

# Clearing Framework in Japan

---



September 23, 2013

Japan Financial Services Agency

# 1、Clearing and Settlement Framework in Japan

## (1) Problems on Securities Settlement Systems in the early 2000s

---

- Financial System Council "Reform for Securities Settlement System in 21<sup>st</sup> Century"  
(June 2000)
  - Problems
    - Fragmentation of settlement systems by securities
      - ✓ Absence of the comprehensive settlement system/framework which disciplines all types of securities
    - Belated move to dematerialization of securities
      - ✓ Risk of stock certificates being lost, Custody cost, etc.
    - Belated move to computerization of securities transactions
      - ✓ Inefficiency of office functions, Barriers to shortening of the settlement cycle
    - Unrealized Delivery versus Payment (DVP)
      - ✓ Risk of not to be paid the settlement amount to one counterparty or not to be transferred the securities to the other

# 1、Clearing and Settlement Framework in Japan

## (2) Measures for Improving Securities Settlement Systems

---

- Measures for improving securities settlement systems
  - Establishment of integrated legal framework for securities settlement
    - ✓ “the Act on Book-Entry Transfer of Company Bonds, Shares, etc.” (enacted in June 2001);
      - Dematerialization of stocks, Japanese government bonds, corporate bonds, etc.
      - Electronic Share Certificate System
    - ✓ Development to computerize securities transactions
    - ✓ “Pre-Settlement Matching System” developed by Japan Securities Depository Center, Inc. (JASDEC) which launched in Sep. 2001
  - Progress on DVP settlement
    - ✓ Structuring central counterparties (CCPs)
    - ✓ Building the linkage between securities settlement in JASDEC and fund settlement in BOJ-Net

# 1、Clearing and Settlement Framework in Japan

## (3) Securities Settlement Framework and CSDs in Japan

---

- Overview of securities settlement framework in Japan
  - Book-entry Transfer System for Stocks, etc.
    - The Book-entry Transfer System for stocks, etc. refers to the computerized management (issuance, transfer and redemption) of shareholders' ownership rights (which had formerly been administered on the assumption of the physical existence of share certificates, etc.) through accounts established by JASDEC and securities companies etc. in accordance with the Act on Transfer of Bonds, Shares, etc. which abolished stock certificates, etc. for the stocks, etc. of publicly listed companies.  
The development of the system started with dematerialization of commercial papers (CPs) in March 2003 and completed with electronization of Share Certificate System in January 2009.
    - Tired participation in Book-entry Transfer System (Indirect participation via an account management institution)
  - Japanese government bonds (JGB) settlement framework
    - Bank of Japan (BoJ) started the JGB book-entry system in January 2003.
    - The JGB book-entry system abolishes the certificates of JGBs in any cases of issuance, transfer or redemption.
    - BoJ is the Special Book-Entry Transfer Institutions stipulated under the Act on Transfer of Bonds, Shares, etc.

# 1、Clearing and Settlement Framework in Japan

## (4) Securities Settlement Framework and CSDs in Japan

---

### ■ Central Securities Depositories (CSDs) in Japan

#### ● Japan Securities Depository Center, Inc. (JASDEC)

➤ JASDEC operates the Book-entry Transfer System for stocks corporate bonds, CPs, etc.

✓ Participants ;approximately 300 firms which consist of securities firms, banks, trust banks, insurances, exchanges, etc.

✓ Approximately 500 direct accounts, 17million indirect participants

✓ 404 billions of shares administrated by JASDEC

➤ JASDEC operates “Pre-Settlement Matching System” which are used by 684 firms.

#### ● Bank of Japan (BoJ)

➤ BoJ settles JGBs under the JGB book-entry

✓ 306 direct participants

✓ Amount of settlement (average per business day) ; JPY95,064billion

# 1、Clearing and Settlement Framework in Japan

## (5) Clearing Framework in Japan

- Overview of clearing framework in Japan
  - Clearing framework under the Financial Instruments and Exchange Act (FIEA)
    - Financial Instruments Clearing Organization (FICO)
      - ✓ Any joint-stock companies intending to provide Financial Instruments Obligation Assumption Service (FIOAS) must obtain a license from JFSA.
      - ✓ Necessity of establishing a robust and enhanced risk management before obtaining a license
    - ← A CCP assumes the credit risks and settlement risks of clearing participants in a concentrated manner.
      - ✓ Resilient and faster financing
      - ✓ Corporate management corresponding to clearing participants
    - Approval of CCP Business Rules
      - ✓ Varieties of CCP Risk management due to types of financial instruments and clearing participants
      - ✓ The FIEA allows CCPs to innovate business models.
      - ✓ CCP Business Rules must specify the transaction causing obligations, participation requirements, matters concerning risk management, etc.
      - ✓ A CCP must conduct its FIOAS in accordance with its Business Rule.
    - Segregation of Clearing Funds from other assets which are held within a CCP

