

(3) Government Sponsored Entity Bonds (Agency Bonds)

These are bonds issued under special legislation by incorporated administrative agencies such as the Japan Expressway Holding and Debt Repayment Agency, local joint companies like the Japan Finance Organization for Municipalities, as well as governmental special companies, including the Japan Finance Corporation.

The issuers of government sponsored entity bonds are public institutions that are closely related to the government, and the funds procured through such government sponsored entity bonds are appropriated to public investment such as railways, roads, and housing construction.

Of the types of government sponsored entity bonds, there are: "**government guaranteed bonds**" for which the government guarantees the payment of principal and interest, "**non-publicly-offered special bonds**" that are directly underwritten by designated financial institutions which have a connection with the issuer, and "**fiscal investment and loan program agency bonds**" that are not guaranteed by the government, but are issued through a public offering.

Government guaranteed bonds have a high degree of recognition and strong creditworthiness, a large size of

Chart 4-6 Outstanding Government Guaranteed Bonds (Domestic Bonds, Publicly Marketed)

(Unit: JPY100 million)

	Outstanding as of the End of FY2023
Japan Finance Corporation	4,350
Japan Expressway Holding and Debt Repayment Agency (Incorporated Administrative Agency)	112,325
Japan Housing Finance Agency	6,900
New Kansai International Airport Co., Ltd.	1,601
Development Bank of Japan Inc.	9,850
Deposit Insurance Corporation of Japan	6,500
Nuclear Damage Compensation and Decommissioning Facilitation Corporation	8,000
Private Finance Initiative Promotion Corporation of Japan	880
Japan Overseas Infrastructure Investment Corporation for Transport & Urban Development	50
Fund Corporation for the Overseas Development of Japan's ICT and Postal Services Inc.	200
Organization for Promoting Urban Development (Incorporated Foundation)	1,208
Central Japan International Airport Company Limited	1,518
Japan Finance Organization for Municipalities	24,750
Total	178,132

(Notes) 1. Because figures have been rounded off, the total does not agree with the individual sums.
2. Calculated on face value basis.
(Source) Prepared based on the Ministry of Finance's "Debt Management Report 2024."

individual issues, and are widely held due to public offering. Accordingly, their liquidity is high, and the trading volume of government guaranteed bonds actually exceeds that of non-government guaranteed bonds. Against the backdrop of the reform of the fiscal investment and loan program under which the fund of postal savings commenced its own funds management and government sponsored entities came to need to undertake their own procurement, issuance of fiscal investment and loan program agency bonds began in FY2001. Since then there have been a variety of product issuances, such as bonds with sinking fund provisions or floating-rate bonds, monthly pass-through securities backed by Japan Housing Finance Agency-sponsored home loans (RMBS), etc.

(4) Local Public Corporation Bonds

These are bonds issued by a public corporation established by a local government (local housing supply public corporations, local highway public corporations, and land development public corporations).

Under the "Securities Settlement System Reform Act" that came into effect on January 6, 2003, the bonds issued by local public corporations are now included within the definition of securities under the SEL (the present Financial Instruments and Exchange Act (FIEA)), thus, improving their liquidity. Furthermore, whereas previously local public corporation bonds were primarily underwritten by financial institutions in private placements, public offerings have also been adopted.

(5) Bank Debentures

Bank debentures are the bonds issued by the Norinchukin Bank, Shoko Chukin Bank, and the Shinkin Central Bank pursuant to their respective enabling legislation (Shinkin Bank Act, etc.).

Bank debentures are interest-bearing bank debentures with a tenor of 1 year or longer (bank debentures issued on a periodic basis usually have a 5-year tenor and the bank debentures issued on a spot basis have various types of tenors).

There are two methods of issuance: primary offerings and secondary offerings. Primary offerings are mainly for corporations, while secondary offerings are for individuals. For either primary offerings or secondary offerings, even where the subscribed amount does not meet the initially scheduled issuance amount, such subscribed amount will be the amount of the debentures. This rule is prescribed under the laws and regulations.

(6) Corporate Bonds (Straight Bonds)

Corporate bonds (straight bonds) are bonds issued by private corporations, and are sub-categorized into telegraph and telephone bonds, utility bonds, general corporate bonds, and bank bonds, etc.

Formerly, bonds issued by the Nippon Telegraph and Telephone Corporation (NTT), the various Japan Railways (JR) companies and Japan Tobacco Inc. (JT) were classified as agency bonds (presently called government-sponsored entity bonds), but they have been reclassified as corporate bonds accompanying the privatization of the Nippon Telegraph and Telephone Public Corporation, Japan National Railways and the Japanese Monopoly Bureau.

Utility bonds are bonds issued by electric power companies nationwide under the Electricity Business Act and they are secured by general security. Following the electricity deregulation under the electricity system reform, the issuance of bonds secured by general security will be abolished in April 2025.

General corporate bonds are bonds issued by private corporations in certain industries such as gas, steel, chemical, and railway, except for bonds issued by NTT and JT and utility bonds.

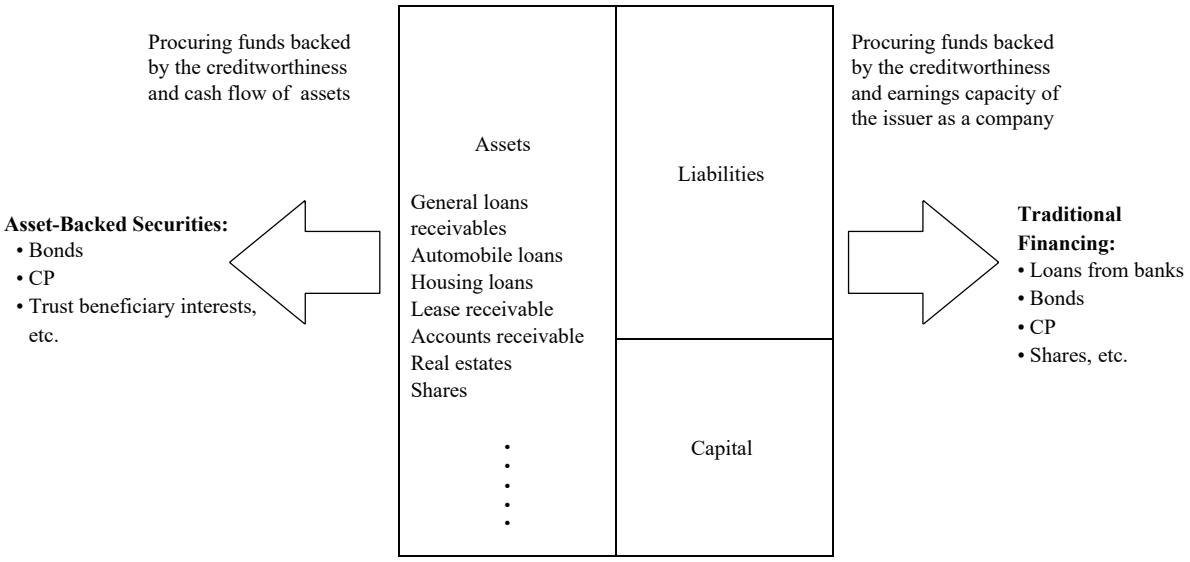
After the prohibition on banks issuing straight bonds was abolished in October 1999, most bonds issued by

financial institutions fall within the category of corporation bonds. Recently, more bonds have been issued by financial holding companies, and this market has been expanding.

(7) Specified Bonds

"Specified bonds" as defined in the "Act on the Securitization of Assets" are bonds issued by a specific purpose company as defined in the said Act. A specific purpose company acquires a variety of assets such as receivables, real estate, etc. from the party procuring the funds, and issues specified bonds backed by those assets, which are called asset-backed securities (See Chart 4-7).

Chart 4-7 Asset-Backed Securities Conceptual Diagram (as an example)



In a traditional financing, the party procuring the funds would be the issuer, and issue securities as pure debt; in contrast, in the asset-backed securities, the party procures the funds based on the creditworthiness or the cash flow of its own assets and the securities do not constitute the direct debt of the party.

(8) Investment Corporation Bonds

Investment Corporation Bonds are bonds issued by an investment corporation pursuant to the "Act on Investment Trusts and Investment Corporations."

(9) Foreign Bonds

Broadly, foreign bonds are defined as bonds for which the issuer, the issue market, or the currency is non-Japanese (foreign). They are classified into yen-denominated foreign bonds (Samurai bonds), Euroyen bonds, and foreign currency-denominated bonds ("foreign bonds" in its narrow meaning).

		Issuer	Issue Market	Currency
Foreign bonds as broadly defined	Yen-denominated foreign bonds (Samurai bonds)	Non-Japanese (Foreign)	Japanese market	Japanese yen
	Euroyen bonds	Japanese/Foreign	Foreign market (Euromarket)	Japanese yen
	Foreign currency-denominated bonds ("foreign bonds" in its narrow meaning) (the followings are examples)			
	Domestic bonds of foreign countries	Foreign	Domestic markets of foreign countries	Foreign currency
	Eurobonds	Japanese/Foreign	Euromarket	Foreign currency
	Yankee bonds	Non-US	US domestic market	US dollar
	Kangaroo bonds	Non-Australian	Australian domestic market	Australian dollar
	Maple bonds	Non-Canadian	Canadian domestic market	Canadian dollar

(Note) The term "Euromarket" refers to markets across the world on which various transactions in Euro money (the local currency of any country held on deposits with financial institutions of other counties or held by non-residents) are conducted. Bonds issued on the Euromarket are generally referred to with a name consisting of the term "Euro" followed by the name of each issuing currency (for example, Euroyen bonds for yen-denominated bonds, and Eurodollar bonds for dollar-denominated bonds). On the Euromarket, where restrictions on trade practice and taxation rules are less strict than on the domestic market and therefore bonds can be issued more freely, it is now a major practice to issue bonds flexibly under the Euro Medium-Term Note (MTN) Program.

(i) Yen-Denominated Foreign Bonds

Yen-denominated foreign bonds (Samurai bonds) are bonds issued in the Japanese market by international agencies, national or local governments of foreign countries or foreign business corporations (non-residents) that are denominated in yen.

The Japanese market has been established as a place to raise funds, and the amount of Samurai bonds issued has remained stable. Most bonds are issued by financial institutions.

(ii) Euroyen Bonds

Euroyen bonds are yen-denominated bonds issued on the market outside of Japan (Euromarket). In the past, a variety of restrictions were imposed on the issuance of Euroyen bonds, and few organizations were eligible to issue them, partly because of the tremendous influence these bonds could have on Japan's domestic fiscal policies and financial system. However, deregulation progressed incrementally and it has become possible to issue bonds more flexibly and freely in terms of the types of bonds to be issued on the Euromarket. Currently, Euroyen bonds are issued by a large number of issuers, mainly business corporations (non-Japanese resident entities).

(iii) Foreign Currency-Denominated Bonds

Since July 1971, ordinary investors in Japan have been permitted to invest in foreign currency-denominated bonds.

Foreign currency-denominated bonds can be categorized according to the markets in which those bonds

are issued as follows:

A. Domestic bonds on foreign markets (U.S. Treasury securities, German government bonds, bonds issued by U.S. and European financial institutions, etc.);
B. Bonds issued on the Euromarket (*a.k.a.,* Eurobonds);
C. Bonds denominated in a foreign currency and issued on a domestic market by a nonresident issuer (*a.k.a.* Yankee Bonds, Kangaroo Bonds, Maple Bonds, Tokyo Pro-Bonds, etc. (including residents)); and
D. Bonds denominated in a foreign currency and issued on a Japanese domestic market by a resident (*a.k.a.*, Origami bonds).

Investment in foreign currency-denominated bonds involves foreign exchange risks when converted into yen. There are also advantages, however, such as the investor can exploit international interest rate differentials and achieve global portfolio diversification.

Among the investments in foreign currency-denominated bond markets, the U.S. Treasury securities (denominated in U.S. dollars) are the largest in terms of scale. In addition, investments are further increasing in high interest rate bonds denominated in currencies of developed countries, such as Euro-denominated bonds and Australian Dollar-denominated bonds. Investment has also been made in bonds denominated in currencies of emerging countries, including Brazilian Real, Turkish Lira and Chinese Yuan.

On the foreign-currency denominated bond markets, foreign-currency denominated bonds (Eurobonds) offered in Japan targeting Japanese individual investors ("*uridashi*") have been issued continuously, not only by highly-rated issuers such as international organizations or G-7 government-affiliated financial institutions, etc. but also by private entities such as financial institutions and business corporations. In addition to bonds denominated in major currencies, such as the US Dollar and Australian Dollar, those denominated in currencies of emerging countries have also been issued. Thus, the size of this market has been expanding to the extent that even the word "*uridashi*" itself is gaining acceptance in the overseas securities market.

(10) Other Financial Products

(i) Commercial Paper (CP)

Commercial paper (domestic CP) is an unsecured, short-term and discounted security issued by a blue chip company to meet its operating capital requirements, and CP also has promissory note-like characteristics. CP is mainly sold to institutional investors who are well versed in the trends of the financial markets.

In January of 2003, the "Act on Book-Entry Transfer of Corporate Bonds, Etc." (the name of the law at that time) came into effect, and transactions of electronic, paperless CP (defined in that law as "short-term corporate bonds") commenced in March of the same year.

(ii) Negotiable Certificates of Deposit (CD)

Negotiable certificates of deposit (CDs) are transferable certificates of deposit issued by financial institutions, and are one of the non-regulated interest rate products. However, since the FIEA does not define CDs issued in Japan (domestic CD) as "securities," securities firms handling domestic CDs are treated as being engaged in operations other than the financial instruments business.

(iii) Foreign Commercial Paper, Foreign Loan Receivables Trust Beneficiary Certificates, and Foreign CD

Foreign commercial paper (foreign CP) is, among foreign securities prescribed in Article 2, Paragraph 1, Item 1 of the "Rules Concerning Foreign Securities Transactions" (hereinafter referred to as the "Foreign Securities Transaction Rules"; such securities shall be referred to as "foreign securities"), the securities prescribed in Article 2, Paragraph 1, Item 15 of the FIEA or the securities or certificates issued by a foreign person that have the nature of the relevant securities as prescribed in Item 17 of the said Paragraph (Article 2, Paragraph 1, Item 12 of the Foreign Securities Transaction Rules).

"Foreign loan receivables trust beneficiary certificates" are beneficiary certificates defined by Article 1, Item 4-4 of the Cabinet Office Ordinance on Disclosure of Information on Specified Securities, and asset finance products based on a trust funded by the loan receivables originated by an overseas financial institution (for example, CARDs) fall within this category.

Foreign certificates of deposit (foreign CDs) are transferable certificates of deposit issued by foreign financial institutions. They are foreign securities that fall within the category of securities prescribed in Article 1, Item 1 of the Order for Enforcement of the Financial Instruments and Exchange Act (Article 2, Paragraph 1, Item 11 of the Foreign Securities Transaction Rules). Unlike domestic CDs, foreign CDs fall within the category of securities under the FIEA.

1 3 Terms of Bond

Bonds, which are fixed-interest-bearing securities, include several commitments by the issuer to the investor regarding the terms and conditions of issue, such as the timing and amount of interest and principal payments. Furthermore, conditions that are added later, such as the unit price of trading and yield can oftentimes come into play.

Therefore, simply stating "terms" belies the complexity in bond terms, all of which can have a subtle effect on the bond's value.

(1) Face Value (Units of Book-Entry Transfers)

In the case of "paperless" bonds (book-entry transfer bonds, etc.), a certificate does not exist as an actual piece of paper, and consequently the amount is not displayed on the face. Nevertheless, the amount set as the "monetary amount of each bond" in written documents listing the conditions of the security delivered to investors by the issuer could be thought of as the "face value" as traditionally conceived. When traded, trades are made using integer multiples of such monetary amount of each bond.

(2) Bond Price

The price of a bond is customarily expressed as a price per par value of JPY100, which constitutes the unit price of a bond. The price may be exactly JPY100 (called "par"), or it may be more than JPY100 (called "over par") or less than JPY100 (called "under par"). In many cases, ordinary bonds are issued at JPY100 or under par but very close to JPY100, but for government bonds whose terms of issue are decided by auction, issuance at over par is not unheard of.

The difference that arises when a bond that was purchased under par is redeemed is referred to as the redemption gain, while the difference that occurs when a bond purchased over par is redeemed is called the redemption loss.

(3) Interest Rates

The interest rate of a bond is expressed as an annual percentage of interest divided by the value of the bond. The majority of Japanese bonds make interest payments twice per year, in semi-annual installments, and coupons entitling the bondholder to each interest payment are attached to the face of each bond certificate. The bondholder can receive interest payments in exchange for the coupon. For this reason, the interest rate is sometimes referred to as the coupon rate, or simply the coupon. No tangible coupon is used in handling book-entry transfer bonds.

Bonds with coupons are called interest-bearing bonds, whereas bonds with no coupons are called discount bonds. The issue price of discount bonds is set under par, and offers bondholders a gain on redemption in lieu of interest payments. At present, short-term treasury securities are handled as discount bonds in Japan.

If the issue date or redemption date of interest-bearing bonds does not correspond to the coupon payment date, fractional interest is added on a per diem basis. Fractional interest consists of initial interest and final interest. The method of calculating fractional interest varies slightly depending on the type of bond.

When an already-issued bond is purchased or sold in the market, interest must be allocated to the purchaser and seller based on the amount of time each held the bond. This is accomplished by having the purchaser pay the seller the accrued interest based on the period from the day following the last interest payment date until the delivery date.

Although the purchaser of a bond is required to pay accrued interest to the seller at the time of purchase, the purchaser will receive the entire amount of the coupon at the next interest payment date; as a result, the interest income received by the purchaser effectively corresponds to his/her holding period.

(4) Redemption

There are two types of redemption for bonds: final redemption and early redemption. The date for final redemption is called maturity, and the period from the date of issuance to maturity is called the term, or maturity years. Newly issued bonds are called new issues, bonds after their issue date are called outstanding bonds, and the period until maturity for each is called the time to maturity. In principle, the redemption price upon final redemption is the face value of the bonds.

The partial redemption of bonds prior to maturity is called early redemption and is done to level the issuer's funding burden at redemption. Early redemption includes scheduled redemption wherein the timing and price for early redemption is determined at the time of issuance, optional redemption that is conducted at the issuer's discretion, and lottery redemption wherein redemption is determined by lottery independently from the bondholder's intention. Scheduled redemption is made by a method of reducing the total balance of bonds of all holders of the relevant bond issue at an equal rate (called the factor method). In the case of lottery redemption, the bondholders who won the lottery for redemption must accept the redemption at the face value.

(5) Yield

Whereas the coupon is the percentage of interest to the value of a bond, the percentage return on invested capital is called yield. Yield usually refers to the simple yield to maturity, which is the ratio of the sum of the annual interest and yearly portion of redemption gain/loss to invested principal if the investor holds the bond until

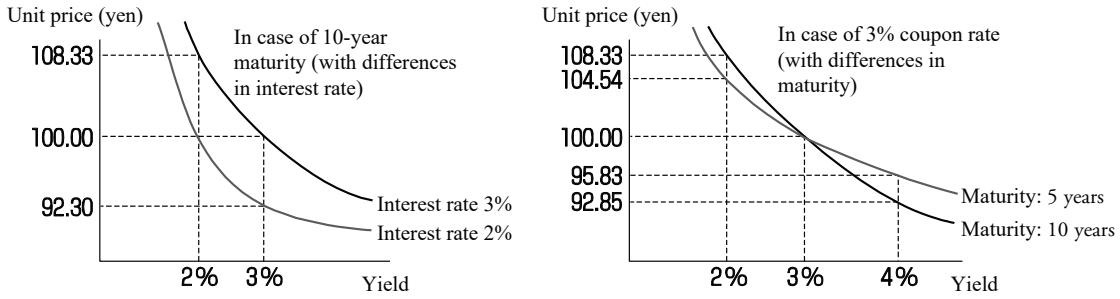
maturity. If the bonds are a new issue, this yield is called the subscriber yield. (For details, see "Section 7. Bond Investment Calculations".)

Simple yield to maturity is the most fundamental indicator of the profitability of bonds. When the bond price of the bond goes up, the yield goes down, whereas when the bond price goes down, the yield goes up. In the secondary market, if yields fall, this can only lead to a rise in bond prices, signaling an upturn in the market. On the other hand increasing yields mean a downturn in the market.

Among several bond issues with the same yield and same maturity, issues with a higher interest rate have a higher price, whereas issues with a lower interest rate have a lower price.

From the issuer's perspective, the costs of floating a bond include not only the interest and redemption gain or loss, but underwriting fees, bond management commission, and fees applicable to interest and principal payments. To assist issuers, a ratio was devised that sums up all of these annual expenses and compares them with the net total amount raised by the bond issue. This ratio is called the Issuer Yield, and expresses the costs of the bond financing.

Chart 4-8 Bond Price and Yields



(6) Offering Period

Soliciting subscriptions from a large number of unspecified investors for a new bond issue is called an offering. The period during which solicitation is made and applications for subscription are accepted is called the offering period. After the close of the offering period, the purchase price for the bonds is paid in lump-sum to the issuer on the payment date. In the case of bonds, the payment date is the same as the date the bonds were issued.

(7) Contract Date and Delivery Date

In the secondary market where outstanding bonds are traded, each trade has a contract date and a delivery date. The contract date is the day that the trade is arranged, and the delivery date is the day the trade is settled.

The delivery date for bond transactions is the fourth business day counting from the contract date. With regard to Japanese government bond transactions contracted as of May 1, 2018, and afterwards (excluding over-the-counter retail transactions and transactions with nonresidents, etc.), the delivery date is the second business day counting from the contract date. For retail transactions in government bonds and transactions in general bonds contracted as of July 13, 2020, and thereafter, the delivery date is the third business day counting from the contract date.

(8) Book-Entry Transfer Bonds, Bearer Bonds, and Registered Bonds

At present, under the "Act on Book-Entry Transfer of Corporate Bonds and Shares," all government bonds issued on or after January 2003 will be book-entry transfer bonds. General bonds other than government bonds, up to now, were issued in either registered bond or bearer bond form, however, since January 2006, due to the

launching of the general bond book-entry transfer system, the Corporate Bonds Registration Act was repealed on January 4, 2008, and since then, general bonds have been issued in book-entry transfer form similarly to government bonds.

These book-entry transfer bonds are not accompanied by a physical issuance of a certificate. Rather, trades (*i.e.*, transfer of rights) are made by recording the value in an account opened by the holder in a financial institution and making adjustments to the said value, thereby making these bonds "paperless" bonds.

2 Outline of the Primary Markets

2 1 Definition of the Bond Primary Market

While different procedures may be followed depending on the type of bond issued, the fundamental steps in the bond issuance process are: (i) determining the date of issue, issue amount and the terms and conditions of the issuance, etc., upon considering the purposes of the funds procurement, the conditions in the bond market, etc.; and (ii) soliciting investor subscriptions, collecting the purchase price for the bonds from subscribing investors, and duly issuing the bonds. These procedures take place in the so-called bond primary market.

The bond primary market in Japan has traditionally been driven by the following four players: (i) issuers who procure funds by issuing bonds; (ii) investors who manage their assets by investing in bonds; (iii) underwriting companies (securities firms and banks, provided, however, that banks deal with public bonds only); and (iv) bond administrators (banks, trust banks, etc.).