# 1、Clearing and Settlement Framework in Japan

## (5) Clearing Framework in Japan

---

### (Note) Segregation of customer assets

- Objectives

Against their bankruptcy, financial institutions have to manage the assets(e.g. cash, securities) received from their customers in a safe manner so that financial institutions can return those assets certainly to their customers.

- Methods of customer assets segregation

- Managed segregation of securities between securities received from customers and other securities
- Setting up a money trust separately by customers with regard to money received from customers

- Requirements under the FIEA

- Requirements for segregation of customer assets from their own assets within securities firms
- Requirements for segregation of Clearing Funds from other assets which are hold within a CCP

etc.

# 1、Clearing and Settlement Framework in Japan

## (6) Major CCPs in Japan

### ■ Major CCPs in Japan

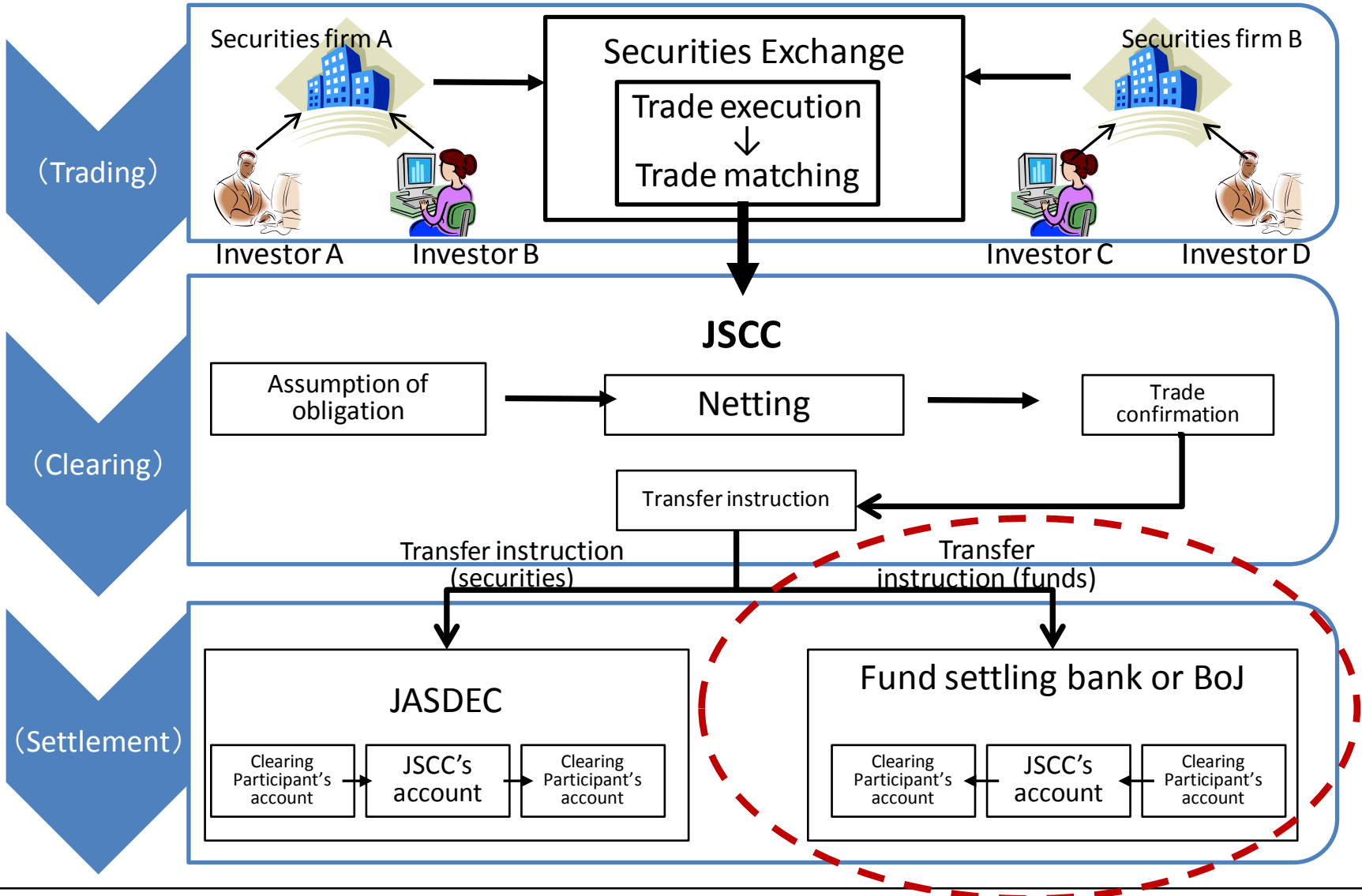
	Japan Securities Clearing Corporation (JSCC)	JASDEC DVP Clearing Corporation (JDCC)	Japan Government Bond Clearing Corporation (JGBCC)
Date of commence	January 2003	May 2004	May 2005
Financial instruments	Stocks, Futures, Options, OTC derivatives(IRS,CDS), etc.	Stocks, Convertible bonds, ETFs, REITs, etc.	JGBs
Transactions Subject to Clearing	Exchange trades (Street Side)	Non-exchange transactions designated by Participants (Customer Side)	Over the Counter JGB transactions
Owners	<ul style="list-style-type: none"><li>• Over 80% owned by JPX group</li><li>• Rest of ownership owned by other Japanese exchanges and clearing participants, etc.</li></ul>	100% of ownership owned by JASDEC	Owned by 31 market participants (Securities firms, Banks, etc.)