(1) Underwriting Companies

When securities are issued, an "underwriting company" is a company that acquires all of the securities from the issuer for the purpose of selling them (a so-called "firm commitment" or "bought deal"), or a company that acquires any securities that remain unsold after the issuance (a so-called "standby underwriting" or "standby agreement"). Interposing an underwriting company between the issuer and purchasers enables the issuer to offer the subscription to a large number of unspecified investors and to simultaneously raise a large amount of funds.

Ordinarily, in order to spread the responsibilities associated with underwriting, several underwriting companies will gather together and form an underwriting syndicate to jointly handle the underwriting business. The underwriting syndicates for municipal bonds and government-guaranteed bonds are comprised of financial institutions such as banks, etc. and securities firms. On the other hand, underwriting syndicates for corporate bonds, etc. are comprised solely of securities firms. This is in line with Article 33 of the FIEA, which provides for the separation of the securities business and the banking business.

(2) Bond Administrators

The Companies Act requires a company issuing corporate bonds to install a bond administrator. A bond administrator is a company that possesses all necessary authority to conduct functions such as receiving payments on behalf of the bondholders, etc. The entities eligible to become bond administrators are limited to banks, trust

banks or companies licensed under the Secured Bond Trust Act, and persons specified by the Order for Enforcement of the Companies Act.

However, if the amount of each bond (minimum trading unit) is JPY100 million or more, establishment of a bond administrator is not necessary. In this case, generally a fiscal agent (a financial institution that handles the repayment of principal and interest, etc. on behalf of the issuer) is installed.

An amendment to the Companies Act that came into effect as of March 1, 2021, introduced a new system of bond administration assistants, in response to the opinion that it is difficult to secure a sufficient number of bond administrators, especially for those handling bonds with low ratings, due to the broad power and heavy responsibility assigned to bond administrators. Under the new system, if bond holders are those who are capable of administering the bonds they hold (*e.g.*, the amount of each bond is JPY100 million or more), they may entrust a bond administration assistant to provide assistance in the administration of the bonds, while limiting the power and responsibility of the bond administration assistant as provided in the contract for entrustment to a certain extent. Persons eligible to become bond administration assistants are those eligible to become bond administrators mentioned above, as well as attorneys and legal professional corporations.

The Secured Bond Trust Act also mandates that companies issuing secured bonds establish a trustee company. A trustee company defined under the Secured Bond Trust Act is required to manage the collateral and conduct the bond administration on behalf of the bondholders pursuant to the trust agreement with the issuer. Therefore, if a default occurs, a trustee company may dispose of the collateral on behalf of the bondholders and use the proceeds to repay principal and interest. There is no trustee company, however, for bonds that are not backed by secured mortgage. The entities eligible to become trustee companies are limited to banks, trust banks or companies licensed under the Secured Bond Trust Act. If a bond administrator is appointed, the bond administrator generally serves as the trustee company.

(3) Method of Issuing Bonds

Methods of issuing bonds are divided into: public offerings, by which bonds are offered to a number of unspecified investors; and private placements, by which bonds are offered to a small number of investors (less than 50) or specified investors. Bond issuing methods are also divided into direct issuance, which means an issuer itself offers bonds, and indirect issuance, which means a third party acts as a broker. Of these, indirect issuance is used as common practice, taking advantage of the offering and credit capability of securities firms, etc.

Indirect issuance through a public offering is carried out by a brokered offering, underwritten offering, or total-amount underwriting.

Brokered offering is a method by which the issuer entrusts another company to make a public offering of its bonds. Since the entrusted party is not responsible for making up for the shortage even when the total amount subscribed falls short of the total amount of bonds to be issued, there is a risk of failure of issuance of bonds. Because of this, most bonds are issued by underwritten offering.

In the case of underwritten offering, the issuer enters into an agreement with an underwriter under which the underwriter is to deal in a public offering and underwrite the bonds unsold, as entrusted by the issuer. If the total amount subscribed falls short of the total amount to be issued, the underwriter is to underwrite the bonds unsold, thereby achieving the issuance of bonds. This method is employed when public bonds are issued and underwritten by syndicates.

Total-amount underwriting means the method by which underwriting syndicates purchase the total amount of bonds to be issued in bulk and then offer these bonds to investors.

Issuance of corporate bonds is subject to the principle that even when not all bonds to be issued are subscribed, bond issuance is valid for those subscribed. To avoid a situation where bond issuance will become valid only with regard to the amount of bonds subscribed, it should be prescribed at the time of issuance that the bond issuance will become valid only when all offers are subscribed.

(4) Underwriting Method and Auction Method

The Japanese primary market has become increasingly deregulated in recent years; even looking at government bonds issuances, for example, one can see changes to the traditional paradigm. Whereas previously government bonds were sold using an underwriting method, in which underwriters would commit to accept a fixed share of bonds in return for underwriting fees, now an auction method is employed.

Under the auction method, securities firms and other financial institutions can freely decide their desired purchase price and amount, but in return forfeit their ordinary fees.

2 2 Current Status of the Bond Primary Market

(1) Public Bonds

The most notable change in the public bond primary markets is the switch from the underwriting method to the auction method for government bond issues.

Previously, government bonds, guaranteed government bonds, and publicly-offered municipal bonds were underwritten by a fixed share by a syndicate comprised of financial institutions and securities firms, but the super-long-term, medium-term, and short-term government bonds (short-term government bonds are currently known as short-term treasury securities) have gradually moved to a public auction method since around 1980, and now long-term government bonds are issued through the public auction method as well starting with April 2006 bonds, as the syndicate underwriting method was abolished at the end of FY2005.

Through the expansion of the auction method, firms with a strong customer base are able to purchase larger volumes of bonds.

In addition, the following can be raised as recent trends in the primary market: the amount of issues of public bonds overall is increasing because of the decrease in tax revenue due to the worsening domestic economy as well as the increase in public works; issue volume for short-term government bonds (currently short-term treasury securities) and 5-year medium-term government bonds which have been issued since February 2000, surpassing the level of long-term government bonds which are a major type of government bonds; finally, the maturities and product design schemes of bonds are becoming more diversified, as exemplified by the issue of, in addition to 5-year medium-term government bonds, 30-year and 40-year super-long-term government bonds, 15-year floating rate government bonds, inflation-indexed government bonds, and government bonds for individual investors, etc.

Further, from October 2007 a new type of teller-window sales of government bonds began. This allows private financial institutions other than post offices to conduct the offering and sale of government bonds at prices designated by the Ministry of Finance that formerly were conducted only at post offices. It is intended to prepare an environment in which it is easy to purchase government bonds and to promote further ownership of government bonds by individual investors. Currently 2, 5, and 10-year fixed interest bonds are sold using the new system.

(2) Private Bonds

Fund procurement by Japanese corporations through bonds can be largely divided into straight bonds and bonds with share options. Convertible bonds and bonds with subscription rights (currently "bonds with share options"; hereinafter the same) were issued in large quantity after the interest rate decline and the rise in share prices. The amount of bonds with share options issued outside of Japan, in particular, has grown as a result of simpler issuance procedures compared with those for domestic issues, and lower funding costs compared with domestic issuance even after avoiding exchange rate risk through foreign exchange forward contracts.

In FY1997 and FY1998, sluggish share prices had the effect of causing a plunge in issues of convertible bonds and bonds with share options while increasing financing with straight bonds. The reason for the trend is the measures taken to lower issue costs such as the deregulation of the bond market and simplified issuance procedures, etc., including various measures such as the introduction of the proposal method by which a lead manager is selected based on the conditions of issuance and other terms proposed by several securities firms, the shelf registration system (described below), the uniform price sales method, and various fee reductions.

In addition, exchangeable bonds (also referred to as EB; those bonds that entitle the bondholder, upon request, to have its bonds redeemed with the share certificates of a specified company other than the issuer) were issued and listed on the Tokyo Stock Exchange in April of 2000.

2 3 Primary Market for Government Bonds

(1) Issuance Methods for Government Bonds

The issuance methods for government bonds are broadly divided into the open market issuance method, the issuance directed towards individual investors method, and the public sector issuance method.

(i) Open Market Issuance Method

Upon the open market issuance of government bonds, conditions are set that reflect the prevailing market on the basis of public auctions (the method of having a bid participant bid on the issue terms desired as well as the amount of desired acquisition, and determining the issue terms and the issue amount on the basis of these bid results) and the price (yield) competitive auction, noncompetitive auction, non-price-competitive auction I, and non-price-competitive auction II are being adopted.

(a) Price (Yield) Competitive Auction

A price (yield) competitive auction is an auction method that determines the issue price and issue amount based on bids by auction participants for the desired auction price (or yield) and desired auction amount that are made in response to issue terms (planned issue amount, maturity, coupon rate, etc.) presented by the Ministry of Finance.

In a price (yield) competitive auction, in principle, bids are successful in order starting from the highest price (or lowest yield) until the planned issue amount is reached. In Japan, the conventional method, in which the bid price (or yield) of each individual successful bidder becomes the issue terms, and the Dutch method, in which the issue terms (allotment minimum price / allotment maximum yield) are uniform regardless of the bid price (or yield) of each individual successful bidder, are used depending on the type of government bond to be issued.

Currently, 40-year bonds and Climate Transition Bonds are issued through a yield competitive

auction and the Dutch method, while inflation-indexed government bonds are issued through a price competitive auction and the Dutch method. Other types of government bonds are issued through a price competitive auction and the conventional method.

Further, from March 2001, the instantaneous issue amalgamation (instant reopen) system was introduced with the purpose of increasing the liquidity of government bonds, etc. Under this system a new issue of a bond is treated as being the same issue as outstanding bonds from the time the new government bond is issued, if it is decided to make an additional issuance (reopen) of a government bond that is the same as outstanding bonds, since the principal and interest payment dates, as well as the coupon rate of the government bond that is to be newly issued are the same as that of government bonds that have already been issued. Following upon the introduction of the instant reopen system, accrued interest is generated in regard to the government bonds that are newly issued as well.

Moreover, liquidity supply auctions were introduced from April 2006. This is a system of additional issuances of issues that lack liquidity with the purpose of striving to maintain and increase the liquidity of government bond secondary markets.

(b) Non-Competitive Auction

Non-competitive auctions are conducted for 2-year, 5-year and 10-year fixed-interest government bonds, taking into consideration small and medium-size auction participants who tend towards smaller bid amounts. A non-competitive auction is an auction where subscriptions take place concurrently with a price competitive auction and the issue price is the weighted average price in the price competitive auction. Bidders may subscribe in only one of either the price competitive auction or the non-competitive auction. The maximum issue amount is 10 percent of the planned issue amount, and the maximum subscription amount is JPY1 billion per each auction participant (excluding Shinkin Central Bank, Shinkumi Federation Bank, Rokinren Bank, and Norinchukin Bank).

(c) Non-Price-Competitive Auction I, and Non-Price-Competitive Auction II

A non-price-competitive auction I is an auction where subscriptions are conducted concurrently with a price competitive auction and the issue price is the weighted average price in the price competitive auction, with the maximum issuance amount being 25 percent of the planned issue amount. Only government bond market special participants are eligible to participate, and offers and accepted bids may be made up to the offer limit amount for each participant that is decided depending on its successful bid record for the most recent two fiscal quarters.

A non-price-competitive auction II is conducted after publication of the results of a price (yield) competitive auction, and the issue price is the weighted average price under the conventional method (or the issue price in the case of the Dutch method). Only government bond market special participants are eligible to participate, and offers and accepted bids may be made up to the maximum offer amount for each participant that is decided depending on its offer record for the most recent two fiscal quarters (however, such maximum amount does not exceed the amount corresponding to 10 percent of the total successful bid amount for the relevant participant in price (yield) competitive auctions and non-price-competitive auctions I).

(ii) Issuance Directed Towards Individual Investors Method

(a) Government Bonds for Individual Investors

Government bonds for individual investors are sold through the handling of subscriptions by financial institutions. In this method, the financial institution solicits ordinary investors for applications to

acquire government bonds for individual investors and sells them under commission from the government.

(b) New Teller-Window Sales Method for Marketable Government Bonds

In addition to government bonds for individual investors, from October 2007 a new teller-window sales method for ordinary interest-bearing government bonds was introduced in order to broaden opportunities for individual investors to purchase government bonds.

This new teller-window sales method allows teller-window sales of government bonds by the handling of subscription sales method, which up to that time had been conducted only at post offices, to be conducted at ordinary private financial institutions, and this allows investors to easily and, in general, regularly purchase government bonds at a financial institution with which they are familiar. There are three types of government bonds that are subject to the new teller-window sales: 2-year, 5-year and 10-year fixed interest-bearing government bonds.

In the new teller-window sales method, as with government bonds for individual investors, while the Ministry of Finance commissions subscription handling institutions to carry out subscriptions and sales of government bonds, the Ministry of Finance pays a fee to the subscription handling institutions based on the volume of subscriptions handled. While the subscription handling institutions conduct subscriptions and sales of government bonds at the price set by the Ministry of Finance within a set period, they are not required to purchase unsold bonds.

(iii) Public Sector Issuance Method

・ Bank of Japan Switch (underwriting of refund bonds by the Bank of Japan)

While Article 5 of the Public Finance Act prohibits the Bank of Japan (the "BOJ") from underwriting government bonds, a *proviso* to this Article provides an exception where there are special grounds within the scope of an amount authorized by the Diet. The BOJ's underwriting of refund bonds within the limit of the redemption amount of the government bonds held by the BOJ (so-called "BOJ switch") falls under this exception.

Through its financial market adjustments, the BOJ holds a large amount of government bonds, and if it redeems those holdings for cash, it is necessary for the issuing authority to issue refund bonds in the market to raise the redemption funds. However, supposing that a large amount of refund bonds were to be issued in the market, the result is that the private sector would lack funds, and in order to clear up this lack of funds, the necessity would arise for the BOJ to supply funds by purchasing a considerable amount of refund bonds from the private sector.

In order to avoid this roundabout route, switching is allowed up to the limit of the amount necessary to roll government bonds held by the BOJ.

(2) Government Bond Market Special Participant System (Primary Dealer System)

The number of countries, including the U.S. and countries in Europe, that are adopting the primary dealer system—which provides designated primary dealers with benefits not enjoyed by other dealers, in exchange for the said primary dealers fulfilling certain obligations with respect to market making, etc. in the secondary market—is increasing.

Under such conditions, the JGB (Japanese Government Bond) Market Special Participants System was introduced in Japan in October 2004; the objective of this system is to foster the stable subscription of government bonds at the same time as sustaining and improving, etc. the liquidity, efficiency, competitiveness, transparency,

and stability of the government bond market.

Government bond market special participants, as so-called primary dealers, perform an important role in the government bond market (primary and secondary markets). They cooperate in terms of the formulation and implementation of government bond management policy, and have special responsibilities and entitlements with respect to the government bond market. The Minister of Finance designates them as "JGB Market Special Participants (hereinafter referred to as "Special Participants").

Specifically, those special participants that meet certain criteria and are designated by the Minister of Finance assume special responsibilities, including: 1) bidding and purchasing responsibilities with respect to primary market auctions; 2) secondary market responsibilities (providing liquidity); and 3) providing information, etc. to the Ministry of Finance.

Special participants are simultaneously entitled to: 1) participate in Meetings of JGB Special Market Participants; 2) participate in auctions for redemption by purchase (the method by which the issuer makes purchases at the market price through the market from holders who agree to be bought out); 3) apply for the stripping and recombination of principal and interest for strippable book-entry government bonds (so-called "STRIPS government bonds"); 4) participate, etc. in the non-price competitive auction; 5) participate in liquidity supply auctions; and 6) become preferential counterparties in interest rate swap transactions.

2 4 Primary Markets for Corporate Bonds

(1) Liberalization of Bond Issuing Methods

Formerly, there were a number of different regulations on the issuance of bonds in Japan. The issue terms were uniformly determined according to a set formula, and issue volumes were constrained as well. This rigid mechanism of floating was subsequently modified to allow issue terms and conditions to be determined in accordance with actual market conditions, in line with other deregulation measures.

(2) Recent Bond Issuing Methods

Efforts to determine the issue terms after more precisely ascertaining actual market conditions and the level of interest on the part of investors persist.

For example, a technique known as "spread pricing" is adopted mainly by highly-rated issuers. When assessing the market interest of investors, issuers will offer terms that, instead of specifying an actual interest rate, state an amount to be added to the interest rate for government bonds, etc. (the "spread"). By using spread pricing, not only can issuers adapt more quickly to changes in interest rates, but also get more detailed investor feedback.

In addition, efforts are being made to shorten the time it takes to determine the issue terms, by using the Internet, etc., when the members of an underwriting syndicate would report to the lead securities firm on the interest in the market.

(3) Bond Ratings

A rating expresses in a simple symbol (such as AAA, AA, A, or BBB) an opinion by a rating company of the comprehensive capacity of an issuing company to perform its financial obligations as well as the probability that it will perform individual obligations, etc. as contracted (its creditworthiness). This communicates to investors in an

easily understood form the creditworthiness of the issuing company and the individual bonds, and is used as information for decisions by investors.

Japan formerly employed a "designated rating agency system" that would use in financial policy a rating that had been assigned by a "designated rating agency" which the Commissioner of the Financial Services Agency had designated in consideration of factors such as rating performance. With the trends in revising and enhancing international rating regulations, however, the FIEA was amended in June 2009, and from April 2010 the "credit rating agency regulations" have been introduced and implemented in stages.

Under the "credit rating agency regulations" the Commissioner of the Financial Services Agency does not make a designation, but rather uses a "registration system" in which a rating company that satisfies requirements such as having in place a framework to make fair ratings may register as a "credit rating agency." Nevertheless, rating companies that are not registered can also engage in the business of assigning ratings. In this case, obligations are imposed on a person providing rating information, such as that the person must explain certain matters to the investor.

(4) Shelf Registration System

The "shelf registration system" is a system whereby an issuing company which has filed in advance a shelf registration statement which sets forth a scheduled issue amount of securities, etc. can issue securities within a certain period of time without having to file a registration statement for each issue at the time of the actual issuance and need file only a shelf registration supplementary statement that sets forth the terms and conditions of the issuance, and was introduced in October 1988.

Utilizing this system enables the issuer to simplify the issuance procedures for corporate bonds and shorten the period of time required from when the issuer company starts considering bond issuance to when the bonds are actually issued, thus, allowing for more flexible funds procurement.

Currently, most issuances of straight bonds make use of the shelf registration system.

3 Outline of the Secondary Market

3 1 Characteristics of the Secondary Market

(1) Definition of the Secondary Market

Rarely will a single investor hold a particular bond from its original issuance until redemption. Most bonds are sold by the first investor to a second investor, then to a third investor, and so on, with the bond changing hands many times.

From the time a bond is newly issued until it is redeemed, the process, location of trading or trading system, the structure, the specific movements in the bond's price, and general trends in the market as a whole concerning bond transactions among investors are collectively referred to as the secondary market.

(2) Players in the Secondary Market

As there are players in the primary bond market who assume various roles upon a new bond issuance, the secondary market is also composed of many players, including those who participate in trading as well as intermediaries who help the trading process run smoothly.

As the financial environment changed, so did the perception of bonds, and now bonds are viewed not as something to hold but as something to manage. The secondary market for bonds has been growing each year and becoming more active. Traditional participants in the secondary market include large-scale financial institutions such as city banks, trust banks, life and non-life insurance companies, and agriculture and forestry cooperative-affiliated financial institutions, but they have been joined in recent years, by business corporations, public corporations, mutual aid associations, investment trusts, local governments, individual investors, and foreign investors.

The secondary market can be said to operate efficiently only when the different buy/sell strategies of these diverse secondary market participants can be joined to consummate a trade. Securities firms and registered financial institutions engaged in dealing activities are the chief players in the secondary market, and perform a vital intermediation role. These firms are called bond dealers.

It is important that the secondary markets realize the intentions of investors as soon and as often as possible, and it is also important that trades can be executed at fair and equitable prices. In this respect, bond dealers also play an important role in gathering a large quantity of investment and price information, and distributing this information to investors.

(3) Exchange Markets and Over-the-Counter Markets

Bond transactions can be broadly divided into exchange market transactions and over-the-counter market transactions.

In transactions on the exchange, the investor will submit via a securities firm his buy or sell order regarding an issue that is listed on one of the securities exchanges, and these trades are concluded in a concentrated manner on the exchange.

On the other hand, an over-the-counter market transaction is a negotiated trade between each investor and the bond dealer, or between two bond dealers, and essentially the buyer and seller are free to decide on transaction terms that best suit their various needs.

Shares are principally traded on an exchange; by contrast, currently over 99% of the total volume of bond trades take place over-the-counter.

This is because there are additional terms and conditions involved in every bond trade, such as the delivery date, the method of delivery (bearer bonds, registered bonds, book-entry transfer bonds) or taxes that must be taken into account when conducting a bond transaction. Bonds by their nature are ill-suited to exchange transactions, which are premised on standardized processing terms. On top of this, bond trades themselves are often complex deals, combining several different series of bonds in a single transaction. In addition, the number of issues of outstanding bonds alone runs into the tens of thousands, and to try to list and centrally manage all of them on an exchange would be practically impossible.

Nevertheless, one advantage of exchange transactions is that the benchmark prices for representative issues are widely disclosed. Exchange transactions can thus be said to play an important role in the context of allowing investors equal access to market information (in Japan, trading prices in negotiated transactions on the over-the-counter market are not disclosed, except for certain types of transactions).

At the Japan Securities Dealers Association (hereinafter referred to as the "JSDA"), public and corporate bond over-the-counter trading reference statistics (hereinafter referred to as "trading reference statistics") are announced every business day based on reports from Association Members that the JSDA designates. These are made for the purpose of reference for Association Members and customers at the time that an Association Member engages in over-the-counter trading in bonds with a customer (for details, see 3.3(3) below).

(4) Bond Broker

Transactions in the over-the-counter market are negotiated trades. In almost all cases, a bond dealer will act as counterparty in trading with investors in order to smoothly complete the negotiated transaction. Accordingly, a bond dealer, like a wholesaler, is expected to keep a certain level of inventory at all times.

However, since keeping an inventory involves price fluctuation risks and a capital cost, there are limits on the volume of inventory any single bond dealer can hold. As a result, dealers may not always be able to accommodate the issues or volume desired by investors. In such cases, it becomes necessary to exchange certain issues or coordinate volume among bond dealers.

In order to meet these needs, a securities firm that specializes only in trades between bond dealers is called bond broker, and it serves the function of coordinating and unifying in one place the trades between bond dealers.

(5) Expansion in Trading Volume Centered on Government Bonds

The total amount of outstanding bonds traded has grown tremendously from a mere JPY55 trillion or so in FY1975. *Gensaki* trading volume increased sharply with abolition of the securities transaction tax and the start of public auctions for short-term government securities (Financing Bills, or "FB") in April 1999, as well as the large increase in the outstanding FBs traded in the market, and as a result, over-the-counter trading volume reached JPY4,000 trillion in FY1999. Over-the-counter trading volume slightly declined in FY2001 and FY2002 owing to declines in trading volumes of discount short-term government bonds (Treasury Bills, or "TB") and FBs, which in turn stemmed from the entrenchment of ultra-low interest rates. In FY2003, however, over-the-counter trading volume has surpassed JPY5,000 trillion for the first time in 16 years since FY1987 (JPY5,094 trillion), with a sharp rise in *gensaki* transactions, which in turn was partly influenced by the Bank of Japan's *gensaki* operations beginning in November 2002. When it comes to FY2007 the trade volume for the first time broke above the JPY10,000 trillion level.

Chart 4-9 Over-The-Counter Trading Volume and Outstanding Amount of Public and Corporate Bonds

(Unit: JPY100 million)

At the End of Fiscal Year	Trading Volume	Government Bonds (%)	Outstanding Amount	Government Bonds (%)
1980	2,810,114	1,643,604 (58.5%)	1,523,943	705,098 (46.3%)
1985	25,146,531	24,042,582 (95.6%)	2,614,843	1,344,315 (51.4%)
1990	32,857,689	31,561,777 (96.1%)	3,427,845	1,663,380 (48.5%)
1995	39,351,791	37,741,479 (95.9%)	4,697,535	2,251,848 (47.9%)
2000	41,478,253	39,715,220 (95.7%)	6,135,610	3,675,913 (59.9%)
2005	72,237,910	69,006,266 (95.5%)	9,042,481	6,662,842 (73.7%)
2010	77,219,520	76,195,034 (98.7%)	9,992,765	7,782,855 (77.9%)
2015	103,953,909	102,508,723 (98.6%)	11,197,485	9,014,630 (80.5%)
2019	195,950,434	195,151,730 (99.6%)	11,927,000	9,775,505 (82.0%)
2020	214,936,584	214,426,851 (99.8%)	12,860,505	10,651,576 (82.8%)
2021	227,594,125	227,059,926 (99.8%)	13,208,842	10,957,940 (83.0%)
2022	375,231,609	374,780,819 (99.9%)	13,530,406	11,271,903 (83.3%)
2023	466,905,870	466,403,364 (99.9%)	13,739,448	11,473,851 (83.5%)

(Note) The trading volume is for each fiscal year and the outstanding amount is at the end of each fiscal year.
(Source) Prepared based on the "Trading Volume of Over-the-Counter Bonds" and the "Issuing, Redemption and Outstanding Amounts of Bonds," which are statistics compiled by the JSDA; as well as the "Issues, Redemptions and Outstanding Amount of Local Government Bonds Offered on the Public Market and Subscribed by Banks, Etc." which are statistics listed in the *Local Government Bond Monthly* of the Japan Local Government Bond Association.

The growth in government bonds in particular is astounding. The share of government bonds among the total trading volume used to be only a few percentage points. However, their share of volume grew to close to 60% in FY1980 and was approximately 95% in FY1985.

The following are reasons given for the growth in over-the-counter trading volume:

(a) The Rapid Increase in the Amount of Outstanding Bond Issues Centered on Government Bonds

Large-scale government bond issues in the decade beginning 1975 started the ball rolling, and overall government bond issues, inclusive of government bonds for rolling over maturing bonds (so-called "refund bonds"), reached JPY70 trillion in the FY 1998; in 2001, immediately following the issuance of fiscal investment and lending special account government bonds (so-called "*zaitō* bonds"), overall government bond issues surpassed JPY130 trillion; in 2005, total government bond issues increased substantially, to approximately JPY181 trillion, partly due to an increase in refund bonds. The amount of outstanding issues is thus expanding owing to these factors.

(b) Increase in the Volume of FBs and TBs in Circulation and the Introduction of New *Gensaki* Transactions

The sales of FBs by the Bank of Japan in the open market began in May 1981, with public auctions starting in April 1999. In addition, TB issues began in February 1986. FBs and TBs were consolidated and became short-term treasury securities ("TDB") in February 2009. New *gensaki* transactions introduced in April 2001 are compatible with contracts in force in Europe and the U.S. Transactions are gradually shifting towards these and away from cash collateral bond borrowing and lending transactions, which were hitherto the core of the short-term financial market, which contributes to an increase in government bond trading volume.

(c) Changes in Funds Management Activities Involving Bonds

While on the one hand the assets held by financial institutions and other investors are increasing, current conditions make it difficult to invest in risk assets due to BIS regulations and non-performing loan disposals, etc., and this has consequently focused the spotlight on bonds, chiefly government bonds, as suitable investment targets.

(d) Prolonged Low Interest Rate Environment

The economy remained in a slump at the same time as interest rate levels continued to fall since the period when the official discount rate peaked at 6.0% in 1990, and the Bank of Japan, starting in February 1999, carried out a so-called "zero interest rate policy" by keeping the short-term market interest rate (unsecured overnight call rate) effectively close to nil. While the Bank of Japan temporarily abandoned this policy in August of the next year, it reverted to a zero interest rate policy in March 2001, and maintained this policy for a long time until finally abandoning it in July 2006 (raising the target level for the short-term market rate to 0.25%). Moreover, interest rates have once again been declining since the money markets fell into confusion as a result of the Lehman Shock of September 2008.

While previously, bond transactions centered on a specific issue from among 10-year government bonds which is referred to as the "benchmark government bond," trading today encompasses bonds of wide-ranging maturities and varieties, and this is one factor, together with high levels of outstanding government bonds, behind high trading volumes.

Furthermore, from among the 10-year government bonds for which trading reference statistics are announced, currently the issue with the longest remaining time to maturity is used as the criterion for long-term interest rates.

3 2 Transactions on Exchanges and Executed Prices

(1) Listed Issues

All bonds other than government bonds may be listed on the exchange by application of the issuer. However, the exchanges have listing standards, and only those issues that satisfy these standards may be listed. As of the end of August 2024, there were 386 issues listed on the Tokyo Stock Exchange. Almost every issue of interest-bearing government bonds (2-year, 5-year, 10-year, 20-year, 30-year, and 40-year) issued in the open market and convertible-type bonds with share options offered publicly domestically are listed. Apart from these, currently no bonds other than yen-denominated foreign bonds and foreign currency-denominated bonds are listed (refer to Chart 4-10).

Chart 4-10 Number of Bond Issues Listed on the Tokyo Stock Exchange

Government Bonds	Yen-Denominated Foreign Bonds	Foreign Currency-Denominated Bonds	Convertible-Type Bonds with Share Options	Corporate Bonds/ Bank Debentures/ Municipal Bonds/Special Bonds	Total
318	11	20	0	37	386

(Source) Prepared based on the "Monthly Statistics Report" posted on Japan Exchange Group's website (as of the end of August 2024).

Because persons that can conduct trades on an exchange are limited to the transaction participant securities firms of that securities exchange, an investor who wishes to trade on the exchange must place his buy or sell order through a securities firm. The securities firm will broker the investor's order and execute the trade on the exchange. A brokerage commission is collected from the investor at that time, and each securities firm is free to independently determine the amount of the brokerage commission.

Following the introduction of the professional market system through the amendments to the FIEA in 2008, "Tokyo Pro-Bond Market" was established as a bond market for professional investors in March 2012. This market is operated under the program listing scheme, which is a method of bond issue generally employed in foreign markets, and the disclosure rule that allows information disclosure to be submitted in English alone. Program listing is a scheme wherein the issuer which seeks to raise funds by issuing bonds registers in advance its program information such as the aggregated maximum limit of the value of bonds to be issued, as well as other basic and financial information, and issues bonds when desired, up to such maximum limit. The market's highly flexible rules offer efficient bond issuance procedures through simplified disclosure documents, and simple formal requirements for listing eligibility for program information and individual bonds, such as acquiring a credit rating and securing a lead manager securities firm specified by the Tokyo Stock Exchange.

(2) Delivery Date

As for the delivery date (*i.e.,* the settlement date), settlement of government bond transactions takes place on the second business day counting from the contract date, and settlement of convertible-type bonds with share options takes place on the third business day counting from the contract date.

(3) Trading Hours

Trading hours are from 9:00 until 11:30 in the morning session and from 12:30 until 15:00 in the afternoon session for convertible-type bonds with share options. Trading hours for government bonds are 12:30 until 14:00 in the afternoon (refer to Chart 4-11).

Chart 4-11 **Bond Trading Methods (Exchange Transactions)**

	Trading Hours	Trading Unit	Nominal Quotation Unit	Sales Type and Settlement Date
Government bonds	12:30 – 14:00	JPY50,000 in face value	JPY0.01 per JPY100 face value	Regular transaction In principle, the second day counting from the contract day (T+1)
Convertible-type bonds with share options (*)	9:00 – 11:30 12:30 – 15:00	JPY100,000, JPY500,000, JPY1 million, JPY2 million, JPY3 million, JPY4 million, or JPY5 million in face value	JPY0.05 per JPY100 face value	Regular transaction Same-day settlement trade

* This refers to a bond with share options for which there has been a resolution to the effect that it is deemed there was substitute payment by the corporate bond portion if there is a request to exercise share options, and moreover, that it is deemed there was a request for substitute payment if there was exercise of the share options.

(Source) Prepared based on the Japan Exchange Group's website (as of September, 2024).

(4) Executed Price, Quotations

In the exchange market, when a trade is completed, the price is immediately publicly announced as the executed price. In the case of convertible-type bonds with share options, even when the trade is not completed, quotations for bid and ask prices are continuously announced, allowing investors to check the market price in real time.

3 3 Over-the-Counter Transactions and the Related Systems

(1) Fair Price

In order to ensure transactional fairness, over-the-counter transactions must be conducted at a fair price, based on the market value of the underlying security, computed under a reasonable formula.

(2) Delivery Date

The delivery date for an over-the-counter transaction of bonds is generally predetermined but may be determined freely by agreement between the parties.

Formerly, the delivery dates for most of the bonds were lumped together on specified days each month, such as the 10th day, 20th day and last day of the month (referred to as "*gotōbi*" settlement, meaning settlement date of the month that is a multiple of 5), which invited large settlement risks to accumulate over the relatively long period of time during which the trades remained unsettled.

Following the G-30 recommendations of 1989, it became important to constrain the balance of unsettled trades

and reduce settlement risk by putting rolling settlement into practice and reducing the amount of time between contract and settlement. As a result, beginning in October 1996, delivery for government bonds shifted to a "rolling settlement (T + 7)" system, under which settlement occurs on the eighth business day counting from the contract date, and subsequently in April 1997 moved to the standard of settlement on the fourth business day (T + 3). From April, 2012, the standard date of settlement has been the third business day (T + 2). With the objective of mitigating settlement risks, improving liquidity, safety and efficiency of government bond markets and short-term financial markets, as well as maintaining and strengthening the international competitiveness of Japanese markets, the shorter settlement cycle, T + 1 has been introduced for transactions contracted on and after March 1, 2018.

Bonds other than government bonds moved to the "rolling settlement (T + 7)" system, under which settlement occurs on the eighth business day counting from the contract date, beginning in November 1997, and subsequently migrated to settlement on the sixth business day (T + 5) from June 1998, and to settlement on the fourth business day (T + 3), starting in October 1999.

For retail transactions in government bonds and transactions in general bonds contracted as of July 13, 2020, and afterwards, the delivery date is the third business day counting from the contract date (T+2).

(3) Reference Statistical Price [Yields] Publication System

Although the over-the-counter trading system is an effective means for completing large and complex bond trades smoothly, there are defects in its system of publicly announcing prices.

Since over-the-counter transactions are negotiated transactions between the seller and buyer, third parties have no way of finding out the details of the transaction. Due to the fact that over-the-counter transactions comprise such a large share of the secondary market, however, it is important to publicly announce and make investors aware of trading prices and rates, not only to promote fair and equitable price formation in bond transactions, but also with a view to protect investors.

In response to such needs, the JSDA has set up the following systems used to broadcast reference information.

(i) Reference Statistical Price [Yields] Publication System for OTC Bonds Transactions

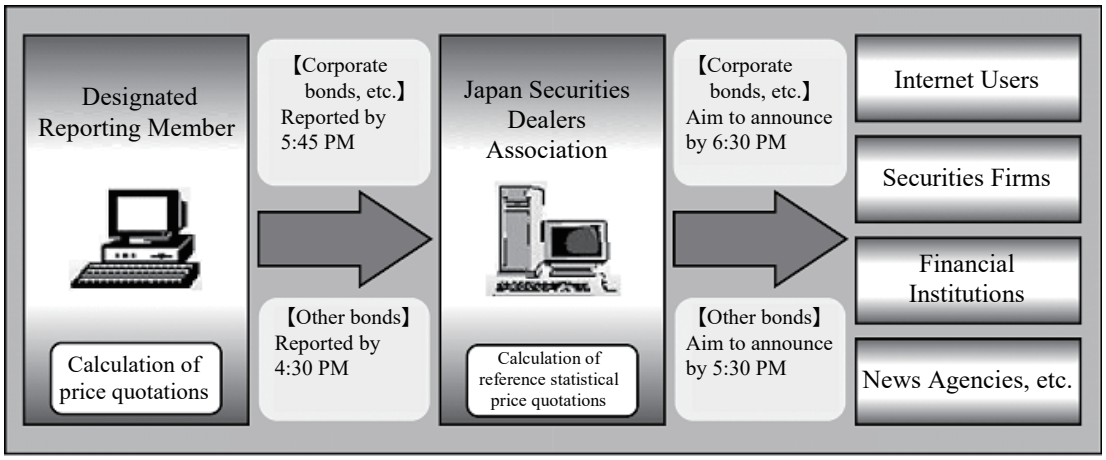
Each business day, the JSDA announces reference statistical prices [yields] for over-the-counter bonds transactions based on the reports received from certain designated Association Member to serve as a reference to investors, securities firms and other parties conducting over-the-counter bond transactions.

Reference prices are announced for issues of publicly-offered public and corporate bonds, etc. (bonds issued in Japan, but other than bonds with share options), the paid-up principal, interest and maturity payments of which are all denominated in yen and chosen by five or more designated reporting members as issues (selected issues) to be reported to the JSDA.

"Reference statistical price [yields] for transactions" means the four quotations for "average price," "median price," "high price" and "low price" quotes reported by the designated reporting members (for bonds other than corporate bonds, etc., excluding certain ranges above and below the respective prices).

In addition to reference statistical price [yields] for transactions, information on corporate bond transactions (*e.g.* actual contract prices) has also been available since November 2, 2015, with the aim of revitalizing the bond market by improving the transparency of the bond price information and ensuring its reliability.

Chart 4-12 **Reference Statistical Price [Yields] Publication System for OTC Bonds Transactions**



(Note) 1. "Corporate bonds, etc." in this figure refer to corporate bonds, specified bonds and yen-denominated foreign bonds.
2. "Other bonds" in this figure refer to government bonds, municipal bonds, government guaranteed bonds, fiscal investment and loan program agency bonds and bank debentures.

(Source) Based on the Japan Securities Dealers Association's website.

(ii) Rating Matrix Publication System

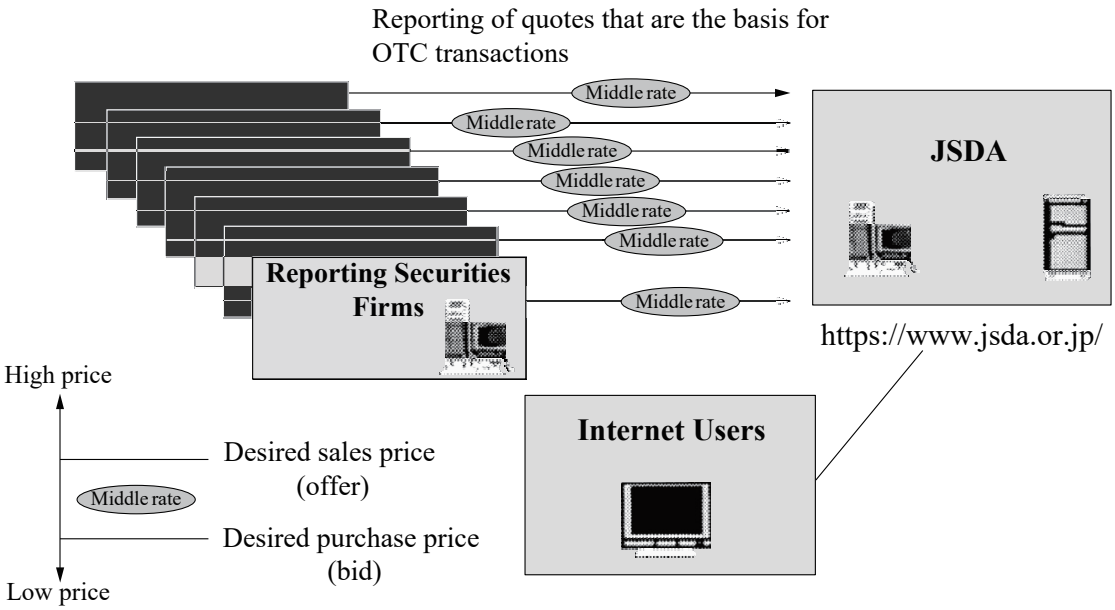
Starting from April 1997, the JSDA began preparing and publishing a "Rating Matrix" as a reference material. The "Rating Matrix" is a table including the ratings and compounded yields for each of the remaining years of bonds. It is prepared and published for each rating institution, in order to strive for the diffusion and awareness of ratings as well as the enhancement of investment information to be provided to investors, in view of, *e.g.*, the increased importance of rating information among market participants, etc. on the bond markets since the abolishment in January 1996 of the issue eligibility standards.

(iii) Publication System of Over-the-Counter (OTC) Quotation of Corporate Bonds, Etc. for Retail Customers

In April 2003, the JSDA began a campaign urging individual investors to actively participate in the bond markets, as well as contributing to the sound development of the over-the-counter bond markets. To meet its goal, the JSDA currently has in place a "Publication System of OTC Quotation of Corporate Bonds, etc. for Retail Customers" which provides individual investors with transaction reference price information related to "bonds for individual investors," etc. Generally, pricing information for bonds, etc. for individual investors is announced each business day.

Pursuant to this, it has become possible for individual investors to view on the JSDA website "reference price information" in the secondary market for the bonds, etc. that they themselves have purchased. Price and yield are reported and announced at the middle rate (middle rate between selling quotes and buying quotes).

Chart 4-13 Publicizing the OTC Quotation of Corporate Bonds, etc. for Retail Customers



(Source) Japan Securities Dealers Association: "Guidebook: 'Bonds, etc. For Individual Investors OTC Quotation.'"

(4) Market Making

In recent years, although bond trading has mushroomed, a breakdown will show that trading has been concentrated in long-term government bonds, and then only a small number of issues among those. Compared to government bonds, government guaranteed bonds, municipal bonds, corporate bonds, yen-denominated foreign bonds, etc. are only issued in small amounts, making them less liquid.

Therefore, for those bonds, in order to (i) promote trading and provide a measure to improve liquidity; and (ii) further clarify the actual conditions of the market, "market making" commenced in June 1986 for yen-denominated foreign bonds, and in September 1986 for government guaranteed bonds, municipal bonds, and corporate bonds. Making a market means that certain designated securities firms and banks announce daily bid/ask quotes and stand ready to buy or sell at the price quoted when approached by an investor.

Also, in April 1988, for new issues of corporate bonds issued under the proposal method, market making during the offering period was introduced. Currently this serves to charge underwriting securities firms with the responsibility for setting issuance conditions by making them present quotations to information vendors and other parties, and to stimulate the secondary market for regular bonds.

(5) Transactions Prior to the Auction and Transactions Prior to the Issue Date (When-Issued, or "WI" Transactions)

Amid vigorous institutional reforms, including diversification of issuance methods and the lowering of underwriting shares for government bond underwriting syndicates, etc., the "need to deliberate on the introduction of so-called WI (When Issued) transactions" was highlighted with the release in July 2002 of "The Vision for the Future of the Financial System and Policy" (the Official Report of the Roundtable Committee on the Vision of the Japanese Financial System and Policies in the Future).

Against this background, from the perspective of endeavoring to make government bond auctions even smoother, the "Guideline for When-Issued Transactions of Japanese Government Bonds" was developed with the

objective of establishing a favorable environment for the adoption of WI transactions (transactions that are engaged in from the time the Ministry of Finance announces and reveals certain terms pertaining to an upcoming issue, such as the expected auction date, the expected issue date, the expected issue amount, and the expected redemption date, up to the time of the announcement of the issue number and coupon rate, etc. on the auction date; which is also referred to as "transactions prior to the auction"), and came into force from February 2003.

Transactions prior to the issue date for government bonds are trades that, on the condition the issue takes place on the originally scheduled issue date for the said government bonds, are engaged in up to and including the day before the issue date, and conduct the delivery of government bonds, in accordance with the contents of the transaction contract, on or after the issue date of the said government bonds (the handling of subscriptions of government bonds, such as selling government bonds for individual investors, does not fall under transactions prior to the issue date).

A transaction prior to the auction is one form of transaction prior to the issue date, but in view of factors such as the transaction having to take place before the coupon rate is determined, the aforementioned guideline prescribes market conventions, for example, that the method for determining the trade unit price pertaining to a transaction prior to the auction involving an interest-bearing government bond should be agreed by using the compounded yield or spread α, etc., and determining the trade unit price after the auction.

(6) Settlement System

Along with technological innovation and economic globalization in recent years, it has become an important task to increase the efficiency, stability and convenience of the settlement system. At present, payments and receipts in transactions of Japanese government bonds (JGBs) are settled by making entries in books under the JGB book-entry transfer system provided by the Bank of Japan (BOJ). In order to ensure the stable and efficient settlement of JGB transactions, the BOJ operates a computer network system called BOJ Net. In addition, with a view to mitigating the risk of the failure of a single financial institution causing an adverse effect on other financial institutions and the settlement system and eventually on the financial system as a whole, the settlement method has been changed from the traditional Deferred Net Settlement system that settles only the difference arising from a number of payments and receipts at a certain point in time during a day, to the real time gross settlement (RTGS) that settles each transaction individually (for details, see (7) below).

On the other hand, transactions of other bonds such as corporate bonds and municipal bonds are settled under the book-entry transfer system provided by the JASDEC. This system was introduced in January 2006 for the purpose of carrying out the management of transfer of bonds by means of electronic recording from the perspective of increasing efficiency. It has speeded up the settlement procedure and reduced costs for management and delivery of bond certificates.

The JASDEC's book-entry transfer system has the following features.

(i) Complete Dematerialization

The entire bond management process from issuance to circulation and redemption is carried out by way of electronic information processing, achieving complete dematerialization and reducing the issuance costs and administrative costs.

(ii) Book-Entry Transfer System by Balance Management

Smooth circulation of bonds is achieved under the book-entry transfer system whereby the transfer of rights thereof is effected by electronically recording the increase and the decrease of the balance in the transfer account book.

(iii) Multi-layer Holding Structure

In order to facilitate various patterns of participation in the system, a multi-layer holding structure is adopted so that account management institutions (*e.g.*, securities firms, financial institutions, etc.) maintain a connection not only directly but also indirectly with the book-entry transfer institutions.

(iv) DVP (Delivery Versus Payment) Settlement

DVP settlement(Note 1) is made available at each phrase, *i.e.*, upon issuance, circulation, and redemption, which is conducive to reducing credit risks.

(v) STP (Straight-Through Processing)

With a view to increasing the efficiency and reducing the risks in operations, the book-entry transfer system is linked with the pre-settlement matching system (PSMS) completing the series of operations by way of electronic information processing, thus realizing straight-through processing (STP)(Note 2) for completing the entire process from trade matching to settlement.