- Roles of JSCC and JDCC in Japanese clearing business
  - Taking into account the different interests related to loss share rules between Street Side and Customer Side, it was preferable for Japanese market that JSCC and JDCC would be established separately.
- Merger agreement between JSCC and JGBCC
  - JSCC will merge JGBCC and be the wholly-owning parent company of JGBCC in October 2013 .

# 1、Clearing and Settlement Framework in Japan

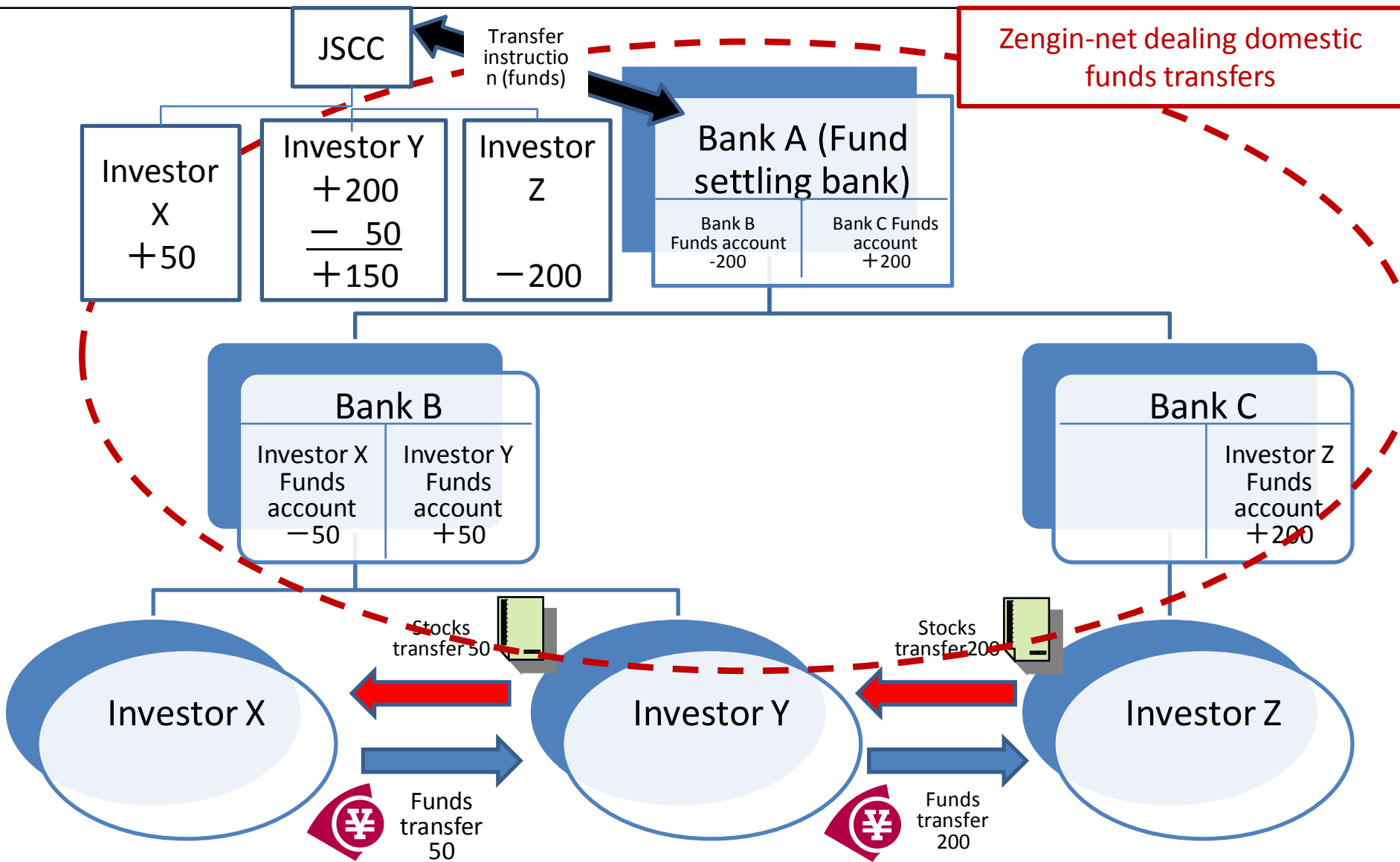
## (7) Japan Securities Clearing Corporation (JSCC)