Bonds that are eligible to be settled under the JASDEC's book-entry transfer system are the following: (i) corporate bonds except for bonds with share options; (ii) municipal bonds; (iii) investment corporation bonds; (iv) specified bonds issued by specified purpose companies (SPCs): (v) special corporation bonds issued by fiscal investment and loan program agencies or local public corporation bonds; (vi) bonds issued by foreign governments or foreign corporations (Samurai bonds): (vii) corporate bonds issued by mutual companies under the Insurance Business Act; and (viii) corporate bond-like beneficial interests in special purpose trusts (with some exceptions).

Bonds managed by financial institutions such as securities firms and banks via book-entry transfer account registries are called book-entry transfer bonds. These bonds are handled electronically, and transactions of bonds (transfer of rights etc.) are effected when the bond holders enter the amount held and an increase or decrease thereof in their book-entry transfer accounts established with the financial institution. Under the Act on Book-Entry Transfer of Bonds and Shares, etc., all Japanese government bonds newly issued on or after January 2003 are book-entry transfer bonds. The book entry transfer system was introduced with regard to bonds other than Japanese government bonds in January 2006, and these bonds can now also be issued as book-entry transfer bonds.

(Notes) 1. DVP Settlement

Delivery versus payment (DVP) settlement service for non-exchange transaction deliveries (NETDs) is a system designed to ensure settlement of funds and reduce capital risks related to securities settlement through linking the delivery of securities with the payment of the settlement amount for NETDs systematically. In order to provide the DVP settlement service for NETDs, the JASDEC DVP Clearing Corporation was founded in June 2003 as JASDEC's wholly-owned subsidiary. JASDEC DVP Clearing Corporation started providing the DVP settlement service in May 2004.

2. Straight-through processing (STP)

Straight-through processing (STP) means seamless, computerized processing of the series of clerical procedures in securities transactions, from the contract to settlement.

(7) Bank of Japan RTGS and "Rules Concerning Resolution of Fails in Bonds, Etc." (Uniform Business Practice Rules)

RTGS stands for "Real Time Gross Settlement," and technically means "instantaneous gross settlement."

The RTGS system was implemented by the Bank of Japan for settlement of current deposits and government bond settlement in January 2001, on the heels of various movements by foreign countries to strengthen their markets against the risk to the settlement system caused by increasingly large financial transactions (international standardization of RTGS). Under the traditional "Deferred Net Settlement" system, the Bank of Japan settles the difference between the gross amount of pay and receive "transfer orders" it receives from various financial institutions that are stored in the system prior to the designated point in time for settlement; under the RTGS system, however, each "transfer order" is settled individually, without netting against another "transfer order," immediately after it is received.

The traditional "Deferred Net Settlement" system has the possibility of throwing the settlement system into chaos upon the failure of a single financial institution, and with the recent cases of Japanese financial institution insolvencies, the shift to RTGS, which is the global standard in settlement systems, became a priority.

Nevertheless, the "Deferred Net Settlement" system allowed participants to settle only the net difference with the counterparty financial institution at a certain point in time, whereas financial institutions must have funds ready to make payment for each settlement concluded under the RTGS system. The burden of procuring the funds needed for gross settlement is a drawback for financial institutions. To compensate for this, the Bank of Japan will provide "intra-day liquidity" on a secured basis for the primary and secondary markets.

In November 2005, with the objective of further enhancing the safety and efficiency of large-value payment systems in Japan, the Bank of Japan announced a proposal on the Next-Generation RTGS (RTGS-XG) Project. In February 2006, following public consultation, the Bank of Japan launched a practical discussion and development process for the RTGS-XG Project in order to accomplish it.

Specifically, the RTGS-XG Project has the following pillars:

(i) Introduce liquidity-saving features (LSF) into the RTGS mode of the BOJ-NET; and

(ii) Modify BOJ-NET to incorporate large-value payments (all payments processed under the Foreign Exchange Yen Clearing System (FXYCS) and large-value domestic exchange payments, *i.e.* at least JPY100 million per payment) currently handled by Deferred Net Settlement (DNS) systems through private-sector settlement system into the RTGS mode of the BOJ-NET.

Of these, the Bank of Japan implemented Phase 1 of the project (introduction of LSF and complete shift to RTGS for foreign exchange yen payments) in October 2008 and confirmed that yen payments were processed smoothly. Subsequently, in November 2011, the Bank of Japan implemented Phase 2 of the project (shift to RTGS for large-value domestic exchange payments, *i.e.* at least JPY100 million per payment), further increasing the stability of payments. The volume of payments handled on the BOJ-NET increased significantly as expected, and payments have been processed smoothly, including those at the end of March when the number and volume of large-value domestic exchange payments hit a peak. As for small-value domestic exchange payments, *i.e.* less than JPY100 million per payment, payment risk has been considerably reduced due to the significant decrease in the value of payments handled on the DNS systems. As a result of the implementation of Phase 2, Japan has achieved the international stability standards for large-value payments at a high level.

The JSDA developed and published the "Japanese Government Securities Guidelines for Real Time Gross Settlement" in August 2000 laying out the practices, etc. that market participants must follow to carry out a smooth shift to RTGS. This was on the basis of their observance of the RTGS-related rules of the BOJ-NET, to reduce settlement risks in the environment for settlements after RTGS for settlements of JGBs has implemented, and to ensure smooth settlements. Thereafter, the JSDA has been appropriately updating the Guidelines. One such market practice is a "fail" practice — even in the event of a "fail" (a situation where a receiving participant is unable to

receive securities to be delivered by a delivering participant although an initially scheduled settlement date has passed), this situation alone does not cause the delivering participant to fall into a default (or the contract shall not be canceled despite such failure of delivery). The JSDA's "Japanese Government Securities Guidelines for Real Time Gross Settlement" and "Rules Concerning Resolution of Fails in Bonds, etc." provide for basic matters concerning how to handle cases in which a "fail" occurs and resolve a prolonged "fail."

In the process of review of the "Japanese Government Securities Guidelines for Real Time Gross Settlement" in June 2010, when the JSDA introduced a fail charge (a certain monetary burden imposed on the delivering participant who has caused a "fail"), the JSDA established the "Practical Guidelines for Handling of Fails Charges" accordingly. The JSDA has also reviewed the conditions for applying the cut-off time (the "deadline for government bond settlements set before the end time of the BOJ-NET JGB services," as prescribed among market participants for the purpose of recognizing fails, etc., with the aim of facilitating completion of daily settlements) and the "fail" practice. In December 2013, in order to respond to the 2nd phase operation of the new BOJ-NET, the JSDA made an overall revision to the Guidelines and put them into force as of October 13, 2015.

(8) Japan Securities Clearing Corporation

The Japan Securities Clearing Corporation (JSCC) was founded as the first securities clearing organization under the Securities and Exchange Law (currently the "financial instruments clearing organization") in Japan, with a license to provide the service of assuming obligations arising from trading securities (currently the "financial instruments obligation assumption service"), and it started operation on January 14, 2003. This led the move for clearing and settlement services for spot transactions, which had been handled independently by the respective securities exchanges (including JASDAQ), to be integrated under the JSCC, which provides inter-market securities clearing infrastructure. The JSCC has continuously expanded the scope of its services since it began operations, and it currently provides clearing services for on-exchange transactions, over-the-counter transactions of derivatives (credit default swap transactions and interest rate swap transactions), and over-the-counter JGB transactions. It is planning to provide its services for overseas users as well. On July 27, 2020, upon the merger with Japan Commodity Clearing House Co., Ltd. for the integration of clearing functions, the JSCC expanded the scope of clearing products to cover listed commodities derivatives transactions.

On securities markets, multiple market participants conduct sale and purchase transactions continuously. If they actually settle payments with the other party, it would be extremely inefficient, and moreover, they would have to execute transactions while taking into account the risk of the other party. To avoid this, there was a call for a mechanism where all transactions between market participants are replaced with transactions between market participants and the clearing organization in the phase of delivering and receiving securities and funds, so as to guarantee the execution of the settlement of transactions. Specifically, a clearing organization assumes an obligation of a party to a transaction (to deliver securities or pay funds), and at the same time, acquires a claim corresponding thereto (to receive securities or funds), and thus the clearing organization, on behalf of the other party to the underlying transaction, delivers or receives the securities or funds to or from the participant, thereby guaranteeing the execution of the settlement of the transaction. This is a fundamental function of a clearing organization. The clearing organization is called a central counterparty (CCP) as it settles transactions as the other party to multiple market participants. The clearing organization conducts netting (complete settlement of the calculated difference between the selling and buying volume, as well as the calculated difference of the corresponding payment amount between two parties, as if by offsetting each other's mutual obligations) for ensuring efficient delivery and receipt of securities and funds, and instructs settlement facilities to settle transactions.

As the uniform clearing organization, the JSCC plays the following roles in providing clearing and settlement services:

(i) Improving Efficiency

The points of access that market participants (*e.g.*, securities firms) previously had for each financial instruments exchange market have been centralized at the JSCC. This enables market participants to standardize administrative work and reduce costs for back-office tasks, as well as considerably offsetting the settlement volume by conducting netting that covers multiple markets, thereby contributing to increasing the efficiency in carrying out administrative work and handling securities and funds.

(ii) Improving Safety

The clearing function is now available for transactions conducted on markets where it had not been available. As a result, it is theoretically possible to conduct transactions without needing to take into account the credit risk of individual participants. Furthermore, the introduction of DVP settlement has also made it possible to eliminate the risk of losing the principal upon delivery. In addition, the JSCC's integrated settlement guarantee scheme as described in its business rules is now provided for financial instruments exchange markets nationwide, thereby contributing to increasing the safety of these markets as a whole.

3 4 Bond Borrowing and Lending Transactions

(1) Definition of Bond Borrowing and Lending Transactions

Accompanying the diversification of secondary markets, in May of 1989 the "bond borrowing and lending (or loan) transaction market" was established, primarily for the purpose of ensuring the liquidity of government bonds.

The bond borrowing and lending transaction market is the place where bond borrowing and lending transactions are conducted. When a person sells bonds short (short sale = the sale of outstanding bonds that are not actually held by the seller on the contract date) and does not repurchase the bonds before the delivery date, that person enters into a bond borrowing and lending transaction in order to borrow bonds to use for delivery. In other words, a bond borrowing and lending transaction is a transaction under which borrowed bonds are used to make delivery, and on the repayment date of the borrowing and lending, the borrower returns to the lender bonds of the same type and volume (loan contracts).

Short selling and borrowing and lending transactions for bonds were in strong demand for a long time by market-related parties, who consider them instrumental in conducting spot/futures arbitrage trading and nimble spot bond trades, etc.

Initially, the expansion in the market for bond borrowing and lending transactions centered mainly on unsecured trades. However, an investment bank in the U.K. collapsed in February 1995 and similar events exposed the risks involved in unsecured transactions. Additionally, in light of the determination to implement rolling settlement, the issue became how to stimulate these transactions while providing increased security. The answer was "cash collateral bond borrowing and lending transactions (commonly referred to as loan-repo transactions, or cash collateralized repo transactions)," which became possible starting in March of 1996.

Not only did this allow securities firms to engage in much more active inventory financing, but also encouraged the participation of trust banks, etc. and other asset management entities in this new market. In November 1997, the Bank of Japan began using repurchase transactions of government bonds as part of its open-

market operations as a method of fine-tuning of the money supply, and these transactions have become a central element of the money markets. Also there are no special restrictions on transaction participants that are engaged in these bond borrowing and lending transactions, transactions between financial institutions are most frequent.

(2) Outline of Bond Borrowing and Lending Transactions

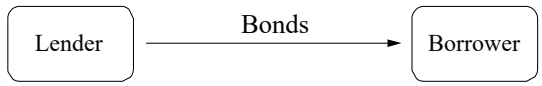
Prior to commencing a bond borrowing and lending transaction, the parties must execute an agreement between themselves.

Bond borrowing and lending transactions can be divided into the following three types, based on whether or not they are collateralized:

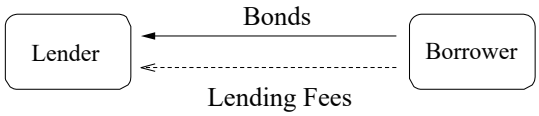
(a) Uncollateralized Bond Borrowing and Lending Transactions

This is the case where the lender lends bonds to the borrower without requiring the borrower to post collateral. The borrower pays the lending fees at the same time it returns the bonds on the settlement date.

(i) Transaction Execution Date (Start Date)



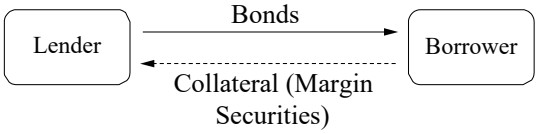
(ii) Transaction Settlement Date (End Date)



Uncollateralized transactions had been widely used by participants due to the simplified administrative work flow; however, the balance of uncollateralized transactions has withered because participants are shifting from no collateral to cash collateral as loan-repo transactions became more widespread, especially due to the industry-wide reexamination of credit management sparked by the 1997 financial crisis. However, against the background of facts that it is possible to procure low-cost financing by combining them with loan-repo transactions or *gensaki* transactions; that it is possible to procure bonds for collateral without any funding burden, and that the cost of holding cash is increasing; the market volume of these deals is gradually increasing.

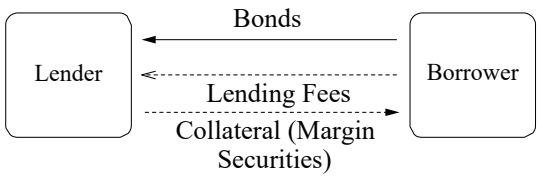
(b) Bond Borrowing and Lending Transactions Collateralized by Margin Securities

(i) Transaction Execution Date (Start Date)



Simultaneously upon lending the bonds, the lender accepts the collateral securities. Conversely, the borrower will submit the collateral securities simultaneously upon borrowing the bonds from the lender.

(ii) Transaction Settlement Date (End Date)

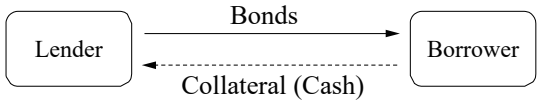


The lender will return the collateral securities simultaneously upon receiving the return of the bonds; conversely, the borrower will collect the collateral securities simultaneously upon returning the bonds to the lender. Lending fees are paid on the underlying bonds.

Users of these transactions are relatively limited, due to the fact that management of the collateral securities is burdensome, and the conversion ratio (*kakeme*) used for the collateral securities makes them less favorable when compared to cash collateral.

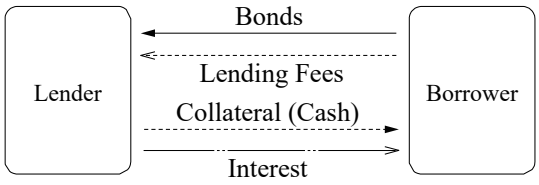
(c) Cash Collateral Bond Borrowing and Lending Transactions (Loan-Repo Transactions)

(i) Transaction Execution Date (Start Date)



Simultaneously upon lending the bonds, the lender (recipient of funds) accepts the cash collateral. Conversely, the borrower (provider of funds) will submit the cash collateral simultaneously upon borrowing the bonds from the lender.

(ii) Transaction Settlement Date (End Date)



The lender (recipient of funds) will return the cash collateral simultaneously upon receiving the return of the bonds; conversely, the borrower (provider of funds) will collect the cash collateral simultaneously upon returning the bonds to the lender. Lending fees are paid on the underlying bonds, and interest is paid on the cash collateral.

The economic effect of this type of transaction is almost exactly the same as a *gensaki* transaction; legally, however, cash collateral bond borrowing and lending transactions are treated as loans, while *gensaki* transactions are treated as sales. The fact that provisions concerning the treatment of counterparty default (collective clearing clause) and a risk management structure (haircut, margin calls) were introduced in 1996 for cash collateral bond borrowing and lending transactions also sets them apart from *gensaki* transactions at the time. However, the same collective clearing clause and risk management structure as above have been introduced for *gensaki* transactions as well.

Backed by the start of repo operations by the BOJ following the financial crisis in 1997, cash collateral bond borrowing and lending balances expanded rapidly in the market, and now, they are a central feature of the money market, surpassing even call loans.

(3) Current Situation of the Bond Borrowing and Lending Transaction Market

Current Japanese loan-repo transactions have been criticized due to the fact that (i) they are not compatible with “repo transactions” in force in Europe and the U.S.; and also because (ii) transactions with non-residents may result in withholding taxes being imposed on the non-resident with respect to interest earned on their cash collateral, thus, practically making cross-border transactions impossible.

In order to tear down these barriers and allow a broad base of non-residents to trade in Japanese government bonds, “*gensaki* transactions” (new *gensaki* transactions) that utilize a contractual framework and transaction

method based on the global standard were introduced in April 2001, and the Bank of Japan began *gensaki* operations (open market operations to supply liquidity to the financial markets) in November 2002.

In addition, a tax-exempt system with respect to interest received on funds loaned under a *gensaki* transaction with a non-resident, etc. that meets certain criteria, has also been introduced.

4 Bond Market Conditions and Volatility Factors

4 1 Volatility in Bond Market Conditions

"Conditions in the bond market" refers to the overall state of volatility of the individual issues in the secondary markets, and "market conditions" (or market prices) is said to be "good" or "bad" depending on price movements or trading volume.

There are many complex factors that affect bond market conditions, including the direction and speed of interest rate movements, and the specific gravity of each factor will change depending on the general state of the economy at the time.

4 2 Factors Affecting Volatility

The basic factors influencing volatility are as follows:

(1) General Economic Trends

Out of all the various phenomena that can influence conditions in the bond market, generally the most direct is a change in interest rate movements accompanying a change in the demand for funds.

In periods of a rising economy, corporations' production, inventory financing and capital investment become more active, increasing the demand for investment funds. Businesses cannot meet their needs through their own working capital, leading to an increase in fund borrowings. When the demand for borrowings increases and businesses start competing for loans, the funds available to lenders such as financial institutions are insufficient, and loan interest rates naturally increase. Accordingly, short-term interest rates in the call money and bill markets, as well as the certificates of deposit market where financial institutions procure their own funds, also increase.

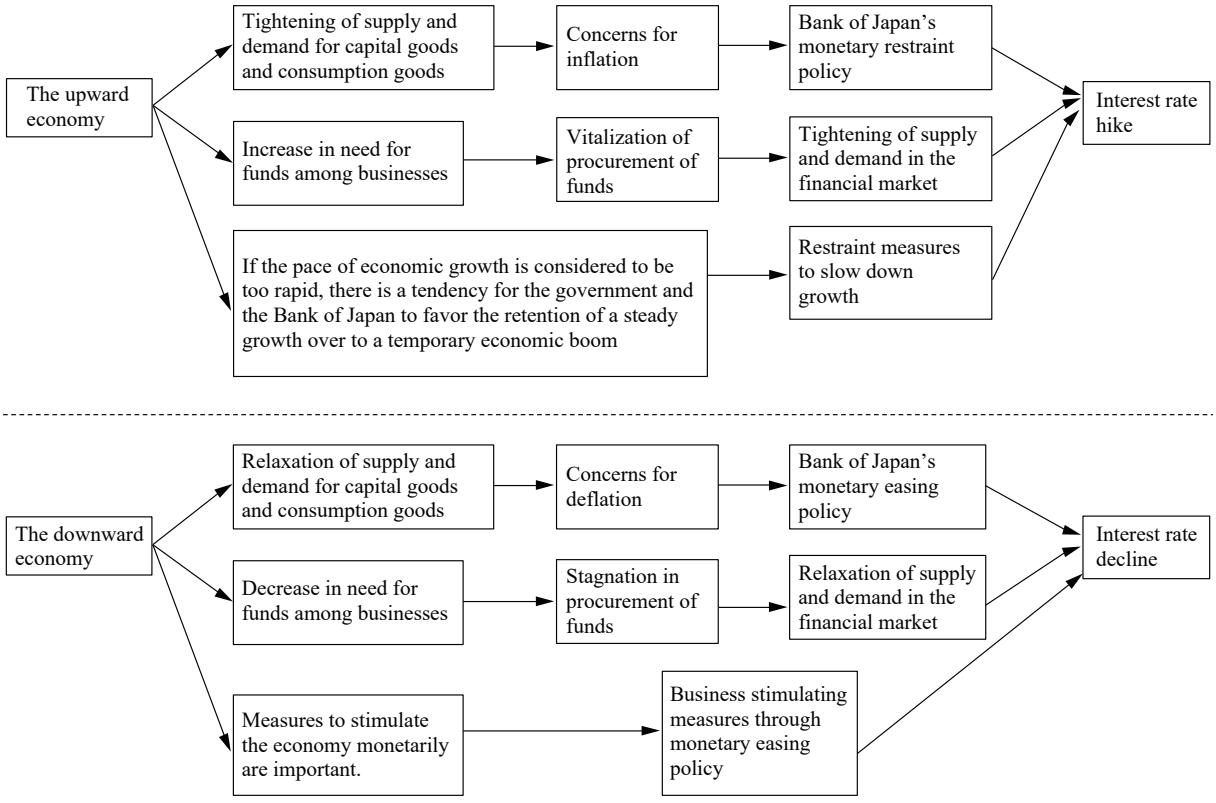
In contrast, in a declining economy or periods of stagnation, business demand for funds wanes, creating an excess balance in the loaning funds of financial institutions. Eventually, the interest rate on loans goes down, as do interest rates in the money market. To this point, we have been discussing the general pattern.

Bond market prices are closely tied to movements in the interest rate, and always maintain a certain balance with various interest rates. In other words, when the general interest rate is higher, the yield on bonds also rises (bond price declines), but when the general interest rate is low, the yield on bonds also goes down (bond price rises).

A second factor affecting volatility is **inflation** (rise in the price of goods and services), which is interrelated with economic movements. When the economy is expanding, the demand for "goods" exceeds the supply of goods, and the increase in wages exceeds the increase in productivity. As a result, prices are inflated. As more "goods" are sold, interest rates will gradually rise, because the number of firms that decide to raise funds in order to invest in plant and equipment will increase, even if interest rates are high. Thus, generally the inflation phase will be linked to a rise in interest rates. This is the relation of the expansion of the economy → inflation → the rise of interest rate → the rise in yields on bonds (fall in bond prices). Meanwhile, events such as a hike in the international goods market or yen depreciation, even if they occur during a sluggish economy, tend to cause inflation, which is a negative factor for the bond market.

Oppositely, when **deflation** (fall in the price of goods and services) exists, the value of money will increase in relative terms because of falling prices, and the need to compensate for lost value with interest will disappear. Thus, interest rates will also decline during a deflationary phase (or stagnation), or when deflationary worries are strong.

Chart 4-14 Domestic Economy and Market Interest Rates



If it were a question simply of "the relationship between the economy and interest rates," the answer would be fairly simple, *i.e.*, in general "when the economy improves, interest rates go up, when the economy worsens, the interest rates go down."

(2) Monetary Policy

As described above, interest rates fluctuate according to economic conditions as well as financial conditions. Also, there are certain instances where policymaking authorities manipulate interest rates through political measures taken for the good of the economy and prices. In Japan, the Bank of Japan is the central bank in charge of this

monetary policy.

The methods available to the Bank of Japan to effectuate monetary policy are raising or lowering the interest level (the basic discount rate and basic loan rate (previously called the "official discount rate"), hereafter referred to as "basic loan rate") for the loans the Bank of Japan makes to other banks, and increasing/decreasing (through operations) the volume of currency in circulation (capital).