### ■ Relevant institutions from trade execution to settlement



# 1、Clearing and Settlement Framework in Japan

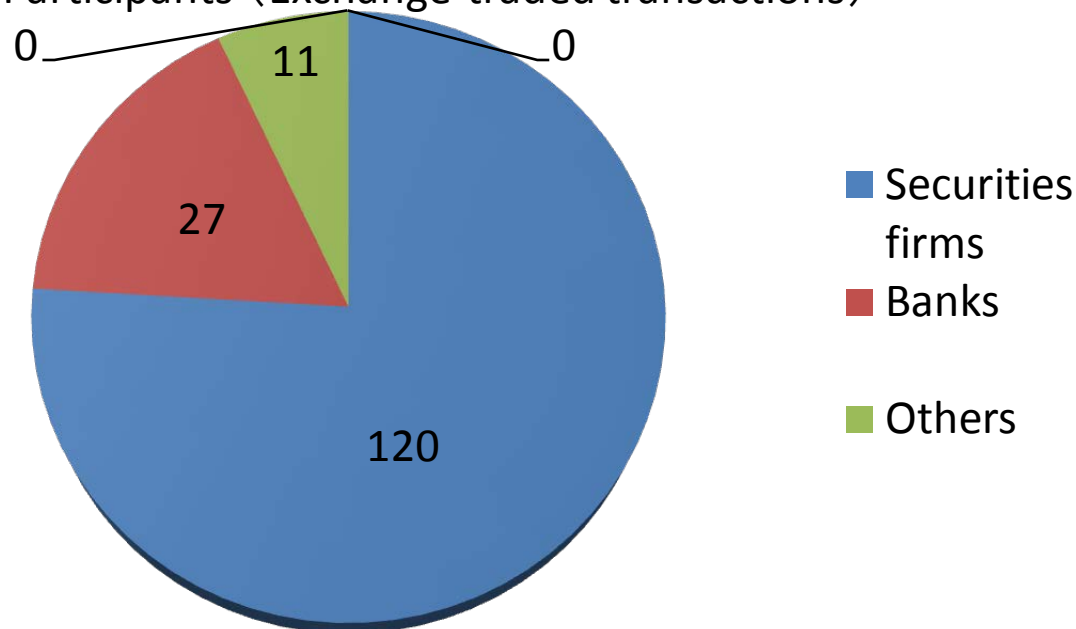
## (7) Japan Securities Clearing Corporation (JSCC)