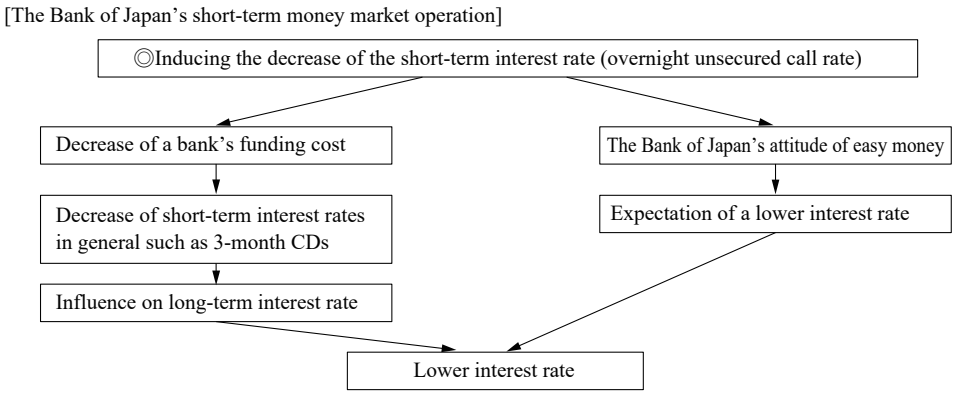
It is said that the influence of the former, basic loan rate manipulation has waned.

The latter, on the other hand, open market operations have become the primary tool used by the Bank of Japan to adjust the money supply.

The Bank of Japan's open market operations can be divided into operations where the Bank of Japan buys government bonds or notes, or borrows government bonds and posts cash collateral (in order to supply liquidity), and operations where the Bank of Japan sells government bonds or notes (in order to absorb funds).

The Bank of Japan's policy, such as cutting the basic loan rate and increasing the supply of funds, is called easy money, which results in a decline in interest rates. This is a positive factor for the bond market. The opposite of this policy is tight money (dear money), which works as a negative factor in the bond market.

Chart 4-15 Monetary Policy Interest Rate and Market Interest Rates



(3) Foreign Exchange and Overseas Interest Rates

In Japan, foreign exchange transactions were subject to strict regulations for much of the post-war period. However, with the onset of the period of high economic growth, and its rise in international status, the change to a favorable balance of international payments and ballooning of foreign currency reserves, a policy of liberalization was gradually implemented from 1970 onward. With the amendment of the Foreign Exchange Act in 1980, transactions were liberalized, in principle, and inbound and outbound capital transactions were effectively deregulated. Furthermore, the entry into force of the 1998 revisions to the Foreign Exchange Act, which was touted as the frontrunner of Japan's Big Bang, led to even further coordination of the transactional environment.

International capital transactions in recent years actively seek out all types of investment opportunities with no regard for national borders. Whether one focuses on the size of the amounts, the speed of capital movements, or the breadth of investment opportunities, all exert a heavy influence on the market. The demand for corporate funds has become more varied in response to increasing international joint ventures and capital alliances, as well as international business expansion. Both the primary and secondary markets have seen international capital shifts. In this environment, the impact of exchange rate and movements in foreign interest rates on domestic bond markets has steadily increased.

When the yen appreciates (strong yen), it leads to: decline in the price of imported goods → restraint of

inflation → decline in interest rates, and bond prices go up (yields go down). Also, in response to a sharp yen appreciation, the Bank of Japan may carry out dollar buying operations or induce lower short-term interest rates designed to stabilize the currency, which works as a positive factor for the domestic bond market.

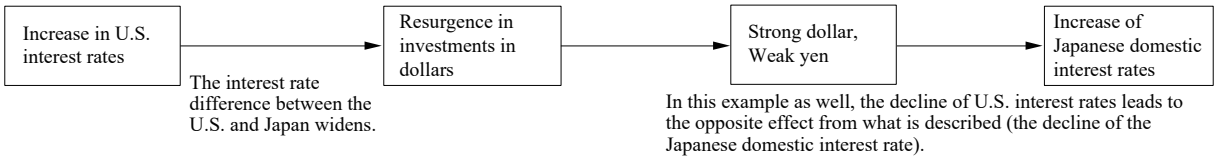
In addition, a strong yen leads to increased investments in Japanese securities by non-resident investors seeking foreign exchange gains, which strains the supply and demand for bonds. On the other hand, a weak yen (depreciation of the yen), works as a negative factor for the domestic bond market, due to the possibility that the Bank of Japan will adopt a tight money policy in apprehension of rising prices.

Next, let us look at the influences that overseas interest rates may have on the domestic bond market. For instance, when the interest rate in the U.S. is higher than the interest rate in Japan, the interest rate differential will widen as the U.S. interest rate increases, which makes investment in dollars relatively more advantageous. Accordingly, funds flow to investments in the U.S., and the dollar will rise against the yen. This has a negative impact on the domestic bond market. Moreover, when the U.S. clearly indicates a tightening monetary policy by raising the basic loan rate, the market will anticipate the effect on the domestic monetary policy and the domestic bond market declines. When the interest rate abroad is lowered, it has the opposite effect.

Moreover, an increase in an interest rate differential (domestic interest rates < foreign interest rates) between domestic and foreign interest rates can be said to signal a strong yen (a strong yen in the future) on a forward exchange basis (since in a forward exchange there is no exchange rate risk, the risk of domestic and foreign investments is the same; that is, the exchange rate fluctuates in a manner such that the return will be the same for a high-yield foreign-currency denominated investment when converted into yen as the return on an investment in yen currency).

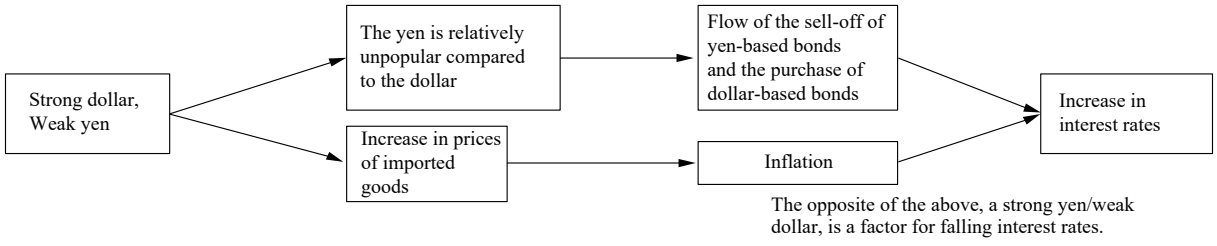
<Overseas Trends and Market Interest Rates>

Since the U.S. has a large impact on the Japanese economy, the following explanation will focus on the United States:



<Foreign Exchange and Market Interest Rates>

This segment focuses on an explanation of the dollar-yen exchange market:



(4) Supply and Demand for Bonds

Like other products, the price of bonds is determined by the relationship between supply (sellers) and demand (buyers). The supply and demand relationship in bonds is the relationship between financial assets that enable new purchases of bonds and the volume of new bond issues. Furthermore, the relationship between the selling and buying volumes of bonds by investors on the secondary market also influences the bond prices.

During the last few years since the announcement of a sizable increase in government bond issues in FY1999

against the backdrop of a worsening government balance of payments situation due to the prolonged recession, we have seen a repeated cycle of a relationship between the supply and demand for Japanese government bonds in which the supply/demand balance eases during phases in which concerns are raised about a worsening equilibrium owing to fiscal deterioration, and when deflationary concerns recede, and in which the supply/demand balance tightens during phases when deflationary concerns spread or hints are made of an anticipated continuing of the monetary easing policy.

In terms of secondary market trading patterns by type of participant, major investors such as financial institutions for agriculture and forestry, trust banks, life and non-life insurers, investment trusts, and foreigners, etc. have by and large become net buyers over the past several years, and are underpinning the bond market. Basically, bond prices will remain firm as long as investors with large amounts of long-term funds continue to buy on actual demand.

In addition, bond-buying operations are sometimes carried out by the Bank of Japan as a measure to supply liquidity, and this has a short-term impact on the bond market.

None of the major factors influencing bond-market fluctuations mentioned above act alone, and all of these factors are closely interrelated.

Chart 4-16 Net Trading Volume by Principal Investors

(Unit: JPY10 billion)

Fiscal Year	City Banks	Regional Banks	Trust Banks	Financial Institutions for Agriculture and Forestry	Life and Non-Life Insurance Companies	Investment Trusts	Business Corporations	Individuals	Foreigners
1998	▲871	32	517	629	253	241	120	86	3,239
2003	5,643	842	3,446	1,133	507	2,063	632	72	2,458
2008	2,553	1,002	3,976	1,336	1,234	1,498	886	32	8,184
2013	▲2,836	482	5,478	779	1,387	3,165	1,104	▲19	16,300
2018	352	16	373	230	407	406	93	▲18	24,486
2019	158	347	880	286	564	519	109	▲19	23,939
2020	3,259	594	1,963	408	728	732	120	▲11	27,909
2021	2,179	326	3,289	177	653	945	79	▲14	27,533
2022	1,143	▲50	2,141	120	581	1,000	115	▲1	29,632
2023	160	499	3,848	191	428	690	127	▲2	29,484

(Notes) 1. Triangles (▲) indicate net sellers, and no mark indicates net buyers.
2. In this table, beginning in FY2003, the total for city banks includes the portion of the long-term credit bank, etc.
3. Rounded off to the nearest unit.

(Source) Prepared based on "Trading Volume of Over-the-Counter (OTC) Bonds", JSDA.

(5) Credit Spreads

Changes in a bond issuer's creditworthiness are another factor affecting bond prices.

Ordinarily, government bonds are deemed to involve no credit risk since the issuer of the bonds is a nation (national government), and therefore, both the principal and interest are expected to be paid. Credit spread generally refers to the yield differential between a certain government bond and another corporate bond, etc. that have equivalent remaining terms to maturity, and bond prices vary as a result of fluctuations in credit spreads. Concretely

speaking, improvement in an issuer's creditworthiness will cause the upgrade of the rating, etc., which lead to the reduction of credit spread. As a result the bond price will rise.

On the other hand, deterioration in an issuer's creditworthiness increases the uncertainty regarding its ability to make principal and interest payments, and will cause the downgrade of the rating, etc., which leads to the expansion of the credit spread. As a result, the bond price will decrease.

5 Bond Trading Methods

5 1 Outright Sales and Outright Purchases

The most fundamental means to effectuate an actual bond trade is the simple outright sale or purchase. The transaction may involve only a single issue, but financial institutions and corporate investors often trade combinations of multiple issues.

Trades are consummated by having each party to the trade present his desired terms and conditions. The most fundamental term is the simple yield to maturity, which is ordinarily called the trading rate. Additionally, each party will use the other major terms of the bond, such as the number of years to maturity, the coupon rate, the type of bonds, interest payment months, number of interest payments per year, delivery date, issuer's credit, etc. in determining the value of the bond.

Some of the reasons why investors engage in outright purchases or sales of bonds include the necessity to invest surplus funds (outright purchases), the necessity to liquidate positions (outright sales), or market perception.

5 2 Bond-Switching

(1) Definition of Bond-Switching

Bond-switching is a trading method involving a contract to simultaneously sell and purchase, as in a contract where the same investor sells one issue while purchasing another issue. Oftentimes, bond-switching involves not one issue traded with one issue, but issues traded on a multiple basis.

Corporate investors, such as financial institutions, conduct bond-switching in order to rationalize the management of their bond portfolios, which can include a large number of different issues, and to improve the composition of their portfolios in line with their funding objectives.

(2) Objectives

The most representative purposes of bond-switching are as discussed below:

(i) Bond-Switching Based on Market Outlook:

If one is bullish on the market and thinks that interest rates will fall in the future, a switching from short and medium-term bonds to medium and long-term bonds, which have greater price movements, would be

advantageous. On the other hand, where one expects a rise in interest rates, a switching into short-term bonds will shrink price movement risks. (In this case, it is necessary to be content with investments whose return will temporarily be depressed.)

For instance, if one forecasts that the current interest rates are at their peaks, and will decline in the future, the switching should be mainly for long-term bonds, even if the short-term interest rate is currently higher than the long-term interest rate. On the contrary, if the interest rate level is judged to have hit bottom, the switching should be into short-term bonds, and one would have to wait for the interest rate to increase, even if the interest rate on short-term bonds is lower than the interest rate on long-term bonds.

(ii) Added Liquidity Bond-Switching:

In consideration of the need to liquidate bonds in the future, a portion of the bond portfolio is switched into highly liquid issues, such as government bonds with a lower price volatility risk.

(iii) Added Current Yield Bond-Switching:

Some corporate investors place an emphasis on the earnings in each accounting period through current yield. To increase current yield, one can simply switch into bonds with a higher coupon rate. However, unless the number of years to maturity is changed, it will be difficult to avoid lowering the simple yield to maturity without assuming the credit risk of the issuer.

(iv) Added Simple Yield to Maturity Bond-Switching:

To increase the simple yield to maturity, as long as the ordinary long-term interest rate stays higher than the short-term interest rate, one can simply switch into long-term issues with the highest possible yield. In return for a lower coupon rate and a slight decrease in liquidity, the holder can expect to increase the simple yield to maturity more effectively.

(v) Yield Spread Management (Spread Transactions):

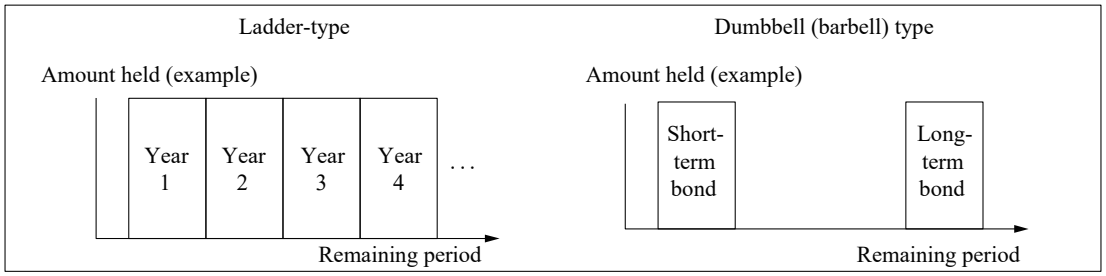
Yield spreads generated by the high or low coupon rates, different maturity lengths, and status as listed or unlisted move within a certain band or trend in the medium-long or long term as long as interest rates do not change significantly. Even so, with such a variety of issue types, it is common for spreads to temporarily widen or tighten. Swiftly taking advantage of these opportunities by bond-switching enables one to increase the efficiency of investments.

(vi) Fixed Portfolio Management:

The balance of redemptions in a portfolio can be maintained at a fixed level by an investment method involving mechanically conducted bond-switching. The maturity ladder-type portfolio and the dumbbell-type (barbell-type) portfolio are two typical examples.

The maturity ladder-type is a portfolio that holds bonds from short-term to long-term in equal weights for every single year maintaining the same composition of maturities each year. The dumbbell-type (barbell-type) is a portfolio that holds only short-term bonds to ensure liquidity and long-term bonds for profitability. Either type is an investment system that intends to secure liquidity to a certain extent and at the same time seeks relatively steady profits by leveling off market volatility risk.

Chart 4-17 Ladder-Type and Dumbbell-Type



5 3 *Gensaki* Transactions

Gensaki transactions, also called "conditional transactions of bonds, etc.," are bond transactions where the parties agree at the time of trading to execute offsetting trades of the same type and volume of bonds at a predetermined date and price. In *gensaki* transactions, there are "brokered *gensaki*" in which a financial instruments business operator acts as broker between a seller that wants to raise funds and a purchaser that wants to invest funds, and there are "dealer *gensaki*" in which the financial instruments business operator itself becomes the seller or the purchaser. Normally, purchases conditioned on their sellback are called "*kai gensaki*" and sales conditioned on their buyback are called "*uri gensaki*."

Gensaki transactions are bond transactions in which the seller and purchaser mutually agree to fix the yield for the period in a way that is completely unrelated to market fluctuations. While they assume the form of bond trades, *gensaki* are actually a system to fix the yield for a certain period through a combination of interest and the difference between the initial trading price and the offsetting trading price. *Gensaki* transactions also possess the characteristics of financing transactions with bonds as collateral.

As in the case of borrowing and lending transactions, *gensaki* transactions are conducted as fund raising or fund management means (for details, see "3.4 Bond Borrowing and Lending Transactions").

The following are the main features of current *gensaki* transactions:

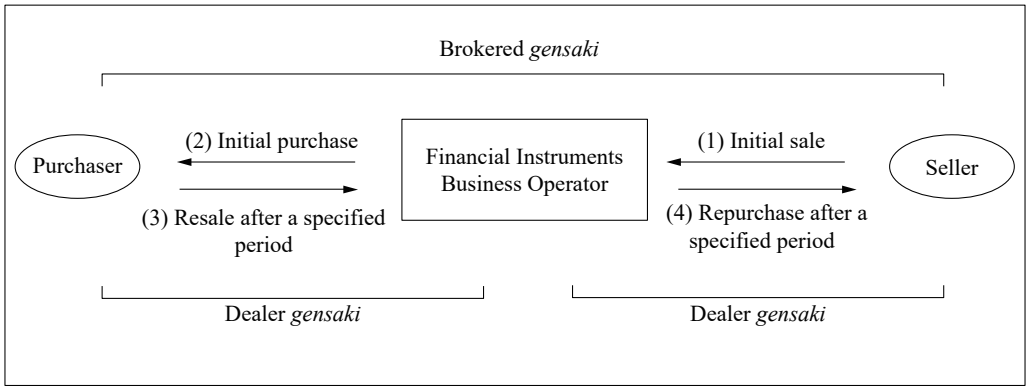
(i) Transactions are premised on global standards;

(ii) Introduction of risk control provisions; and

(iii) Contractual procedures exist to deal with unforeseen events such as the occurrence of a default.

Concerning *gensaki* transactions, JSDA has provided rules as follows for matters such as the conclusion of trading agreements and the scope of the bonds, etc. that are subject to the transaction (Rules Concerning Handling of Conditional Sale and Purchase of Bonds, Etc.).

Chart 4-18 Mechanism of *Gensaki* Transactions



(i) Prior to commencing *gensaki* trading, an agreement must be executed with the customer, and such agreement must be filed and held in safe keeping;

(ii) In principle, a terms sheet must be delivered to the customer for each trade;

(iii) The counterparty to a *gensaki* transaction is limited to listed companies or corporations equivalent thereto, which possess economic and social credibility;

(iv) Bonds eligible for *gensaki* transactions are government bonds, municipal bonds, government sponsored entity bonds, corporate bonds, specified bonds, and investment corporation bonds, as well as yen-denominated foreign bonds and foreign currency-denominated bonds. However, bonds with share options are excluded;

(v) In conducting a *gensaki* transaction, the parties must be aware of the rights connected with the bonds to be traded and fully consider the liquidity and price movement of such issues;

(vi) In principle, bonds registered under another person's name cannot be traded;

(vii) In conducting a brokered *gensaki* transaction, generally the selling date and the purchase date for the initial trade must be the same, and the repurchase date and the resale date for the offsetting trade must also be the same; and

(viii) The balance of *gensaki* transactions must be monitored to avoid excessive transactions in light of each JSDA member's financial position. Also *gensaki* transactions must not be overly concentrated into transactions with a single counterparty.

5 4 Delayed Delivery Transactions

A delayed delivery transaction is a contract in which both parties agree to the delivery of bonds at a predetermined date and under certain conditions, where delivery is scheduled at least one month later than the contract date (after the anniversary date in the following month).

However, setting a delivery date that far in the future involves credit risks; moreover, under certain circumstances, it has the nuance of being a speculative transaction. For instance, the variety of risks would include whether or not the seller can securely arrange the actual bonds and whether or not the buyer can securely arrange the funds at the time of the contract; whether or not the bonds and funds will be kept available until the delivery date; whether the agreement could potentially be broken if a major market fluctuation occurred before the delivery

date; and whether trouble could arise because the agreement between the parties was merely an oral agreement.

As a result, JSDA has set forth the following requirements with regard to matters concerning delayed delivery transactions, including concluding a transaction agreement, the scope of the bonds etc. subject to the transaction, and the transaction procedure (Rules Concerning Handling of Sale and Purchase of Bonds, etc. with Delayed Settlement.):

(i) A delayed delivery transaction is defined as a transaction with a period of at least 1 month from the trade date to the delivery date;

(ii) When executing a delayed delivery transaction, an Agreement Concerning Delayed Delivery Transaction must be executed with the customer for each transaction, and a copy of the said agreement shall be filed and preserved;

(iii) Eligible customers for delayed delivery transactions are to be limited to listed companies or corporations equivalent thereto, which possess economic and social credibility;

(iv) The bonds eligible for delayed delivery transactions are government bonds, municipal bonds, government sponsored entity bonds, corporate bonds, specified bonds, and investment corporation bonds, as well as yen-denominated foreign bonds and foreign currency-denominated bonds. However, bonds with share options are excluded;

(v) The period between the trade date and the delivery date (the delay period) must not exceed six months; however, the period may be extended up to three years if certain requirements are satisfied; and

(vi) The balance of delayed delivery transactions must be monitored to avoid excessive transactions in light of each JSDA member's financial position. Also, transactions must not be overly concentrated into transactions with a single counterparty.

5 5 Transactions of Bonds with Options

(1) What Is a Transaction of a Bond with an Option (an Over-the-Counter Transaction of a Bond Option)?

A transaction of a bond with an option, which is also referred to as an over-the-counter transaction of a bond option, is a transaction of a bond wherein either of the parties has the right (option) to designate the delivery date, and if the delivery date is not designated within the exercise period, the agreement for the transaction is cancelled. The JSDA specifies matters necessary for transactions of bonds with options conducted by Association Members over the counter, such as the publication of quotations of option price, conclusion of a sale and purchase agreement, and method of transaction (Rules Concerning Handling of Sale and Purchase of Bonds with Options).

This type of transaction is characterized by the following two points: the details of an option can be customized: and the bonds sold and purchased are actually delivered.

For the first point, particular types of options can be tailored, such as an option subject to a condition precedent (an option expires when the price of the bond to be traded reaches a predetermined level), an average option (the average price of the bond to be traded during a period is set as exercise price), and a look-back option (an option is exercised at the highest or lowest price during a period), etc.

For the second point, an actual securities portfolio can be directly involved in transactions. This feature greatly contributes to diversification of cash bond transactions.

(2) Trading System

(i) Trading period

For a transaction of a bond with an option, the period from the contract date to the delivery date of the bond shall not exceed one year and three months. Within this range, a period for exercising an option can be determined freely by agreement between the parties for each transaction.

In practice, long-term transactions with an exercise period of more than three months are rarely seen. Most transactions are conducted on a shorter term from one week to about one month.

(ii) Trading unit

The minimum face value for a transaction is JPY100 million (or the value equivalent to JPY100 million for foreign currency-denominated bonds).

(iii) Trading price (exercise price)

As in the case of the exercise period, the trading price or exercise price can also be determined freely by agreement between the parties.

(iv) Method of exercising the option

An option shall be exercised during the exercise period according to the procedure for the delivery of the bond as prescribed in an individual transaction agreement beforehand. An option holder (buyer), when exercising the option, shall notify an option writer (seller) of the date of delivery of the subject bond. The option shall expire if it is not exercised during the exercise period.

(v) Offsetting

Resale is prohibited for transactions of bonds with options. The outstanding portion of the option contract yet to be exercised may be liquidated by being offset with another option contract if (a) a seller under a former contract is a buyer under a latter contract, (b) except for this difference, all the other details are the same (*e.g.,* underlying bonds, face value, exercise period, exercise price, etc.), and (c) a new contract is concluded with the same counterparty. In offsetting the two option contracts, option prices are paid and received separately for these contracts, and net settlement is prohibited.

(vi) Trading Margin

In transactions of bonds with options, an option holder should require a trading margin from the option writer, except where an option writer is a professional investor. The amount of the margin should be not less than "the option price + 5% of the face value," and should be paid to the option holder by noon of the third business day counting from the contract date. An additional margin may also be demanded when the option writer incurs a loss due to the fluctuation of the market or other reasons.

These trading margins may be substituted by securities in the full amount.

(vii) Fees

In transactions of bonds with options, the option price (premium) is all that is to be paid and received, and in this sense, it could be considered that all fees and costs are included in the premium offered to investors.

5 6 Other Transaction Methods, Etc.

(1) Roll Forwards

A roll forward is a bond-switching in which the delivery date for the selling contract and the delivery date for

the buying contract are staggered, such as when sales are made in February and purchases are made in April. The transaction can be considered a combination of a simple sale with a delayed delivery purchase transaction. Roll forwards facilitate both (i) portfolio improvements through bond-switching, as well as (ii) short term capital turnovers.

(2) Accumulation and Amortization

When the book value of a bond is significantly lower than its face value (under par), the holder will accrue a single large gain upon maturity. On the other hand, if the book value of a bond is significantly higher than its face value (over par), the holder will realize a loss when the bonds are redeemed at maturity.

Financial institutions in particular may attempt to stabilize their earnings by evenly distributing profits and losses from redemption for all of their fiscal periods over the whole maturity period for a bond, and not concentrating such profits and losses on only one fiscal period at maturity. Under the Companies Act, the book value can be adjusted by a certain amount in each fiscal period if the book value is different from the face value.

The adjustment to increase the value is referred to as accumulation, while the adjustment to decrease the value is referred to as amortization.

(3) Basis Transactions

A basis transaction is a type of transaction that focuses on the spread between spot prices and future prices and seeks to take a margin.

The spread between spot prices and future prices theoretically should converge toward a certain standard range through active arbitrage transactions. In reality, however, since both the spot prices and the future prices change according to the supply and demand balance in their respective markets, the spread may widen or contract.

If the spread widens abnormally, the position with the comparatively higher price is sold and the one with the comparatively lower price is purchased, with the expectation that the spread will contract again in the future. If the spread tightens abnormally, the opposite would hold. If the spread widens and contracts as expected, margins can be earned by conducting reverse transactions.

Basis is a spread between a spot price and a future price, and is usually calculated as “spot price - future price × CF (conversion factor).”

For instance, when large volumes of new bonds are issued, sparking short hedging transactions originating from their purchasers, futures prices sometimes become extremely low and thus the basis widens. Also, during the period when leading contract month are replaced, there is a tendency to cover (repurchase) short hedges on nearby futures contracts (futures contracts with the closest settlement due date) and newly hedge with more distant futures contracts. Accordingly, with nearby futures contracts, the basis can shrink rapidly, whereas with other more distant futures contracts the basis widens rapidly.

(4) Trading Methods Utilizing Options

These include, as broad examples, “target buying,” in which put options are sold to buy a given bond at a desired level, and “covered calls,” in which call options are sold for a premium to improve yields during the period to maturity of a given bond held.

In addition, volatility trades are widely used, focusing not on the bond prices but the volatility of the prices.

6 The Secondary Market for Convertible-Type Bonds with Share Options (CBs)

6 1 Definition of Share Options

Share options entitle the holder to purchase a specified number of shares of the issuer company at a predetermined price if the request is made within a specified period of time.

Correspondingly, the issuer company must issue new shares, or deliver treasury shares in lieu of issuing new shares, to the holder of the rights when those rights are exercised.

6 2 Issuance of Share Options

Share options and bonds with share options are issued by a public company through a resolution of its board of directors and by a private company through a special resolution passed at its shareholders' meeting.

6 3 Change of Name

As a result of the amendments to the Commercial Code that became effective in 2002, bonds that had been called convertible bonds and bonds with non-detachable subscription rights (warrant bonds) were collectively named bonds with share options.

In the securities sectors, bonds that enable their holders to acquire shares when exercising the share options by using the redemption money of the bonds instead of paying the exercise price are referred to as "convertible-type bonds with share options" and this name is used in situations where it may be seen by investors such as in explanations and bond descriptions provided to investors.

However, in practice, they are still often called "convertible bonds."

6 4 Product Characteristics of Bonds with Share Options

Under the old Commercial Code (up to the 2002 amendment), convertible bonds were a product that had a lower interest rate than straight bonds, but in return offered the bondholder the right to convert a portion of its holdings into the shares of the issuer. The bond and the conversion right were seen as inseparable and were always priced as a single unit at the time of issuance and when circulating in the secondary market, and a separate value for the conversion rights portion was not recognized.

Similarly, the current Companies Act does not allow share options embedded in bonds with share options to be

stripped from the bonds and sold separately.

6 5 Definition of Convertible-Type Bonds with Share Options

"Convertible-type bonds with share options" (hereinafter referred to by the acronym "CB") are bonds with attached share options, which cannot be detached or sold independently from the bonds. Additionally, when the share option is exercised, the bondholder is deemed to pay the paid-up amount for the share option in lieu of redeeming the entire amount of the bond, and the issue price of the bond and the paid-up amount upon the exercise of the share option must be the same.

Thus, similar to traditional convertible bonds, the investor can participate in the appreciation of the issuer's shares. Furthermore, if the investor holds the bond without exercising the share option, he/she can still enjoy the bond as a fixed-income security, and receive the bond's face value upon maturity (there is also a type of convertible bond with no interest payment (zero-coupon)).

Convertible-type bonds with share options are sometimes referred to as potential shares, because in spite of their outward appearance as bonds they can be converted to shares (potential shares mean shares that have the potential to increase by means of the rights to acquire common shares, rights to request conversion into common shares, or other rights under contracts; for example, shares that arise upon the exercise of rights such as stock options and share options attached to convertible-type bonds with share options; the total number of issued shares in the case where all rights for potential shares are exercised is referred to as the "potential number of shares," and each company is required to disclose the "diluted per-share amount of net income" along with the "per-share earnings" in consideration of the possibility of dilution). Thus, CBs are unique financial instruments combining the profitability of shares with the safety of bonds.

(1) Attributes as Corporate Bonds

Convertible-type bonds with share options feature all the usual terms and conditions of bonds, such as price, coupon rate and term. Their characteristics are described below:

(i)	Issue Price:	In the past, the issue price was generally the face value (JPY100 payment for a JPY100 face value), but in recent years, it is frequently set higher than the unit price of the face value, such as JPY 102.50 payment for a JPY 100 face value.
(ii)	Coupon Rate:	Since these bonds have an advantage in that they can be converted into shares, the coupon rates are set lower than those for straight bonds, and the zero-rate type has become mainstream. The coupon rate is determined in reference to the conversion premium, ratings, maturity and the actual demand among investors, and based on the advice given by the lead manager securities firm.
(iii)	Term:	While there is a tremendous variety among bond terms for convertible bonds, most are plus or minus five years.
(iv)	Collateral:	In the past, secured bonds were frequently encountered; recently, however, almost all issues are non-secured bonds.
(v)	Series:	For smooth trading on the exchanges, one series per issue. Most issues have

denominations of JPY1 million.

(vi) Redemption: Most issues are redeemed as a bullet payment at maturity. However, there are cases where the issuing company will cancel the bonds by repurchasing its convertible-type bonds with share options in circulation in the market. Also, there are some bonds with put option redemption of the bondholders, and with call option redemption of the issuing company. In addition, some bonds contain provisions allowing the issuer to redeem the issue before maturity if a resolution is approved that the issuer becomes the wholly-owned subsidiary of another company through a share exchange or share transfer, or if the share price maintains a certain percentage above the conversion price for a specified period of time.

Furthermore, as convertible-type bonds with share options are regarded as having the same product characteristics as traditional convertible bonds, the issue price of the share option is deemed to be nil. Also, since the issue price of the share options is set at zero, depending on the exercise conditions, the bonds may fall within the definition of an "advantageous issue" under the Companies Act, requiring the issuer to obtain a special resolution by two-thirds majority vote of the shareholders general meeting to be able to issue the bonds.

(2) Conditions of Conversion into Shares

With regard to the conversion of convertible-type bonds with share options into shares, the conversion price, period for requesting the exercise of share options, and the details of the shares to be issued upon conversion of the convertible-type bonds with share options into shares are set out in the terms sheet at the time of issuance.

- Conversion Price (Exercise Price)

  The conversion price is the issue price per share upon conversion (upon exercise of the share options). The conversion price is set at an amount higher than the closing price for the underlying shares at a certain date prior to the beginning of the offering period for the convertible bonds (the percentage by which the conversion price, when determined, exceeds the market price of the shares is referred to as the "conversion premium").

  The bondholder can compute the number of shares he will acquire if he converts the convertible-type bonds with share options by dividing the total issue price of the bonds delivered when requesting the exercise by conversion price.

(Example) If the conversion price is JPY1,500, and the total issue price of the bonds delivered is JPY3 million:

$$\text{Number of Shares Acquired} = \frac{\text{Total Issue Price of Bonds Delivered}}{\text{Conversion Price}} = \frac{3{,}000{,}000}{1{,}500} = 2{,}000 \text{ shares}$$

6 6 Listing Rules for Convertible-Type Bonds with Share Options

(1) Listing Examination

The listing examination for an issue of convertible-type bonds with share options focuses on matters associated with the aftermarket circulation of the bonds, such as the determination of the minimum issue amount, etc., with a view to ensuring the efficient distribution of the bonds post-listing. (For details, see Volume 2, Chapter 2, "3. Securities Listing Regulations.")

(2) Listing Management

Since share options are attached to convertible-type bonds with share options, administering the exercise of these share options similarly constitutes a major part of the listing management for convertible bond issues.

More specifically, upon conversion of the listed convertible-type bonds with share options, a decrease in the total listed par value for the listed convertible-type bonds with share options and an increase in the number of listed shares occur simultaneously. Therefore, each month, the stock exchange requires issuers to report the details of any conversions and any changes to the total listed par value of the convertible-type bonds with share options and number of listed shares.

In addition, when the listed convertible-type bonds with share options are redeemed or cancelled by repurchase (the method by which the issuer makes purchases at the market price through the market from holders who agree to be bought out), or the conversion price is changed, the issuer must report to the stock exchange regarding such matters.

(3) Delisting

If the exercise period expires, if the total listed par value falls below JPY300 million, or if the shares of the issuing company become subject to the delisting criteria for shares, etc., the convertible-type bonds with share options will be delisted. If the convertible-type bonds with share options are delisted by the time of the final redemption date or the expiration of the period for requesting the exercise of share options, the delisting date shall be the third business day prior to the final date of the period in which the intermediating of requests to exercise the share option can be made on the JASDEC.

Moreover, in the event that convertible-type bonds with share options are handled in the clearing operations of JASDEC, the requirement for delisting shall be that they be excluded from being handled by these clearing operations.

6 7 Trading Rules for Convertible-Type Bonds with Share Options

Transactions of convertible-type bonds with share options in the secondary market can be classified into exchange transactions and off-exchange transactions. Exchange transactions can be further subdivided into "transactions during trading sessions" and "transactions other than those during trading sessions."

Attention should be paid in this connection, as there are detailed rules regarding the matters to be observed in these transactions, such as the time window for trading, limits on price movements, etc. (although conceptually the

rules are the same as the rules for transactions of shares).

(1) Transactions During Trading Sessions (Sale and Purchase Executed on the Market During Trading Sessions)

Similar to transactions in shares, transactions are categorized as either principal (proprietary) transactions or broker transactions. The detailed rules such as session hours, etc. are as set forth in the chart (in the case of the Tokyo Stock Exchange; see Chart 4-19).

Chart 4-19 Summary Table of Transactions During Trading Sessions (ToSTNeT transactions)

Trading Session Hours	9:00 – 11:30 12:30 – 15:00
Trading Unit	Par value, JPY100,000, JPY500,000, JPY1,000,000, JPY2,000,000,JPY3,000,000, JPY4,000,000, or JPY5,000,000
Minimum Tick	JPY0.05 per JPY100 par value
Types of Quotations	Limit price and market price
Price Limit	Price limit on the underlying shares × Conversion ratio (must be at least JPY5)
Method of Executing Trading Contract	Individual competitive sale and purchase (same as shares)
Conditional Trading	On-open and IOC orders are allowed (On-close and *Funari* orders are not allowed)
Type of Trade and Settlement Date	Regular/same day settlement transactions
Method of Settlement	Book-entry Transfer at the Japan Securities Depository Center

(Source) Prepared based on the Japan Exchange Group's website (as of August 1, 2024).

(2) Transactions Other Than Those During Trading Sessions (Sale and Purchase on the Market Other Than Those Executed During Trading Sessions)

With the rise in the number of institutional customers, increasingly larger block orders and basket trades, etc., transactions other than those during trading sessions was introduced in order to respond to the diversified needs of investors, starting in November 1997.

The specific transaction rules such as the trading hours are set forth in the chart (In the case of the Tokyo Stock Exchange, where transactions other than those during trading sessions are called "ToSTNeT (Tokyo Stock Exchange Trading NeTwork System)" transactions; see Chart 4-20.).

Chart 4-20 Summary Table of Transactions Other Than Those During Trading Sessions

	Single Issue Transactions	VWAP Guarantee Trading(Note 1) / VWAP Target Trading(Note 2) /VWAP Trading between agency orders(Note 3)	Basket Transactions	Closing Price Transactions	Off-Auction Own Share Repurchase
Eligible shares	Domestic shares, foreign shares, ETFs, REITs and CBs	Domestic shares, foreign shares, ETFs, REITs and CBs	Domestic shares, foreign shares, ETFs, REITs and CBs	Domestic shares, foreign shares, ETFs, REITs and CBs	Domestic shares, foreign shares, and REITs
Trading Hours	8:20 – 17:30 * Until 12:30 for T+1	8:20 – 9:00 previous day VWAP (VWAP Target Transactions are not possible) 11:30 – 12:30 morning session VWAP 15:00 – 17:30 afternoon session and whole day VWAP * (*) Until 12:30 for T+1	8:20 – 17:30 * (*) Until 12:30 for T+1	8:20 – 8:45 11:30 – 12:15 15:00 – 16:00 (Hours of order acceptance are 8:20 – 16:00)	8:45 (Sell orders are accepted from 8:00 to 8:45)
Trading Unit	Possible from the minimum trading unit	Possible from the minimum trading unit	15 issues or more and total trading price of JPY100 million or more	Possible from the minimum trading unit	Possible from the minimum trading unit
Trading Price	Within ±7% of the most recent trading price of the auction market(*1)(*2) (*1) Where there is a special quote or a sequential contract quote, the relevant special quote price or sequential contract quotation price (*2) Within the range of the last trading price + or - JPY5 without exception if 7% of the last trading price is less than JPY5.	VWAP Guarantee Trading: Price obtained by adding/reducing the amount corresponding to commission to VWAP VWAP Target Trading: Weighted average price of the execution results in the auction market that targeted the VWAP (transactions are also possible at a price that reflects the weighted average price as a result of execution plus the amount of commission) VWAP Trading between agency orders: VWAP designated for each trading time zone	Amount within ±5% of the base price calculated from the last trading price of the auction market for the composite issues	8:20 – 8:45 Previous day's closing price (including final special quote price or final sequential contract quote; where there is neither, that day's base price; the same hereinafter), previous day's whole day VWAP 11:30 –12:15 Morning session's closing price, morning session VWAP 15:00 –16:00 Day's closing price, afternoon session and whole day VWAP	Previous day's closing price (including final special quote price or final sequential contract quote; where there is neither, that day's base price)

(Note 1) VWAP guarantee trading: A type of transaction that aims to guarantee VWAP-based executions. Cross-match with clients' sell or buy order at the VWAP net price with pre-arranged brokerage commissions included.
(Note 2) VWAP target trading: Aiming for VWAP, traders execute transactions in the auction market in which the name/number of stocks are pre-arranged, and cross-match with clients' sell or buy orders at the VWAP of the execution result. Transactions at the weighted average price of clients' execution results with brokerage commissions reflected are also available.
(Note 3) VWAP Trading between agency orders: Agency cross orders within the same participant for VWAP transactions at VWAP designated for each trading time zone.
(Source) Prepared based on the website of the Japan Exchange Group (as of August 1, 2024)

6 8 Fundamental Valuation Methods for Convertible-Type Bonds with Share Options

In valuing convertible-type bonds with share options, the valuation of the bond portion is based on the bond's yield, and it is computed in the same manner as straight bonds are calculated, as described above. Moreover, in valuing the equity portion, the parity value and the premium over parity are the standard methods used.

For the specific methods used to compute yield, please refer to the explanation for the bond portion.

(1) Parity Value (Theoretical Value in Terms of Share Price)

Parity value measures the theoretical value of a convertible-type bond with share option from the share price and the conversion price. It is computed by dividing the share price by the conversion price, and expressed as the theoretical price per JPY100 face value of a convertible-type bond with share option (it does not take into consideration accrued interest on the convertible-type bond with share option, dividend payments on shares, or associated transaction costs, etc.).

A concrete illustration of an example calculation is as follows: where the conversion price is JPY1,200, and the share price of the convertible-type bond with share option is JPY1,800, parity is JPY1,800 ÷ JPY1,200 × JPY100 = JPY150. In other words, in terms of the current share price, JPY150 is the appropriate value of this convertible-type bond with share option.

Supposing that at that time the current market price for the convertible-type bond with share option is JPY155, that convertible-type bond with share option is being purchased at a value above the theoretical value. Conversely, if the market price is JPY145, it may be judged that it is being purchased at a low price.

$$\text{Parity Value (JPY)} = \frac{\text{Share Price}}{\text{Conversion Price}} \times 100$$

(Example) The parity value of a convertible-type bond with share option where the share price as follows is shown below (the conversion price is JPY1,200):

Share Price (JPY)	Parity Value (JPY)
1,800	150
1,200	100
600	50

(2) Premium Over Parity

The gap that arises between the market value of a convertible-type bond with share option and its parity value is called the Premium over Parity, and can also be expressed as a percentage.

$$\text{Premium Over Parity (\%)} = \frac{\text{Market Value of CB} - \text{Parity Value}}{\text{Parity Value}} \times 100$$

(Example) The Premium over Parity of a convertible-type bond with share option where the share price, etc. is as follows is shown below (the conversion price is JPY1,200):

Share Price (JPY)	Parity Value (JPY)	Market Price of Convertible-Type Bond with Share Option (JPY)	Premium Over Parity (%)
1,800	150	147	-2
1,200	100	115	15
600	50	95	90

(3) Conversion to Shares (Exercise of Share Options) in Practice

(i) Approach to Conversion

The decision to sell a convertible-type bond with share option as a bond or to convert and sell the shares depends on the premium over parity. In general, when the premium is positive (parity value < market price of a convertible-type bond with share option), it is more advantageous to sell the convertible-type bond with share option, whereas if the premium is negative (parity value > market price of a convertible-type bond with share option), it is more advantageous to convert the bonds to shares and sell the shares.

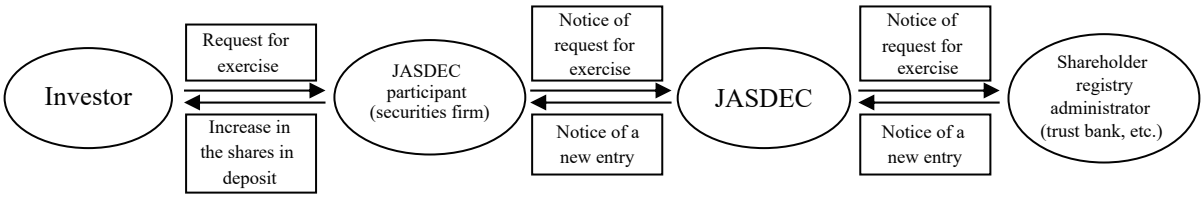
In practice, however, converting into shares necessitates taking into account the following points:

a. Transaction costs associated with the share sale (brokerage commissions, etc.); and

b. Accrued interest that can be received at the time of the sale of the convertible-type bond with share option (in the case of requesting the exercise, accrued interest cannot be received).

(ii) Conversion to Shares in Practice

In practice, the following process is used when converting to shares:



* With some differences among securities firms, it generally takes about five business days from the time when the investor makes a request for the exercise of the share option until the bonds are converted into shares.

* The investor bears the risk of any share price fluctuation during the period from the exercise request until the delivery of the share certificates.

6 9 Price Volatility Factors of Convertible-Type Bonds with Share Options

If convertible-type bonds with share options are generally thought of as a combination of bonds and shares, then the price of a convertible-type bond with share option can be broken down into:

Price of a convertible-type bond with share option
= (Price of a straight bond with the same bond terms as the convertible-type bond with share option)
+ (Price of an option with the same exercise price as the conversion price of the convertible-type bond with share option)

Accordingly, when analyzing the price volatility factors of convertible-type bonds with share options, it is necessary to consider the following four factors:

(1) Approach Towards Bond Valuation

The valuation of the bond portion of a convertible-type bond with share option is premised on the assumption that the bond portion should have the same value as a straight bond with the same terms (same issuing entity, same rating, same remaining years to maturity, same coupon). Based on this assumption then, the following factors are the volatility factors of bond value:

(i) Interest Rate Fluctuation

The benchmark for this factor is generally an interest-rate swap for the same period as the convertible-type bond with share option.

Thus, if the swap rate falls, the bond price will rise; conversely, if interest rates trend upwards, the bond price will fall.

(ii) Fluctuations in Bond Credit Spread

The credit spread fluctuates generally based on the financial soundness of the issuing company. Theoretically, the spread is determined based on the company's ratings announced by the ratings agencies.

If the credit spread shrinks, bond price will rise; conversely, if the credit spread widens, the bond price will fall.

(2) Approach Towards Option Value

Valuation of the option portion of the convertible-type bond with share option is premised on the assumption that theoretically, the value of the option will equal that of a call option on the underlying shares with the same terms (same issuing entity, same term to expiration, same conversion price). Based on this premise, the volatility factors are as follows:

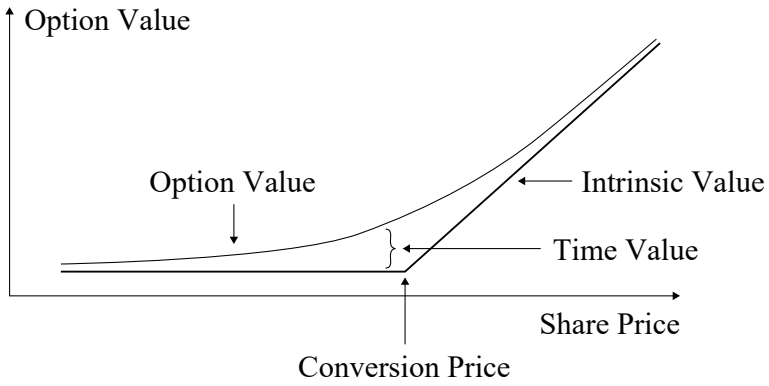
(i) Share Price Fluctuation

The value of the call option fluctuates based on movements in share price.