# 1、Clearing and Settlement Framework in Japan

## (7) Japan Securities Clearing Corporation (JSCC)

### ■ JSCC Clearing Participants (Exchange-traded transactions)



### ■ Netting ratio concerning JSCC exchange-traded transactions (average per business day)

	Amount of assumption (billion JPY)	Amount of settlement (billion JPY)	Netting ratio (%)	Numbers of shares of assumption (million)	Numbers of shares of transfer (million)	Netting ratio (%)
FY2009	1,918	125	6.5%	2,801	763	27.2%
FY2010	1,857	119	6.1%	2,655	711	26.8%
FY2011	1,599	98	6.1%	2,556	657	25.7%

# 1、Clearing and Settlement Framework in Japan

## (7) Japan Securities Clearing Corporation (JSCC)

### ■ JSCC risk management (Exchange-traded transactions)

#### 1. Clearing Participant Qualifications

- ✓ JSCC has defined the qualifications to become a participant for exchange-traded clearing, and regularly monitors the management structure, ability to conduct business, and financial standing of clearing participants.
- ✓ JSCC may suspend the assumption of its obligations and revoke its qualification as a clearing participant where JSCC deems it necessary

#### 2. Collateral System

##### 【Clearing Fund】

⇒To be deposited to cover the risk exposure of the price fluctuation for each equity which covers 99% confidence level for the past 120 days based on each participant's unsettled position.

#### 3. ① Default Management

- ① In the event of a default of a clearing participant, JSCC first suspends the delivery of the settlement of funds and securities to the defaulting participant.
- ② JSCC conducts transactions to offset the unsettled contracts of the defaulting clearing participants while at the same time selling the securities whose delivery was suspended so as to determine the amount of loss resulting from the default.
- ③ Clearing participants are thus assured of safe market transactions even in the event of default as JSCC acts as the counterparty to complete the settlement with other clearing participants.

#### Loss compensation scheme

First Tire; Collateral deposited by the defaulting participant

Second Tire; Loss compensation by stock exchanges

Third Tire; Compensation by JSCC

Fourth Tire; Special clearing charge

## 2、Financial Market Infrastructure Reform at the Global Level

### (1) Current Trends①

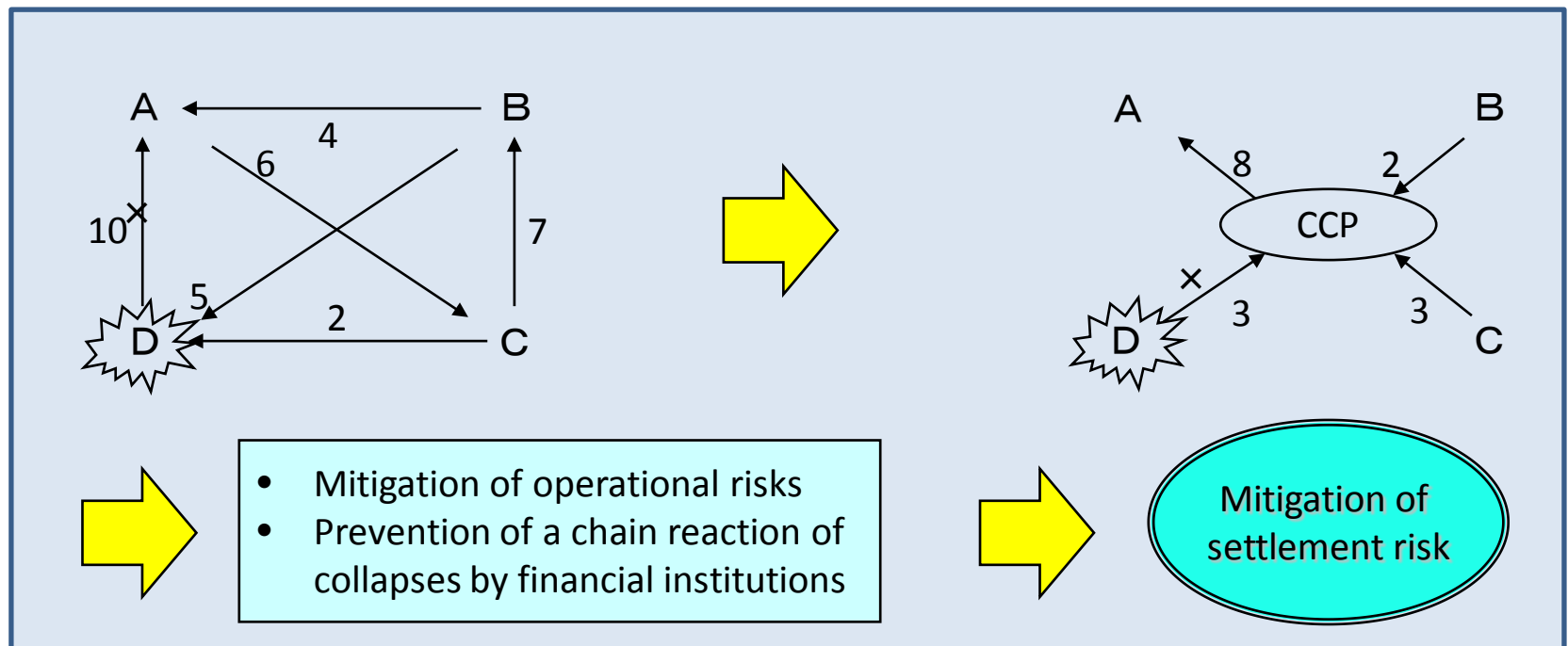
- Lehman Brothers bankruptcy (Lehman Shock)
- Enormous losses of American International (AIG) Group, Inc.  
⇒Financial Crisis (2008)  
⇒G20 Pittsburgh Summit Statement (September.24-25, 2009)