The option value can be described simplistically as:

Option Value = Intrinsic Value + Time Value

Chart 4-21 Option Value and Payout



The option payout moves in parallel with movements in the share price, as shown in the chart. However, when the share price is lower than the conversion price, the option value becomes less sensitive to share price movements and the option value payout diagram shows a shallow curve. By contrast, when the share price is higher than the conversion price, the option value becomes more sensitive to share price movements and the option value payout diagram shows a steep curve and becomes closer to the intrinsic value.

(ii) Movements in Volatility

Volatility means the annualized daily percentage fluctuation in share price or variability in the stock price. Generally as the volatility increases, the time value portion in the chart will increase, and the option value will also increase. Conversely, as the volatility declines, so will the option value.

Generally, the share price of a share with a high volatility is judged to have a stronger possibility of changing the price range in the future, causing the option value to rise.

(3) Conclusion

If the volatility factors of convertible-type bonds with share options can be plugged into a matrix, as shown below:

Chart 4-22 Factors of Price Fluctuation in Convertible-Type Bonds with Share Options

	Interest Rates	Credit Spreads	Share Prices	Volatility
Price Rises	Fall	Contract	Rise	Increases
Price Falls	Rise	Widen	Fall	Decreases

6 10 Market Trends of Convertible-Type Bonds with Share Options

Major changes in markets of convertible-type bond with share options are underway in recent years.

In the past, investors in the market were mainly comprised of domestic institutional investors and individuals; however, gradually more foreigners, particularly hedge funds, began to actively participate in the market. One can observe a similar trend in the primary market as well.

(1) Outstanding Balances of Convertible-Type Bonds with Share Options

Volumes of convertible-type bonds with share options in the secondary market expanded in the latter half of the 1980s in response to the large increase in equity finance during those years, whereas in recent years this large volume has approached maturity, while new issues have declined. Other major factors for this decrease include the reduction in interest-bearing debt at the corporate level, and changes in attitudes towards capital costs.

Another recent feature is that while the market balance of convertible-type bonds with share options issued domestically has withered, issues have shifted to the Euromarket. In particular, most large financings of over JPY50 billion have been done in the Euromarket. As the demand for convertible-type bonds with share options increasingly shifts from domestic to foreign markets, tapping the Euromarket allows issuers the ability to complete deals on more favorable terms than would be possible domestically.

Chart 4-23 Issue and Redemption of Convertible-Type Bonds with Share Options

(Unit: JPY100 million)

Year	Domestic Issues	Domestic Redemptions
2019	50	651
2020	210	1,340
2021	149	719
2022	55	509
2023	246	230

(Source) Prepared based on "Issuing, Redemption and Outstanding Amounts of Bonds" by the JSDA

However, as interest rates are low on a global basis, the advantage of convertible-type bonds with share options as low-interest financing means has somewhat declined, resulting in a decrease in issues of convertible bonds and a gradual decline in the outstanding balance.

(2) Trends in Trading Balance by Investor Category

When observing the recent trends in trading balances of convertible-type bonds with share options for different investor categories, individual investors have been seen to be net sellers, which may be attributed to a fact that a relatively larger portion of new issues has been allotted to individual investors and then sold on the market. Meanwhile, foreign investors continued to purchase more than they sell (see Chart 4-24).

Foreign investors and corporations tend to use the market transactions other than those during trading sessions and the off-exchange trades more frequently in addition to the transactions during trading sessions.

Chart 4-24 Trading Trends of Convertible-Type Bond with Share Options by Investment Category

(Unit: JPY100 million)

Year	Total			Proprietary			Broker			Details of Broker Trades								
										Corporate			Individual			Foreign Investor		
	Sells	Buys	Net	Sells	Buys	Net	Sells	Buys	Net	Sells	Buys	Net	Sells	Buys	Net	Sells	Buys	Net
2018	228	221	-7	38	73	36	190	147	-43	57	38	-19	119	10	-110	14	100	86
2019	134	132	-1	56	33	-23	78	100	22	34	59	25	40	4	-36	4	37	33
2020	193	132	-61	24	68	44	169	64	-105	66	17	-49	96	11	-84	8	37	29
2021	89	66	-23	21	42	21	68	24	-44	35	3	-32	16	1	-14	18	20	2
2022	63	51	-13	11	36	25	53	15	-38	5	2	-3	14	1	-14	34	12	-22

(Note) The survey targeted general trading participants capitalized at JPY3 billion or more. Rounded off to the nearest JPY100 million.

(Source) Prepared based on "Trading Volume by Type of Investor (Convertible Bond)" in the "Monthly Statistics Report", of the Japan Exchange Group. Data for 2023 and thereafter has ceased to be published.

7 Bond Investment Calculations

7 1 Coupon (Interest-Bearing) Bonds

(1) Profits of Bond Investments

The fundamental terms of a bond are the interest rate, the price and the number of years to maturity. Profits from investments in bonds can be calculated using these three conditions.

In addition, profits from bond investments can be divided into three components, as described below:

(i) Coupon income ---Interest income (income gains)
(ii) Redemption gain/loss ---Difference between redemption price and purchase price (capital gain/loss)
(iii) Reinvestment earnings of coupons ---Investment earnings from reinvestment of interest payments received during the life of the bond

(2) Yield Computations

(i) Simple Yield to Maturity

The simple yield to maturity is the yield if bonds are held from purchase until redemption. The simple yield to maturity computes how much interest income and redemption gain/loss was received on the bond each year as a percentage of the purchase price:

Formula <1>

$$\textbf{Simple Yield to Maturity} = \frac{\left[\begin{array}{c}\text{Interest Income}\\ \text{per Year}\end{array}\right] + \left[\begin{array}{c}\text{Redemption}\\ \text{Gain/Loss per Year}\end{array}\right]}{\text{Purchase Price}} \times 100\ (\%)$$

$$= \frac{\text{Coupon} + \dfrac{(\text{Redemption Price} - \text{Purchase Price})}{\text{Number of Years to Maturity (years)}}}{\text{Purchase Price}} \times 100\ (\%)$$

(Sample Question)

What is the simple yield to maturity of a coupon bond with an annual coupon rate of 2.0%, 10 years remaining until maturity, and a purchase price of JPY99.80?

Based on Formula <1>:

$$\frac{2.0 + \dfrac{(100 - 99.80)}{10}}{99.80} \times 100 = \frac{2.02}{99.80} \times 100 = 2.024048\% \approx 2.024\%$$ (Fractions are rounded down)

(Note) Normally figures are rounded down after the fourth decimal place (hereinafter the same).

(Sample Question)

What is the simple yield to maturity of a coupon bond with an annual coupon of 3.1%, 8 years remaining until maturity, and a purchase price is JPY109 (cases where a redemption loss is included)?

$$\frac{3.1 + \dfrac{(100 - 109)}{8}}{109} \times 100 = \frac{3.1 - 1.125}{109} \times 100 = 1.8119266\% \approx 1.811\%$$ (Fractions are rounded down)

(ii) Subscriber Yield

The simple yield to maturity in cases where a new bond issue is purchased is called the subscriber yield:

Formula <2>

$$\textbf{Subscriber Yield} = \frac{\text{Coupon} + \dfrac{(\text{Redemption Price} - \text{Issue Price})}{\text{Number of Years to Maturity (years)}}}{\text{Issue Price}} \times 100\ (\%)$$

(Sample Question)

What is the subscriber yield for a long-term government bond with an annual coupon of 2.0%, a maturity of 10 years, and an issue price of JPY100.63?

Based on Formula <2>:

$$\frac{2.0 + \frac{(100 - 100.63)}{10}}{100.63} \times 100 = \frac{2.0 - 0.063}{100.63} \times 100 = 1.9248732\% \approx 1.924\%$$

(Fractions are rounded down)

(iii) Current Yield

Current yield is a measure of bond profitability expressed as the annual interest on a bond divided by the bond price. It is often used since calculation is relatively simple. Because current yield is a measure of interest income, it is an important index for investors who place an importance on constant and immediate profits:

Formula <3>

$$\textbf{Current Yield} = \frac{\text{Coupon}}{\text{Purchase Price}} \times 100\ (\%)$$

(Sample Question)

What is the current yield for a government bond with an annual coupon of 3.3%, 8.5 years remaining until maturity, and a purchase price of JPY110.80?

Based on Formula <3>:

$$\frac{3.3}{110.80} \times 100 = 2.9783393\% \approx 2.978\%$$ (Fractions are rounded down)

(iv) Yield During the Holding Period

With actual bond investments, the bonds in the portfolio are not necessarily held until the redemption date because of cashing or rolling over. Therefore, profits must be evaluated if sold prior to the redemption date.

A representative yet simple measure of the profit during any holding period is the yield during the holding period. This can be derived by replacing the redemption price with the selling price, and the number of years to maturity with the period of ownership in the above-mentioned simple yield to maturity formula:

Formula <4>

$$\textbf{Yield During Holding Period} = \frac{\text{Coupon} + \frac{(\text{Selling Price} - \text{Purchase Price})}{\text{Holding Period (years)}}}{\text{Purchase Price}} \times 100\ (\%)$$

An increasing number of institutional investors are investing with the intention of collecting this yield based on the period of ownership.

(Sample Question)

Two years after an investor purchased an interest-bearing government bond at JPY99.80 with an annual coupon of 2.0% and a maturity of 10 years, it rose in price to 101.50, so the investor sold it. What

is my yield during the holding period?

Based on Formula <4>:

$$\frac{2.0 + \frac{(101.50 - 99.80)}{2}}{99.80} \times 100 = \frac{2.85}{99.80} \times 100 = 2.8557114\% \approx 2.855\%$$

(Fractions are rounded down)

(3) Bond Unit Price Calculation

In bond trading, the unit price of the bond (purchase price) must in some cases be derived from the desired yield:

Formula <5>

$$\textbf{Purchase Price} = \frac{\text{Redemption Price} + (\text{Coupon} \times \text{No. of Years to Maturity})}{1 + \left(\frac{\text{Yield}}{100} \times \text{No. of Years to Maturity}\right)}$$

(Sample Question)

What must the purchase price be for an interest-bearing government bond with an annual coupon of 2.0%, and 5 years remaining until maturity, if the required simple yield to maturity is 1.4%?

Based on Formula <5>:

$$\frac{100 + (2.0 \times 5)}{1 + (0.014 \times 5)} = \frac{110}{1.07} = 102.803738 \approx \text{JPY}102.803$$ (Fractions are rounded down)

(4) Simple Yield and Compound Yield

All of the yield computations so far used the simple yield method.

With the simple yield method, the yield is expressed in terms of the ratio of profits relative to the invested principal by simply dividing the total profits generated by the invested principal during the period of ownership by the number of years proportional to the holding period.

On the other hand, the compound yield method calculates the final yield on the invested principal if the interest generating the yield is reinvested periodically.

The compound yield method is more detailed and more rational, and as the length of ownership increases, the difference between the simple yield method and compound yield method increase accordingly. Since the calculation is more complicated, in Japan, it was only used for some bonds such as discount government bonds, with a number of years to maturity in excess of one year, but currently, it is more widely used.

The following example evaluates the effect of reinvesting the interest.

There are two bonds, bond A and bond B. Bond A has a coupon of 3.0%, 5 years remaining until maturity, and a price of JPY92; bond B meanwhile has a coupon of 5.0%, 5 years remaining until maturity and a price of JPY100. The simple yield to maturity for both bonds is the same when the simple yield method is used, computed as follows:

$$\text{A: } \frac{3.0 + \dfrac{(100 - 92)}{5}}{92} \times 100 = 5.0\%$$

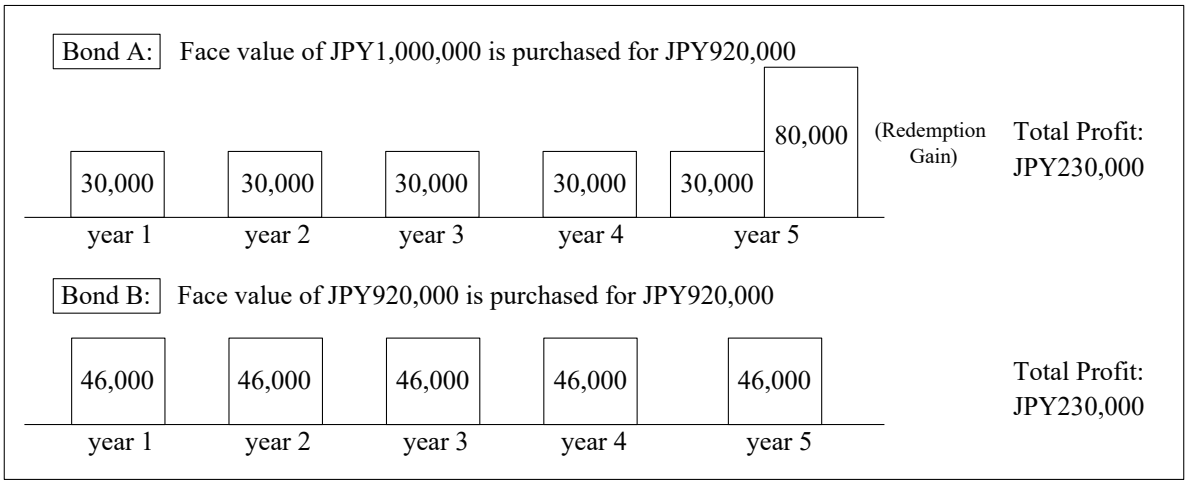
$$\text{B: } \frac{5.0 + \dfrac{(100 - 100)}{5}}{100} \times 100 = 5.0\%$$

Comparing this to a case in which the same amount (investment principal: JPY920,000) is invested, the receipt of profits would be timed as shown in the chart below.

The total profit for the 5-year period is the same for both (meaning the same with the simple yield method), but bond A generates an annual interest income of JPY30,000 (a redemption gain of JPY80,000 obtained in 5 years), whereas bond B generates an annual income of JPY46,000. There is a difference of approximately JPY16,000 in annual interest received between the two.

Bond B would thus be considered more advantageous as an investment if the coupon reinvestment income obtainable from investing the JPY16,000 is considered.

Chart 4-25 Timing of Earnings Receipts



(5) Calculation Example for Foreign-Currency Denominated Interest-Bearing Bonds

The calculation method for foreign-currency denominated interest-bearing bonds is as follows:,

Foreign Currency-denominated Purchase Price
Foreign Currency-denominated Contract Price
= Foreign Currency Face Value × Unit Price (Rounded to the nearest local currency unit) ---- (1)

$$\begin{array}{c}\text{Foreign Currency Accrued Interest}\end{array} = \begin{array}{c}\text{Foreign Currency Face Value}\end{array} \times \frac{\text{Coupon (Interest Rate)}}{100} \times \frac{\text{Number of Days Elapsed (According to the market practice)}}{\text{Number of Days per Year (According to the market practice)}}$$

(Rounded to the nearest local currency unit) ---------- (2)

*Please see (6)(ii) below regarding accrued interest.

Foreign Currency-denominated Purchase Price = (1) + (2)

Contract Price Converted into Yen = Foreign Currency-denominated Contract Price
× Exchange Rate (Fractions less than one whole yen are rounded down*) ---------- (3)
Accrued Interest Converted into Yen = Foreign Currency-denominated Accrued Interest
× Exchange Rate (Fractions less than one whole yen are rounded down*) ---------- (4)
Purchase Price Converted into Yen = (3) + (4)
*In the case of selling by customers, fractions of less than one whole yen are rounded up.

(Sample Question)

Compute the yen equivalent amount for the purchase of a U.S. treasury bond (T-bond with a maturity date of November 15, 2025 with semi-annual interest payments on May 15 and November 15).

Coupon: 9.125%
Face Value: USD1 million
Unit Price: 115-17 (= 115.53125)

* The number after the hyphen is referred to as a "tick," where a tick means the fraction 1/32. The quotation "115-17," expressed as a fraction, would thus be "115 17/32," which in decimal form is "115.53125."

Exchange Rate: JPY80 (= USD1)
Delivery Date: April 14, 2018
Days Elapsed: 150 days have elapsed from the last interest payment date.
Days in a Year: 181 days × 2 = 362 days (Twice the number of days from the last interest payment date (November 15) to the next interest payment date (May 15))

(i) Foreign Currency-Denominated Contract Price

$$= \text{USD1 million} \times \frac{115.53125}{100} = \text{USD1,155,313}$$

(ii) Foreign Currency Accrued Interest

$$= \text{USD1 million} \times \frac{9.125}{100} \times \frac{150 \text{ days}}{362 \text{ days}} = \text{USD37,811}$$

Foreign Currency-Denominated Purchase Price
= (i) + (ii) = USD1,155,313 + USD37,811 = USD1,193,124
(iii) Contract Price Converted Into Yen = USD1,155,313 × JPY80 = JPY92,425,040
(iv) Accrued Interest Converted Into Yen = USD37,811 × JPY80 = JPY3,024,880
Purchase Price Converted Into Yen
= (iii) + (iv) = JPY92,425,040 + JPY3,024,880 = JPY95,449,920

* Note that the calculation method for the number of days elapsed for foreign-currency denominated interest-bearing bonds other than U.S. government bonds varies according to market practices (including the currency and issue).

(6) Bond Trading Business Practices

(i) Over-the-Counter Transactions and Exchange Transactions

The secondary market for public and corporate bonds consists broadly of two markets, the over-the-counter market and the securities exchange markets. Share trading is concentrated mostly in the securities exchanges, while one of the major characteristics of the public and corporate bond transactions is that great majority of them are traded in the over-the-counter market. Any kind of bond can be traded in the over-the-counter market, but only listed bonds can be traded on the securities exchanges.

The over-the-counter transactions are dealer transactions (principal transactions), and amounts equivalent to a commission are included in the bond price. There are instances where a separate brokerage commission is collected for transactions on the securities exchange, and such brokerage commission is to be determined independently by each securities firm.

(Sample Question)

If a long-term government bond with a face value of JPY3 million and bond price of JPY99 per unit is purchased, what is the total amount necessary (assuming a brokerage commission of JPY4,000 per face value of JPY 1 million, accrued interest of JPY2,000, and consumption tax at 10%)?

Brokerage Commission = JPY3,000,000 ÷ JPY1,000,000 × JPY4,000 = JPY12,000

Consumption Tax = JPY12,000 × 10% = JPY1,200

$$\text{Delivery Amount} = \text{JPY3,000,000} \times \frac{99}{100} + \text{JPY2,000} + (\text{JPY12,000} + \text{JPY1,200})$$

$$= \text{JPY2,985,200}$$

(Sample Question)

If interest-bearing bonds with a face value of JPY2 million are sold at a bond price of JPY101 per unit on the exchange, what is the delivery price (assuming a brokerage commission of JPY3,000 per face value of JPY1 million, accrued interest of JPY2,500, and consumption tax at 10%)?

Brokerage Commission = JPY2,000,000 ÷ JPY1,000,000 × JPY3,000 = JPY6,000

Consumption Tax = JPY6,000 × 10% = JPY600

$$\text{Delivery Amount} = \text{JPY2,000,000} \times \frac{101}{100} + \text{JPY2,500} - (\text{JPY6,000} + \text{JPY600})$$

$$= \text{JPY2,015,900}$$

(ii) Accrued Interest

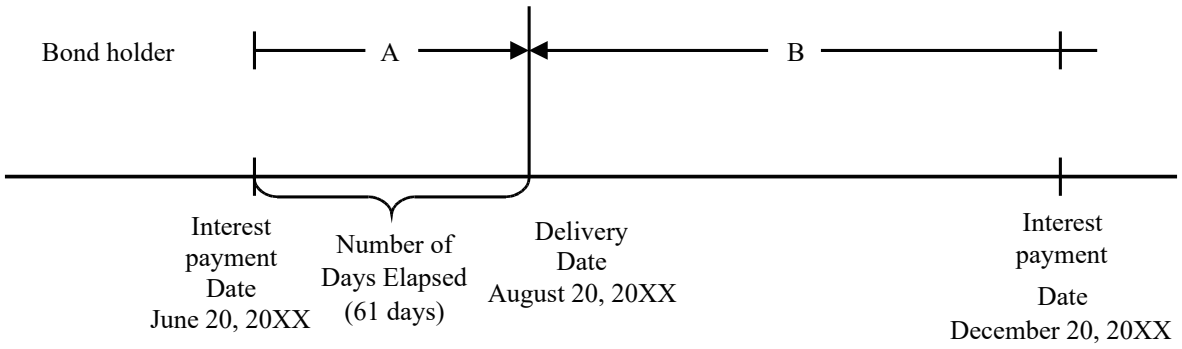
Attention must be paid to the receipt and payment of accrued interest if interest-bearing bonds are traded.

Interest for most interest-bearing bonds is paid semi-annually on predetermined payment dates. In other words, the interest is not paid on days other than the interest payment dates. So, a bondholder selling a bond between interest payment dates would not receive interest for the period from the last interest payment date to the date of sale. On the other hand, the bondholder buying the bond mid-period would receive the entire semiannual interest amount on the next interest payment date. In order to resolve this imbalance, the buyer pays to the seller, at the time of sale, the interest that accrued during the period from the day after the last interest payment date to the settlement date when the bond is traded.

As depicted in the chart below, if Mr. A sells an interest-bearing government bond for face value JPY1 million with an annual interest rate of 2.0% on August 20, 20XX, Mr. A will receive the 61 days of interest accrued from the day after the last interest payment date, *i.e.*, June 20, 20XX to the delivery (settlement) date (the date on which money is exchanged, not the date on which the trade is contracted), *i.e.*, August 20, 20XX.

On the other hand, Mr. B, who purchased the government bond, must pay the purchase price of the bond plus accrued interest.

The JSDA has established a method for calculating the accrued interest for over-the-counter transactions.



The accrual days are counted from the day after the interest payment date to the delivery date (including only the day at the end of the period).

For example, suppose as set forth above, a trade for long-term government bonds is contracted on August 17, 20XX, where the most recent interest payment date was on June 20, 20XX. If delivery is set for August 20, 20XX, the number of days elapsed would be 61 days, from June 21, 20XX (the day after the most recent interest payment date) until August 20, 20XX (delivery date). Thereafter, the number of elapsed days is computed based on a 365 day year.

Specifically, the following formula is used for calculations:

Formula <6>

$$\text{Accrued Interest (A)} = \text{Annual Interest per Face Value (JPY100)} \times \frac{\text{Number of Days Elapsed}}{365}$$

$$\text{(A)} \times \frac{\text{Total Face Value of Trade}}{100} = \text{Accrued Interest for Total Face Value of Trade}$$

* Previously, a withholding tax of 20% (20.315% on or after January 1, 2013) was deducted except in special cases. However, this treatment has been changed and withholding tax is not deducted for over-the-counter transactions in which the delivery is made on or after the first day of the interest calculation period for the interest in domestic bonds which becomes due on or after January 1, 2016. In relation to transactions at exchanges, the same calculation method applies to the interest accrued in transactions of interest-bearing bonds, etc. for which the first interest payment date after the settlement date falls on January 1, 2016, or thereafter.

(Note) (A) is rounded down to the seventh decimal place from the eighth decimal place and beyond.

In the example above, Mr. A will receive accrued interest in the amount calculated as follows:

$$\text{Accrued Interest per Face Value (JPY100)} = 2 \times \frac{61}{365} = 0.3342465$$

Accrued Interest for Total Face Value (JPY1 million in this case)

$$= 0.3342465 \times \frac{\text{JPY1,000,000}}{100} = \text{JPY3,342}$$

Also, for government bonds that are now subject to the instant reopen (instantaneous issue amalgamation) system, in some cases accrued interest will be generated even for a bond purchased on the issue date (because the first interest payment for issues subject to the instant reopen system is regarded as uniform with all six-month portions regardless of the actual period of time from issuance until interest is paid).

7 2 Discount Bonds

Discount bonds are issued with the interest equivalent amount subtracted from the face value and a promise to redeem the bond at face value upon maturity. In Japan, the practice is to calculate the interest on a discount bond with more than one year to maturity using a compound annual interest rate. Therefore, the yields from a discount bond with one year or less to maturity and a discount bond with more than one year to maturity are calculated separately.

(1) Calculation of Yields and Unit Prices of Discount Bonds Redeemed Within One Year

The simple yield to maturity for a discount bond redeemed within a year is calculated using the simple yield method. The calculation formula is the same as the formula for the simple yield to maturity using the simple yield method for a coupon bond, but the interest rate is replaced by 0:

Formula <7>

$$\textbf{Simple Yield to Maturity}\ (\%) = \frac{\text{Redemption Price} - \text{Purchase Price}}{\text{Purchase Price}} \times \frac{365}{\text{Number of Days not Elapsed}} \times 100$$

The formula for calculating the purchase price from the yield would be as follows:

Formula <8>

$$\textbf{Purchase Price}\ (\text{yen}) = \frac{\text{Redemption Price}}{1 + \frac{\text{Annual Yield}}{100} \times \text{No. of days Not Elapsed} \div 365}$$

The number of days that have not elapsed is calculated by including only the day at the end of the period.

(Sample Question)

If the payment for a discount bond with one year until maturity is JPY99.30, what is the yield?

Based on Formula <7>:

$$\frac{100 - 99.30}{99.30} \times 100 = 0.704\%$$

(Sample Question)

If a discount bond with a redemption date of January 31, 20XX+1 is purchased on October 17, 20XX for JPY99.80, what is the simple yield to maturity? (The number of remaining days is: (10/17 - 1/31: counting only the last day) 106 days)

Based on Formula <7>:

$$\frac{100 - 99.80}{99.80} \times \frac{365}{106} \times 100 = 0.690\%$$

(Sample Question)

If a discount bond with a redemption day of February 28, 20XX+1 is purchased on September 30, 20XX for a yield of 1%, what is the purchase price?

(The number of remaining days is: (9/30 - 2/28: counting only the last day) 151 days)

Based on Formula <8>:

$$\frac{100}{1 + 0.01 \times 151 \div 365} = \text{JPY}99.58$$

(2) Yield for Discount Bonds with Over One Year to Maturity

For the yield on long-term discount bonds with over one year to maturity, a formula based on the compound yield method is used:

Formula <9>

$$\textbf{Compound Yield (\%)} = \left(\sqrt[\text{No. of Yrs. To Mat.}]{\frac{\text{Redemption Price}}{\text{Purchase Price}}} - 1 \right) \times 100$$

The formula for calculating the purchase price from the yield would be as follows:

Formula <10>

$$\textbf{Purchase Price} = \frac{\text{Redemption Price}}{\left(1 + \frac{\text{Compound Yield}}{100} \right)^{\text{No. of Yrs. To Mat.}}}$$

(Note) Calculating the compound yield based on the formula mentioned above is difficult to do by hand or with a regular calculator. For practical purposes, a table of yields for bonds based on the compound yield, or a programmed computer, is used.

7 3 *Gensaki* Transactions

The yield during the holding period for a *gensaki* transaction is usually calculated using the simple yield method and reinvestment of the interest received during the term is not considered. The calculation methods for *gensaki*, in principle, are the discount-bond method for bonds traded as discount bonds and the coupon bond method for bonds traded as interest-bearing bonds. Only the discount-bond method is explained here.

(1) Computing Purchase Price Using the Discount Bond Method (*Kai Gensaki*, Repurchase)

Yield during the holding period is computed as follows:

$$\text{Yield During Holding Period (\%)} = \frac{\text{Unit Selling Price} - \text{Unit Purchase Price}}{\text{Unit Purchase Price}} \times \frac{365}{\text{Period (days)}} \times 100$$

To solve for the purchase price (start price):

Formula <11>

$$\textbf{Unit Purchase Price (yen)} = \frac{\text{Unit Selling Price}}{1 + \dfrac{\text{Yield During Holding Period}}{100} \times \dfrac{\text{Period (days)}}{365}}$$

(Sample Question)

What is the unit purchase price (start price) for a *gensaki* (repo) with an annual rate of 1.00% and a term of 180 days? The trading unit is JPY100.

Based on Formula <11>:

$$\text{Unit Purchase Price} = \frac{100}{1 + \dfrac{1.00}{100} \times \dfrac{180}{365}} = \text{JPY99.50}$$

(2) Computing Unit Selling Price (Kai-Gensaki, Reverse Repurchase)

Formula <12>

$$\textbf{Unit Selling Price} = \text{Unit Purchase Price} \times \left[1 + \frac{\text{Yield During Holding Period}}{100} \times \frac{\text{Period (days)}}{365}\right]$$

(Sample Question)

What is the unit selling price of a government bond purchased for JPY97.80 and settled in 98 days at an

annual rate of 1.00%?

Based on Formula <12>:

$$\text{Unit Selling Price} = 97.80 \times \left(1 + \frac{1.00}{100} \times \frac{98}{365}\right) = \text{JPY}98.06$$

7 4 Convertible-Type Bonds with Share Options

(1) Conversion Price

The conversion price is the price per share when convertible-type bonds with share options are converted into shares. For example, if the conversion price is JPY1,000, convertible-type bonds with share options with a face value of JPY1 million can be converted into1,000 shares in the company.

The conversion price is often a price that is a several percentage to several dozen percentage points more than the closing price of the shares on the day on which the issuance conditions are decided. If the value per share is diluted by the issuance of new shares during the period for requesting the exercise of share options, the conversion price is decreased to protect the rights of the bondholders of convertible-type bonds with share options. Reductions in the conversion price are called "conversion price adjustments."

The number of shares acquired when convertible-type bonds with share options are converted to shares is derived with the following formula:

Formula <13>

$$\textbf{Number of Shares Acquired} = \frac{\text{Total Value of the Issue Price of the Bonds Submitted by the Bondholder}}{\text{Conversion Price}}$$

If fractional amounts result from the computation, the amount computed as:

Face Value – Conversion Price × Number of Shares (Portion of Integer)

is paid in cash.*

* Recently, odd-lot shares of less than one share are not paid in cash but are disregarded. Whether or not such shares are paid in cash should be confirmed with prospectus, etc. for each issue.

(Sample Question)

If the convertible-type bonds with share options of Company A (face value: JPY1 million) are converted into shares at a conversion price of JPY670 (trading unit is 100 shares), what is the number of shares that are acquired?

Using Formula <13>:

$$\frac{1{,}000{,}000}{670} \approx 1{,}492.53 \text{ (shares)}$$

The number of shares acquired is 1,492.
Odd-lot shares (0.53 shares) may be disregarded or paid in cash [JPY360 (= 1,000,000 – 670 × 1,492)].

(2) Newly-Issued Bonds and Outstanding Bonds

Newly-issued convertible-type bonds with share options are offered by securities firms and basically listed on a financial instruments exchange on the following business day of the date of issuance.

If the market value of convertible-type bonds with share options is over JPY100, it is called "over par," and if it is lower than JPY100, it is called "under par."

A brokerage commission is charged when listed and already-issued convertible-type bonds with share options are traded. Just as with shares and bonds, each securities firm is free to independently determine the brokerage commission it will charge.

At the time of sale, any profits from the sale of convertible-type bonds with share option sale are taxed. The accrued interest is included in the delivery amount.

(3) Price of Convertible-Type Bond with Share Option – Parity Value and Premium Over Parity –

(i) Domestic Convertible-Type Bonds with Share Options

The price of a convertible-type bond with share option is generally evaluated by its yield as a corporate bond when the share price is significantly lower than the conversion price, however, the market price of convertible bonds parallels movements in the share price when the share price rises closer to the conversion price.

For example, if convertible-type bonds with share options with a conversion price of JPY1,000 are held with a face value of JPY1 million and the price of shares in the company rises to JPY1,200, the parity value would be JPY120, and the bondholder is deemed to have the shares with value of JPY1.2 million:

Formula <14>

$$\textbf{Parity Value (JPY)} = \frac{\text{Share Price}}{\text{Conversion price}} \times 100$$

However, the actual market price may be more or less than the parity value due to the fact that it is affected by the yield on convertible-type bonds with share options and general trends in interest rates, the share market and the market of convertible-type bonds with share options. The difference is called "premium over parity." The higher the positive premium, the higher the price of convertible-type bonds with share options is trading relative to the share price (there are cases where the premium over parity is a negative number, and this condition is called "discount to parity"):

Formula <15>

$$\textbf{Premium Over Parity (\%)} = \frac{\text{Price of Convertible-Type Bond with Share Options} - \text{Parity Value}}{\text{Parity Value}} \times 100$$

(Sample Question)

The convertible-type bonds with share options of company A have an annual coupon of 4% and a conversion price of JPY500. If the share price of company A becomes JPY700, what is the parity value of the convertible-type bond with share option issued by company A? What is the premium over parity if the price of the convertible-type bond with share option issued by company A is JPY150 or JPY135 at the time?

Based on Formula <14>:

$$\text{Parity Value} = \frac{700}{500} \times 100 = \text{JPY}140$$

Based on Formula <15>:

$$\text{Premium over Parity if the Conversion Price is JPY}150 = \frac{150 - 140}{140} \times 100 \approx 7.14\%$$

$$\text{Premium over Parity if the Conversion Price is JPY}135 = \frac{135 - 140}{140} \times 100 \approx -3.57\%$$

(Discount to Parity)

(ii) Foreign Currency-Denominated Convertible Bonds

The following is the calculation method used when investing in convertible-type bonds with share options denominated in foreign currencies such as US dollar, Swiss Franc, etc. When the foreign currency-denominated convertible-type bonds with share options are issued, the conversion price is set and, at the same time, a fixed exchange rate is determined for use when the bonds are converted to shares:

$$\text{Number of Shares after Conversion} = \frac{\text{Total Value of the Issue Price of the Bonds Submitted by the Bondholder} \times \text{Fixed Exchange Rate}}{\text{Conversion Price}}$$

In other words, the number of shares described above will never change due to fluctuations in the exchange rate.

The following formula is used to calculate the parity value:

Formula <16>

$$\textbf{Parity Value} = \frac{\text{Share Price} \times \text{Fixed Exchange Rate}}{\text{Conversion Price} \times \text{Current Exchange Rate}} \times 100$$

Premium over parity calculations are the same as those for domestic bonds.

(Sample Question)

If dollar-denominated convertible-type bonds with share options of company B have an issue price

that is 100% of the face value, a conversion price of JPY600 and a fixed exchange rate of USD1 = JPY110, what is the parity value if the share price is JPY900 and the current exchange rate is USD1 = JPY100?

Based on Formula <16>:

$$\text{Parity Value} = \frac{900 \times 110}{600 \times 100} \times 100 = \text{JPY}165$$

Recently, some convertible-type bonds with share options are converted at a price denominated in foreign currencies rather than JPY, which has been used as the denominated currency.

In these cases, the number of shares after conversion and the parity value are calculated respectively by the following formulas in which the fixed exchange rate does not apply:

$$\text{Number of Shares after Conversion} = \frac{\text{Total Value of the Issue Price of the Bonds Submitted by the Bondholder (Foreign currency)}}{\text{Conversion Price (Foreign currency)}}$$

$$\text{Parity Value} = \frac{\text{Share Price}}{\text{Conversion Price (Foreign currency)} \times \text{Current Exchange Rate}} \times 100$$

Outline of the Qualification Examination System for Sales Representatives

For Use by Examinees Applied Through Association Members of JSDA

[Note] The following information has been written based on the relevant systems effective as of the date of issue of these Manuals and may be subject to changes.

1. What Is the Sales Representative Qualification Examination?

Persons who wish to engage in securities operations must pass the Sales Representative Qualification Examination described below (hereinafter referred to as the "Examination") and must be registered in the Original Registry of Sales Representatives before they become engaged in the conduct of duties of a Sales Representative.

A Sales Representative must possess a certain minimum level of basic knowledge concerning Japan's laws on financial instruments, including the Financial Instruments and Exchange Act, etc., and other laws and ordinances, as well as financial products and financial instruments transactions.

The Examination administered by the Japan Securities Dealers Association (hereinafter referred to as the "JSDA") tests the extent of acquisition of this knowledge, and is part of the self-regulatory system of the securities industry.

2. Qualification to Take the Examination

With regard to the Class-1 Sales Representative Qualification Examination (hereinafter referred to as the "Class-1 Examination") and Class-2 Sales Representative Qualification Examination (hereinafter referred to as the "Class-2 Examination"), the people for whom the Association Member finds it necessary to have him/her take the Examination, and who do not fall under any of the following persons are qualified to sit for the Examination:

- Class-1 perpetrator of an inappropriate act;
- A person for whom five years have yet to elapse from the day on which such person came to be treated as a Class-2 perpetrator of an inappropriate act;
- A person who is under a waiting period to take the next Examination due to failure (for details, see "7. Required Waiting Period for Repeat Examinations"); and
- A person who is under a period during which he/she is excluded from taking the Examination due to misconduct (for details, see "8. Misconduct").

3. Examination Procedures

Each Association Member files an application with the JSDA on behalf of the persons who want to take the Examination.

The applications for officers and employees of a financial instruments intermediary service provider are handled by an Association Member with whom the financial instruments intermediary service provider has executed entrustment agreement.

Procedures for applying to take the Examination are handled exclusively by the relevant department at the Association Member. Individuals wishing to take the Examination cannot submit an application directly to the JSDA.

4. Date and Location of the Examination

(1) Examination Date

The JSDA holds, in principle, the Examinations on every business day (except Saturdays, Sundays, public holidays and during the New Year period). However, this will be different for each examination site.

(2) Examination Sites

The examination sites (test centers) are located in major cities all over Japan. Examinees should check with the examination site at their desired location for the examination date via the respective department of the Association Member in advance.

After the application, the examination site, date and time of the Examination are assigned to each applicant individually. In addition, examinees cannot sit for the Examination other than at the location and time scheduled in advance.

5. Checklist for the Day of Examination

(1) Some test centers may close unexpectedly due to inclement weather such as typhoons.

Please confirm that the test center is open via the Prometric K.K. website prior to departing for the test center.

[Prometric website]

([Top page]-[For Candidates])

URL: https://www.prometric-jp.com/en/examinee/

* If examinees have any questions, they should confirm with the responsible persons at the Association Member to which examinees belong. It should be noted that the examination administrator mentioned above and the examination sites do not accept any inquiries about whether a specific examination will be held as scheduled.

(2) Arrival at the Examination Site

Examination instructions will be announced at the test site prior to the commencement of the Examination. Therefore, all examinees should come to the examination site by the appointed time (at least 15 minutes before the fixed start of the Examination). (If examinees do not arrive at the examination site at least 15 minutes prior to the fixed examination time, they will not be permitted to take the Examination regardless of the reason.)

(3) Consent to the Rules for Taking the Examination

Examinees should carefully read and understand the " Examination Regulations" provided at the examination site before going to the reception desk.

They will be deemed to have consented to the "Rules for Taking the Examination" when they complete the reception procedure.

[Reference] Examinees can check the "Rules for Taking the Examination" in advance at the following URL:https://www.prometric-jp.com/exam_rules/

(4) Documents Necessary for Personal Identification

The identity of the examinee will be verified at the reception desk of the examination site. Examinees must bring one of the following identification documents (documents other than those listed below, such as a student's ID card, are not acceptable):

(i) Driver's license (temporary license, driver's license issued in a country outside Japan and driver's license with no indication stating "driver's license" are not allowed);
(ii) Certificate of driving history (limited to those issued on or after April 1, 2012);
(iii) Individual Number Card (<1>"Individual Number Notice" and "Notification Card" issued to notify every resident of their Individual Number ("My Number") are not allowed; <2> limited to one bearing a photo);
(iv) Basic Resident Registration Card (limited to one with a photograph affixed thereto);
(v) Passport (Check your name printed in alphabetic characters);
(vi) Resident card or special permanent resident certificate (limited to those bearing a photo); or
(vii) If an examinee does not have any of the above, the examinee must bring either (a) or (b) below:
(a) A "photo bearing employee identification card (Note)" and a "health insurance card or qualification confirmation letter" (substitute documents are not acceptable); or

(Note) The photo must either be split-sealed, embossed or laminated, or printed on a plastic card. The card must bear the first and last names of the examinee, the name of the Association Member and a corporate logo or the logo of the corporate group to which the Association Member belongs.

(b) An "identity verification card with photo specified by the JSDA (which must bear a company seal; a personal seal is not acceptable)" and a "health insurance card" (substitute documents are not acceptable).

(Notes)
1. Persons not in possession of a form of personal identification upon taking the Examination will not be permitted to take the Examination under any circumstances.
2. The forms of personal identification mentioned above are acceptable only if they are the originals (copies are not acceptable).
3. The forms of personal identification referred to above must be valid. Those that have become invalid by reason of expiry or other reason are not acceptable.
4. A "photo bearing employee identification card" or an "identity verification card" shall only be valid if it has been issued by an Association Member. Such cards issued by financial instruments intermediary service providers or temporary agencies are not acceptable.
5. An "identity verification card" is valid for a period of six months after the date of issuance (except when there has been a change of content).

(5) Miscellaneous

No reference material such as texts or notes may be used during the Examination. No personal belongings are allowed in the test room. Examinees must put their personal belongings except for the personal identification documents (including wristwatches, cellular devices, memo pads, etc.) in the lockers situated outside the test room at the examination site.

Examinees may use the calculator function displayed on the PC in order to solve calculation questions. If examinees need to make notes, they should use the mechanical pencil and notepad provided at the examination site.

6. Notification of Pass or Fail

Examination results will be given by a notice from the JSDA to a person-in-charge within each Association Member, in principle two business days after the Examination. The results given will be whether examinees have passed or failed, and their total score (the JSDA will not disclose any examination questions). The JSDA will not respond to inquiries from individual examinees.

7. Required Waiting Period for Repeat Examinations

A person who has taken and failed the Examination may not take any Examination for a period of 30 days from the day following the date of the original Examination.

If an examinee is later discovered to have taken the Examination within the waiting period above, the examinee's qualification will be nullified even if the examinee has passed.

8. Misconduct

(1) Acts Deemed as Misconduct and Specific Examples

Entering the examination room with notes or with information written on one's body, etc.

* **Even if such information is unrelated to the examination, this will be deemed an act of misconduct.**

(Specific examples)

- Entering the examination room with notes including information regarding the examination
- Entering the examination room with textbooks and workbooks or copies of such materials
- Entering the examination room with writing on one's palms, arms, or other areas

Bringing items other than those necessary for the examination (ID number case and personal identification documents) into the examination room

* **Even if items are unrelated to the examination, this will be deemed an act of misconduct.**

(Specific examples)

- Bringing in clocks of any kind (including watches)
- Bringing in portable devices (smartphones, tablets, wearable devices, etc.)
- Bringing in any writing tools such as pens, etc. (excluding items provided by the test center)
- Bringing in personal belongings such as notebooks, card cases, etc.

Writing information anywhere other than the dry erase board or taking information out of the examination room

* **Even if such information is unrelated to the examination, this will be deemed an act of misconduct.**

(Specific examples)

- Writing on one's body or clothes or leaving the examination room with written information
- Writing on the paper inside the ID number case or taking it out of the examination room
- Writing on one's personal identification documents and then taking them out of the examination room

Any other inappropriate behaviors inside the examination room such as the following:

(Specific examples)

- Talking inside the examination room
- Looking over at other seats
- Entering or exiting the examination room without the proctor's permission

- Not following the instructions of the proctor

(2) Monitoring Inside the Examination Venue

The examination room is monitored by the proctor walking throughout the room and by a security camera.

(3) Measures Taken in Cases of Misconduct

Those who commit acts of misconduct will not only fail that day's examination, but in addition to the misconduct being reported to the test taker's company or organization, there will be an investigation into the test taker, and he/she will be prohibited from taking any further examination for a period of up to one year (excluding renewal training). Additionally, the name of the company or organization to which the test taker belongs will be disclosed for a period of one year to all Association Members.

Even if a person's examination is halted after the person commits any act of misconduct or the person is treated as having failed the examination, the examination fee will be payable.

9. Subjects and Methods of Examination

	Class-1 Examination	Class-2 Examination
Subjects	[Laws, Regulations and Various Rules] ・Financial Instruments and Exchange Act and related laws and regulations ・Laws Relating to Solicitation and Sales of Financial Instruments ・Articles of Association and Various Rules of the Association ・Articles of Incorporation and Various Regulations of the Exchanges [Product Business] ・Equity Business ・Bond Business ・Investment Trusts and Investment Corporations Business ・Incidental Businesses ・Derivatives Transactions (Class-1 Examination Only) [Related Subjects] ・Basic Knowledge Concerning Securities Markets ・Stock Company Law in General ・Basic Knowledge of Economics, Finance and Fiscal Policy ・Financial Statements and Company Analysis ・Taxation of Securities Transactions ・Sales Operations	

<table>
<tr><td></td><td>Class-1 Examination</td><td>Class-2 Examination</td></tr>
<tr><td rowspan="2">Range of Questions</td><td>(1) Practical and professional knowledge regarding the subjects listed above
(2) Fundamental and important compliance-related topics</td><td>(1) Basic knowledge regarding the subjects listed above
(Questions regarding basic knowledge concerning items such as margin transactions and derivatives transactions, which are not included in the scope of activities a Class-2 Sales Representative may conduct, appear in the Class-2 Examination in connection with the covered subjects, such as “Equity Business” and “Bond Business.”)
(2) Same as the left</td></tr>
<tr><td colspan="2">(Note) If there is a change to the related laws, ordinances or various regulations, the questions will test the new laws, etc.</td></tr>
<tr><td>Format of Questions</td><td colspan="2">True or false questions and multiple-choice questions (to be answered by choosing the right term or making a calculation)
The questions should be answered by making entries on the computer.</td></tr>
<tr><td rowspan="2">Number of Questions</td><td>100 questions in total
(70 true or false questions, and 30 multiple-choice questions (from five choices))</td><td>70 questions in total
(50 true or false questions, and 20 multiple-choice questions (from five choices))</td></tr>
<tr><td colspan="2">For true or false questions, each correct answer corresponds to 2 points. For multiple-choice questions (from 5 choices), each correct answer corresponds to 10 points (each correct answer to multiple-choice questions (choose 2 answer choices) corresponds to 5 points).</td></tr>
<tr><td>Examination Time</td><td>2 hours and 40 minutes</td><td>2 hours</td></tr>
<tr><td>Grading</td><td>A perfect score is 440 points. A score of 70% (308 points) or higher is a passing score.</td><td>A perfect score is 300 points. A score of 70% (210 points) or higher is a passing score.</td></tr>
</table>

10. Instructions for Taking Examination

Examiners should pay attention to the following when taking the Examination:

(1) Follow the instructions of the proctors at the examination site and in their test room. Examinees who do not follow their instructions may be treated as cheating (for details, see “8. Misconduct”);

(2) Make sure they read the instructions and the questions carefully before proceeding to answer the individual questions; and

(3) Make sure they fully understand the question, and give their answer according to the directions.

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