”Implementing OTC Derivatives Market Reforms” :  
All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest.

## 2、Financial Market Infrastructure Reform at the Global Level

### (1) Measures taken in Japan①

- Expansion of JSCC Clearing Business to OTC derivatives market
  - July 2011; CDS transactions (iTraxx Japan Index)
  - October 2012; JPY denominated Interest Rate Swaps
- Mandatory clearing
  - Mandatory use of CCPs among large Japanese financial institutions



## 2、Financial Market Infrastructure Reform at the Global Level

### (2) Current Trends②

- CPSS-IOSCO “Principles for Financial Market Infrastructure (PFMIs)” (April 2012)
  - Lessons form recent financial crisis; PFMIs includes robust risk management requirements
  - PFMIs applies to all systemically important FMIs including CCPs established in IOSCO member countries/iurisdictions

Principles	
General organization	Default management
1: Legal Basis	13: Participant-default rules and procedures
2: Governance	14: Segregation and portability
3: Framework for the comprehensive management of risks	General business and operational risk management
Credit and liquidity risk management	15: General business risk
4: Credit risk	16: Custody and investment risks
5: Collateral	17: Operational risk
6: Margin	Access
7: Liquidity risk	18: Access and participation requirements
Settlement	19: Tiered participation arrangements
8: Settlement finality	20: FMI links
9: Money settlements	Efficiency
10: Physical deliveries	21: Efficiency and effectiveness
Central securities and exchange-of-value settlement systems	22: Communication procedures and standards
11: Central securities depositories	Transparency
12: Exchange-of-value settlement systems	23: Disclosure of rules, key procedures, and market data
	24: Disclosure of market data by trade repositories

## 2、Financial Market Infrastructure Reform at the Global Level

### (2) Measures taken in Japan ②

#### Establishment of Comprehensive Guidelines for Supervision of CCPs ,CSDs, etc.

- Background
  - Business expansion and complexity in recent Japanese clearing and settlement services
  - Drastic changes in international regulation circumstances after the financial crisis  
e.g.) Principles for Financial Market Infrastructure (PFMIs)
- Objectives;
  - To specify and detail points of supervisory view and measures, etc.
  - To ensure appropriate service operations at the international standard level
- Scope of application
  - FMIs providing services in Japanese market
- Key points
  - Effectiveness of governance
  - Financial prudence
    - ① Appropriateness and Sufficiency of Equity Capital
    - ② Credit and liquidity risks management
  - Appropriateness of Business Operations
    - ① Compliance
    - ② Business continuity plan (BCP)
    - ③ Operation and information technology risk management

## 2、Financial Market Infrastructure Reform at the Global Level

### (3) Key issues currently under discussion

---

- Cross border recognition for CCPs
  - The U.S./EU/Japan
  - ODRG (OTC Derivatives Regulators Group) addresses to resolve cross-border conflicts, inconsistencies, gaps and duplicative requirement.
  
- International discussions
  - International organizations
    - FSB (Financial Stability Board)
    - CPSS ( Committee on Payment and Settlement Systems)
    - IOSCO (International Organization of Securities Commissions)
  - Recovery and Resolution Plans (RRPs) for FMIs

---

**Thank you for your attention !**

**[www.fsa.go.jp/en/](http://www.fsa.go.jp/en/)**

---